



ANNUAL REPORT 2010

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Corporate Information

LEGAL FORM

Public Limited Liability Company

COMPANY REGISTRATION NUMBER

PB 67

DIRECTORS

Nishantha Wickramasinghe – Chairman

Nihal Jayamanne PC

Kapila Chandrasena

Shameendra Rajapakse

Manilal Fernando

Dr Chris Nonis

COMPANY SECRETARY

Mildred Peries

REGISTERED OFFICE

Airline Centre
Bandaranaike International Airport
Katunayake
Sri Lanka

AUDITORS

Ernst & Young
Chartered Accountants
P O Box 101
Colombo 10

HIGHLIGHTS

| | | Group 2010 | Group 2009 | Company 2010 | Company 2009 |
|---|--------------|-----------------------|-----------------------|-------------------------|-------------------------|
| Financial | | | | | |
| Revenue | Rs. Million | 63,358.45 | 74,264.60 | 62,363.58 | 73,307.77 |
| Operating Expenditure | Rs. Million | 69,283.84 | 84,402.01 | 69,026.74 | 84,794.86 |
| Loss Before Tax | Rs. Million | (6,004.61) | (9,957.00) | (2,673.91) | (9,269.15) |
| Net Loss for the Year | Rs. Million | (6,034.27) | (9,996.85) | (2,698.20) | (9,305.94) |
| Total Assets | Rs. Million | 46,977.16 | 37,210.84 | 44,442.57 | 34,341.56 |
| Shareholders' Funds | Rs. Million | 6,833.16 | 12,800.86 | 3,598.43 | 6,230.06 |
| Traffic | | | | | |
| Passenger capacity | ASK Millions | | | 10,724.83 | 11,731.56 |
| Overall capacity | ATK Millions | | | 1,541.03 | 1,635.62 |
| Passengers carried | RPK Millions | | | 8,357.89 | 8,546.44 |
| Overall load carried | RTK Millions | | | 1,028.11 | 1,065.15 |
| Passenger load factor | % | | | 77.93 | 72.85 |
| Overall load factor | % | | | 66.72 | 65.12 |
| Breakeven load factor | % | | | 78.94 | 78.19 |
| Staff Productivity | | | | | |
| Average Strength | Nos. | 5,192 | 5,317 | 4,614 | 4,837 |
| Revenue per employee | Rs. Million | 12.20 | 13.97 | 13.52 | 15.16 |
| Value added per employee | Rs. Million | 0.81 | 0.17 | 1.53 | 0.22 |
| Aircraft Fleet as at 31st March 2010 | | | | | |
| A320-200 | Nos. | 3 | | | |
| A330-200 | Nos. | 4 | | | |
| A340-300 | Nos. | 5 | | | |
| Aircraft in service at year end | Nos. | 12 | | | |

Chairman's Overview

Introduction

SriLankan Airlines has withstood the most unrelenting period of adversity during its 30-year history, and now stands on the verge of success in no uncertain terms.

Your company successfully weathered a period of great turbulence during the last financial year, and now has its sights set firmly on expansion in all sectors of its business, with the broad objective being a return to profitability within the shortest possible time.

In this backdrop, it is with great pleasure that I present to our esteemed shareholders the Annual Report and Audited Accounts of SriLankan Airlines Limited and the SriLankan Airlines Group for the financial year 2009/10.

Sri Lanka's Economy

As the global economy slowly turns itself around and begins its long-term recovery – driven by rapid growth in Asia, greater stability in the United States and the Middle East, tempered somewhat by Europe's continuing economic troubles, Sri Lanka today stands on the verge of success and prosperity.

Following the dawn of permanent peace to the country in May 2009, the government has accelerated economic progress through a series of measures. These include:

- Control of inflation
- Reduction in interest rates
- Stability of the nation's currency and build up the nation's foreign exchange reserves
- Emphasis on development of infrastructure – ports, airports, highways, power stations
- Reductions in tariffs
- Stabilizing of the nation's banking and financial systems
- Strengthening of relations with several global and regional economic giants including India, China and Japan
- Long-term political stability through the people's mandate in a series of national and provincial elections
- Recovery of the economies of the Northern Province and Eastern Province and their attendant contribution to the nation's economic growth

- Standby arrangements from the International Monetary Fund (IMF)

During the calendar year 2009, Sri Lanka achieved an economic growth rate of 3.5% (*source: Central Bank Annual Report 2009*). This was an impressive result at a time when the global economic meltdown had not yet abated, with the first half of the year being adversely affected by the final stages of the country's ethnic conflict. The last quarter of 2009 recorded a growth of 6.2% which is indeed, a very positive sign for the future. All major sectors of the economy – agriculture, industry, services, etc – contributed to this growth.

The Global Air Transport Industry

The International Air Transport Association (IATA) reported that “the worst economic recession in 80 years saw revenues drop by \$81 billion and losses of almost \$10 billion in 2009” throughout the global air transport industry.

However, IATA Director General Giovanni Bisignani, at the Annual General Meeting of IATA on 7th June 2010, noted that “Today there is some cautious optimism. Global traffic is back to pre-recession levels and the bottom line is improving. Asia-Pacific is powering the upturn, North American carriers will move into the black, Latin American airlines will likely record their second consecutive profitable year, and Middle Eastern and African carriers will each deliver profits. Europe with its weak economy will be the only region in the red, with a \$2.8 billion loss. But we are upgrading our global industry forecast to a full-year profit of \$2.5 billion, the first global profit since 2007.”

Tourism into Sri Lanka

Sri Lanka's tourism industry began its long-awaited expansion following the dawn of peace. Tourist arrivals for the financial year 2009/10 surged past the half a million mark to total 501,597, a 22% increase compared to 409,661 during the financial year 2008/09 (*source: Sri Lanka Tourism Development Authority*).

Tourist arrivals in the 12 months since the end of the war recorded a 48% increase over the previous 12-month period. Every major tourism market witnessed significant increases, which augurs well for the future.

The Government has identified tourism as a major area of growth that is expected to considerably aid the country's economic growth, and the tourism industry has now been brought under the purview of the newly created Ministry of Economic Development.

Supporting our Nation

SriLankan Airlines continued to be at the forefront of major institutions that supported the Government of Sri Lanka in its drive towards national development. The National Carrier in particular, worked in partnership with the Sri Lanka Tourism Promotions Bureau and the nation's hospitality industry in enhancing Sri Lanka's image and positioning the island as a destination of choice for global travelers. The Chief Executive Officer's report provides greater details of these efforts.

According to statistics of the Sri Lanka Tourism Development Authority, SriLankan Airlines brought in approximately half of the tourists who visited the island during the financial year under review. This was three times as many as the second placed airline, and five times as many as the third placed Airline.

The Airline also continued to support all other import and export industries, by providing cargo facilities. It also provided ground handling services at Bandaranaike International Airport, in-flight catering to other airlines that operate to the country, and operated the Cargo Centre at BIA.

Despite the Airline's financial position, SriLankan honoured its promise to support Janadhipathi Prathamika Vidyalaya in the Hambantota District, and completed the second phase of a project which provided the school with facilities to expand and teach Advanced Level subjects, ensuring that students no longer need to transfer to other more distant schools for their learning. This assignment was part of the Corporate Social Responsibility undertaking of Sri Lankan Cares-our community development arm.

Awards

The SriLankan Airlines Group's commitment to comfort, punctuality, quality, safety, and reliability continued to gain recognition in the industry. The Group received the following awards:

- Best Airline Operator (South Asia) at the Kuala Lumpur International Airport Awards 2009 for the fifth consecutive year
- Best Passenger Airline by Growth in South Asia for 2009 at Singapore's Changi Airport Awards
- The Airline's commitment to superior standards of service resulted in the Imperial Mark Committee, a global service rating agency, extending its earlier '**Imperial Mark**' certification of two years for a further five years, following a stringent audit.

- Platinum Award from the International Air Transport Association for being among the first airlines to complete a major technological innovation in ticketing
- Airline of the Year - Presidential Awards for Travel & Tourism 2008
- Airline of the Year - Presidential Awards for Travel & Tourism 2009
- Best Outbound Tour Operator (SriLankan Holidays) - Presidential Awards for Travel & Tourism 2008
- Best Outbound Tour Operator (SriLankan Holidays) - Presidential Awards for Travel & Tourism 2009
- Best Tourism Education & Training Effort - Presidential Awards for Travel & Tourism 2008
- SriLankan Catering won 23 medals and one trophy at Culinary Art 2010

The Airline also voluntarily requested the global aviation rating agency Skytrax to carry out an extensive audit of its products and services throughout the year 2010, with the objective of being upgraded to Four-Star status from its present categorization of Three-Star. This audit is now in progress.

Significant Events at SriLankan Airlines

SriLankan Airlines continued its strategy of combining caution with prudent expansion in consolidating its financial position during the year, whilst preparing a solid base for the future.

The Airline expanded its route network to 49 cities in 31 countries by launching services to Milan in December 2009 and Shanghai in July 2010 in addition to new code-share services through other reputed international airline partners. SriLankan has embarked upon a strategy of optimizing revenue from existing routes by providing direct, non-stop services with the maximum number of frequencies as per market demand, and by matching aircraft types to each sector.

The Airline continued to modernize and expand its fleet and took delivery of one Airbus A320-200 narrow-body aircraft in July 2009, and one wide-body A330-200 aircraft in the second quarter of 2010.

The Airline is also finalizing plans to re-launch its domestic floatplane service, SriLankan Air Taxi, which was suspended due to restrictions on domestic flying during the Country's ethnic conflict.

The Airline's sustained focus on driving down costs in all areas resulted in a significant reduction in losses and unit costs; in comparison with the previous year. This is discussed in more detail in the Chief Executive Officer's Review.

The Airline's strategic business units continued their efforts to diversify the Group's business activities, and invested in new facilities and upgraded existing facilities for this purpose. SriLankan Engineering enhanced its position as a Maintenance-Repair-Overhaul facility in the region by securing a major contract from GoAir, The business unit also demonstrated its ability to build long-term relationships by continuing the maintenance contract from IndiGo, and carrying out several ad hoc projects for another long-term customer- Airblue.

SriLankan Cargo doubled its handling capacity by moving into the new Exports Terminal building at BIA, which is expected to provide sufficient capacity to serve Sri Lanka's growing economy for many years to come.

The Airline's Ground Handling operation continued to support the expansion of BIA which is fast becoming a modern, sophisticated air terminus.

The Airline greatly strengthened its training facilities, and signed an agreement with SIM Industries BV of the Netherlands, to set up a Full Flight Simulator Centre at BIA. This is expected to reduce our pilot training costs and procure additional revenue through the provision of training services for other airlines.

Performance of Subsidiary

SriLankan Catering (Pvt) Ltd. is the fully owned subsidiary of the Company, with a Board that is appointed from amongst the Directors of the Group. Its state of the art flight kitchen at Bandaranaike International Airport (BIA) has a production capacity of over 25,000 meals per day, in a 24-hour operation, 365 days a year. It also operates several restaurants and lounges at BIA.

SriLankan Catering signed agreements during the year under review to provide catering services to several customer airlines which operate to BIA, and is confident of attracting several more during the next financial year. The subsidiary also invested in a new facility to diversify its activities through the provision of airline laundry services. This is scheduled to commence operations in the second quarter of the financial year 2010/11.

During the year under review, SriLankan Catering completed an extensive programme which transformed the company into an environmentally friendly operation, and was awarded the ISO 14001:2004 certification for Best Environmental Practices in April 2010 -one of a handful of airline caterers in the world to receive this prestigious accreditation. SriLankan Catering also received the ISO 9001:2008 certification for Quality Management Systems during the year under review. The subsidiary already possesses ISO 22000:2005 for Food Safety Management Systems, and HACCP-Codex Alimentarius for Food Safety and Hygiene. SriLankan Catering also distinguished itself at the Culinary Art 2010 competition.

Group Performance

- The Group's Revenue for the year under review was Rs. 63,358 million, compared to Rs. 74,265 million in the previous year.
- Operating Expenditure was reduced to Rs. 69,284 million from last year's 84,402 million.
- This resulted in the Loss before Tax being reduced to Rs. 6,005 million, from the loss of Rs. 9,957 million during the previous year.
- The Net Loss after Tax was reduced to Rs. 6,034 million, compared to the net loss of Rs. 9,997 million in 2008/09.

Funding of Expansion

I am proud to state that SriLankan Airlines was steadfast in its policy of maintaining its financial independence and not becoming a burden to the Government of Sri Lanka and the taxpaying public.

The Airline stayed true to the philosophy of its Business Turnaround Plan of "Earn More, Spend Less, Waste Not". Expenditure was controlled; however, revenues were lower than the previous year due to reduced operations and the reduction in fuel surcharges.

As mentioned above, the Airline has taken significant steps that are expected to strengthen its position in the near future. In order to maintain liquidity whilst funding expansion, the Airline also embarked on the financial restructuring of the investment in SriLankan Catering, which had a positive impact on the Airline's finances.

The Company plans to carry out a refinancing exercise in the second quarter of 2010/11 of three Airbus A330-200 aircraft which are currently on finance leases, in order to provide a cash infusion for its expansion programme, including the acquisition of an A330-200 on an operating lease in the second quarter of 2010/11.

The Future of the Airline

The Board is of the opinion that this Airline has successfully navigated through the worst period in its history, and is now firmly headed in the direction of greater success and profitability. The Airline's prudent investments in future business activities will doubtless bear fruit within a short period.

The prospects for the National Carrier are now excellent due to a combination of factors - the dawn of peace and political stability bringing economic growth and in particular the revival of tourism; a sense of stability and confidence returning to the global economy; and the sound base from which the airline has launched its long term plan, following a sustained period of caution.

The Group intends to continue expanding its range of products and services in the core area of international air transport, and the ancillary areas of domestic passenger transport, catering, ground services, engineering, duty free sales, SriLankan Holidays, and airline-related training, all of which are expected to contribute significantly to the bottom-line.

Dividends

The Board is of the opinion that while the SriLankan Airlines Group can be expected to become profitable in the near future as per the Five-Year-Plan, it is not yet prudent to issue a dividend to our shareholders, given the financial results during the year under review. We seek the patience of our shareholders, and will redouble our efforts to reward our shareholders shortly.

Conclusion

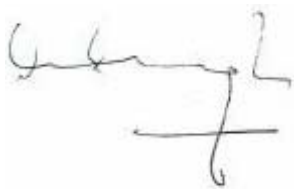
On behalf of the National Carrier, I take this opportunity to express my gratitude to His Excellency the President, Mahinda Rajapaksa, for his faith in the employees of this Airline, and the support of the Government of Sri Lanka in all our many business activities.

I also thank Hon. Chamal Rajapaksa, MP and Speaker of Parliament, who served as Minister of Ports & Aviation during the year under review; and Hon. Sarath Gunarathna, MP, former Deputy Minister of Aviation for their support.

My sincere thanks to the Members of the Board for their support and commitment in driving and guiding the Airline during this period – Messrs. Nihal Jayamanne, PC, Kapila Chandrasena, and Shameendra Rajapaksa, all of whom continue to be Members; Mr. Manilal Fernando and Dr. Chris Nonis, whom I have the pleasure of welcoming to the Board; and Messrs. Sunil G. Wijesinha and Sanath Ukwatte, who served as Members of the Board.

I would be remiss if I did not make special mention of the leadership of the Management Team and the resilience and sheer hard work of every member of the staff, both in Sri Lanka and overseas, and our network of general sales agents around the globe. They have been the foundation upon which this Airline has stood during trying times.

My thanks to the many other stakeholders of the Airline – our shareholders for their trust; our aircraft lessors, bankers and financiers who unflinchingly supported us; the many government agencies such as Sri Lanka Tourism, Airport & Aviation Services (Sri Lanka) Ltd, the Civil Aviation Authority of Sri Lanka; hoteliers, travel agents and other members of the travel trade; our suppliers and business partners; and most of all our valued customers for their continued patronage.



Nishantha Wickremasinghe

Chairman

31 July 2010

Chief Executive Officer's Review

SriLankan Airlines once again emerged stronger than ever from a turbulent year, and is now perfectly placed to drive the impending boom in the country's tourism industry, contribute to the entire national economy, and move closer towards achieving profitability.

Standing Tall and Unbowed

I would like to emphasise at the outset to our esteemed shareholders that SriLankan Airlines once again navigated through an extraordinarily difficult year without becoming a drain on the financial resources of our nation. Your Airline stood tall and built upon its strong tradition of service.

The Chairman in his Overview has described the stern challenges that the Airline faced during the year under review, ranging from the global economic meltdown to the final months of the country's war. It is in the backdrop of these challenges that the Airline carried out its global operations.

Sri Lanka, unfortunately emerged into peacetime during a period when the global economy was in the throes of one of the largest crises in decades. The explosive growth that could be expected has thus understandably been delayed, unlike many other nations that experienced immediate extensive growth following the end of a wartime situation.

However, with the global and national economic situations improving steadily, and the country's tourism industry firmly set for sustained long-term growth, the Airline's own prospects have improved significantly.

In addition, SriLankan Airlines' focus on key areas of our business activities over the last two years has positioned the Company very strongly to enhance all existing business areas, and the tapping of lucrative markets in new business areas.

Overall Strategy

SriLankan Airlines followed a multi-dimensional strategy during the year under review that was futuristic, yet financially prudent, with the overall objectives of:

- a. Strengthening the financial position of the Company by continuing with the key cost reduction and revenue enhancement measures as per the Airline's Business Turnaround Plan.
- b. Expanding our business activities into ancillary areas such as Aircraft Engineering and Aviation Training, and strengthening our existing operations in Cargo Handling, Airport Ground Handling, and Duty Free Sales, together with our subsidiary's activities in the area of In-flight Catering.
- c. Enhancing our global route network by increasing capacity on routes in order to optimise revenue.
- d. Prudent investments providing an excellent springboard for the Airline's future expansion
- e. Promoting and supporting the country's tourism industry which is expected to drive its peacetime economic growth
- f. Supporting the Government of Sri Lanka in positioning the country as a global and regional hub for aviation, commercial activities, and knowledge

Core Indicators of Performance

The success of the Airline's Business Turnaround Plan can be gauged by the fact that significant improvements were recorded in several core financial indicators, including Unit Cost, and most importantly the Overall Loss incurred by the Company and the Group.

The Company implemented a strong series of cost control measures in all areas of its operations, which resulted in cost savings of 19% compared to the previous financial year. Full details of these cost saving measures and their impact will be published shortly in our third annual Business Turnaround Plan Update, which will be made available to all our staff in the spirit of transparency and accountability.

The Company's emphasis on the principles of its Business Turnaround Plan – Earn More, Spend Less, Waste Not – resulted in a continuous improvement of its financial performance as the year progressed. The Loss incurred during the second half of the financial year was 44% lower than that of the first half.

All major variable cost factors were significantly reduced – Fuel by 35%, Aircraft Maintenance by 19%, Catering by 3%, Landing by 13%, Airport Handling by 7%, and Overflying by 16%. All major Fixed Costs were also reduced, including Aircraft Related Costs by 4%.

Total Passenger Revenue decreased by Rs. 10.1 billion, a 17% decline in comparison with the previous financial year, due to reduced operations and the removal of the fuel surcharge which had inflated the previous year's revenue. Revenue Passenger Kilometres (RPK) totaled 8,358 RPK millions, down from the previous year's 8,546 RPK millions.

Overall Seat Factor during the year under review improved significantly to 77.93% from the 72.85% of the previous year. The Airline carried 2.6 million passengers in 2009/10, a reduction of 6% from the previous year's 2.7 million, due to a reduction in Capacity. Overall Capacity was reduced to 1,541 million Available Tonne Kilometres (ATK), from 1,636 million. Passenger Capacity also decreased from 11,732 million Available Seat Kilometres (ASK) to 10,725 million. Despite the reduction in Capacity, the Airline's Unit Cost was reduced by a dramatic 14%, registering Rs. 43.4 / tkm in comparison with Rs. 50.7 / tkm in the previous year.

The Group Loss after Taxation was Rs. 6,034 million during the year under review, which is a reduction of 40% from the loss of Rs. 9,997 million of the previous financial year.

New Five-Year Business Plan

The Company finalised its new Five-Year Business Plan during the year under review, following an in-depth analysis of present and future trends in the airline, tourism and cargo industries, both globally and country-specific to Sri Lanka. Immediate operational changes that are included in the Plan are:

1. A strategy of direct, non-stop flights to all destinations with maximum frequencies and matching aircraft capacities. This includes a 15% increase in flights throughout the route network in 2010/11, and increased capacity to Europe -London, Paris, Frankfurt, Middle East -Doha, Kuwait, Far East- Japan, China and India.
2. Establishing new markets. This included the launch of a new four times a week service to Shanghai, on 1st July 2010, in addition to existing flights to China (Beijing), thrice a week. The Company will also closely monitor market demand for leisure and ethnic travel in specific cities and regions, and evaluate prospects of launching / re-launching services to more destinations, including India, Europe, the Far East and Australia.
3. Focusing on off-line sales, particularly to North America (U.S. and Canada), Iberia (Spain, Portugal), Central and Eastern Europe (Russia, Czech Republic, Austria, Hungary, Poland), Levant and Near East (Jordan, Cyprus, Turkey, Lebanon), Australasia (Australia, New Zealand, Indonesia).
4. Exploring the possibility of code-share partnerships with reputed airlines in regions not yet covered by SriLankan's global route network.

5. Proposed relaunch of the Airline's domestic service- SriLankan Air Taxi in the third quarter of the financial year 2010/11.
6. Enhance global promotions with the Sri Lanka Tourism Promotions Bureau to optimise publicity for Sri Lanka and SriLankan Airlines.
7. Upgrading of cabin interiors, including the introduction of Lie-Flat Seating and other measures to further improve our on-board products and services. The new A330-200 aircraft acquired in July 2010 has been fitted with Lie-Flat Seating. A programme is to be launched in the near future, to convert several of the Airline's newer A330 and A340 aircraft to Lie-Flat Seating.
8. Systematic acquisition of new aircraft to modernise and expand the widebody and narrowbody fleet to double fleet strength in five years.

Future Challenges

1. Supporting growth of tourism

Supporting the government to deliver the level of tourism growth on which our Five-Year Business Plan depends. This will require a concerted and coordinated effort to build the Country's tourism infrastructure, attract investment, and market the destination. The Airline will provide more convenient schedules for the Sri Lanka-bound traveler, with direct service that meets the customer's needs wherever possible. In addition, SriLankan's focus on delivering a high level of service will see passengers starting a Sri Lanka vacation from the first touch, with a recognisably Sri Lankan experience at every step of the journey – from reservations to check-in, airport, on-board and arrival. The Airline will also align itself with other providers of the Sri Lankan experience such as hotels.

2. Increased competition

SriLankan intends to differentiate itself in the face of increased competition from other airlines throughout Europe, the Middle East, India, and the Far East, which have already identified Sri Lanka's potential for high growth in tourism. The Airline views such competition as opportunities to demonstrate its adaptability and high service standards, as well as to expand its ancillary services to customer airlines which include in-flight catering, ground handling, and aircraft maintenance.

Key area of focus in the coming year will be building a competitive selling position against competitors who enjoy a dominant position in most of our points of sale. SriLankan views a strategic alliance with Sri Lanka Tourism as essential to building this selling position.

Maintaining competitive unit costs against the Indian low cost carriers and Gulf airlines, who will attempt to compete with SriLankan on price will be a key challenge that SriLankan will face in the coming year. The strong financial measures adopted in the last two years have positioned the Company very strongly in this area.

3. Increased costs

The rise in global fuel prices is likely to drive an increase in costs, and the Company is continuing to focus on fuel conservation methods to mitigate the impact in this regard.

Launch of Services to Milan

SriLankan launched a thrice-weekly service to Milan during the year under review, after carefully evaluating market conditions in the Northern Italy / Southern France / Switzerland region. This follows the launch of services to Rome during the previous financial year.

Expansion of Code-Share Network

During the year under review, SriLankan expanded its code-share network with Etihad Airways and Malaysia Airlines. This resulted in the addition of nine destinations to our global route network - Los Angeles, New York, Sydney, Melbourne, Jakarta, Seoul, Athens, Istanbul and Larnaca (Cyprus). The entry into the North American market added a significant market segment to our network.

Investment in a New Widebody Aircraft

SriLankan took delivery of a new Airbus A330-200 aircraft in July 2010, to strengthen its wide-body fleet for ongoing expansion of long-haul routes.

The Airline also took delivery of one Airbus A320 aircraft which arrived in June 2009. This was the third aircraft within a period of eight months, and completed the modernisation of the narrow-body fleet. Subsequently, the Airline completed the decommissioning of its older A320 fleet.

The Airline is formulating plans for the acquisition of two more narrowbody aircraft, in all likelihood during the next financial year.

The scheduled refurbishment of the A330 and A340 fleet is to begin in the next financial year, and will include a significant upgrading of products on board.

Changing the Way Our Passengers Experience Travel

SriLankan Airlines in March 2010 reinvented its wide range of products and service standards vowing to “Change the way we fly, and the way our passengers experience travel”.

The salient features of this multifaceted programme included:

- A new image for SriLankan Airlines with the introduction of new uniforms for cabin crew and frontline staff.
- Launch of a new Five-Star Meal Service in Business Class.
- Addition of a new A-La-Carte Meal Service in Business Class.
- Upgrading of all Economy class menus.
- Introduction of an upgraded selection of wines and champagnes.
- Enhancement of the Serendib on-board duty free selection.
- Refurbishment of cabin interiors.
- Introduction of new Signature Dishes and Signature Cocktails.
- All new beverage selection.
- Enhancement of the in-flight entertainment system.

Investment in IT Infrastructure

The Airline continued to invest in sophisticated technology that has been identified as having a clear and significant impact on customer convenience and cost reduction.

This included the complete revamping of the Airline’s website www.srilankan.aero in the second quarter of the new financial year; the launch of a significantly improved Internet Booking Engine; the popularisation of On-Line-Check-In facilities; and the completion of 2D Bar-Coded Boarding Passes throughout the route network which won the Airline a Platinum Award from IATA.

The Airline has also invested in a new user-friendly Internet Booking Engine that will significantly enhance the customer experience in the booking process.

Increased productivity and employee harmony

The National Carrier strengthened the level of harmony throughout the Airline's family of employees during the year under review, and received the unflinching support of its six employee unions for the Company's business operations and cost reduction initiatives.

Employee productivity was improved through the introduction of a Variable Pay programme for key departments, which provided incentives for sales managers to achieve and exceed their sales targets.

The Company also enhanced its training wing, particularly in relation to instilling the most sophisticated customer service techniques among our frontline staff.

Recruitment for the Future

The Company carried out recruitment in selected areas in preparation for its future expansion. These include:

- New batches of Cadet Pilots
- Several new groups of Trainee Aircraft Technicians
- Introduction of Part Time Staff in Airport Service to strengthen passenger handling
- Recruitment of Cabin Crew after a lapse of two years

The Airline plans to focus its recruitment on the following areas:

- Graduate Engineers
- Trainee Executives
- Cabin Crew
- Airport Service Support staff – both fulltime and part-time

Increased Customer Base of Sri Lankan Engineering

SriLankan Engineering played a key role in the Company's diversification strategy, and achieved significant progress towards positioning itself as a Maintenance-Repair-Overhaul (MRO) unit of choice in the region.

A significant milestone was SriLankan Engineering being contracted by a new airline customer, GoAir, to carry out major maintenance checks on two Airbus A320 aircraft.

In addition, SriLankan Engineering's contract to provide C-checks for another Indian low-fare carrier, IndiGo, was renewed from the previous year, which includes maintenance checks on thirteen A320 aircraft in 2010.

SriLankan Engineering also carried out two major projects for the Pakistani airline Airblue, namely a C-check on an A321 and a Landing Gear Change on an A320.

Other significant projects at SriLankan Engineering included:

- Launch of new dedicated website
- Planned expansion of hangar facilities to specialise in A320 aircraft, which are widely used among airline customers in the region
- Realignment of processes to conform to the European standard EASA Part M

SriLankan Cargo Launches New Exports Terminal

SriLankan Cargo launched its new Exports Terminal during the year under review, which has doubled its handling capacity for export, import and transshipment cargo at Bandaranaike International Airport.

The new building, of 13,300 square metres on two floors, is being commissioned in a phased out manner, and will include facilities for perishables, courier cargo, pure mail, a customer facilitation centre, cold rooms and chiller rooms, a large number of acceptance bays, a customs safe vault for valuables, an animal holding room, and areas for animal and plant quarantine offices. The new facility will further enhance all-round efficiency and handling speed as it will include pallette build-up stations and barcode scanners to further enhance capacity, as well as CCTV to increase security throughout the premises.

Cargo revenue management was restructured with a new system of tariffs being introduced to optimise revenue and also to take on increased competition in some markets.

In addition, SriLankan Cargo launched Dedicated Freighter Operations with a chartered aircraft, to optimise revenue generation in selected markets in the region.

Turning BIA into a Hub for Aviation Training

SriLankan took an important step forward in its quest to turn Bandaranaike International Airport into a centre for aviation training, by entering into a partnership with SIM Industries BV of the Netherlands, to set up a state-of-the-art, Full-Flight Simulator Centre to serve the region.

This is expected to significantly reduce the costs of training our pilots, while at the same time opening up a new stream of revenue by marketing of the simulator to other airlines in the region. The project will see the commissioning of an Airbus A320 Simulator during the third quarter of the year 2010/11, and is likely to be followed by an A330 / A340 Simulator at a later date. The memorandum of understanding (MOU) was signed on 31st May 2010.

Prospects for the Future

The company has set itself significant targets for the financial year 2010/11, with the ultimate objective of achieving profitability within the shortest possible time.

These targets include:

- Increasing Passenger Revenue and Cargo Revenue by almost one third
- Increasing Flights by 15% and Capacity by 17%
- Maintaining a healthy Cabin Factor at the current level of 78%

The achievement of these targets and the continual improvement of all core indicators in subsequent years is projected to bring back the Company and the Group to a level of profitability.

Thank You

None of these achievements would have been possible without the full support of our many stakeholders both in Sri Lanka and overseas.

I wish in particular to thank His Excellency the President, Mahinda Rajapaksa, for his faith in the National Carrier and its staff.

My thanks also to Hon. Chamal Rajapaksa, MP, former Minister of Ports & Aviation, and Hon. Sarath Gunarathna, MP, Deputy Minister for Aviation.

My sincere gratitude to our Board of Directors, especially our Chairman Mr. Nishantha Wickremasinghe, for their ever-present guidance and wisdom.

To my Management Team and every member of the SriLankan Family of Employees, including staff the world over, I say: "Well Done!" Many of you made notable sacrifices of some comforts over the last year, and justified the faith of our stakeholders in our Airline. A special word of thanks to our employee unions for their support.

There are many others who contributed to an eventful year – our shareholders, customers, financiers, business partners, suppliers, the many Government institutions including Airport & Aviation Services (Sri Lanka) and the Sri Lanka Tourism Promotions Bureau.

SriLankan Airlines today stands on the verge of success. There's still a lot of work to be done. But the future is certainly looking far brighter than it did two years ago. I expect this trend to continue, and expect to report greater success in our march towards profitability in the year to come.

A handwritten signature in black ink, appearing to read 'Manoj Gunawardena', with a long horizontal line extending from the bottom of the signature.

Manoj Gunawardena

Chief Executive Officer

31 July 2010

Annual Report of the Board of Directors

The Board of Directors of SriLankan Airlines Limited, take pleasure in presenting the Annual Report for the year ended 31 March 2010.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The principal business activities of the Company is the operation of international, scheduled/non-scheduled air services for the carriage of passengers, freight and mail as the designated carrier of Sri Lanka. Providing air terminal services at the Bandaranaike International Airport, sale of duty-free goods on-board, marketing inbound and outbound holiday packages constitute other main activities of the Company. Providing third party maintenance, provision of flight operation services and conducting aviation related training programs constitute ancillary activities of the Company.

There was no significant change in the nature of activities of the Company during the financial year.

The Group consists of the Company and its' wholly owned Subsidiary SriLankan Catering (Private) Limited, whose principal activity is the provision of Inflight Catering Services to airlines operating through Bandaranaike International Airport, Katunayake, Sri Lanka.

FINANCIAL STATEMENTS AND AUDITOR'S REPORT

The complete Financial Statements duly signed by the Head of Finance and the Directors and the Auditors Report thereon for the year ended 31 March 2010 are attached to this Report.

ACCOUNTING POLICIES

The Accounting Policies adopted in the preparation of the Financial Statements are given on pages 38 to 55.

GROUP TURNOVER

The turnover of the Group amounted to Rs. 63,358.45 million (2008/09 : Rs.74,264.60 million). A detailed analysis of Group Turnover is given in Note 16 to the Financial Statements.

Transactions between the Company and its fully owned subsidiary, SriLankan Catering (Private) Limited is conducted at fair market prices.

RESULTS

Group results before taxation amounted to a deficit of Rs. 6,004.61 million (2008/09: Group deficit Rs. 9,957.00 million). After adjusting Rs. 29.66 million (2008/09: Rs. 39.85 million) for taxation, the Group result for the year was a deficit of Rs. 6,034.27 million (2008/09: Group deficit of Rs. 9,996.85 million).

The consolidated Income Statement for the year is given on page 34.

GROUP INVESTMENT

Group capital expenditure during the year on property, plant and equipment amounted to Rs. 11,744.34 million (2008/09: Rs. 453.47 million).

PROPERTY, PLANT AND EQUIPMENT

The net book value of the Property, Plant and Equipment of the Group as at the Balance Sheet date amounted to Rs. 17,205.32 million (2008/09: Rs. 4,535.18 million). Details of Property, Plant and Equipment and their movements are given in Note 3 to the Financial Statements.

STATED CAPITAL

The Stated Capital of the Company, consisting of 51,463,463 Ordinary Shares, amounts to Rs 5,146.35 million (2008/09: Rs 5,146.35 million).

RESERVES

Total Group Reserves as at 31 March 2010 amount to Rs. 1,686.81 million (2008/09: Rs. 7,654.51 million). This consists of accumulated profits of Rs. 518.47 million (2008/09: Rs. 6,552.74 million), Capital Reserves of Rs 1,114.27 million (2008/09: Rs. 1,047.70 million), Revenue Reserves of Rs. 0.63 million (2008/09: Rs. 0.63 million), and General Reserves of Rs. 53.44 million (2008/09: Rs. 53.44 million). Movement in these Reserves is shown in the Statement of Changes in Equity in the Financial Statements.

CORPORATE DONATIONS

The Group has not made any cash donations during the year. No donations were made for political purposes.

TAXATION

The Company enjoys a tax holiday up to 31 March 2013 in terms of its agreement with the Board of Investment of Sri Lanka.

The Company is liable for tax on its overseas operations in countries where there are no double taxation treaties at present.

In the case of the wholly owned Subsidiary, SriLanka Catering (Private) Limited the income derived from the Flight Kitchen and Transit Restaurant is exempted from taxation with effect from 1 June 2006, in terms of its agreement with the Board of Investment of Sri Lanka.

The income derived from the Public Restaurant is liable at the prevailing tax rate.

SHARE INFORMATION

Share information as at 31 March 2010 is as follows (further details on the share holding is disclosed in Note 25 to the financial statements).

| Share Ownership | No.of Shares | % of Holding |
|-------------------------|--------------|--------------|
| Government of Sri Lanka | 26,275,436 | 51.05% |
| Emirates | 22,451,516 | 43.63% |
| Employees | 2,736,511 | 5.32% |

CONTINGENT LIABILITIES AND CAPITAL COMMITMENTS

Contingent Liabilities as at 31 March 2010 and Commitments made on Capital Expenditure as at that date are given in Note 23 to the Financial Statements.

EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

No circumstances have arisen since the Balance Sheet date that would require adjustment or disclosure, other than those disclosed in Note 25 to the Financial Statements.

EMPLOYMENT POLICIES

Employment policies of the Group respect the individual and offer equal career opportunities regardless of sex, race or religion. Occupational health and safety standards receive substantial attention. The number of persons employed by the Company and its Subsidiary at the year-end was 5,192 (2008/09: 5,317).

STATUTORY PAYMENTS

The Directors, to the best of their knowledge and belief, are satisfied that all statutory payments in relation to employees and the Government of Sri Lanka have been made up to date.

ENVIRONMENTAL PROTECTION

The Group's business activities can have direct and indirect effects on the environment. It is the Group's policy to keep adverse effects on the environment to a minimum and to promote co-operation and compliance with the relevant authorities and regulations.

CORPORATE GOVERNANCE/INTERNAL CONTROL

Adoption of good governance practices has become an essential requirement in today's corporate world.

The Directors acknowledge their responsibility for the Group's system of internal control. The system is designed to provide assurance, inter alia, on the safeguarding of assets, the maintenance of proper accounting records and the reliability of financial information generated. However, any system can ensure only reasonable and not absolute assurance that errors and irregularities are prevented or detected within a reasonable time. The Report of the Board Audit Committee forms part of this Annual Report.

The Board is satisfied with the effectiveness of the system of internal control for the period up to the date of signing of the Financial Statements.

GOING CONCERN

As noted in the Statement of Directors' Responsibilities, the Directors have adopted the going concern basis in preparing the Financial Statements.

DIRECTORATE

The current Directorate of the Company is set out below.

| | | |
|-----------------------------|---|----------|
| Mr Nishantha Wickramasinghe | - | Chairman |
| Mr Nihal Jayamanne PC | - | Director |
| Mr Kapila Chandrasena | - | Director |
| Mr Shameendra Rajapakse | - | Director |
| Mr Manilal Fernando | - | Director |
| Dr Chris Nonis | - | Director |

The Board of Directors as at 01 April 2009 was as follows.

| | |
|-----------------------------|-------------------|
| Mr Nishantha Wickremasinghe | - Acting Chairman |
| Mr Sunil G Wijesinha | - Director |
| Mr Nihal Jayamanne PC | - Director |
| Mr Sanath Ukwatte | - Director |
| Mr Kapila Chandrasena | - Director |

Mr Nishantha Wickremasinghe/ Acting Chairman, assumed the role of Chairman with effect from 29 June 2009.

Mr Shameendra Rajapakse was appointed a Director on 24 August 2009 to fill the vacancy created by the demise of Dr U N Obeysekera. Messrs Sunil Wijesinha and Sanath Ukwatte resigned from the Board on 10 May and 11 May 2010 respectively and Messrs Manilal Fernando and Dr Chris Nonis were appointed as Directors on 17 May 2010.

SriLankan Catering (Private) Limited is the wholly owned subsidiary of SriLankan Airlines and the current Directorate is as follows: -

| | | |
|-----------------------------|---|----------|
| Mr Nishantha Wickremasinghe | - | Chairman |
| Mr Nihal Jayamanne PC | - | Director |
| Mr Shameendra Rajapakse | - | Director |
| Mr Kapila Chandrasena | - | Director |

The SriLankan Catering Board as at April 2009 was as follows,

| | | |
|-----------------------------|---|----------|
| Mr Nishantha Wickremasinghe | - | Chairman |
| Mr Sunil G Wijesinha | - | Director |
| Mr Nihal Jayamanne PC | - | Director |
| Mr Sanath Ukwatte | - | Director |

Mr Shameendra Rajapakse was appointed a Director of SriLankan Catering on 01 September 2009.

The role of Messrs Sunil Wijesinha and Sanath Ukwatte as Directors of SriLankan Catering ceased when they resigned from the Board of SriLankan Airlines in May 2010. Accordingly Mr Kapila Chandrasena was appointed Director of SriLankan Catering with effect from 14 June 2010.

DIRECTORS' REMUNERATION

The Directors have not received any emoluments and/or any other payment that constitutes a payment for participation/attendance at Board Meetings during the year ended 31 March 2010. The Directors, their spouses and dependent children were entitled to FOC Business Class travel on SriLankan Airlines online services during their term of office.

DIRECTORS' SHAREHOLDINGS

By virtue of office two of the Government of Sri Lanka (GOSL) Nominee Directors including Chairman are holders of 03 Ordinary Shares of the Company.

DIRECTORS' INTERESTS IN CONTRACTS

Directors' interests in contracts of the Company are disclosed in Note 26 to the Financial Statements and have been declared at Meetings of the Directors. The Directors have no direct or indirect interest in any other contracts or proposed contracts with the Company.

ANNUAL GENERAL MEETING

The Annual General Meeting will be held on 20 September 2010.

AUDITORS

In accordance with the Companies Act No.07 of 2007, a resolution proposing the re-appointment of Messrs. Ernst & Young, Chartered Accountants, as Auditors of the Company will be submitted at the Annual General Meeting.

Details of audit fees are set out in Note 19 to the Financial Statements. The Auditors, do not have any relationship (other than of an Auditor) with the Company or its Subsidiary.

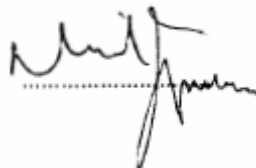
By Order of the Board



Mildred Peries
Company Secretary



Director



Director

31 July 2010

Statement of Directors' Responsibilities

The responsibilities of the Directors in relation to the financial statements of the Company and the Group differ from the responsibilities of the Auditors which are set out in their report appearing on page 31.

The Companies Act No.7 of 2007 requires the Directors to prepare financial statements for each financial year giving a true and fair view of the state of affairs of the Company and the Group as at end of the financial year and of the Profit or Loss of the Company and the Group for the financial year. In preparing the financial statements, appropriate accounting policies have been selected and applied consistently, reasonable and prudent judgements and estimates have been made, and applicable accounting standards have been followed.

The Directors are responsible for ensuring that the Company and its subsidiary keep sufficient accounting records to disclose with reasonable accuracy the financial position of the Company and the Group for ensuring that the financial statements have been prepared and presented in accordance with the Sri Lanka Accounting Standards and provide the information required by the Companies Act No.7 of 2007. They are also responsible for taking reasonable measures to safeguard the assets of the Group, and in that context to have proper regard to the establishment of appropriate systems of internal control with a view to the prevention and detection of fraud and other irregularities.

The Directors continue to adopt the going concern basis in preparing the Financial Statements. The Directors, after making enquiries and following a review of the Group's Budget for the financial year ending 31 March 2010 including cash flows and borrowing facilities, consider that the Group has adequate resources to continue in operation.

The Directors have taken steps to ensure that the Auditors have been provided with every opportunity to undertake whatever inspections they considered appropriate to enable them to form their opinion on the financial statements.

The Directors confirm that to their best of knowledge, all taxes, levies and financial obligations of the Company and its subsidiary as at the Balance Sheet date have been paid or adequately provided for in the financial statements.

By Order of the Board



Mildred Peries
Company Secretary
31 July 2010

Report of the Board Audit Committee

The Role and Responsibilities

The Board Audit Committee (BAC) primary role is to assist the Board of Directors in fulfilling its oversight responsibilities for the system of internal control, the financial reporting process, the risk management process, the governance, the audit process and the company's process for monitoring compliance with laws and regulations and the code of conduct.

The BAC responsibilities include;

- review the functions and processes of internal controls including IS/IT controls
- review the financial reporting system, in order to provide accurate, appropriate and timely information to the management, regulatory authorities and shareholders
- review the management of business risks and monitor risk management process
- review and monitor the Group's compliance with key statutory and regulatory requirements, company policies and industry best practices
- review the management of Internal Audit function
- review the independence of External Audit

BAC Composition

The BAC comprises of three members. The members of the BAC at 31 March 2010 were Mr. Sunil G Wijesinha (Chairman), Nihal Jayamanne PC (Member) and Lalith Withane (Independent Observer).

A new BAC was appointed with effect from 14 June 2010. Nihal Jayamanne PC was appointed as the new chairman of the BAC. Dr. Chris Nonis was appointed as a member and Mr. Lalith Withane continues as the independent observer.

The Terms of Reference (TOR)

The BAC has a clearly defined Terms of Reference specifying its scope, role and responsibilities.

Meetings

The BAC held 3 meetings during the financial year ended 31 March 2010. The members of the management participated in the above meetings upon invitation to brief the BAC on specific issues. Ernst and Young & KPMG Ford Rhodes Thornton & Company met with BAC to discuss the SriLankan Airlines Limited and SriLankan Catering (Private) Limited management letters respectively.

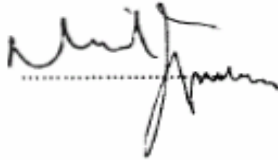
Details of the attendance of the members are as follows.

| Name of Director | Attendance |
|-----------------------|------------|
| Mr. Sunil G Wijesinha | 3/3 |
| Nihal Jayamanne PC | 3/3 |
| Mr. Lalith Withane | 3/3 |

Group Internal Audit

The main focus of the internal audit function is to provide independent assurance over the overall system of internal controls, risk management and governance processes by evaluating the adequacy, integrity and effectiveness of internal controls.

The BAC has reviewed the progress of the audit engagements performed by the Internal Audit Division and made recommendations as and when required to strengthen the Company's internal control system.

A handwritten signature in black ink, appearing to read 'Nihal Jayamanne', written over a horizontal dotted line.

Nihal Jayamanne PC
Chairman
Board Audit Committee

31 July 2010



Chartered Accountants

201 De Saram Place
P.O. Box 101
Colombo 10
Sri Lanka

Tel : (0) 11 2463500
Fax Gen : (0) 11 2697369
Tax : (0) 11 5578180
eysl@lk.ey.com

I

**INDEPENDENT AUDITORS' REPORT
TO THE SHAREHOLDERS OF SRILANKAN AIRLINES LIMITED**

Report on the Financial Statements

We have audited the accompanying financial statements of SriLankan Airlines Limited ("Company"), the consolidated financial statements of the Company and its subsidiary, which comprise the balance sheets as at 31 March 2010, and the income statements, statements of changes in equity and cash flow statements for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Sri Lanka Accounting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Scope of Audit and Basis of Opinion

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Sri Lanka Auditing Standards. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

Partners: A D B Talwatte FCA FCMA M P D Cooray FCA FCMA R N de Saram ACA FCMA Ms. Y A De Silva ACA W R H Fernando FCA FCMA
W K B S P Fernando FCA ACMA A P A Gunasekera FCA FCMA A Herath FCA D K Hulangamuwa FCA FCMA LLB (Lond)
H M A Jayasinghe FCA FCMA Ms. G G S Manatunga ACA Ms. L C G Nanayakkara FCA FCMA B E Wijesuriya ACA ACMA

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purposes of our audit. We therefore believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion, so far as appears from our examination, the Company maintained proper accounting records for the year ended 31 March 2010 and the financial statements give a true and fair view of the Company's state of affairs as at 31 March 2010 and its loss and cash flows for the year then ended in accordance with Sri Lanka Accounting Standards.

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs as at 31 March 2010 and the loss and cash flows for the year then ended, in accordance with Sri Lanka Accounting Standards, of the Company and its subsidiary dealt with thereby, so far as concerns the shareholders of the Company.

Without qualifying our opinion we draw attention to Note 2.1.2 in these financial statements.

Report on Other Legal and Regulatory Requirements

In our opinion, these financial statements also comply with the requirements of Sections 151(2) and 153(2) to 153(7) of the Companies Act No. 07 of 2007.



Ernst & Young
Chartered Accountants
Colombo

31 July 2010

BALANCE SHEET

As at 31 March 2010

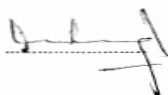
| | Note | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|------|------------------------|------------------------|--------------------------|--------------------------|
| ASSETS | | | | | |
| Non-current Assets | | | | | |
| Property, Plant and Equipment | 3 | 17,205.32 | 4,535.18 | 15,522.79 | 2,488.94 |
| Major Overhauls and Upgrade of Aircraft Engines | 4 | 5,956.08 | 9,988.61 | 5,956.08 | 9,988.61 |
| Aircraft Maintenance Reserve | 5 | 5,406.24 | 4,704.73 | 5,406.24 | 4,704.73 |
| Aircraft and Spare Engine Deposits | | 1,414.13 | 1,844.12 | 1,414.13 | 1,844.12 |
| Intangible Asset | 6 | 168.60 | 219.60 | 166.55 | 212.86 |
| Investments | 7 | 23.92 | 23.52 | 65.96 | 93.92 |
| | | 30,174.29 | 21,315.76 | 28,531.75 | 19,333.18 |
| Current Assets | | | | | |
| Inventories | 8 | 3,921.32 | 4,240.08 | 3,709.03 | 4,029.26 |
| Trade and Other Receivables | 9 | 8,425.43 | 7,675.60 | 7,952.33 | 7,142.18 |
| Aircraft Maintenance Reserve | 5 | 2,597.45 | 1,194.24 | 2,597.45 | 1,194.24 |
| Cash and Bank Balances | 10 | 1,858.67 | 2,785.16 | 1,652.01 | 2,642.70 |
| | | 16,802.87 | 15,895.08 | 15,910.82 | 15,008.38 |
| Total Assets | | 46,977.16 | 37,210.84 | 44,442.57 | 34,341.56 |
| EQUITY AND LIABILITIES | | | | | |
| Capital and Reserves | | | | | |
| Stated Capital | 11 | 5,146.35 | 5,146.35 | 5,146.35 | 5,146.35 |
| Reserves | 12 | 1,168.34 | 1,101.77 | 1,168.34 | 1,101.77 |
| Accumulated Profit / (Loss) | | 518.47 | 6,552.74 | (2,716.26) | (18.06) |
| Total Equity | | 6,833.16 | 12,800.86 | 3,598.43 | 6,230.06 |
| Non-current Liabilities | | | | | |
| Interest Bearing Liabilities | 13 | 9,492.38 | 1,228.98 | 8,792.48 | 4.44 |
| Other Deferred Liabilities | 14 | 3,828.67 | 3,241.06 | 3,651.74 | 3,094.75 |
| | | 13,321.05 | 4,470.04 | 12,444.22 | 3,099.19 |
| Current Liabilities | | | | | |
| Trade and Other Payables | 15 | 18,889.78 | 18,760.90 | 21,068.71 | 24,360.55 |
| Income Tax Payable | | 263.20 | 184.11 | 175.45 | 175.45 |
| Interest Bearing Liabilities | 13 | 7,669.97 | 994.93 | 7,155.76 | 476.31 |
| | | 26,822.95 | 19,939.94 | 28,399.92 | 25,012.31 |
| Total Equity and Liabilities | | 46,977.16 | 37,210.84 | 44,442.57 | 34,341.56 |

These financial statements are in compliance with the requirements of the Companies Act No. 7 of 2007.

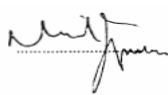


Head of Finance

The Board of Directors is responsible for the preparation and presentation of these financial statements.
Signed for and on behalf of the Board by:



Chairman



Director

The accounting policies and notes on pages 38 through 76 form an integral part of these financial statements.

Colombo
31 July 2010

INCOME STATEMENT

Year ended 31 March 2010

| | Note | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|--------------------------------|------|------------------------|------------------------|--------------------------|--------------------------|
| Revenue | 16 | 63,358.45 | 74,264.60 | 62,363.58 | 73,307.77 |
| Cost of Sales | | (61,016.36) | (75,488.74) | (62,044.06) | (76,606.48) |
| Gross Profit / (Loss) | | 2,342.09 | (1,224.14) | 319.52 | (3,298.71) |
| Other Income and Gains | 17 | 491.37 | 85.31 | 4,516.99 | 2,034.76 |
| Sales and Marketing Cost | | (5,204.39) | (5,791.38) | (5,204.39) | (5,791.39) |
| Administrative Expenses | | (3,063.09) | (3,121.89) | (1,778.29) | (2,396.99) |
| Finance Cost | 18.1 | (596.00) | (218.82) | (545.71) | (128.40) |
| Finance Income | 18.2 | 25.41 | 313.92 | 17.97 | 311.58 |
| Loss Before Tax | 19 | (6,004.61) | (9,957.00) | (2,673.91) | (9,269.15) |
| Income Tax Expense | 20 | (29.66) | (39.85) | (24.29) | (36.79) |
| Loss for the Year | | (6,034.27) | (9,996.85) | (2,698.20) | (9,305.94) |
| | | | | | |
| Basic Earnings Per Share (Rs.) | 21 | (117.25) | (194.25) | | |

The accounting policies and notes on pages 38 through 76 form an integral part of these financial statements.

Colombo
31 July 2010

SriLankan Airlines Limited

STATEMENT OF CHANGES IN EQUITY

Year ended 31 March 2010

| GROUP | Stated Capital Rs. M | Capital Reserve Rs. M | Revenue Reserve Rs. M | General Reserve Rs. M | Accumulated Profit Rs. M | Total Rs. M |
|---|----------------------------|-----------------------------|-----------------------------|-----------------------------|--------------------------------|-----------------|
| Balance as at 31 March 2008 | 5,146.35 | 1,047.70 | 0.63 | 53.44 | 16,549.59 | 22,797.71 |
| Loss for the year | - | - | - | - | (9,996.85) | (9,996.85) |
| Balance as at 31 March 2009 | 5,146.35 | 1,047.70 | 0.63 | 53.44 | 6,552.74 | 12,800.86 |
| Surplus on Revaluation of Land & Building | - | 66.57 | - | - | - | 66.57 |
| Loss for the year | - | - | - | - | (6,034.27) | (6,034.27) |
| Balance as at 31 March 2010 | <u>5,146.35</u> | <u>1,114.27</u> | <u>0.63</u> | <u>53.44</u> | <u>518.47</u> | <u>6,833.16</u> |

The accounting policies and notes on pages 38 through 76 form an integral part of these financial statements.

Colombo
31 July 2010

SriLankan Airlines Limited

STATEMENT OF CHANGES IN EQUITY

Year ended 31 March 2010

| COMPANY | Stated Capital Rs. M | Capital Reserve Rs. M | Revenue Reserve Rs. M | General Reserve Rs. M | Accumulated Profit / (Loss) Rs. M | Total Rs. M |
|---|----------------------------|-----------------------------|-----------------------------|-----------------------------|---|-----------------|
| Balance as at 31 March 2008 | 5,146.35 | 1,047.70 | 0.63 | 53.44 | 9,287.88 | 15,536.00 |
| Loss for the year | - | - | - | - | (9,305.94) | (9,305.94) |
| Balance as at 31 March 2009 | 5,146.35 | 1,047.70 | 0.63 | 53.44 | (18.06) | 6,230.06 |
| Surplus on Revaluation of Land & Building | - | 66.57 | - | - | - | 66.57 |
| Loss for the year | - | - | - | - | (2,698.20) | (2,698.20) |
| Balance as at 31 March 2010 | 5,146.35 | 1,114.27 | 0.63 | 53.44 | (2,716.26) | 3,598.43 |

The accounting policies and notes on pages 38 through 76 form an integral part of these financial statements.

Colombo
31 July 2010

CASH FLOW STATEMENT

Year ended 31 March 2010

| | Note | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|-----------|------------------------|------------------------|--------------------------|--------------------------|
| Cash Flows From/(Used in) Operating Activities | | | | | |
| Loss before Income Tax Expense | | (6,004.61) | (9,957.00) | (2,673.91) | (9,269.15) |
| Adjustments for | | | | | |
| Depreciation / Amortisation | | 5,543.45 | 6,324.00 | 5,158.24 | 5,939.60 |
| Finance Cost | 18.1 | 596.00 | 218.82 | 545.71 | 128.40 |
| Amortisation of Pre-delivery Payments | | 59.95 | 98.23 | 59.95 | 98.23 |
| Profit on disposal of Property, Plant and Equipment | 17 | (4.90) | (2.61) | (4.79) | (2.61) |
| Finance Income | 18.2 | (25.41) | (313.92) | (17.97) | (311.58) |
| Dividend Income | | - | - | - | (1,950.00) |
| Provision for Bad & Doubtful Debts | | 81.28 | 96.58 | 81.52 | 91.00 |
| Provision for Slow Moving Inventory | | 334.30 | 43.03 | 332.92 | 43.03 |
| Provision for Doubtful Recoveries of Maintenance Reserve | | 315.45 | 583.95 | 315.45 | 583.95 |
| Net Unrealized Exchange (Gain) / Loss | | 43.71 | (497.90) | 43.71 | (497.90) |
| Gain on Investment bought back by subsidiary | 17 | - | - | (3,971.84) | - |
| Provision/ (Reversal) for Gratuity | 14.1 | 572.40 | (149.19) | 533.95 | (181.16) |
| Operating Profit / (Loss) before Working Capital Changes | | 1,511.62 | (3,556.01) | 402.94 | (5,328.19) |
| Increase in Inventories | | (15.54) | (293.44) | (12.69) | (268.16) |
| (Increase)/Decrease in Trade and Other Receivables | | (915.35) | 2,909.43 | (975.91) | 2,817.31 |
| Increase/(Decrease) in Trade and Other Payables | | 1,445.68 | (2,570.84) | 1,944.47 | (1,211.43) |
| Cash Generated from/ (used in) Operations | | 2,026.41 | (3,510.86) | 1,358.81 | (3,990.47) |
| Finance Cost Paid | | (365.44) | (91.92) | (315.15) | (4.13) |
| Gratuity Paid | 14 | (110.65) | (224.50) | (102.82) | (192.04) |
| Income Tax Paid | | (6.77) | (3.53) | - | - |
| Net Cash flows From/ (Used in) Operating Activities | | 1,543.55 | (3,830.81) | 940.84 | (4,186.64) |
| Cash Flows From/(Used in) Investing Activities | | | | | |
| Proceeds from upliftments of Fixed Deposit | | - | 6,866.32 | - | 6,866.32 |
| Interest Received | | 22.14 | 259.50 | 14.70 | 257.16 |
| Investment in Shares | | (0.40) | - | (0.20) | - |
| Payments for Aircraft Deposits | | (81.71) | (207.83) | (81.71) | (207.83) |
| Recoveries of Aircraft Deposits | | 495.16 | 29.67 | 495.16 | 29.67 |
| Payments for Maintenance Reserve | 5 | (3,305.28) | (3,229.45) | (3,305.28) | (3,229.45) |
| Recoveries of Maintenance Reserve | 5 | 798.53 | 3,552.47 | 798.53 | 3,552.47 |
| Acquisition of Property, Plant and Equipment | | (828.23) | (546.17) | (811.47) | (472.60) |
| Payments made on Engine Overhauls | | (3,165.46) | (6,459.38) | (3,165.46) | (6,459.38) |
| Acquisition of Intangible Assets | | (34.29) | (77.97) | (34.24) | (77.97) |
| Proceeds from Disposal of Property, Plant and Equipment | | 4.90 | 3.06 | 4.79 | 3.06 |
| Net Cash from / (used in) Investing Activities | | (6,094.64) | 190.22 | (6,085.18) | 261.45 |
| Cash Flows From/(Used in) Financing Activities | | | | | |
| Repayment of Interest Bearing Liabilities | 13.1 | (1,035.99) | (390.69) | (506.94) | (14.94) |
| Proceeds from Interest Bearing Loans and Borrowings | | 2,579.54 | 230.50 | 2,579.54 | 230.50 |
| Net Cash from/ (used in) Financing Activities | | 1,543.55 | (160.19) | 2,072.60 | 215.56 |
| Net Decrease in Cash and Cash Equivalents | | (3,007.54) | (3,800.78) | (3,071.74) | (3,709.63) |
| Cash and Cash Equivalents at the beginning of the year | 10 | 2,556.40 | 6,357.18 | 2,413.94 | 6,123.57 |
| Cash and Cash Equivalents at the end of the year | 10 | (451.15) | 2,556.40 | (657.81) | 2,413.94 |

The accounting policies and notes on pages 38 through 76 form an integral part of these financial statements.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

1. CORPORATE INFORMATION

1.1 General

SriLankan Airlines Limited (the “Company”) is a Limited Liability Company incorporated and domiciled in Sri Lanka. The registered office of the Company and the principal place of business is located at Airline Center, Bandaranaike International Airport, Katunayake, Sri Lanka.

1.2 Principal Activities and Nature of Operations

Company

The principal activities of the Company consist of operating international scheduled, non-scheduled air services for the carriage of passengers, freight and mail as the designated carrier of Sri Lanka. Providing Air Terminal services at the Bandaranaike International Airport, sale of duty free goods on-board, marketing inbound and outbound holiday packages constitute other main activities. Providing third party maintenance, flight operation services and conducting aviation related training programs constitute ancillary activities of the Company.

Subsidiary – SriLankan Catering (Private) Limited

The principal activity of the Subsidiary is to provide in-flight catering services to airlines operating through Bandaranaike International Airport, Katunayake, Sri Lanka.

1.3 Date of Authorisation for Issue

The financial statements for the year ended 31 March 2010 were authorized for issue in accordance with a resolution of the Board of Directors on 26 July 2010.

2. GENERAL ACCOUNTING POLICIES

2.1 Basis of Preparation

The financial statements have been prepared under the historical cost convention unless otherwise indicated. The financial statements are presented in Sri Lanka Rupees Million and all values are rounded to the nearest one hundred thousand Sri Lanka Rupees except when otherwise indicated. The preparation and presentation of these Financial Statements is in compliance with the Companies Act No. 07 of 2007.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

2.1.1 Statement of Compliance

The financial statements have been prepared in accordance with Sri Lanka Accounting Standards (SLAS).

2.1.2 Going Concern

During the current year the Company recorded a loss of Rs. 2,698.20 million (2009 – Rs.9,305.94 million). Further, the Company has recorded an accumulated loss of Rs.2,716.26 million (2009 – Rs.18.06 million) and Company's current liabilities exceeded its' current assets by Rs.12,489.10 million (2009 – Rs.10,003.93 million) and the total equity of the Company as of balance sheet date has declined to Rs. 3,598.43 million from Rs. 6,230.06 million in 2009. These factors may raise doubts that the Company will be able to continue as a going concern.

The Government of Sri Lanka (GOSL) having eradicated terrorism from the country has embarked on a major economic development drive and a key element of this plan is the development of a vibrant regional hub for aviation, commercial activities and knowledge. SriLankan Airlines as the national carrier is expected to be a vital partner in this development drive.

The Company has submitted a five year Strategic Business Plan which is presently under discussion with the GOSL as the way forward towards supporting the development plans and growing the business of the Airline in a commercially viable manner. The GOSL recently facilitated the purchase of the 43.63% equity stake held by Emirates in the Company which could be identified as a vital step towards supporting the growth plans of the Company.

Further, the measures adopted to mitigate losses and improve the cash position during the last year have yielded positive results with a noteworthy reduction in operating losses recorded during the year.

The Directors have assessed and are confident of the Company's ability to continue in operation as a going concern for the foreseeable future, as a consequence of the significance of the abovementioned factors and actions of the GOSL and the mitigating activities undertaken by the Company in the last financial year which includes revenue enhancement measures, a

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

route and fleet expansion program and effective cost reduction initiatives which will be further strengthened in the ensuing financial years through continuous review and implementation.

Other Developments

- *Strengthening immediate and medium term financing*

Several successful measures have been taken to secure funding which include the following.

Rs 1 billion from institutional investors from the transfer of preference shares of SriLankan Catering issued to the Company. The Company is confident of raising a further Rs. 1.0 billion from a similar transaction.

Refinancing three Airbus A330-200 aircraft finance leases by way of a sale and lease back arrangement. This agreement is expected to be executed in August 2010 and will result in a net cash inflow of approximately USD 33.0 million (Rs. 3.77 billion).

- *Pursuing and Implementing strategic initiatives*

Several key actions have been taken including new revenue generating/ cost saving measures in order to realise the full potential of the Company's strategic business units, such as SriLankan Engineering, Airport Services (Ground Handling) and airline related training.

2.1.3 Comparative Information

The accounting policies and estimates adopted are consistent with those of previous financial year except for the change in Accounting Estimate as disclosed under Note 22. The previous year's figures and phrases have been re-arranged wherever necessary to conform to the current presentation including the reclassification of Aircraft and Spare Engine deposits (maintained on account of operating leases) as a separate line item in the balance sheet from the previous classification within Other Receivables.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

2.2 Basis of Consolidation

The consolidated financial statements comprise of the financial statements of SriLankan Airlines Limited and its wholly owned subsidiary SriLankan Catering (Private) Limited as at 31 March each year. The financial statements of the subsidiary are prepared for the same reporting year as the parent Company, using consistent accounting policies.

All significant intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full.

Subsidiary is fully consolidated from the date of incorporation, being the date on which control commences and continues to be consolidated until the date that control ceases.

2.3 Significant Accounting Estimates and Assumptions

In the preparation of the consolidated financial statements, a number of estimates and assumptions have been made relating to the application of accounting policies and reported amounts of assets, liabilities, income and expense. The estimates and associated assumptions are assessed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The following estimates and assumptions addresses amongst others that which require subjective and complex judgments.

(a) Estimates

(i) Depreciation of Property, Plant and Equipment

Management assigns useful lives and residual values to property, plant and equipment based on the intended use of assets and the economic lives of these assets. Subsequent changes in circumstances such as technological advances or utilization of the assets concerned could result in the actual useful lives or residual values differing from initial estimates. Management reviews annually the residual values and useful lives of major items of property, plant and equipment.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

(ii) Amortisation of Major Overhaul of Aircraft Engines

Management amortises the cost of major overhaul of aircraft engines over flown hours between major overhauls.

(iii) Recognition of Unutilized Passenger tickets

Passenger and cargo sales are recognized as operating revenue when the transportation is provided. The value of unused tickets and airway bills is included in current liabilities as sales in advance of carriage. The value of unused tickets and airway bills are recognized as revenue if unused after three years. The cut-off period of three years has been based on historical and experienced trends in the upliftment of tickets and airway bills.

(iv) Determining fair value and deferment of revenue for award credits under 'FlySmiLes'

The Company operates a frequent flyer program 'FlySmiLes' that provides travel awards to members of the program based on accumulated mileage. The fair value of credits awarded is estimated by reference to the fair value of the services for which the award credits may be redeemed. Determination of the fair value of the award credit involves estimating, based on the network average of air fares and expected award credit redemption pattern. At the point of award the revenue is deferred for all miles awarded. These estimates are reviewed annually and the liability adjusted appropriately.

(b) Assumptions

Defined Benefit Plan

The cost of the retirement benefit plan of staff based in Sri Lanka is determined using an actuarial valuation. The actuarial valuation is based on assumptions concerning the rate of interest, rate of salary increase, special premium, retirement age and going concern of the Company. Due to the long term nature of the plan, such estimates are subject to significant uncertainty.

2.4 Effect of Change in Accounting Estimation

Company has reviewed its accounting estimation for amortising major overhaul cost of aircraft engines. Accordingly management considers that using the number of flown hours instead of straight line amortization reflects the better presentation of the consumption of the underlying asset. Please refer Note 22 for the effect of change in accounting estimate.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

2.5 Summary of Significant Accounting Policies

2.5.1 Foreign Currency Translation

The financial statements are presented in Sri Lanka Rupees, which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. The resultant foreign exchange gains and losses are recognized in the income statement. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

2.5.2 Taxation

(i) Current Income Tax

Company

(a) Local Taxation

The Company has signed an agreement under Section 17 of the Board of Investment Law No. 4 of 1978 which exempts it from the payment of income tax in respect of profit and income derived from the operation of the business of a commercial airline, providing international air transportation and all other ancillary and related services thereto, and on dividend and royalties for an initial period of seven years from 01 September 1979, subsequently extended for a period of three years from 01 August 1986, and thereafter a period of five years from 01 August 1989. In August 1994 the Board of Investment of Sri Lanka granted flagship status to the Company, extending the tax exemption period up to 31 March 1998. In March 1998, the Board of Investment of Sri Lanka granted a further extension of the tax exemption period up to 31 March 2013.

(b) Overseas Taxation

The Company is liable for tax on its overseas operations in countries where there are no double tax treaties at present. However, there is no liability in the current year due to the carry forward tax losses available to the Company.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

Subsidiary - SriLankan Catering (Private) Limited

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

The Income from Flight Kitchen and Transit Restaurant is exempted from income tax up to 31 May 2021 as per the agreement with Board of Investment (BOI). The Public Restaurant is liable at the normal rate.

(ii) Deferred Income Tax

Deferred Income tax is provided using the liability method on temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Company

As the Company is in its tax holiday period the provisions of the Inland Revenue Act will not apply and temporary differences do not exist during the tax exemption period. Accordingly no deferred taxation has been provided for in these financial statements.

Subsidiary – SriLankan Catering (Private) Limited

Deferred tax is recognized using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

The principal temporary differences arise from depreciation on property, plant and equipment, tax losses carried forward and provisions for defined benefit obligations.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

Deferred tax assets relating to the carry forward of unused tax losses are recognized to the extent that it is probable that future taxable profit will be available against which the unused tax losses can be utilized.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized. Deferred tax assets are reviewed at balance sheet date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

2.5.3 Borrowing Costs

Borrowing costs are recognized as an expense in the period in which they are incurred, except to the extent where borrowing costs that are directly attributable to the acquisition, construction, or production of an asset that takes a substantial period of time to get ready for its intended use or sale, are capitalized as part of that asset.

2.5.4 Intangible Assets

Intangible assets are recognized if it is probable that the future economic benefits that are attributable to the assets will flow to the entity and the cost of the assets can be measured reliably. Accordingly, these assets are stated in the Balance Sheet at cost less accumulated amortization and any accumulated impairment losses.

The cost of acquisition or development of computer software that is separable from an item of related hardware is capitalized separately and amortized over a period not exceeding 5 years on a straight line basis. The carrying value of this asset is reviewed periodically for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

2.5.5 Major Overhaul of Aircraft Engines

Cost of major engine overhauls that provides future economic benefits for more than one period are capitalized net of prefunds and warranty claims and amortized over the shorter of flown hours between major overhaul and lease period.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

2.5.6 Inventories

Inventories are valued at the lower of cost and net realizable value after making due allowances for obsolete and slow moving items. All inventories are valued on the basis of Weighted Average Cost.

2.5.7 Trade and Other Receivables

Trade Receivables are stated at the amounts that they are estimated to realize net of provision for bad and doubtful receivables.

Other receivables and dues from related parties are recognized at cost less provision for bad and doubtful receivables.

2.5.8 Cash and Cash Equivalents

Cash and cash equivalents are defined as cash at bank and in hand, call deposits, and short term highly liquid investments readily convertible to known amounts of cash and subject to insignificant risk of changes in value.

For the purpose of cash flow statement, cash and cash equivalents consist of cash at bank, cash in hand and call deposits in banks net of outstanding bank overdrafts. Investments with short maturities (i.e. three months or less from date of acquisition) are also treated as cash equivalents. Bank overdrafts are disclosed under Interest Bearing Liabilities in the Balance Sheet.

2.5.9 Property, Plant and Equipment

(a) Cost and Valuation

All items of property, plant and equipment are initially recorded at cost. Cost includes expenditure that is directly attributable to the acquisition. Where items of property, plant and equipment are subsequently revalued such revalued property, plant and equipment are carried at revalued amounts less any subsequent depreciation thereon. All other property, plant and equipment are stated at historical cost less depreciation.

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When an asset is revalued, any increase in the carrying amount is credited directly to a revaluation surplus unless it reverses a previous revaluation decrease relating to the same asset, which was previously recognized as an expense. In such instance the increase is recognized as income, to the extent of the previous write down. Any balance remaining in the revaluation surplus in respect of an asset is transferred directly to the accumulated profits on retirement or disposal of the asset.

Subsequent cost are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be reliably measured.

Cost of repairs and maintenance are charged to the Income Statement during the period in which they are incurred.

Property, plant and equipment includes amongst others the following:

(i) Aircraft Rotable Spares

Aircraft rotatable spares, which are treated as tangible assets, are initially recorded at cost and depreciated over the estimated useful life. This item is grouped under "Aircraft Related Equipment".

(ii) Capital Work-in-Progress

Capital work-in-progress is stated at cost which include all costs incurred from the date of acquisition to the date on which it is commissioned. When commissioned, capital work-in-progress is transferred to the appropriate category under property, plant and equipment and depreciated over the estimated useful life.

(b) Depreciation

Provision for depreciation is calculated by using a straight line method on cost or valuation of all property, plant and equipment, other than freehold land, in order to write off such amounts over the following estimated useful lives by equal installments.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

| | | |
|---------------------------|---|--|
| Used aircraft | - | over the estimated remaining useful life, which is currently estimated to be 6 years after making a 10% allowance for residual value |
| Aircraft rotatable spares | - | over 8 years |
| Plant & Equipment | - | over periods ranging from 1 to 10 years according to the type of equipment |
| Buildings | - | over the expected useful life subject to a maximum of 20 years |

The assets useful lives, residual values and method of depreciation are reviewed and adjusted for if appropriate at each financial year end.

(c) Derecognition

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognizing of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the Income Statement in the year the asset is derecognized.

2.5.10 Aircraft Maintenance Reserve

Aircraft maintenance reserve consists of payments made to lessors on a monthly basis for the future overhaul of engines, airframes and aircraft components in terms of operating lease agreements. Such payments are recorded as receivables net of provision for doubtful receivables in the balance sheet. Company recovers the cost incurred on overhauls of engines, airframes and aircraft components from lessors against such reserve on completion of the maintenance event.

2.5.11 Leases

(a) Operating Leases

Leases where the lessor effectively retains substantially all the risks and benefits of ownership over the leased term are treated as operating leases. Payments made under operating leases are recognized in the Income Statement when it falls due.

Cost of re-configuration are capitalized and amortized over the shorter of the useful life and the lease period.

(b) Finance Leases

Leases where the risks and benefits incidental to ownership of the leased items effectively transfer to the Company are capitalized at the inception of the lease at the fair value of the leased property or if lower, at the present value of the minimum lease payments. Capitalised leased assets are disclosed as property, plant and equipment and depreciated over the period the Company is expected to benefit from the use of the leased assets. Refer accounting policy 2.5.9 (a).

The corresponding principle amount payable to the lessor is shown as a liability. The interest on the lease liability is accrued at the time when the lease rentals fall due.

(c) Deferred Engine Upgrade Cost

The present value of deferred engine upgrade cost in line with the return conditions of the related operating lease agreements is included as part of Non-Current Assets and amortized over the shorter of useful life of the asset and lease period with the corresponding liability measured in accordance with SLAS 36 and grouped under Other Deferred Liabilities in the Balance Sheet.

2.5.12 Investments

Long-term investments

Long-term investments are stated at cost. The cost of investments is the cost of acquisition. Carrying amounts are reduced to recognize a decline other than temporary, determined for each investment individually.

In the Company's financial statements, investment in subsidiary company has been accounted for at cost, net of any provision for other than temporary diminution in value.

2.5.13 Impairment of Non-financial Assets

The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing is required for an asset, the Company makes an assessment of the assets' recoverable amount. When the carrying amount of an asset exceeds its' recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

2.5.14 Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, where it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Company expects some or all of the provision to be re-imbursed, the re-imburement is recognized as a separate asset but only when the re-imburement is virtually certain. The expense relating to any provision is presented in the income statement net of any re-imburement. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre tax rate that reflects current market assessments of the time value of money and, where appropriate the risk specific to the liability.

Where discounting is used any change in the provision resulting from the unwinding effect is dealt in the Income Statement.

2.5.15 Retirement Benefit Obligation

(a) Defined Benefit Plan-Gratuity

Company

The Company measures the present value of the promised retirement benefits of gratuity which is a defined benefit plan with the advice of an Actuary every two years using the Projected Unit Credit method.

The key assumptions used by the actuary include the following:

| | | 2010 | 2009 |
|-----------------------------|----------|-------------|-------------|
| i) Rate of interest | | 10% | 12% |
| ii) Rate of Salary Increase | - LKR | 10% | 10% |
| | - USD | 2% | 2% |
| iii) Retirement Age | - Male | 60 years | 60 years |
| | - Female | 60 years | 60 years |

iv) The Company will continue as a going concern

The gratuity liability is not externally funded. This item is grouped under “Other Deferred Liabilities” in the Balance Sheet.

Overseas-based employees are covered under social security schemes applicable in their home countries.

Subsidiary - SriLankan Catering (Private) Limited

The Company measures the present value of the promised retirement benefits of gratuity which is a defined benefit plan with the advice of an actuary using the Projected Unit Credit method. Based on the assumptions made in the preceding year the present value of the gratuity liability has been valued. The liability is not externally funded.

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ACCOUNTING POLICIES
Year ended 31 March 2010

(b) Defined Contribution Plans – Employees’ Provident Fund and Employees’ Trust Fund.

Employees based in Sri Lanka are eligible for Employees’ Provident Fund Contributions and Employees’ Trust Fund Contributions in line with the respective statutes and regulations. The Company contributes 15% and 3% of gross emoluments to Employees’ Provident Fund and Employees’ Trust Fund respectively.

2.5.16 Frequent Flyer Programme

The Company operates a frequent flyer programme called ‘FlySmiLes’ that provides travel awards to programme members based on accumulated mileage. Revenue received in relation to miles earning flights is allocated, based on fair value, between the flight and miles earned by members of the FlySmiLes program. The value attributed to the awarded miles is deferred as a liability, within sales in advance of carriage, until the miles are utilized or expired.

As and when members redeem miles for an award, revenue is brought to account within the Income Statement. Revenue is recognized at point of redemption where non-flight rewards are awarded. Revenue in relation to flight awards is recognized when the passenger coupons are uplifted.

Revenue received from partner companies for the issue of miles is also deferred as a liability within sales in advance of carriage. Difference between the fair value of the miles accrued and the miles paid by the partner at the contracted rate is dealt in the Income Statement.

The value attributed to miles that are expected to expire is recognized as revenue when the miles expire.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

2.5.17 Revenue Recognition

Company

(a) Airline Revenue

Revenue is generated principally from the carriage of passengers, cargo and mail, rendering of airport terminal services, engineering services, air charters and related activities. Revenue for the Group excludes inter-company transactions.

- (i) Passenger and cargo sales are recognized as operating revenue when the transportation is provided.
- (ii) The value of unused tickets and airway bills is included in current liabilities as sales in advance of carriage. The value of unused tickets and airway bills are recognized as revenue if unused after three years.
- (iii) Revenue from the provision of airport terminal services is recognized upon rendering of services.
- (iv) Revenue from provision of third party maintenance services is recognized upon completion of such event.
- (v) Revenue from the provision of flight operation services is recognized upon rendering of services.

(b) Dividend income

Dividend income is accounted for when the shareholders right to receive the payment is established.

(c) Rental income

Rental income is recognized on an accrual basis.

(d) Interest income

Interest income is recognized on an accrual basis.

(e) Other income

Other income is recognized on an accrual basis.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

Subsidiary – SriLankan Catering (Private) Limited

Sale of Goods

Revenue is recognized when the significant risks and rewards of ownership have been transferred to the buyer. Revenue excludes value added sales taxes and is arrived at after deduction of trade discounts. No revenue is recognized if there are significant uncertainties regarding recovery of the consideration due, associated costs or the possible return of goods and continuing management involvement with the goods.

2.5.18 Fuel Risk Management

The Company incurred a net loss of Rs. 352.69 million (USD 3 million) under the fuel risk management program for the financial year ended 31 March 2010. As at the balance sheet date the Company has liquidated all such programmes.

2.5.19 Segment Reporting

A segment is a distinguishable component of the Group that is engaged in providing services within a particular economic environment which is subject to risks and rewards that are different from those of other segments.

Primary segments are determined based on the geographical spread of operations as the Company's risks and rate of return are predominantly affected by the fact that it operates in different countries. The analysis of turnover by origin of sale is derived by allocating revenue to the area in which the sale was made. Expenses that cannot be directly identifiable to a particular segment are not segregated and disclosed.

Management considers that there is no suitable basis for allocating assets and related liabilities to geographical segments. Accordingly, segment assets, segment liabilities and other segment information by geographical segment is not disclosed.

The secondary reporting by business segment is based on the nature of services provided by the Group. The Group is engaged in two main business segments - Air transportation and in-flight catering services through its subsidiary.

SriLankan Airlines Limited
ACCOUNTING POLICIES
Year ended 31 March 2010

2.6 Effects of Sri Lanka Accounting Standards issued but not yet effective

The following accounting standards have been issued by the Institute of Chartered Accountants of Sri Lanka and are effective for the accounting periods on the dates specified below.

a) Sri Lanka Accounting Standard 44 Financial Instruments; Presentation (SLAS 44) and Sri Lanka Accounting Standard 45 Financial Instruments; Recognition & Measurement (SLAS 45)

SLAS 44 and 45 becomes effective for financial years beginning on or after 1 January 2011. Accordingly, the financial Statements for the year ending 31 March 2012 will adopt SLAS 44 and 45, for the first time.

These two standards together provide comprehensive guidance on identification, classification, measurement and presentation of financial instruments (including Derivatives) into financial assets, financial liabilities and equity instruments.

In order to comply with the requirements of these accounting standards, the Group is in the process of assessing the effect of adoption of the aforesaid two recent accounting standards. Due to the complex nature of the effect of these standards the impact of adoption cannot be estimated as at the date of publication of these financial statements.

b) Sri Lanka Accounting Standard 39- Share Based Payments (SLAS 39)

SLAS 39- Share based payments, effective for periods beginning on or after 1st January 2010 will be first adopted in the year ending 31 March 2011. This standard requires an expense to be recognized where the Company buys goods or services in exchange for shares or rights over shares (equity –settled transactions), or in exchange for other assets equivalent in value to a given number of shares or rights over shares (cash- settled transactions).

For equity-settled share-based payment transactions, the Company is required to apply SLAS 39 to grants of shares, share options or other equity instruments that were granted after 1 January 2010.

However, Group is of the view that the above accounting standard on adoption will not have any significant impact on these financial statements in the absence of share base payments.

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

3 PROPERTY, PLANT AND EQUIPMENT

3.1 GROUP

| | Land and Buildings | Plant & Equipment | Improvements to Aircraft / Engines on Operating Leases | Aircraft Related Equipment | Aircraft under Finance Lease | Capital Work-in-Progress | Total |
|---|-----------------------|----------------------|--|-------------------------------|---------------------------------|-----------------------------|------------------|
| | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M |
| Cost/Revaluation | | | | | | | |
| Balance as at 01 April 2009 | 3,199.06 | 5,223.70 | 944.35 | 4,964.19 | - | 1.97 | 14,333.27 |
| Acquisitions/Modifications/Revaluations | 35.86 | 161.03 | - | 213.24 | 11,400.43 | 0.35 | 11,810.91 |
| Transfers/Adjustments | - | (1.72) | (360.82) | (22.86) | 4,262.92 | - | 3,877.52 |
| Disposals | - | (3.70) | (22.57) | - | - | - | (26.27) |
| Balance as at 31 March 2010 | 3,234.92 | 5,379.31 | 560.96 | 5,154.57 | 15,663.35 | 2.32 | 29,995.43 |
| Accumulated Depreciation | | | | | | | |
| Balance as at 01 April 2009 | 736.75 | 4,274.82 | 697.03 | 4,089.49 | - | - | 9,798.09 |
| Charge for the Year | 165.71 | 454.28 | 95.54 | 190.05 | 570.33 | - | 1,475.91 |
| Transfers/Adjustments | (35.01) | 0.53 | (269.14) | 1.54 | 1,844.46 | - | 1,542.38 |
| Disposals | - | (3.70) | (22.57) | - | - | - | (26.27) |
| Balance as at 31 March 2010 | 867.45 | 4,725.93 | 500.86 | 4,281.08 | 2,414.79 | - | 12,790.11 |
| Net Book Value as at 31 March 2010 | 2,367.47 | 653.38 | 60.10 | 873.49 | 13,248.56 | 2.32 | 17,205.32 |
| Net Book Value as at 31 March 2009 | 2,462.31 | 948.88 | 247.32 | 874.70 | - | 1.97 | 4,535.18 |

3.2 (a) The details of buildings at valuation of the Company are disclosed under Note 3.4 (a).

(b) During the year, the Group acquired property, plant and equipment to the aggregate value of Rs. 11,744.34 million (including the acquisition of aircraft under finance lease) (2008/09 - Rs. 453.47 million). Cash payments amounting to Rs. 790.52 million (2008/09 - Rs. 546.17 million) were made (excluding payments for finance lease) during the year to acquire property, plant and equipment.

(c) Group Property, plant and equipment includes fully depreciated assets having a gross carrying amount of Rs. 8,614.88 million (2008/09 - Rs. 7,387.58 million).

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

3 PROPERTY, PLANT AND EQUIPMENT (Contd.)

3.3 COMPANY

| | Land and Buildings | Plant & Equipment | Improvements to Aircraft / Engines on Operating Leases | Aircraft Related Equipment | Aircraft under Finance Lease | Capital Work-in-Progress | Total |
|---|-----------------------|----------------------|--|-------------------------------|---------------------------------|-----------------------------|------------------|
| | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M |
| Cost/Revaluation | | | | | | | |
| Balance as at 01 April 2009 | 1,638.91 | 3,572.56 | 944.35 | 4,964.19 | - | 1.97 | 11,121.98 |
| Acquisitions/Modifications/Revaluations | 31.55 | 148.58 | - | 213.24 | 11,400.43 | 0.35 | 11,794.15 |
| Transfers/Adjustments | - | (1.72) | (360.82) | (22.86) | 4,262.92 | - | 3,877.52 |
| Disposals | - | (3.25) | (22.57) | - | - | - | (25.82) |
| Balance as at 31 March 2010 | 1,670.46 | 3,716.17 | 560.96 | 5,154.57 | 15,663.35 | 2.32 | 26,767.83 |
| Accumulated Depreciation | | | | | | | |
| Balance as at 01 April 2009 | 524.80 | 3,321.72 | 697.03 | 4,089.49 | - | - | 8,633.04 |
| Charge for the Year | 88.03 | 151.49 | 95.54 | 190.05 | 570.33 | - | 1,095.44 |
| Transfers/Adjustments | (35.01) | 0.53 | (269.14) | 1.54 | 1,844.46 | - | 1,542.38 |
| Disposals | - | (3.25) | (22.57) | - | - | - | (25.82) |
| Balance as at 31 March 2010 | 577.82 | 3,470.49 | 500.86 | 4,281.08 | 2,414.79 | - | 11,245.04 |
| Net Book Value as at 31 March 2010 | 1,092.64 | 245.68 | 60.10 | 873.49 | 13,248.56 | 2.32 | 15,522.79 |
| Net Book Value as at 31 March 2009 | 1,114.11 | 250.84 | 247.32 | 874.70 | - | 1.97 | 2,488.94 |

3.4 (a) During the year the buildings of the Company were revalued by Mr. S D A L Marshall a Corporate Valuer. The results of such revaluations are incorporated in these financial statements from its effective date. The surplus arising from the revaluation was transferred to the revaluation reserve (Note 12.1).

(b) During the year, the Company acquired property, plant and equipment to the aggregate value of Rs. 11,727.58 million (including the acquisition of aircraft under finance lease) (2008/09 - Rs. 379.93 million). Cash payments amounting to Rs. 773.76 million (2008/09 - Rs. 472.60 million) were made (excluding payments for finance lease) during the year to acquire property, plant and equipment.

(c) Property, plant and equipment of the Company includes fully depreciated assets having a gross carrying amount of Rs. 8,425.40 million (2008/09 - Rs. 7,217.67 million).

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

4 MAJOR OVERHAULS AND UPGRADE OF AIRCRAFT ENGINES**Group / Company**

| Cost | 2010 Rs. M | 2009 Rs. M |
|---|-----------------------------|-----------------------------|
| Balance as at 01 April | 15,656.56 | 12,489.75 |
| Incurred during the year (Net) | 2,287.33 | 7,305.95 |
| Transfers to Aircraft under Finance Lease | (3,902.10) | - |
| Derecognised during the year | (4,625.92) | (4,139.14) |
| Balance as at 31 March | 9,415.87 | 15,656.56 |
| | | |
| Accumulated Amortisation | | |
| Balance as at 01 April | 5,667.95 | 4,565.24 |
| Amortisation for the Year | 3,993.08 | 5,241.85 |
| Transfers to Aircraft under Finance Lease | (1,575.32) | - |
| Derecognised during the year | (4,625.92) | (4,139.14) |
| Balance as at 31 March | 3,459.79 | 5,667.95 |
| | | |
| Net Book Value as at 31 March | 5,956.08 | 9,988.61 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

5 AIRCRAFT MAINTENANCE RESERVE

Group / Company

| | | 2010 | | | 2009 | | |
|------------------------------|------------|----------------------------------|---------------------------------|-----------------|----------------------------------|---------------------------------|----------|
| | | Amount Recoverable Within 1 Year | Amount Recoverable After 1 Year | Total | Amount Recoverable Within 1 Year | Amount Recoverable After 1 Year | Total |
| | | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M |
| Aircraft Maintenance Reserve | (Note 5.1) | 2,597.45 | 5,406.24 | 8,003.69 | 1,194.24 | 4,704.73 | 5,898.97 |

| | Balance as at 01 April 2009 | Payments | Interest Accrued | Recoveries | Balance as at 31 March 2010 |
|---|-----------------------------|----------|------------------|------------|-----------------------------|
| | Rs. M | Rs. M | Rs. M | Rs. M | Rs. M |
| 5.1 Aircraft Maintenance Reserve | 5,898.97 | 3,305.28 | 3.27 | (798.53) | 8,408.99 |
| Less: Provision for doubtful Recoveries | | | | | (315.45) |
| Unrealised Exchange Loss | | | | | (89.85) |
| Net Recoverable | | | | | 8,003.69 |

6 INTANGIBLE ASSET

Computer Software

Group
Rs. M Company
Rs. M

Cost

| | | |
|------------------------------------|---------------|---------------|
| Balance as at 01 April 2009 | 700.60 | 674.25 |
| Acquisitions/Modifications | 23.46 | 23.41 |
| Balance as at 31 March 2010 | 724.06 | 697.66 |

Accumulated Amortisation

| | | |
|------------------------------------|---------------|---------------|
| Balance as at 01 April 2009 | 481.00 | 461.39 |
| Charge for the Year | 74.46 | 69.72 |
| Balance as at 31 March 2010 | 555.46 | 531.11 |

Net Book Value as at 31 March 2010

168.60 **166.55**

Net Book Value as at 31 March 2009

219.60 212.86

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

7 INVESTMENTS

| 7.1 GROUP | Country of Incorporation | Holding % | 2010 Cost Rs. M | 2009 Cost Rs. M |
|---|-----------------------------|--------------|-----------------------|-----------------------|
| Non-Current | | | | |
| Investments in Equity Securities | | | | |
| -SITA INC Foundation | Netherlands | 0.8% | 23.52 | 23.52 |
| -Air Lanka (Private) Limited (40,000 Shares) | Sri Lanka | 100% | 0.40 | - |
| | | | 23.92 | 23.52 |
| | | | | |
| 7.2 COMPANY | Country of Incorporation | Holding % | 2010 Cost Rs. M | 2009 Cost Rs. M |
| Non-Current | | | | |
| Investments in Equity Securities | | | | |
| -SriLankan Catering (Private) Limited (based on Net Asset Value Rs. 3.28 billion (2009 - Rs. 6.64 billion)) | Sri Lanka | 100% | 42.24 | 70.40 |
| -SITA INC Foundation | Netherlands | 0.8% | 23.52 | 23.52 |
| -Air Lanka (Private) Limited (20,000 Shares) | Sri Lanka | 50% | 0.20 | - |
| | | | 65.96 | 93.92 |

The investment in SITA INC Foundation, represents unquoted depository certificates without fixed maturity.

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

| 8 INVENTORIES | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Consumables and Spares | 3,717.04 | 3,978.62 | 3,652.07 | 3,931.23 |
| Raw Materials | 147.32 | 163.43 | - | - |
| Duty Free Merchandise | 56.96 | 98.03 | 56.96 | 98.03 |
| | <u>3,921.32</u> | <u>4,240.08</u> | <u>3,709.03</u> | <u>4,029.26</u> |
| | | | | |
| 9 TRADE AND OTHER RECEIVABLES | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
| Trade Receivables | 6,089.27 | 4,872.81 | 5,876.23 | 4,719.90 |
| Less: Provision for doubtful debts | (312.22) | (230.94) | (309.44) | (227.92) |
| | <u>5,777.05</u> | <u>4,641.87</u> | <u>5,566.79</u> | <u>4,491.98</u> |
| | | | | |
| Other Debtors | 1,741.31 | 2,057.92 | 1,566.96 | 1,710.33 |
| Deposits, Advances and Prepayments | 869.35 | 941.40 | 785.05 | 910.81 |
| | <u>8,387.71</u> | <u>7,641.19</u> | <u>7,918.80</u> | <u>7,113.12</u> |
| | | | | |
| Loans and Advances to Company Officers (Note 9.1) | 37.72 | 34.41 | 33.53 | 29.06 |
| | <u>8,425.43</u> | <u>7,675.60</u> | <u>7,952.33</u> | <u>7,142.18</u> |

9.1 Loans to Company Officers:

Given below are particulars of loans granted to Company officers in excess of Rs. 20,000 only;

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|-------------------------------|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Balance as at 01 April | 8.98 | 5.43 | 1.32 | 1.50 |
| Loans granted during the year | 7.52 | 7.43 | 3.21 | 2.16 |
| Repayments | (3.60) | (3.88) | (2.01) | (2.34) |
| | <u>12.90</u> | <u>8.98</u> | <u>2.52</u> | <u>1.32</u> |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

10 CASH AND CASH EQUIVALENTS IN THE CASH FLOW STATEMENT

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Components of Cash and Cash Equivalents | | | | |
| 10.1 Favourable Cash and Cash Equivalents Balance | | | | |
| Cash and Bank Balances | 1,534.49 | 1,687.64 | 1,327.83 | 1,545.18 |
| Short Term Deposits | 324.18 | 1,097.52 | 324.18 | 1,097.52 |
| | <u>1,858.67</u> | <u>2,785.16</u> | <u>1,652.01</u> | <u>2,642.70</u> |
| 10.2 Unfavourable Cash and Cash Equivalents Balance | | | | |
| Bank Overdrafts (Note 13) | (2,309.82) | (228.76) | (2,309.82) | (228.76) |
| | <u>(451.15)</u> | <u>2,556.40</u> | <u>(657.81)</u> | <u>2,413.94</u> |
| Total Cash and Cash Equivalents for the purpose of Cash Flow Statement | <u>(451.15)</u> | <u>2,556.40</u> | <u>(657.81)</u> | <u>2,413.94</u> |

11 STATED CAPITAL**Group / Company****Issued and Fully Paid**

| | 2010 Rs. M | 2009 Rs. M |
|----------------------------|-----------------------|-----------------------|
| 51,463,463 Ordinary Shares | 5,146.35 | 5,146.35 |
| | <u>5,146.35</u> | <u>5,146.35</u> |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

| 12 RESERVES | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|------------------------------|------------------------|------------------------|--------------------------|--------------------------|
| Capital Reserves (Note 12.1) | 1,114.27 | 1,047.70 | 1,114.27 | 1,047.70 |
| Revenue Reserves | 0.63 | 0.63 | 0.63 | 0.63 |
| General Reserves (Note 12.2) | 53.44 | 53.44 | 53.44 | 53.44 |
| | <u>1,168.34</u> | <u>1,101.77</u> | <u>1,168.34</u> | <u>1,101.77</u> |

12.1 Capital Reserves

(a) Movement in Capital Reserve

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|-------------------------------------|------------------------|------------------------|--------------------------|--------------------------|
| Balance as at 01 April | 1,047.70 | 1,047.70 | 1,047.70 | 1,047.70 |
| Surplus on revaluation of buildings | 66.57 | - | 66.57 | - |
| Balance as at 31 March | <u>1,114.27</u> | <u>1,047.70</u> | <u>1,114.27</u> | <u>1,047.70</u> |

(b) Capital Reserves of the Company/ Group comprise of surplus arising from the revaluation of property, plant and equipment.

12.2 General Reserve

General reserve of Rs. 53.44 million represent transfers from Capital Reserves in prior years relating to exchange differences capitalised in 1987/88 and in 1988/89 in respect of property, plant and equipment which have been financed through foreign currency loans.

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

13 INTEREST BEARING LIABILITIES

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|------------------------|------------------------|--------------------------|--------------------------|
| Current Liabilities | | | | |
| Finance Leases (Note 13.2(b)) | 2,031.49 | - | 2,031.49 | - |
| Long-term Loans (Note 13.1(b)) | 518.62 | 535.67 | 4.41 | 17.05 |
| Short Term Loan | 2,810.04 | 230.50 | 2,810.04 | 230.50 |
| Bank Overdraft | 2,309.82 | 228.76 | 2,309.82 | 228.76 |
| | 7,669.97 | 994.93 | 7,155.76 | 476.31 |
| Non-current Liabilities | | | | |
| Finance Leases (Note 13.2(b)) | 8,792.48 | - | 8,792.48 | - |
| Long-term Loans (Note 13.1(b)) | 699.90 | 1,228.98 | - | 4.44 |
| | 9,492.38 | 1,228.98 | 8,792.48 | 4.44 |
| 13.1 (a) Long-term Loans | | | | |
| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
| Balance as at 01 April | 1,764.65 | 2,153.98 | 21.49 | 35.07 |
| Payments during the year | (546.13) | (390.69) | (17.08) | (14.94) |
| Adjustments | - | 1.36 | - | 1.36 |
| Balance as at 31 March | 1,218.52 | 1,764.65 | 4.41 | 21.49 |
| 13.1 (b) Long-term Loans | | | | |
| Long-term Loans | 2010 | 2009 | 2010 | 2009 |
| Group | Rs. M | Rs. M | USD M | USD M |
| Payable within one year | 518.62 | 535.67 | 4.54 | 4.65 |
| After one year but not more than five years | 699.90 | 1,228.98 | 6.12 | 10.66 |
| The interest rate applicable to the loan of the Subsidiary is at LIBOR + 2.35%. | | | | |
| Company | Rs. M | Rs. M | USD M | USD M |
| Payable within one year included under Current Liabilities | 4.41 | 17.05 | 0.04 | 0.15 |
| After one year but not more than five years | - | 4.44 | - | 0.04 |
| 13.2 (a) Finance Lease Liabilities | | | | 2010 |
| Group / Company | | | | Rs. M |
| Balance as at 01 April | | | | - |
| Additions during the year | | | | 11,362.72 |
| Payments during the year | | | | (489.86) |
| Restatements | | | | (48.89) |
| Balance as at 31 March | | | | 10,823.97 |
| 13.2(b) Finance Lease Liabilities | | | 2010 | 2010 |
| Group / Company | | | Rs. M | USD M |
| Payable within one year included under Current Liabilities | | | 2,031.49 | 17.78 |
| After one year but not more than five years | | | 8,792.48 | 76.94 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

14 Other Deferred Liabilities

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Retirement Benefit Obligation (Note 14.1) | 2,144.70 | 1,682.95 | 1,967.77 | 1,536.64 |
| Deferred Engine Upgrade Cost (Note 14.2) | 1,683.97 | 1,558.11 | 1,683.97 | 1,558.11 |
| | 3,828.67 | 3,241.06 | 3,651.74 | 3,094.75 |

14.1 Retirement Benefit Obligation - Gratuity

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Balance as at 01 April | 1,682.95 | 2,056.64 | 1,536.64 | 1,909.84 |
| Current year service cost and interest cost | 343.20 | 344.64 | 305.94 | 312.67 |
| Actuarial (Gain) / Loss | 229.20 | (493.83) | 228.01 | (493.83) |
| Payments during the year | (110.65) | (224.50) | (102.82) | (192.04) |
| Balance as at 31 March | 2,144.70 | 1,682.95 | 1,967.77 | 1,536.64 |

14.2 Deferred engine upgrade cost is recognised in line with Accounting Policy No. 2.5.11 (c). The unwinding effect of the discount is recognised in the Income Statement as a finance cost as it occurs with the corresponding increase in the carrying amount of the deferred engine upgrade cost.

15 TRADE AND OTHER PAYABLES

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|------------------------------|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Trade & Other Payables | 7,232.47 | 8,512.49 | 9,411.40 | 14,112.14 |
| Sales in Advance of Carriage | 11,657.31 | 10,248.41 | 11,657.31 | 10,248.41 |
| | 18,889.78 | 18,760.90 | 21,068.71 | 24,360.55 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

16 REVENUE AND SEGMENT INFORMATION

16.1 Revenue

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---------------------------------|------------------------|------------------------|--------------------------|--------------------------|
| Scheduled services - Passenger | 48,360.66 | 58,429.30 | 48,360.66 | 58,429.30 |
| - Cargo | 7,106.06 | 9,754.95 | 7,145.20 | 9,781.04 |
| - Excess Baggage | 633.97 | 651.07 | 633.97 | 651.07 |
| - Mail | 158.80 | 117.76 | 158.80 | 117.76 |
| | 56,259.49 | 68,953.08 | 56,298.63 | 68,979.17 |
| Air Terminal and Other Services | 5,110.18 | 3,692.74 | 5,162.45 | 3,735.16 |
| Duty Free | 713.51 | 502.19 | 713.51 | 502.19 |
| Non-Scheduled Services | 188.99 | 91.25 | 188.99 | 91.25 |
| Flight Catering | 1,086.28 | 1,025.34 | - | - |
| Total | 63,358.45 | 74,264.60 | 62,363.58 | 73,307.77 |

16.2 Segment Information

(a) Primary Reporting by Geographical Segment - Revenue by Origin of Sale

| | Asia | Europe & Africa | Middle East | North & South America | South West Pacific | Total 2010 Rs. |
|---------------------------------|-----------|--------------------|-------------|--------------------------|-----------------------|----------------------|
| Revenue | | | | | | |
| Scheduled services - Passenger | 23,082.21 | 14,353.86 | 9,239.00 | 1,467.95 | 217.64 | 48,360.66 |
| - Cargo | 6,049.14 | 630.00 | 346.36 | 73.86 | 6.70 | 7,106.06 |
| - Excess Baggage | 392.32 | 28.25 | 211.63 | 1.59 | 0.18 | 633.97 |
| - Mail | 56.58 | 96.10 | 0.27 | 0.04 | 5.81 | 158.80 |
| | 29,580.25 | 15,108.21 | 9,797.26 | 1,543.44 | 230.33 | 56,259.49 |
| Air Terminal and Other Services | 5,110.18 | - | - | - | - | 5,110.18 |
| Duty Free | 182.59 | 239.38 | 193.36 | - | 98.18 | 713.51 |
| Non-Scheduled Services | 188.99 | - | - | - | - | 188.99 |
| Flight Catering | 1,086.28 | - | - | - | - | 1,086.28 |
| Segment Revenue | 36,148.29 | 15,347.59 | 9,990.62 | 1,543.44 | 328.51 | 63,358.45 |

| | Asia | Europe & Africa | Middle East | North & South America | South West Pacific | Total 2009 Rs. |
|---------------------------------|-----------|--------------------|-------------|--------------------------|-----------------------|----------------------|
| Revenue | | | | | | |
| Scheduled services - Passenger | 26,873.79 | 17,118.06 | 12,042.37 | 1,700.29 | 694.79 | 58,429.30 |
| - Cargo | 8,216.11 | 880.78 | 501.34 | 136.92 | 19.80 | 9,754.95 |
| - Excess Baggage | 396.49 | 38.03 | 214.11 | 2.09 | 0.35 | 651.07 |
| - Mail | 55.49 | 56.62 | 0.38 | 0.41 | 4.86 | 117.76 |
| | 35,541.88 | 18,093.49 | 12,758.20 | 1,839.71 | 719.80 | 68,953.08 |
| Air Terminal and Other Services | 3,692.74 | - | - | - | - | 3,692.74 |
| Duty Free | 128.52 | 168.48 | 136.09 | - | 69.10 | 502.19 |
| Non-Scheduled Services | 91.25 | - | - | - | - | 91.25 |
| Flight Catering | 1,025.34 | - | - | - | - | 1,025.34 |
| Segment Revenue | 40,479.73 | 18,261.97 | 12,894.29 | 1,839.71 | 788.90 | 74,264.60 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

(b) Secondary Reporting by Business Segment

| | Business Segment | | Group | Business Segment | | Group |
|--|------------------|--------------------|------------------|------------------|--------------------|------------------|
| | Airline | Flight Catering | | Airline | Flight Catering | |
| | 2010 Rs. M | 2010 Rs. M | 2010 Rs. M | 2009 Rs. M | 2009 Rs. M | 2009 Rs. M |
| Revenue | | | | | | |
| Sales to external customers | 62,272.15 | 1,086.28 | | 73,239.25 | 1,025.34 | |
| Inter-segment Sales | 91.43 | 1,627.40 | | 68.52 | 1,765.96 | |
| Total Revenue | 62,363.58 | 2,713.68 | 63,358.45 | 73,307.77 | 2,791.30 | 74,264.60 |
| Results | | | | | | |
| Profit / (Loss) After Tax | (2,698.20) | 635.74 | (6,034.27) | (9,305.94) | 1,259.06 | (9,996.85) |
| Other Segment Information | | | | | | |
| Assets | 44,442.57 | 4,958.26 | 46,977.16 | 34,341.56 | 8,723.37 | 37,210.84 |
| Liabilities | 40,844.14 | 1,681.39 | 40,144.00 | 28,111.50 | 2,082.23 | 24,409.98 |
| Acquisition of Property, Plant and Equipment | 11,727.58 | 16.76 | 11,744.34 | 379.93 | 73.54 | 453.47 |
| Depreciation and Amortisation | 5,158.24 | 385.21 | 5,543.45 | 6,093.62 | 384.41 | 6,478.03 |
| Operating Expenses | 63,868.50 | 1,590.73 | 63,740.39 | 78,701.24 | 1,579.02 | 77,923.98 |

Values reported under "Group" exclude inter-group balances.

| 17 OTHER INCOME AND GAINS | Group | Group | Company | Company |
|---|---------------|---------------|-----------------|-----------------|
| | 2010 Rs. M | 2009 Rs. M | 2010 Rs. M | 2009 Rs. M |
| Profit on Disposal of Property, Plant and Equipment | 4.90 | 2.61 | 4.79 | 2.61 |
| Exchange Gain | 395.97 | - | 452.63 | - |
| Miscellaneous | 90.26 | 82.46 | 87.49 | 81.91 |
| Rental | 0.24 | 0.24 | 0.24 | 0.24 |
| Dividend | - | - | - | 1,950.00 |
| Gain on Investment bought back by Subsidiary | - | - | 3,971.84 | - |
| | 491.37 | 85.31 | 4,516.99 | 2,034.76 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

18.1 FINANCE COST

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Interest Cost on Borrowings and Bank Overdrafts | 164.13 | 94.55 | 113.84 | 4.13 |
| Finance Charges on Deferred Engine Upgrade | 139.66 | 124.27 | 139.66 | 124.27 |
| Finance Charges on Lease Liabilities | 292.21 | - | 292.21 | - |
| | <u>596.00</u> | <u>218.82</u> | <u>545.71</u> | <u>128.40</u> |

18.2 FINANCE INCOME

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|-----------------|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| Interest Income | 25.41 | 313.92 | 17.97 | 311.58 |
| | <u>25.41</u> | <u>313.92</u> | <u>17.97</u> | <u>311.58</u> |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

| 19 LOSS FROM OPERATING ACTIVITIES stated after charging/(crediting): | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|---|------------------------|------------------------|--------------------------|--------------------------|
| Included in Cost of Sales: | | | | |
| Staff Costs | 6,505.08 | 6,756.66 | 6,505.08 | 6,756.66 |
| Defined Benefit Plan Costs - Gratuity | 423.13 | (169.40) | 423.13 | (169.40) |
| Defined Contribution Plan Costs - EPF & ETF | 610.56 | 604.86 | 610.56 | 604.86 |
| Operating Lease Rentals | 8,053.29 | 9,124.09 | 8,053.29 | 9,124.09 |
| Depreciation / Amortisation | 4,997.06 | 5,810.93 | 4,992.33 | 5,806.00 |
| Amortisation of A330 Pre-delivery Payments | 59.95 | 98.23 | 59.95 | 98.23 |
| Provision for Slow Moving Inventory | 334.30 | 46.13 | 332.91 | 43.03 |
| Loss on Fuel Risk Management Program | 352.69 | 942.21 | 352.69 | 942.21 |
| Franchise Fees | 243.86 | 223.30 | 139.68 | 119.45 |
| Included in Administrative Expenses: | | | | |
| Staff Costs | 1,109.51 | 1,174.99 | 754.33 | 804.29 |
| Defined Benefit Plan Costs - Gratuity | 133.09 | (6.74) | 94.64 | (38.71) |
| Defined Contribution Plan Costs - EPF & ETF | 119.86 | 121.74 | 92.50 | 95.42 |
| Provision for Doubtful Debts | 81.32 | 96.30 | 81.52 | 90.72 |
| Depreciation / Amortisation | 528.26 | 539.54 | 147.78 | 160.07 |
| Loss on Exchange | - | 544.71 | - | 544.71 |
| Auditors' Remuneration | 5.24 | 5.12 | 4.22 | 4.22 |
| Provision / Write-off of Maintenance Reserve | 524.28 | 635.25 | 524.28 | 635.25 |
| Included in Sales & Marketing Costs: | | | | |
| Advertising Costs | 287.98 | 334.61 | 287.98 | 334.61 |
| Staff Costs | 1,134.64 | 1,228.62 | 1,134.64 | 1,228.62 |
| Defined Benefit Plan Costs - Gratuity | 16.18 | 26.95 | 16.18 | 26.95 |
| Defined Contribution Plan Costs - EPF & ETF | 70.68 | 69.43 | 70.68 | 69.43 |
| Depreciation / Amortisation | 18.13 | 29.32 | 18.13 | 29.32 |
| Marketing Fees Charge / (Reversal) FlySmiLes | (135.82) | 275.79 | (135.82) | 275.79 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

20 TAXATION**Tax Expense**

The major components of income tax expense are as follows:

Current income tax

Current Tax Expense on Ordinary Activities for the Year (Note 20.1)

Economic Service Charge written-off

Under/(Over) Provision of current taxes in respect of prior years

| | Group 2010 Rs. M | Group 2009 Rs. M | Company 2010 Rs. M | Company 2009 Rs. M |
|--|---------------------------------|---------------------------------|-----------------------------------|-----------------------------------|
| | 29.08 | 29.97 | 24.31 | 26.91 |
| | - | (33.95) | - | (33.95) |
| | 0.58 | 43.83 | (0.02) | 43.83 |
| | 29.66 | 39.85 | 24.29 | 36.79 |

20.1 Reconciliation between Current Tax Expense/ (Income) and the product of Accounting Loss.

Accounting Loss before Tax

Aggregate Disallowed Items

Income not subject to Tax

Statutory Income under Normal Tax Rate of 35%

Utilisation of brought forward tax loss

Taxable Profit

Statutory Tax Charge at Normal Rate of Tax 35%

Social Responsibility Levy @ 1.5%

Current Income Tax Expense

| | | | | |
|--|-------------------|------------|-------------------|------------|
| | (6,004.61) | (9,957.00) | (2,673.91) | (9,269.15) |
| | 1.99 | 4.20 | - | - |
| | 6,128.59 | 10,081.05 | 2,779.18 | 9,385.70 |
| | 125.97 | 128.25 | 105.27 | 116.55 |
| | (44.09) | (43.88) | (36.84) | (40.79) |
| | 81.88 | 84.37 | 68.43 | 75.76 |
| | 28.65 | 29.53 | 23.95 | 26.51 |
| | 0.43 | 0.44 | 0.36 | 0.40 |
| | 29.08 | 29.97 | 24.31 | 26.91 |

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

21 EARNINGS PER SHARE

21.1 Basic Earnings Per Share is calculated by dividing the loss for the year attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year.

21.2 The following reflects the income and share data used in the Basic Earnings Per Share computation.

| | Group 2010 | Group 2009 |
|---|------------------------|-----------------|
| Loss attributable to Ordinary Shareholders for Basic Earnings Per Share (Rs. Million) | (6,034.27) | (9,996.85) |
| Weighted average number of Ordinary Shares in issue | 51,463,463 | 51,463,463 |
| Basic Earnings Per Share Rs. | <u>(117.25)</u> | <u>(194.25)</u> |

22 EFFECT OF CHANGE IN ACCOUNTING ESTIMATE

As stated in Accounting Policy 2.4 the Company has changed its accounting estimate for amortisation of major overhaul cost of aircraft engines. The effect of change in the accounting estimate is outlined below.

| | Effect for Year ended 31 March 2010 Rs. M |
|--|--|
| Income Statement | |
| Decrease in Cost of Sales | 973.53 |
| Decrease in Loss | <u>973.53</u> |
| Balance Sheet | |
| Increase in Major Overhaul of Aircraft Engines | 973.53 |
| Increase in Equity | <u>973.53</u> |

23 COMMITMENTS AND CONTINGENCIES**23.1 Capital Expenditure Commitments**

The Group and Company's commitment for acquisition of property, plant and equipment incidental to the ordinary course of business as at 31 March, is as follows:

| | 2010 Rs. M | 2009 Rs. M |
|---|---------------|-----------------|
| Contracted but not provided for | | |
| Tangible | 21.89 | 92.15 |
| Intangible | 10.99 | 12.05 |
| Engine Overhaul | 411.93 | 1,325.38 |
| | <u>444.81</u> | <u>1,429.58</u> |
| Authorised by the Board, but not contracted for | | |
| Tangible | 36.29 | 60.29 |
| Intangible | 205.75 | 2.19 |
| | <u>242.04</u> | <u>62.48</u> |
| | <u>686.85</u> | <u>1,492.06</u> |

23.2 Financial Commitments

(a) The Company's annual commitment for minimum lease payments under non-cancellable operating leases as at 31 March were as follows:

| | Company | |
|---|------------------|------------------|
| | 2010 Rs. M | 2009 Rs. M |
| Within one year | 5,298.41 | 19,447.66 |
| After one year but not more than five years | 20,096.86 | 14,935.84 |
| Later than five years | - | 3,864.79 |
| | <u>25,395.27</u> | <u>38,248.29</u> |

(b) The remaining lease rental commitment for the land in Katunayake, leased by the Company and Subsidiary for a period of 30 years from 1 April 1998 and 20 April 2004 respectively is as follows:

| | Group | | Company | |
|---|---------------|---------------|---------------|---------------|
| | 2010 Rs. M | 2009 Rs. M | 2010 Rs. M | 2009 Rs. M |
| Installment payable: | | | | |
| Within one year | 299.93 | 158.07 | 289.48 | 147.62 |
| After one year but not more than five years | 1,591.49 | 899.79 | 1,546.56 | 844.40 |
| Later than five years | 3,981.76 | 3,503.75 | 3,392.30 | 2,914.29 |

Under the terms of the lease agreements, no contingent rentals are payable.

23.3 Commitment on Guarantee of Loan

The Company has guaranteed the loan of USD 10.6 million obtained by its' Subsidiary SriLankan Catering (Private) Ltd. for the construction of the new flight kitchen.

23.4 Contingencies**Company**

a) No provision has been made in these financial statements as the Directors do not anticipate any significant liability in respect of any contingent liabilities arising in the ordinary course of business of the Company in respect of legal actions, other claims and potential claims being made against the Company. The management estimates contingent liabilities at Rs. 2,844.55 million as at 31 March 2010 (2009: Rs. 7,838.29 million).

Subsidiary

There are several cases pending before the Labour Tribunal against the Company as at 31st March 2010. No provision has been made in the financial statements as the amount of the obligation cannot be established at this stage.

NOTES TO THE FINANCIAL STATEMENTS

Year ended 31 March 2010

24 ASSETS PLEDGED

Company pledged the following share investment against the short term loan obtained. Please refer Note 13.

| Pledged to | Share Certificate of | No. of shares |
|-------------------|--------------------------------------|----------------------|
| Bank of Ceylon | SriLankan Catering (Private) Limited | 59,999,999 |

As per the share mortgage agreement, in the event of any increase of registered capital, conversion to a public limited company, share split, share substitution, share dividend or replacement of shares, the shares which will accrue or be declared in respect of the above mortgaged shares (along with the relevant certificates) shall also be mortgaged to Bank of Ceylon.

25 EVENTS OCCURRING AFTER THE BALANCE SHEET DATE

The Company took delivery of an Airbus A330 aircraft under a five year operating lease term in July 2010.

The lease commenced on 13th July 2010 and is due to expire on 12th July 2015.

The total future commitment under this lease agreement is valued at Rs.2,700 million. (USD 23.55 million).

The Company has entered into agreements for the sale and lease back transaction for 03 A330-200 aircraft to be executed in July / August 2010. The net cash inflow is estimated at Rs. 3.77 billion (USD 33 million).

Rs. 1 billion worth of preference shares received from the Subsidiary, SriLankan Catering (Private) Limited was transferred during June 2010, to an institutional investor.

In July 2010 the Government of Sri Lanka facilitated the purchase of the 43.63% equity stake held by Emirates in the Company (the registration of the share transfer is not finalised as at date).

Conversion rate - 1 US Dollar = Rs. 114.275

26 RELATED PARTY DISCLOSURES

26.1 GROUP

26.1.1 Transactions with Key Management Personnel (KMP)

Related parties include KMP's defined as those persons having authority and responsibility for planning, directing and controlling the activities of the Company and its Subsidiary. Such KMPs include the Board Directors, Chief Executive Officer and other Senior Management Executives of the Group who meet the criteria described above.

| | Group | | Company | |
|--------------------------|---------------|---------------|---------------|---------------|
| | 2010 Rs. M | 2009 Rs. M | 2010 Rs. M | 2009 Rs. M |
| Short Term benefits | 174.14 | 196.02 | 174.14 | 196.02 |
| Post Employment Benefits | 68.58 | 60.09 | 68.58 | 60.09 |

26.2 COMPANY

26.2.1 SriLankan Catering (Private) Limited provides flight catering services to the Company, and the Company provides passenger and freight services to the Subsidiary in the ordinary course of business. Refer Note 26.3.1 for details of transactions carried out with the Subsidiary.

26.2.2 Emirates holds 43.63% of the Stated Capital of the Company. The Company has entered into a number of specific related party agreements in the ordinary course of business to obtain goods and services from Emirates Group on commercial terms. Transactions between the Company and Emirates are summarised as follows:

| | 2010 | 2010 | 2009 | 2009 |
|--|-------------------------|-------------------------|-------------------------|-------------------------|
| | USD | Rs. | USD | Rs. |
| | Receipts/ (Payments) | Receipts/ (Payments) | Receipts/ (Payments) | Receipts/ (Payments) |
| (a) Information systems and related services | (1,644,460) | (189,255,270) | (4,137,111) | (453,135,957) |
| (b) Purchase of other goods and services | (3,955) | (454,924) | (163,582) | (17,605,758) |
| (c) Net receipt on transactions relating to international air transport, settled through IATA Clearing House | 4,149,275 | 478,214,032 | 7,440,340 | 808,503,115 |
| (d) Galileo segment commission | 196,193 | 22,507,322 | 749,728 | 82,878,508 |
| (e) Frequent flyer programme (net) * | 477,371 | 54,885,784 | (118,985) | (12,826,979) |
| (f) Net Sales | 1,912,320 | 220,695,409 | 2,401,032 | 261,641,005 |
| (g) Net Payment on Ground Handling Services | (3,078,911) | (354,531,169) | (3,262,651) | (359,567,732) |
| Total | 2,007,833 | 232,061,184 | 2,908,771 | 309,886,202 |

* 2010 represents the amounts received during the year on termination of the frequent flyer programme in March 2008.

| | 2010 | 2009 |
|----------------|--------------------------|--------------------------|
| | Rs. | Rs. |
| | Receivable/ (Payable) | Receivable/ (Payable) |
| Emirates Group | <u>(114,156,691)</u> | <u>(46,952,938)</u> |

For purposes of disclosing related party transactions Emirates Group comprises of the following entities:

Emirates
Dnata
Mercator
Changi International Airport Services Pte Limited

26.2.3 Transactions including the following have been carried out with entities controlled by the Government of Sri Lanka in the ordinary course of business.

| | 2010 | 2009 |
|--------------------------------|-------------------------|-------------------------|
| | Rs. | Rs. |
| | Receipts/ (Payments) | Receipts/ (Payments) |
| Sales | 505,419,092 | 222,850,282 |
| Others | 636,963,891 | 1,413,197,706 |
| Short Term Loan - Receipt | 4,011,592,500 | - |
| - Repayment including Interest | (1,266,365,726) | - |
| Purchase of Goods and Services | <u>(13,806,596,859)</u> | <u>(20,038,937,871)</u> |
| | <u>(8,652,621,377)</u> | <u>(18,402,889,882)</u> |

During the year the Company obtained a short term loan amounting to USD 35 million, repayable within a period of 10 months on equal monthly installments. The Treasury of Sri Lanka secured by way of a letter of comfort an amount of USD 10 million against the short term loan obtained from Bank of Ceylon.

| | 2010 | 2009 |
|--|--------------------------|--------------------------|
| | Rs. | Rs. |
| | Receivable/ (Payable) | Receivable/ (Payable) |
| Net Balance Outstanding as at 31 March | <u>(2,652,597,888)</u> | <u>446,086,175</u> |

Government controlled entities comprise of the following entities:

| | | |
|--|------------------------------------|---------------------------------|
| Airport and Aviation Services of Sri Lanka Ltd | Board of Investment of Sri Lanka | Sri Lanka Telecom |
| Ceylon Electricity Board | Ceylon Tourist Board | Bank of Ceylon |
| Ceylon Petroleum Corporation | Sri Lanka Police | Sri Lanka Insurance Corporation |
| Department of Inland Revenue | Mihin Lanka Ltd | |
| Sri Lanka Customs | Ministry of Higher Education | |
| State Pharmaceutical Corporation | Ministry of Finance and Planning | |
| Ministry of Foreign Affairs | Sri Lanka Postal Authority | |
| Sri Lanka Airforce | Sri Lanka Tourism Promotion Bureau | |
| Civil Aviation Authority | Presidential Secretariat | |
| Sri Lanka Army | Sri Lanka Convention Bureau | |

Further transactions relating to contributions for employment retirement benefits are made in line with the respective statutes and regulations to Employees Provident Fund (EPF) and Employees Trust Fund (ETF).

26.2.4 Transactions, arrangements and agreements involving entities which are controlled, and / or significantly influenced by the KMP's include the following.

| <u>Organisation</u> | <u>Nature of transaction</u> | 2010 | 2009 |
|-----------------------------|-------------------------------|-----------|-----------|
| | | Rs. | Rs. |
| Mount Lavinia Hotel Limited | Hotel charges for conferences | 160,967 | 3,041,427 |
| Dankotuwa Porcelain PLC | Inflight purchases | 2,953,321 | 349,767 |

26.2.5 Balances from / to related parties are included in Trade Receivables / Trade Payables in the Balance Sheet.

26.3 SUBSIDIARY**26.3.1 Transactions with Related Parties**

(i) The Company in the ordinary course of business has made the following Transactions:

| | 2010 | 2009 |
|----------------------------------|--------------------------|--------------------------|
| | Rs. | Rs. |
| | Revenue/ (Expenses) | Revenue/ (Expenses) |
| SriLankan Airlines Limited | 1,627,398,529 | 1,765,955,898 |
| Emirates | 498,761,282 | 582,778,702 |
| Mihin Lanka Ltd | 66,677,023 | 15,110,904 |
| Airport & Aviation Services Ltd. | <u>(132,888,835)</u> | <u>(160,836,328)</u> |
| | 2,059,947,999 | 2,203,009,176 |
| | 2010 | 2009 |
| | Rs. | Rs. |
| | Receivable/ (Payable) | Receivable/ (Payable) |
| SriLankan Airlines Limited | 2,381,477,660 | 5,783,765,792 |
| Emirates | 82,842,293 | 72,802,590 |
| Mihin Lanka Ltd | 49,769,906 | 48,644,449 |
| Airport & Aviation Services Ltd. | <u>(30,017,081)</u> | <u>(15,891,246)</u> |
| | 2,484,072,777 | 5,889,321,586 |

Company carried out the following transactions with the Parent Company.

| Organisation | Relationship | Nature of transaction | 2010 | 2009 |
|----------------------------|---------------------|------------------------------|---------------|---------------|
| | | | Rs. | Rs. |
| | | | Payments | Payments |
| SriLankan Airlines Limited | Parent Company | Freight Services | 39,158,497 | 26,100,970 |
| | | Other Services | 52,276,426 | 42,422,540 |
| | | Dividends Paid | - | 1,950,000,000 |
| | | Share buy-back | 4,000,000,000 | - |

TEN YEAR REVIEW - COMPANY

| | | 2001 | 2002 | 2003 |
|---------------------------------|----------------|------------|------------|-----------|
| INCOME STATEMENT | | | | |
| Revenue | Rs. Million | 30,437.09 | 29,352.91 | 36,235.04 |
| Operating expenditure | Rs. Million | 31,817.28 | 31,307.87 | 33,440.83 |
| Net profit/(loss) | Rs. Million | (4,734.89) | (2,048.95) | 3,347.23 |
| BALANCE SHEET | | | | |
| Share capital / Stated Capital | Rs. Million | 5,146.35 | 5,146.35 | 5,146.35 |
| Non Current Assets | Rs. Million | 14,952.28 | 12,826.78 | 12,229.44 |
| Current assets | Rs. Million | 14,247.30 | 12,061.52 | 18,713.33 |
| Total assets | Rs. Million | 29,269.98 | 24,958.70 | 31,038.66 |
| Current liabilities | Rs. Million | 16,886.18 | 11,578.40 | 16,641.12 |
| YIELD/UNIT COST | | | | |
| Overall yield | Rs. tkm | 30.2 | 38.6 | 43.0 |
| Unit cost | Rs. tkm | 24.5 | 27.5 | 31.5 |
| Breakeven load factor | % | 81.1 | 71.3 | 73.3 |
| Revenue per RPK | Rs./RPK | 3.1 | 3.8 | 4.3 |
| PRODUCTION | | | | |
| Passenger capacity | ASK Millions | 10,891.61 | 8,556.92 | 8,422.77 |
| Overall capacity | ATK Millions | 1,454.78 | 1,148.73 | 1,121.89 |
| TRAFFIC | | | | |
| Passengers carried | Nos. Thousands | 1,891 | 1,615 | 1,806 |
| Passengers carried | RPK Millions | 7,447.87 | 5,862.09 | 6,408.38 |
| Passenger load factor | % | 68.38 | 68.51 | 76.08 |
| Cargo carried | Tonnes | 58,618 | 46,067 | 47,650 |
| Cargo load carried | RTK Millions | 266.75 | 186.47 | 200.45 |
| Overall load carried | RTK Millions | 932.72 | 711.72 | 785.11 |
| Cargo load factor | % | 54.77 | 44.19 | 46.22 |
| Overall load factor | % | 64.11 | 61.96 | 69.98 |
| STAFF | | | | |
| Average strength | Nos. | 5,196 | 4,049 | 4,182 |
| Revenue per employee | Rs. | 5,857,792 | 7,249,422 | 8,664,524 |
| Capacity per employee | Tonne-km | 279,981 | 283,706 | 268,266 |
| Load carried per employee | Tonne-km | 179,507 | 175,777 | 187,735 |
| FLEET | | | | |
| A320-200 | Nos. | 2 | 1 | 2 |
| A330-200 | Nos. | 6 | 4 | 4 |
| A340-300 | Nos. | 4 | 3 | 3 |
| Turbo Otter | Nos. | - | - | - |
| Aircraft in service at year end | Nos. | 12 | 8 | 9 |

TEN YEAR REVIEW - COMPANY

| 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|-----------|------------|------------|------------|------------|------------|-------------------|
| 45,397.54 | 53,808.85 | 61,160.14 | 67,963.76 | 79,128.56 | 73,307.77 | 62,363.58 |
| 39,441.82 | 54,145.20 | 60,720.29 | 69,406.68 | 82,154.01 | 84,794.86 | 69,026.74 |
| 7,424.48 | 479.87 | 476.53 | 568.04 | 4,428.23 | (9,305.94) | (2,698.20) |
| 5,146.35 | 5,146.35 | 5,146.35 | 5,146.35 | 5,146.35 | 5,146.35 | 5,146.35 |
| 13,072.68 | 10,908.79 | 16,136.77 | 16,568.73 | 15,730.43 | 19,333.18 | 28,531.75 |
| 24,954.44 | 22,303.26 | 21,866.73 | 21,347.46 | 32,209.67 | 15,008.38 | 15,910.82 |
| 38,123.01 | 33,307.94 | 38,003.50 | 37,916.19 | 47,940.10 | 34,341.56 | 44,442.57 |
| 20,612.84 | 22,381.67 | 25,485.05 | 25,006.65 | 29,134.89 | 25,012.31 | 28,399.92 |
| 47.3 | 48.1 | 52.2 | 55.71 | 61.01 | 64.85 | 54.94 |
| 34.8 | 36.2 | 37.62 | 40.30 | 46.48 | 50.71 | 43.37 |
| 68.7 | 74.9 | 72.0 | 72.34 | 76.18 | 78.19 | 78.94 |
| 4.9 | 5.1 | 5.3 | 5.6 | 6.5 | 6.8 | 5.8 |
| 9,692.08 | 11,326.54 | 11,934.86 | 12,375.62 | 12,599.58 | 11,731.56 | 10,724.83 |
| 1,289.94 | 1,484.02 | 1,590.55 | 1,695.91 | 1,741.10 | 1,635.62 | 1,541.03 |
| 2,065 | 2,423 | 3,005 | 3,176 | 3,196 | 2,735 | 2,558 |
| 7,276.35 | 8,142.54 | 9,050.44 | 9,535.79 | 9,793.05 | 8,546.44 | 8,357.89 |
| 75.08 | 71.89 | 75.83 | 77.05 | 77.73 | 72.85 | 77.93 |
| 54,943 | 66,977 | 82,142 | 88,833 | 93,161 | 73,106 | 72,058 |
| 240.90 | 296.68 | 300.73 | 325.97 | 350.35 | 302.36 | 283.83 |
| 896.59 | 1,039.34 | 1,102.77 | 1,150.84 | 1,232.62 | 1,065.15 | 1,028.11 |
| 52.08 | 56.95 | 56.11 | 58.44 | 61.60 | 53.17 | 56.42 |
| 69.51 | 70.04 | 69.33 | 67.86 | 70.80 | 65.12 | 66.72 |
| 4,714 | 5,163 | 5,395 | 5,272 | 5,113 | 4,837 | 4,614 |
| 9,630,365 | 10,422,012 | 11,336,449 | 12,891,457 | 15,475,955 | 15,155,627 | 13,516,164 |
| 273,640 | 287,433 | 294,820 | 321,683 | 340,523 | 338,148 | 333,991 |
| 190,197 | 201,305 | 204,406 | 218,293 | 241,077 | 220,210 | 222,825 |
| 3 | 5 | 5 | 5 | 5 | 3 | 3 |
| 4 | 4 | 4 | 4 | 4 | 4 | 4 |
| 5 | 5 | 5 | 5 | 5 | 5 | 5 |
| - | 2 | 2 | 2 | | | |
| 12 | 16 | 16 | 16 | 14 | 12 | 12 |

Glossary

Available Seat Kilometres (ASK)

The product of seats offered for sale and distance over which they are carried.

Available Tonne Kilometres (ATK)

This is the measure of transport production.

The ATK produced by a flight are the capacity for payload of the aircraft measured in tonnes multiplied by the distance flown.

Revenue Passenger Kilometres (RPK)

The product of passengers carried and the distance over which they are carried.

Revenue Tonne Kilometres (RTK)

The product of passenger and cargo carried in tonnes and the distance over which they are carried.

Load Factor

The percentage relationship of revenue load to capacity provided.

The passenger load factor relates RPK to ASK while the overall load factor relates RTK to ATK.

Revenue per RPK

The revenue per RPK relates the passenger revenue to RPK.

Unit Cost

The unit cost relates the total operating cost to ATK.

Overall Yield

Overall Yield relates the net traffic revenue to RTK.

The net traffic revenue being the sum of the passenger, excess baggage, cargo and mail revenue.

Break-even Load Factor

The load factor required to equate revenue from scheduled airline operations with operating costs.



NOTICE OF MEETING

Notice is hereby given that the Thirty Second Annual General Meeting of the Shareholders of SriLankan Airlines Limited will be held at the **"Cat'seye Ballroom" of the Ceylon Continental Hotel, No.48 Janadhipathi Mawatha, Colombo 1 at 3.00 p.m** for the following purposes.

Agenda

1. To receive and consider the Report of the Directors, the Financial Statements for the year ended 31st March 2010, and the Report of the Auditors thereon.
2. To re-appoint M/s Ernst & Young as Auditors and authorize the Directors to fix their remuneration.

By Order of the Board

A handwritten signature in black ink, appearing to read "M Peries", with a horizontal line underneath.

Mildred Peries
Company Secretary

31 July 2010
Katunayake

Note:

1. Member entitled to attend and vote at the meeting is entitled to appoint a proxy to attend and vote instead of him.
2. A Proxy need not be a member of the Company
3. A form of Proxy accompanies this Notice
4. Shareholders/Proxies attending the meeting are requested to bring this Notice and their National Identity Cards.

PROXY

SRILANKAN AIRLINES LIMITED

I, of
.....

Being a member/s of SriLankan Airlines Limited hereby appoint:

..... of
.....or failing
..... of
.....

as my/our proxy to represent me/us and on my/our behalf at the Thirty Second Annual General Meeting of the Shareholders of SriLankan Airlines Limited to be held on **Monday – 27 September 2010 at 3.00 p.m** and at any adjournment thereof.

Signed this day of..... Two Thousand and Ten

.....
Signature

NOTE:

If no words are deleted or there is in the view of the proxy holder doubt (by reason of the way in which the instructions contained in the proxy have been completed) as to the way in which the proxy holder should vote, the proxy holder will vote as he thinks fit.

INSTRUCTIONS AS TO COMPLETION:

1. Perfect the Form of Proxy after filling in legibly your full name and address, by signing in the space provided and filling in the date of signature.
2. In the case of Resident/Non-Resident shareholders, the stamping will be attended to on return of the completed Form of Proxy to the Company.
3. The completed Form of Proxy should be deposited at the Registered Office of the Company at the under noted address not less than 48 hours before the time appointed for the holding of the meeting.

By Order of the Board

Company Secretary
SriLankan Airlines Limited
Airline Centre
Bandaranaike International Airport
Katunayake