



## ROYAL CERAMICS LANKA PLC

### INTERIM UPDATE- 1QFY11

***BOASTS DOMINANCE IN TILE SECTOR WITH HEALTHY 1QFY12 RESULTS***

# ROYAL CERAMICS LANKA

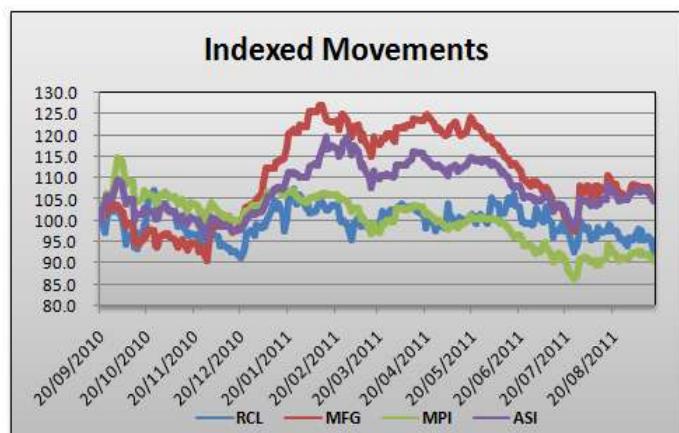
## INTERIM RESULTS UPDATE

Tile sector star Royal Ceramics Lanka PLC (RCL) is a premier Sri Lankan company. The new entrant to the Milanka Price Index has interests in porcelain and ceramic tiles, bathware and newly to paints and allied products.

The group reported a mere 2.0% YoY growth in 1QFY12 to the tune of LKR 391.5mn as profit attributable to equity holders. The 4Q trailing PE is currently at 11.0X at the price of LKR142.50. The revenue at LKR 1.4bn in 1QFY12 was a circa 19.0% above the LKR 1.2bn recorded in 1QFY11. The quarterly EPS of LKR 3.53 for the first quarter was marginally above the LKR 3.45 recorded in the corresponding period in the previous year.

RCL's first quarter investments arrayed to be a 100% takeover of Ever Paint & Chemical Industries on 1<sup>st</sup> April 2011 at a total value of LKR125 mn and a 20.03% stake of Lewis Brown & Company Ltd (holding company of Delmege Forsyth & Co. Ltd) on 16<sup>th</sup> June 2011 for LKR621.2 mn. RCL too has an interest in Hayleys PLC with a 5.07% holding as at 30<sup>th</sup> June 2011.

Thus on the light of a favourable economy, RCL primarily anticipate to focus on growing retail operations both local and overseas. In addition the tile sector star hopes to further embark significantly into other trade and service sectors to set an indelible local footprint. Hence, RCL's robust business model expects to generate forward PE multiples of 8.0X and 5.2X in FY12 and FY13 respectively, solely on recurring earnings.



### Major Shareholders (%)

### Voting (as at 30th June 2011)

Vallibel One Ltd	51.00%
A.M Weerasinghe	8.33%
Employee Provident Fund	3.70%
SLIC - General Fund	2.46%
SLIC - Life Fund	2.27%

As at 20.08.2011		RCL
<b>Price/Index Movement</b>		
1 Month		-5.0%
3 Months		-12.6%
12 Months		-7.4%
<b>Average Daily Turnover (LKR mn)</b>		65.3
<b>Market Capitalization (LKR mn)</b>		15,787.5
PER		11.0
PBV		3.1
ROE		28.1%
DY (%)		1.8%

YE 31 Mar	FY08	FY09	FY10	FY11	FY12E	FY13E
<b>Net Profit (LKR 'mn)</b>	610.8	517.9	964.4	1,441.2	1,968.2	3,038.8
<b>+/- YoY</b>	85.6%	-15.2%	86.2%	49.4%	36.6%	54.4%
<b>EPS (LKR)</b>	5.5	4.7	8.7	13.0	17.8	27.4
<b>+/- YoY</b>	85.6%	-15.2%	86.2%	49.4%	36.6%	54.4%
<b>P/E</b>	25.8	30.5	16.4	11.0	8.0	5.2
<b>PEG</b>	30.2	-200.4	19.0	22.2	21.9	9.5
<b>DPS</b>	0.5	1.0	1.3	2.5	3.3	3.3
<b>DY (%)</b>	0.4%	0.7%	0.9%	1.8%	2.3%	2.3%
<b>BVPS (LKR.)</b>	24.0	27.6	35.1	45.6	60.1	84.3
<b>PBV (X)</b>	5.9	5.2	4.1	3.1	2.4	1.7
<b>ROE (%)</b>	23.0%	16.9%	24.8%	28.5%	29.6%	32.5%

## COMPANY OVERVIEW

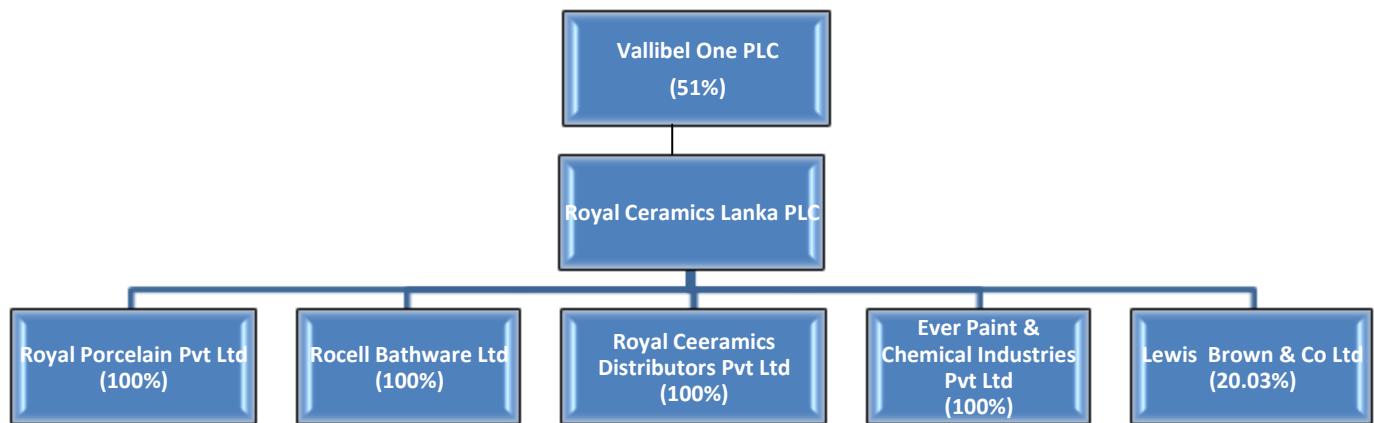
The prime activity of the Group continues to be the manufacture and sale of porcelain and ceramic tiles, along with the manufacture and sale of sanitary ware. These products were launched into the market on 1 April 2009 to both the local & export markets.

The products of the Company and its subsidiaries, Royal Porcelain (Pvt) Ltd and Rocell Bathware Limited, are distributed mainly through its own showroom network under the brand names "Rocell" and "Rocell Bathware".

Royal Porcelain (Pvt) Ltd, a fully owned subsidiary of the Company, was incorporated to obtain a tile manufacturing factory at Horana and has recorded a net profit of LKR1.1 bn for the financial year ended 31<sup>st</sup> March 2011.

Royal Ceramics Distributors (Pvt) Ltd is another fully owned subsidiary of Royal Ceramics Lanka PLC and has recorded a loss of LKR156.0 k during the year under review. This Company's operations were transferred to the parent Company during midyear ended 31 March 2006.

Rocell Bathware Limited, another fully owned subsidiary of the Company, was incorporated to manufacture and sell sanitary ware products to the local and export markets and has recorded a net profit of LKR31.0 mn for the year.



# QUARTERLY RESULTS

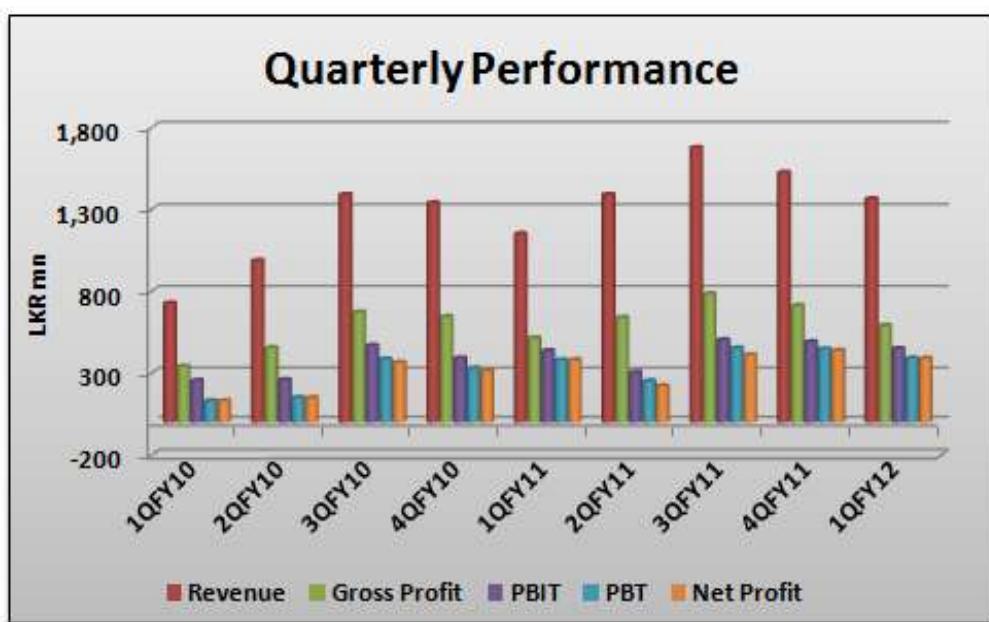
## QUARTERLY FINANCIAL PERFORMANCE

	1QFY12	1QFY11	% Change	1QFY12	4QFY11	% Change
Revenue	1,366.7	1,152.4	18.6%	1,366.7	1,527.3	-10.5%
Cost of Sales	(774.7)	(636.2)	21.8%	(774.7)	(813.7)	-4.8%
Gross Profit	592.0	516.2	14.7%	592.0	713.6	-17.0%
Other Operating Income	122.3	182.9	-33.1%	122.3	21.8	460.6%
Distributing Expenses	(176.3)	(178.7)	-1.4%	(176.3)	(90.7)	94.4%
Administrative Expenses	(86.4)	(82.3)	5.0%	(86.4)	(152.2)	-43.2%
Finance Expenses	(59.7)	(55.8)	6.9%	(59.7)	(43.7)	36.5%
Finance Income	0.1	0.2	-24.8%	0.1	0.1	47.5%
Profit Before Tax	392.1	382.5	2.5%	392.1	448.9	-12.6%
Taxation	(0.7)	-	-100.0%	(0.7)	(9.2)	-92.7%
Net Profit	391.5	382.5	2.4%	391.5	439.7	-11.0%

## QUARTERLY SEGMENTAL FINANCIAL PERFORMANCE

(LKR 'mn)	Tiles			Sanitaryware			Paints and Allied Products		
	1QFY12	1QFY11	% Change	1QFY12	1QFY11	% Change	1QFY12	1QFY11	% Change
Revenue	1,172.7	1,050.9	11.6%	162.9	101.5	60.6%	31.14	N/A	N/A
Gross Profit	546.2	498.5	9.6%	38.4	17.7	117.5%	7.37	N/A	N/A
Profit before tax and finance cost	420.9	433.4	-2.9%	28.9	4.7	511.8%	1.87	N/A	N/A
Profit before tax	372.4	388.3	-4.1%	18.8	(5.8)	420.7%	1.02	N/A	N/A
Net Profit	371.7	388.3	-4.3%	18.8	(5.8)	420.7%	1.02	N/A	N/A
Total Assets	7,238.4	4,494.0	61.1%	2,131.5	2,188.1	-2.6%	84.23	N/A	N/A
Total Liabilities	3,505.1	1,810.2	93.6%	629.2	741.7	-15.2%	99.40	N/A	N/A

\* Since RCL acquired Ever Paint & Chemical Industries Pvt Ltd on 1QFY12, the corresponding period of the previous year 1QFY11 is not taken into consideration.



### **PERSISTENT REVENUE INCREASE .....**

The group net revenue increased by circa 19% to LKR1.4 bn during 1QFY12 as opposed to the corresponding quarter of the previous year. This was primarily supported by the tiles division with an 86% to the group top line. Tiles division recorded an 11.6% growth in revenue in 1QFY12 as compared to 1QFY11 mainly due to heavy demand for tiles from commercial constructions such as condominiums and resort hotels. Local economic recovery, heavy advertising campaigns, quality and reliability in the product portfolio had led to the increase in demand for the tiles and bathware during the 1QFY12.

In addition during the quarter RCL increased the selling prices on the tile range after one and half years. This pumped up the revenue as the demand for the merchandise is price inelastic with the prevailing quality.

### **DIP IN OTHER INCOMES .....**

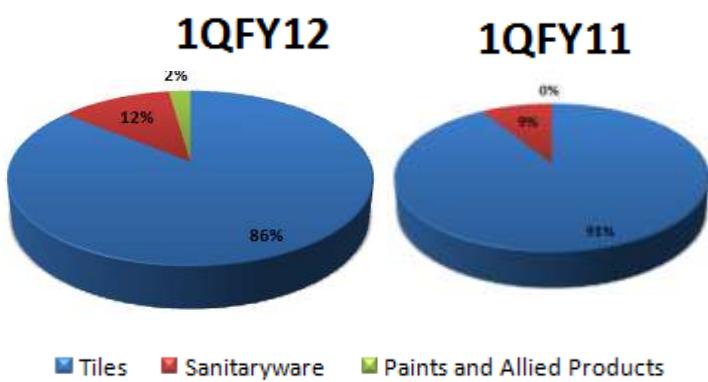
RCL's other operating income mainly comprised of realized capital gains on equity investments. During the period 1QFY12 other operating income dipped to LKR122.3 mn as opposed to LKR182.9 mn 1QFY11. The prime element for this decline was the adversity in the Colombo bourse, where the performance massively fickle.

### **STABLE EXPENSE LEVELS .....**

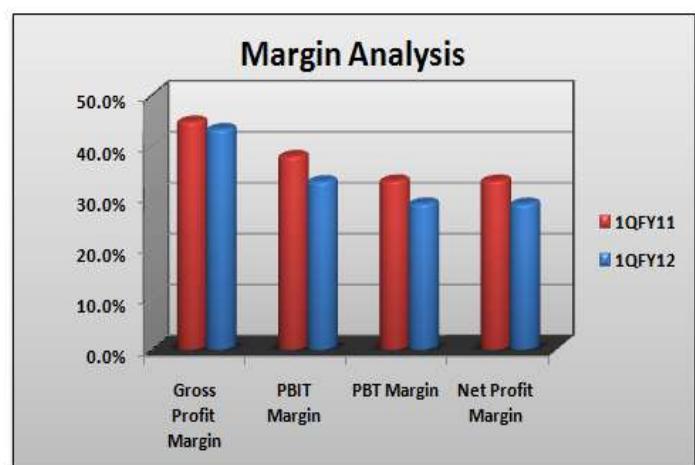
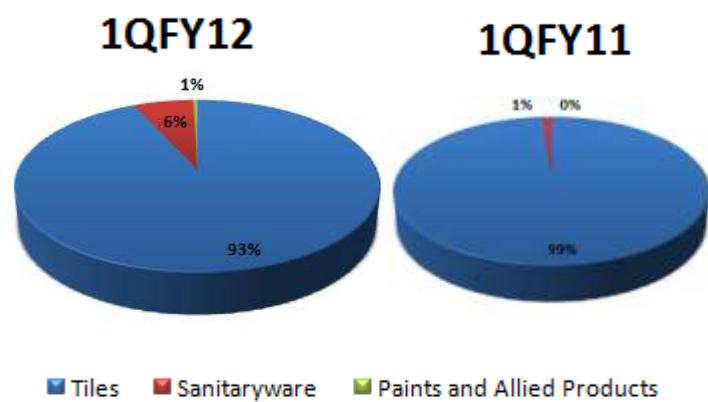
The cost of sales significantly rose curbing the gross profit margin by 150 basis points in 1QFY12. The prime reason for this was the exorbitant energy cost which accounted to 30%-40% of the total cost. Escalating crude oil prices and heavy electricity costs had massively eroded the margins.

In addition the distribution expenses had a mild diminution as the market campaigns were heavily launched in FY11; hence the requirement was minimal in the current financial quarter.

### **Sector Revenue Contribution**



### **Sector EBIT Contribution**



Margin Analysis	1QFY12	1QFY11
Gross Profit Margin	43.3%	44.8%
PBIT Margin	33.0%	38.0%
PBT Margin	28.7%	33.2%
Net Profit Margin	28.6%	33.2%

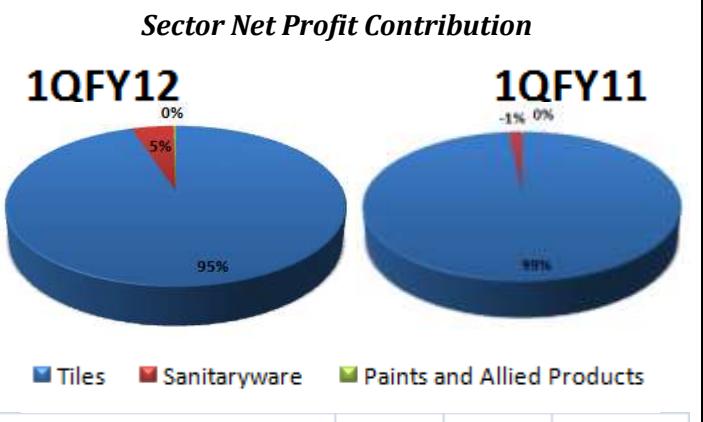
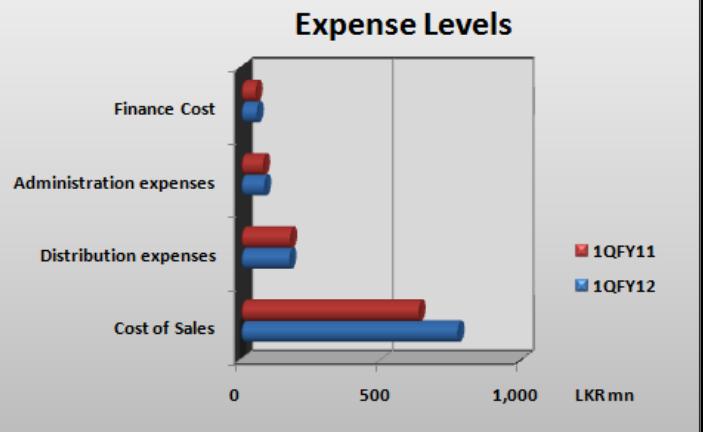
However, the administration expenses increased by 7% YoY in 1QFY12 to LKR86.4 mn. This was due to salary increments and rise in overhead expenses backed by inflation.

Moving forward, despite of reduced interest rates, finance cost rose by 7% YoY in 1QFY12 due to extensive borrowing in order to partially fund the acquisition of Ever Paint & Chemical Industries Pvt Ltd.

Furthermore, in the current quarter, the group encountered a tax expense of LKR0.7 mn as opposed to zero tax expense in the corresponding period of the previous year. This was due to tax liabilities overwhelming tax benefits.

#### **PERSISTENT YOY NET PROFIT GROWTH .....**

The group net show increased by mere 2% YoY to LKR391.5 mn during 1QFY12 compared to corresponding period of the previous year. Despite of expense hikes, robust revenue levels and hale and hearty other incomes drifted RCL's earnings to the positive territory.



Net Profit	1QFY12	1QFY11	% Change
Tiles	371.71	388.30	-4.3%
Sanitaryware	18.75	-5.85	420.7%
Paint and Allied Products	1.02	N/A	N/A

Ratio Analysis	FY08	FY09	FY10	FY11	FY12E	FY13E
<b>Profitability</b>						
Revenue Growth	33.9%	7.7%	19.0%	29.2%	30.7%	46.7%
Gross Profit Margin	42.4%	43.9%	47.6%	46.2%	47.0%	47.5%
PBIT Margin	28.6%	25.6%	31.0%	30.2%	31.0%	31.4%
PBT Margin	18.5%	14.4%	22.5%	26.7%	27.5%	29.0%
Net Profit Margin	17.6%	13.8%	21.7%	25.1%	26.2%	27.6%
<b>Efficiency</b>						
Receivable Days	34.7	36.8	46.5	41.1	35.0	30.0
Inventory Days	194.0	260.5	237.2	162.7	110.0	100.0
Payable Days	56.0	65.9	69.6	86.1	70.0	50.0
Current Ratio	1.3	1.0	1.4	1.8	1.6	2.5
Acid Test Ratio	0.6	0.3	0.5	1.2	1.1	1.9
Interest Cover	2.8	2.3	3.6	8.5	8.9	12.9
Gearing(debt/equity)	96.7%	85.3%	47.1%	48.8%	46.2%	32.0%
Gearing(debt/debt+equity)	49.2%	46.0%	32.0%	32.8%	31.6%	24.2%
<b>Investor Ratios</b>						
ROE	23.0%	16.9%	24.8%	28.5%	29.6%	32.5%
ROA	17.5%	15.5%	21.3%	20.5%	21.7%	25.8%
Equity Multiplier	2.1	2.0	1.7	1.7	1.6	1.4
Asset Turnover	0.6	0.6	0.7	0.7	0.7	0.8

## DUPONT ANALYSIS

### ➤ *Equity Multiplier*

The asset equity ratio determines the proportion of debt in RCL's capital structure. Throughout the four year period the financial leverage on average has been satisfactorily reducing. This has been due the reduction in the exorbitant debt levels that were used to fund group expansion.

### ➤ *Asset Turnover*

Improvement in asset turnover depicts the efficient utilization of group resources to generate sale revenue. This has been affirmative with the rapid growth in revenue superseding the growth in total assets. Between the FY10 and FY11, the 30.5% growth in total assets created a promising 45.2% boost in net revenue which highlights the asset utilization efficacy of 0.7X.

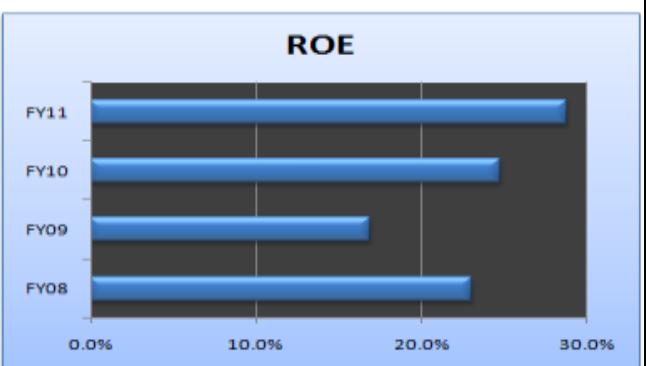
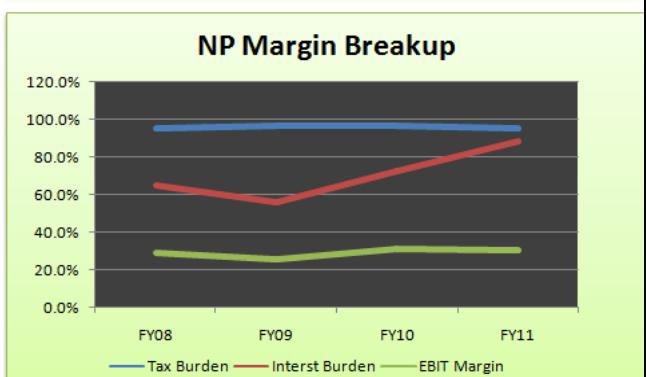
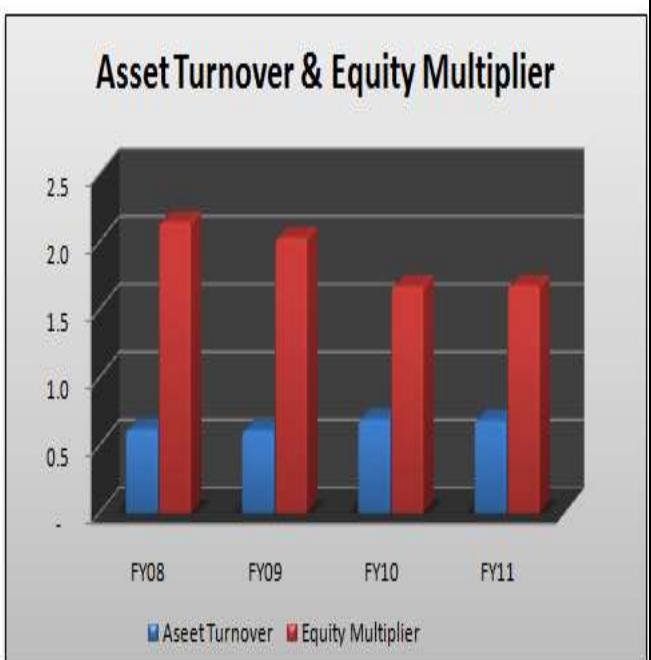
### ➤ *Net Profit Margin*

The net profit margin is further subdivided as tax burden, interest burden and EBIT margin. A colossal increase in the tax expense by 151.1% to LKR 93.7 in FY11 implies the exhaust in tax holiday. Strong operating profits have countered high interest cost, which has created an improvement in interest burden in FY11. The EBIT margins have increased by 160 basis points from FY08 to FY11. Diminish in finance cost contributed to the overall bottom line with a three year compounded growth of circa 33.1% between FY08 and FY11.

### ➤ *ROE*

When compared to FY10, there has been a gain in the ROE by 370 basis points in FY11 primarily due to improved margins couple with asset efficiency. Furthermore, RCL with its robust business model and sustainable earnings expect to deliver healthy ROE's in future.

	FY08	FY09	FY10	FY11
<b>ROE</b>	23.0%	16.9%	24.8%	28.5%
<b>Tax Burden</b>	94.9%	96.3%	96.3%	93.9%
<b>Interest Burden</b>	64.8%	56.1%	72.5%	88.3%
<b>EBIT Margin</b>	28.6%	25.6%	31.0%	30.2%
<b>Asset Turnover</b>	0.6	0.6	0.7	0.7
<b>Equity Multiplier</b>	2.1	2.0	1.7	1.7



## RISK FACTORS

- ✗ Cess on importation of certain categories of worked monumental or building stones such as tiles, granite, marble etc. were reduced from 30 per cent to 20 per cent. This may directly affect RCL as cheaper imports from China would dominate the market. Severe price competition may arise squeezing the margins of local industry including RCL.
- ✗ Tile industry consumes large quantities of clay. Although there is an abundant supply of high quality ball and china clay in Sri Lanka, mining restrictions prevailing in the country act as a barrier in acquiring required quantities. Illicit clay mining in the rural districts is also taking place which has a negative impact on the larger producers. Currently 95% of the raw materials are supplied locally. Stringent regulations on ball clay mining may in turn escalate raw material prices to increase the production cost.
- ✗ Currently 35%-40% of the production cost is attributable towards the energy cost which acts as a critical factor for the industry whilst they consume over 1,170 metric tons LPG per month. It is estimated that the increase in cess for LP Gas by Rs. 13.12 per kilo effective 1 September 2010 would push costs by over Rs. 15 m per month for one heavy user and impose additional burdens for some of the seriously struggling companies.
- ✗ Severe competition from local and foreign tile suppliers may erode future margins of the company. This in turn may have an adverse impact on the overall bottom line of the business.
- ✗ Due to stringent rules on local ball clay mining, RCL's last resort may be to import from countries such as India and China. Nevertheless the quality of the material and adverse exchange rate fluctuations may escalate the future costs, thereby negatively impacting on potential earnings.
- ✗ Currently RCL exports its products to Australia and Canada. Future possible economic instability in these regions could hinder the export revenue of RCL.

## FUTURE OUTLOOK

RCL future performance would be strongly shouldered by the growth in the GDP of the country together with the staggering construction upbeat. With the local economy growing at circa 8.2% and industry growth rate of 9.4% RCL would easily be levered towards higher earnings in the future.

The company's broad coverage with 41 showrooms and wider distribution network of 250 island wide dealers has strengthened the penetration ability of RCL. In addition RCL has expansion strategies down the pipeline, where it plans to have 10 additional showrooms during FY12 and 5 more in FY13. The management has expectations of increasing the dealer network at 10% YoY.

RCL plans to invest circa LKR3.0 bn (finance via both debt and internally generated funds) to build its third tile factory in Kiriwaththuduwa, Homagama expansion and have already contracted an overseas companies to supply machinery. Once completed in about 18 month's time, the plant will add 12,000 m<sup>2</sup> per day to the ceramic tiles segment thereby cater to the heavy demand possessed by RCL tiles. Further the bathware segment would be efficiently run on the back of the capacity increasing over time with demand for the product being generated island wide. Both tiles and bathware segments expect to have circa 90%-95% capacity during FY12 and FY13.

The newly acquired paint company has a capacity of circa 65,000 gallons per month and is operating at full capacity catering to customer pre-manufacture orders. The group has a plan down its pipeline to expand the capacity to cater excess demand in the future.

Moving forward, the tile and bathware segments expect to introduce new colours, designs and sizes to create vividness to the customer segment. This expectation may also be applied to the range of paint and allied products.

*Further, Royal Ceramics could be high turnover and robust earnings generating counter which has ample opportunity to further gain from the booming construction sector in the island. With the protectionist policies the government has placed on the local tile sector industries, RCL with its premium quality tiles and sanitary ware will have effortless penetration power in the local context. In addition this too will give RCL the momentum to shine in global ceramic market.*

## VALUATION

**Forecast FY12E earnings are in line to LKR1, 968.2 mn.** We revise our forecast, because despite the loss figure in the 'other income' criteria, the newly acquired paint company and associate profit of Lewis Brown & Company Ltd expects to expound future earnings. With the company functioning at extended capacity and the Bathware segment gaining market recognition we expect the earnings to grow by 36.6% YoY in FY12E to LKR1, 968.2 mn and a YoY growth of 54.4% FY13E to LKR3, 038.8 mn.

**Share is valued at 11.0X based on four quarter trailing earnings.** With the capitalization of reserves that took place, market prices hit circa LKR157.0 FY11 which amounted to a 38.9% healthy rise YoY compared to a price of LKR113.0 FY10. Following such a substantial gain, RCL is yet trading at 8.0X projected FY12E net profit whilst on a Price-Earnings potential of 5.2X for FY13E.

Based on an analysis of a historic 52 week price movement, we derived a price volatility of 3.4% on a mean of LKR 153.0 (Adjusted for capitalization) and a price standard deviation of LKR5.1. Furthermore, if it is assumed that the same upside momentum is witnessed pushing the price to LKR 147.3 (from the current level of LKR 142.5), the forward PE multiples would be 8.3X in FY12E and 5.4X in FY13E. [Refer Table Below].

*Thus, given the expected strong growth in demand for construction sector facilities steered by economic development in the island together with the company's increasing capacity, capped up utilization and the renowned brand name 'Rocell', we rate in the long term (over a twelve month time horizon) RCL as a BUY.*

RCL : 142.50	FY11	FY12E	FY13E
EPS (LKR)	13.0	17.8	27.4
P/E	11.0	8.0	5.2
PBV	3.1	2.4	1.7
Sector P/E	15.0		
Sector PBV	2.6		
Market P/E	15.6		
Market PBV	2.8		

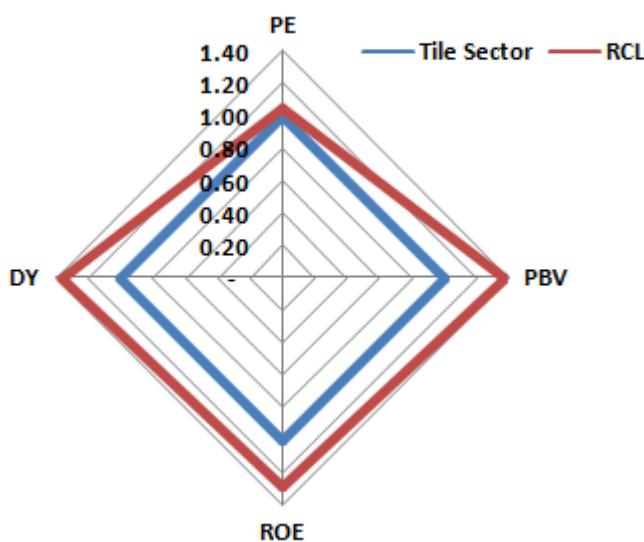
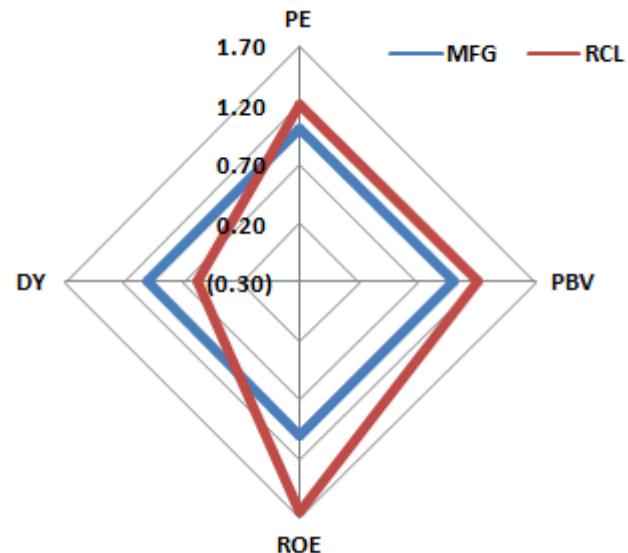
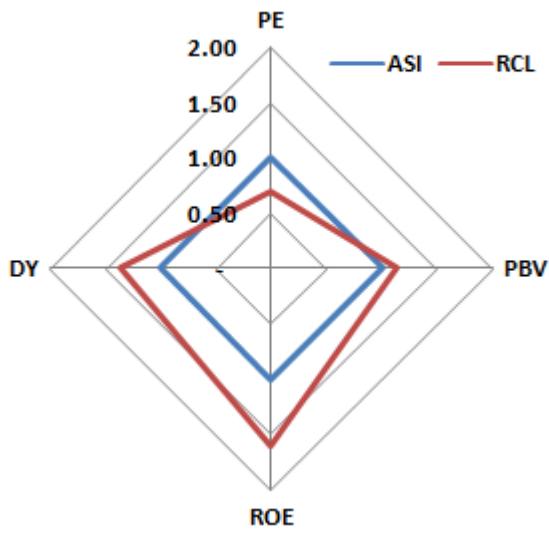
Assimilation of Price Movements*	FY12E		FY13E	
LKR	147.3	165.3	147.3	165.3
P/E	8.3	9.3	5.4	6.0
PBV	2.5	2.8	1.7	2.0

\*Price band LKR147.3 is based on an upside growth of 3.4% derived via the 12 month standard deviation of the market price.

\*\*Price band LKR165.3 is the highest traded price over the past 12 month period.

## RCL VS INDICES

As at 20.08.2011	Market Performance		Sector Performance	
	RCL	ASI	MFG	Tile Sector
<b>Price/Index Movement</b>				
1 Month	-5.0%	-2.6%	-4.6%	N/A
3 Months	-12.6%	-2.1%	-6.8%	N/A
12 Months	-7.4%	5.4%	5.6%	N/A
Average Daily Turnover (LKR mn)	65.3	2,799.35	335.57	N/A
Market Capitalization (LKR mn)	15,787.5	2,465,700.0	125,086.69	30,219.6
PER	11.0	15.8	15.2	10.4
PBV	3.1	2.8	2.6	2.3
ROE	28.1%	17.6%	17.1%	21.9%
DY (%)	1.8%	1.5%	3.1%	1.3%



\*The radar charts used, benchmarks the RCL performance against the relevant index in terms of PE, PBV, ROE and Dividend Yield.

## FINANCIAL SUMMARY

INCOME STATEMENT						
For the year ended 31st March (LKR 'mn)	FY08	FY09	FY10	FY11	FY12E	FY13E
Revenue	3,474.8	3,741.2	4,451.2	5,751.4	7,516.5	11,029.8
Gross Profit	1,472.5	1,643.5	2,118.7	2,654.6	3,532.8	5,239.1
PBIT	992.4	958.9	1,382.0	1,738.4	2,330.1	3,463.3
Finance Cost	(349.0)	(421.0)	(381.9)	(204.3)	(261.7)	(268.7)
PBT	643.4	537.9	1,001.6	1,534.9	2,069.2	3,195.4
Tax	(32.6)	(20.0)	(37.3)	(93.7)	(101.0)	(156.6)
Profit to Equity Holders	610.8	517.9	964.4	1,441.2	1,968.2	3,038.8

BALANCE SHEET						
For the year ended 31st March (LKR 'mn)	FY08	FY09	FY10	FY11	FY12E	FY13E
Fixed Assets	3,692.8	4,103.6	4,033.5	4,450.1	6,556.5	6,868.2
Current Assets	1,986.7	2,094.8	2,451.3	4,010.0	4,201.1	6,547.5
Total Assets	5,679.5	6,198.5	6,484.8	8,460.1	10,757.6	13,415.7
Long Term Liabilities	1,499.1	1,118.2	829.2	1,157.3	1,460.5	1,444.9
Short Term Liabilities	1,526.9	2,019.7	1,769.4	2,252.2	2,638.5	2,633.4
Total Equity	2,653.4	3,060.5	3,886.4	5,050.6	6,658.6	9,337.4
Total Liabilities & Equity	5,679.5	6,198.5	6,485.0	8,460.1	10,757.6	13,415.7

	FY10				FY11				FY12
	1QFY10	2QFY10	3QFY10	4QFY10	1QFY11	2QFY11	3QFY11	4QFY11	1QFY12
Revenue	729.1	988.3	1,392.3	1,341.4	1,152.4	1,392.4	1,679.3	1,527.3	1,366.7
Cost of Sales	(387.1)	(532.4)	(717.7)	(695.2)	(636.2)	(751.9)	(893.0)	(813.7)	(774.7)
Gross Profit	342.0	456.0	674.6	646.2	516.2	640.5	786.3	713.6	592.0
Other Operating Income	108.7	10.3	22.2	15.5	182.9	24.1	(14.5)	21.8	122.3
Distributing Expenses	(130.3)	(134.9)	(131.6)	(141.4)	(178.7)	(269.3)	(166.7)	(90.7)	(176.3)
Administrative Expenses	(64.1)	(69.5)	(94.5)	(127.2)	(82.3)	(88.3)	(100.2)	(152.2)	(86.4)
Finance Expenses	(124.4)	(110.7)	(83.9)	(62.8)	(55.8)	(53.7)	(51.0)	(43.7)	(59.7)
Finance Income	0.6	0.3	0.3	0.3	0.2	0.2	0.2	0.1	0.1
Profit Before Tax	132.4	151.6	387.1	330.6	382.5	253.4	454.1	448.9	392.1
Taxation	0.0	(0.2)	(20.8)	(16.3)	0.0	(29.3)	(41.2)	(9.2)	(0.7)
Net Profit	132.4	151.4	366.3	314.2	382.5	224.0	412.9	439.7	391.5

# Research

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CSE Floor	CSE,01-04, World Trade Centre, Colombo – 1.			
Kiribathgoda	Level 2-6,Udehy City Shopping complex, No 94,Makola Rd,Kiribathgoda			
Kurunegala	Union Assurance Building, No.6,1st Floor, Rajapilla Rd, Kurunagala.			
Matara	E.H.Cooray Building, Mezzanine Floor, No:24, Anagarika Darmapala Mw, Matara			
Galle	Peoples Leasing Building, 2nd Floor, No.118,Matara Road, Galle			
Negombo	Asia Asset Finance, 171/1, Station Road, Negombo.			
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## Service Centers

Kandy	k3-L1,Level 01,kcc, No 5 ,Daldha Veediya, Kandy.			
Hambantota	Hambanthota Chamber of Commerce, Thangalle Road, Hambantota.			
Ampara	2 <sup>nd</sup> Floor, T.K.S. Building, D.S. Senanayake Street, Ampara.			
Jaffna	11-8, First Floor, Stanley Road, Jaffna			
Wennappuwa	Asia Asset Finance, No.176, Negombo Road, Katuneriya.			
Moratuwa	Asia Asset Finance, No.18, New De Zoysa Rd, Moratuwa.			
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