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## ONE MONTH IN, WHAT'S THE IMPACT OF INDIA'S DEMONETIZATION FIASCO ?

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A month into India's demonetization initiative, long lines of people looking to exchange notes still spew out of banks, some sectors of the economy continue struggling with the lack of readily available cash, grassroots businesses are still being revolutionized with electronic payment capabilities, and masses of people continue transitioning towards new ways of paying for basic goods and services.

On Nov. 8, 86% of India's currency was nullified in a great demonetization effort that aimed to clean out the black market's cash supply and counterfeit notes which completely disrupted the social, political, and economic spheres of the world's second largest emerging market. All 500 and 1,000 rupee notes were instantaneously voided, and a 50 day period ensued where the population could (ideally) redeem their canceled cash for newly designed 500 and 2,000 rupee notes or deposit them into bank accounts. India has done this before. In 1946, all 1,000 and 10,000 rupee notes were recalled. In 1978, 1,000, 5,000, and 10,000 rupee notes were demonetized. This recent bout of demonetization was planned in secret by a small, tight-knit group led by Prime Minister Modi, and it overtook the country like a flash flood. This surprise was by design, as it was feared that if the black market caught wind of what the government was planning they would find ways to rapidly unload their illicit cash, and the initiative would flop on one of its initially-stated goals.

Of course, this meant that the rest of Indian society was also caught in the demonetization crossfire. Not even the banks — who would be required to do the heavy lifting on the ground — were in the loop. In the days following Modi's announcement, the banks didn't have enough of the newly designed banknotes on-hand to distribute in exchange for the canceled notes, and there simply wasn't an adequate supply of smaller denominations in circulation to run the cash economy. Far from being a 50 day transition, it is estimated that even if India's printing presses were to run 24/7 it would take upwards of four months to a year before the currency supply was adequately restored.

*More articles about Modi demonetization initiative [here](#) and [here](#).*

"I personally think it's a chicken or egg situation because the more prepared you are, the more people who are aware, the more opportunity you're giving to people to find loopholes in the system," said Arpan Nangia, the head of the India desk for HSBC's commercial banking division. "Whereas the downside of making it a surprise was [that] the government and the central bank were severely unprepared to manage the whole situation."

Modi's demonetization initiative caused a sudden breakdown in India's commercial ecosystem. Trade across all facets of the economy was disrupted, and cash-centric sectors like agriculture, fishing, and the voluminous informal market were virtually shutdown, with many businesses and livelihoods going under completely -- not to mention the economic impact of millions of people standing in line for hours to exchange or deposit canceled banknotes rather than working or doing business.

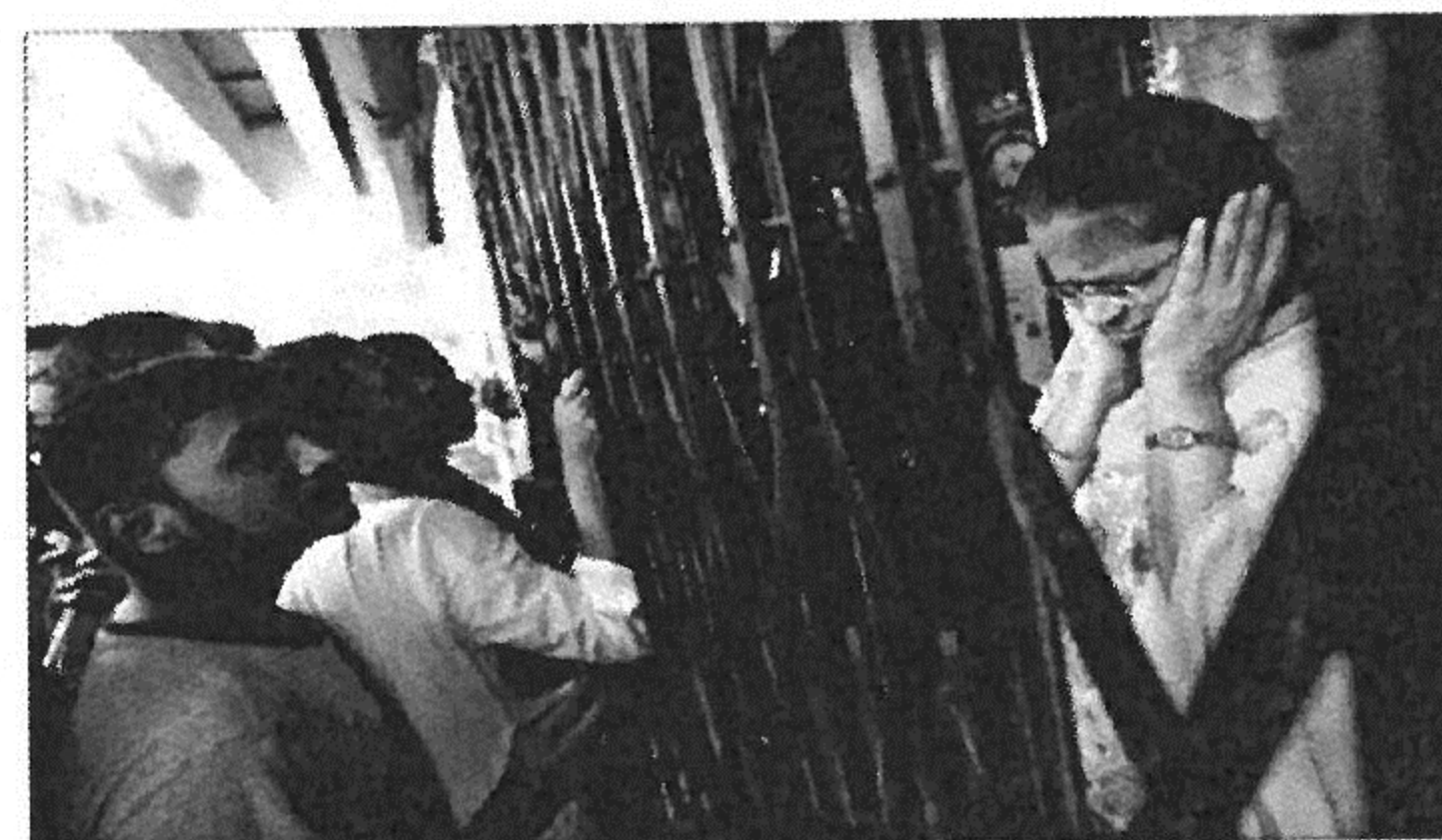
"The unbanked and informal economy is hard hit," explained Monishankar Prasad, the New Delhi-based author and editor for *Alochona*, an Australian current events publication. "The poor do not have the access to structural and cultural resources to adapt to shock doctrine economics. The poor were taken totally off guard and the banking infrastructure in the hinterland is rather limited. The tech class has poor exposure to critical social theory in order to understand the impact on the ground. There is an empathy deficit."

However, although India's demonetization initiative was seemingly severely mismanaged, this doesn't mean that the entire endeavor was a complete failure. 35 days in, there are some positive indicators. Like most other above-ground industries, India's shadow economy had its financial legs taken out from under it with



**7. Moving towards digital payments**

Use of apps/ websites to make payments should be done as it reduces hassles in transactions, but at the same time, government must declare the list of certified websites so that people can go ahead and make full use of online payments. Digital payment is a way of payment which is made through digital modes. In digital payments, payer and payee both use digital modes to send and receive money. It is also called electronic payment. No hard cash is involved in the digital payments. All the transactions in digital payments are completed online. Demonetization will likely result in people adopting virtual wallets such as Paytm, Ola Money etc.: This behavioural change could be a game changer for India.

**8. Temporary chaos and confusion**

Short term pain has accepted by all, including Prime Minister and RBI. But Government assured that it is short term pain for long term gain. The president also of the view of that it will be short term recession. People have mostly welcomed this decision and they are waiting for fruits of decision.

People faced minor problem for a few days owing to the scarcity of lower denomination notes in the system. To begin with, demonetization has often been used a tool to

cut down hyperinflation. We, on the contrary, were running smooth on Inflation and for that matter, were the fastest growing economy in the world.

**Conclusion:**

The aim of Demonetisation's to wash the stock of "black money" out of the economy and get it into the licit, banked and taxable, part of the economy. There have long been concerns about terror financing through forged notes. There's quite obviously substantial tax revenue going uncollected. Large portions of the population feel that the basic system is unfair. As per

Ambit Capital, a respected Mumbai-based equity research firm, has officially estimated that the Demonetisation-driven cash crunch will result in GDP growth crashing to 0.5% in the second half of financial year 2016-17. This means the GDP growth for six months, from October 2016 to March 2017, could decelerate to 0.5%, down from 6.4% in the previous six months. Further, Ambit Capital estimates that during the October to December quarter that we are currently in, the GDP growth may contract, thus showing negative growth. However, Ambit is hopeful that a strong formalisation of the informal economy will ensue through 2017 until 2019 and this disruption could also crimp GDP growth in 2017-18 to 5.8 % from their earlier estimate of 7.3%.

"The Demonetisation-driven cash crunch that is playing out in India will paralyse economic activity in the short term. We expect a strong 'formalisation effect' to play out as nearly half of the non-tax paying businesses in the informal sector (40% share in GDP) will become unviable and cede market share to their organised sector counterparts

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**DEMONETIZATION STOCK PICK AS BERGER PAINTS INDIA LTD.**

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**Abstract**

This paper gives an insight of the Demonetization stock pick of Berger Paints India Ltd. The paint industry is also facing challenges in sales as an effect of demonetization. The main objective of this paper is to give a detailed focus on the impact of demonetization on Berger Paints India Ltd. and its investment rational covering the rising urbanization to drive demand for Decorative paints, Strong distribution network to drive growth, Improving channel connect through sales initiatives, Gradual recovery in Industrial segment, Improving working capital efficiency to boost cash flows and Key Risk. This paper will be helpful for the researchers working in the field of Paint industry. The study of paper reveals a positive view on the company given its strong distribution network, increasing market share, healthy cash flows and strong RoE. Thus it should be recommended to investors to BUY the scrip for implying a return of 16% from current level.

**Keywords :** Demonetization, Berger Paints India Ltd., Paint Industry.

**Introduction**

The paint industry is likely to face challenges in sales in the second half of these fiscal following constraints on discretionary spending after demonetization.

The industry was expecting a double-digit growth (more than 10 per cent) following a good monsoon, but uncertainty over demonetization and the impact of the transition to GST (goods and services tax) could impede growth.

(Ghosh, 2016) "The third quarter (October-December) has started very well. But demonetization has definitely put an immediate freeze on spending by the consumers. How quickly demonetization would play out is difficult to estimate. It's not that off take is totally zero, but it has gone down," said K.B.S. Anand, managing director and CEO of Asian Paints at a Think Lecture Series organized by the Bengal Chamber of Commerce and Industry and The Telegraph.

Paint is a major input in real estate and automobile sectors, which are being impacted by cash constraint. Currency depreciation is another cause for concern. At least 30 per cent of the raw materials are imported and this could impact margin.

**Objective**

The main objective of this paper is to give a detailed focus on the impact of demonetization on Berger Paints India Ltd. and its investment rational.

To carry out the present study the Berger Paints India Ltd. as a stock pick from Paint Industry has been selected. These data have been taken from the company website, reports from various Government and private publications.

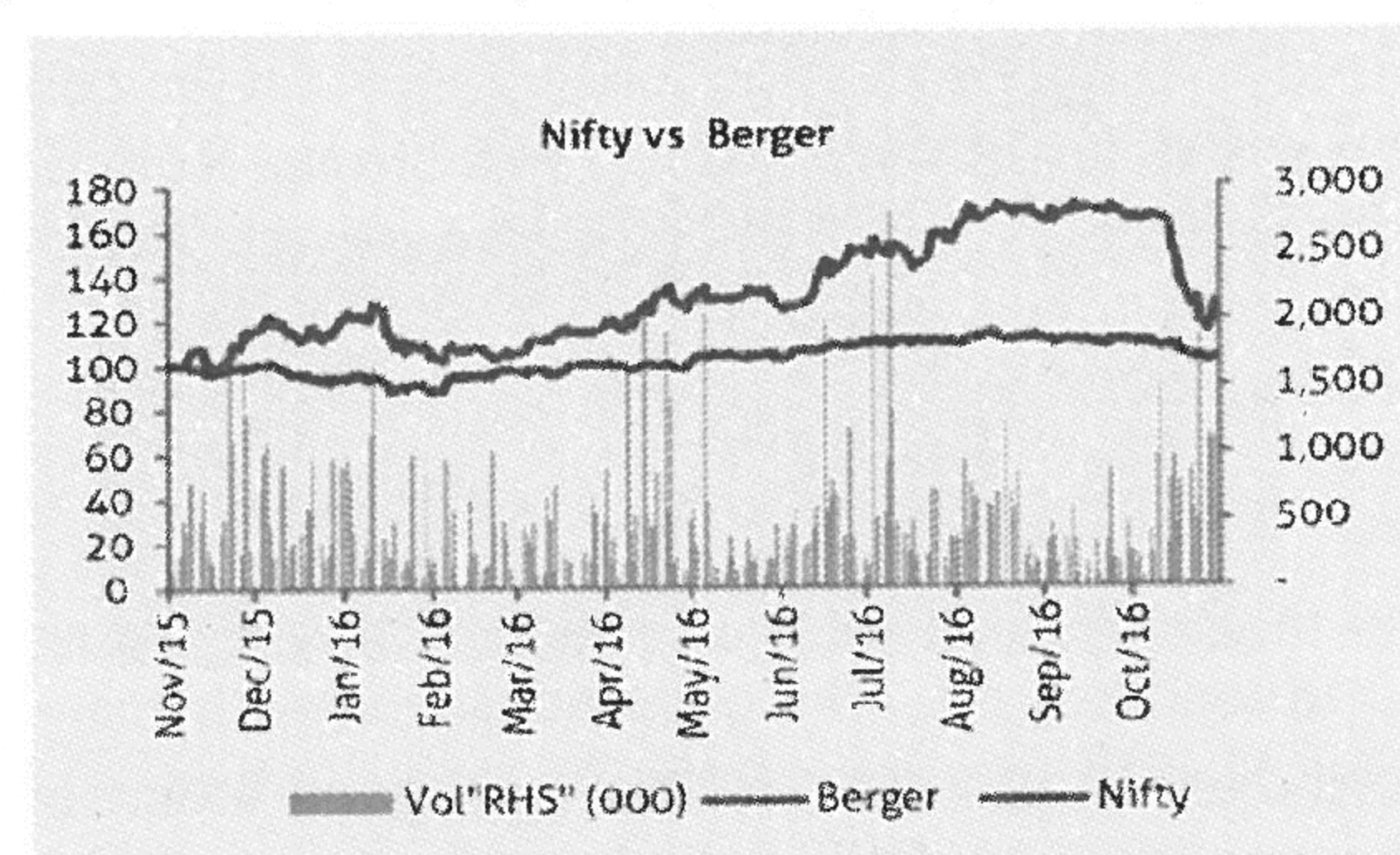
**Company Profile**

The driving forces of Berger Paints - reflect the very spirit of its founder Lewis Berger - who laid the foundations of brand Berger way back in 1760 in the UK. With modest beginnings in India in 1923, today, Berger Paints India Limited is the second largest paint company in the country with a consistent track record of being one of the fastest growing paint companies, quarter on quarter, for the past few years.

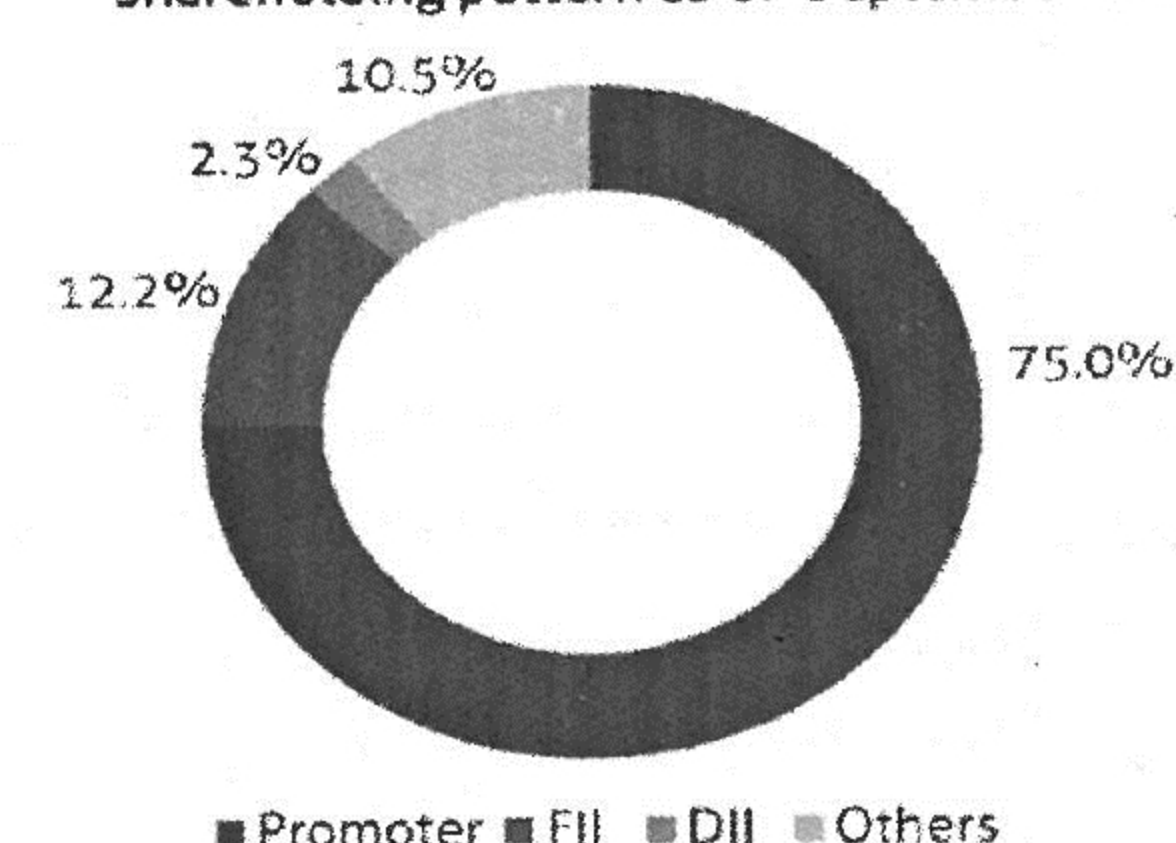
Undergoing a number of changes in ownership and nomenclature in its 88 year old history in India, the company has come a long way. Berger Paints has established itself through a long course of time. Berger Paints India is headquartered at Kolkata, with 10 strategically located manufacturing units and about 110 stock points. The company also has an international presence in 4 countries (Nepal, Bangladesh, Poland and Russia). With employee strength of above 2800 and a countrywide distribution network of 25,000+ dealers, Berger is acclaimed as a game changer in the sector with a vibrant portfolio of paints and tailor-made customer services in every paint segment.



| Company Information             |              |
|---------------------------------|--------------|
| BSE Code                        | 509480       |
| NSE Code                        | BERGEPAINT   |
| Bloomberg Code                  | BRGR IN      |
| ISIN                            | INE463A01038 |
| Market Capita (Rs. Cr.)         | 23,332       |
| Outstanding Shares (Cr.)        | 97.09        |
| 52-wk Hi/Lo (Rs.)               | 276.8/152.8  |
| Avg. daily volume (1yr. on NSE) | 4,23,212     |
| Face Value(Rs.)                 | 1.0          |
| Book Value (Rs)                 | 16.73        |



Shareholding pattern as of September 2016



| Particulars (in Rs. Cr.) | FY <sub>13</sub> | FY <sub>14</sub> | FY <sub>15</sub> | FY <sub>16</sub> |
|--------------------------|------------------|------------------|------------------|------------------|
| Net Sales                | 3,334.60         | 3,854.50         | 4,305.00         | 4,195.10         |
| Growth (%)               | 13.60%           | 15.60%           | 11.70%           | -2.60%           |
| EBITDA                   | 371.2            | 431.4            | 510.7            | 645.9            |
| EBITDA Margin (%)        | 11.10%           | 11.10%           | 11.80%           | 15.30%           |
| Net Profit               | 218.4            | 249.4            | 264.7            | 371.6            |
| Net Profit Margin (%)    | 6.50%            | 6.50%            | 6.10%            | 8.90%            |
| EPS (Rs.)                | 2.14             | 2.44             | 2.54             | 3.57             |
| Source : Capitaline      |                  |                  |                  |                  |

### Demonetization impact and Investment Rationale :

#### 1) Rising urbanization to drive demand for Decorative paints

Government's sudden move to drive out black money from the economy by demonetizing Rs 500 and Rs 1000 bank notes overnight, poised an emergency situation in the paint industry. In response to the situation, Berger paint has adopted a two pronged strategy to ensure its top line takes minimal hit as consumers resort to discretionary purchases, thus making paints a secondary or deferred priority. Before demonization, company was expecting 17-18% growth in paints business in the ongoing October-December quarter, which has now been downgraded to 12-13%. Impact of demonetization has been significant to paint industry in near term as 80-85% sales has been done through cash. Post government's demonization move, Berger has been asking its 3000 strong major dealers to shift over to digitized payments to keep business going. In order to cope with the situation, Berger's management is meeting with dealers, restoring their confidence in such a crucial juncture and urging them to shift over to e-payments. Further, company is in talks with various agencies which install card swiping machines to install the same in the dealer outlets while it is also roping in mobile wallet provider Paytm, to connect its dealers to the mobile payments network. As the cash transaction is nearing to an end, dealers have also understood the situation and management expects that at least 50% of the paints dealers will

shift over to electronic payments in the coming days. It is expected that the effects of demonetization will go on for the coming one and half months on the paints industry and Berger paints will focus more on the upcountry market, where it perceives the impact to be lesser than the metros. Company has also provided some leeway to dealers by extending the credit period to dealers by seven days from the existing 14 days earlier in order to push sales. As the painting being a high ticket item, the impact can be larger and there will certainly be postponement of demand, thus hurting the revenue growth. However, it is expected that in month or two, the impact of demonetization would smoothen out and there could be demand revival.

#### 2) Rising urbanization to drive demand for Decorative paints

Domestic paint industry growth is driven by factors including urbanization, prosperity, new housing demand, product innovation and penetration of rural and semi-urban areas. The rate of urbanization is likely to grow over the next decade following the initiatives taken by the government by building 100 smart cities, housing for all by 2022, Swachh Bharat and urban development around industrial corridors. Government in its program "housing for all by 2022" is likely to make houses affordable through credit linked subsidies, slum rehabilitation, tax concessions and a construction subsidy, thus would result in reduction in the prices of affordable houses. Moreover, urbanization has been increasing since 2014 and is expected to touch 50% of total population from 32% in 2014. According to National Council of Applied Economic Research (NCAER) estimates, the number of middle class households is expected to more than double in the next decade. The study further stated that disposable income is rising and India's middle class is expected to emerge as the world's largest middle-class consumer market by 2030.

The demand in major urban areas accounts for about 75% of the decorative paint market, thus steady increase in urbanization would boost the demand for decorative paint. Berger paints being the second largest paint manufacturer in India with 18% market share is well placed to tap the high growth phase of the industry.

#### 3) Strong distribution network to drive growth

Berger paints is the second largest paint manufacturer in India, occupying 18% market share in organized paint market and is placed among the top four companies. Berger paints, with 19,000 dealers, has the second largest distribution network and has strong presence in the eastern part of the country, where the region is witnessing strong growth. The company adds 1,500-2,000 dealers every year and intends to sustain a 10% compounded annual growth rate in distribution. Company in the past few years had aggressively increased its dealerships which increased from 16,500 during FY14 to 19,000 presently and more than 90% have tinting machines, which increases customer choices significantly. Increasing tinting machine help the company to tap the new customers, thus supporting the company to increase its domestic market share. Company had already invested Rs 600 million in tinting machines so far in FY17 and more capex planned as the company intends to increase its presence in Tier 3 and 4 cities. Berger derives 75% of its revenue from decorative paint segment and 25% comes from industrial paint. In decorative paint segment, company's major products are water based paints, thus have limited exposure to crude based raw materials and somewhat insulated from crude price volatility and has sustainable margins. As the annual consumption of decorative paints is still very low in India (2.7 kg per person) as compared to other countries, there is huge scope for domestic decorative paint industry to grow in near future. Industrial paints demand depends on auto industry and industrial coatings and is estimated at Rs 120 billion market, accounting about 30% of overall paint demand in India. As the domestic auto industry has been showing sign of revival and gradual uptick in industrial activities, industrial paint segment of Berger should witness traction going ahead.

#### 4) Improving channel connect through sales initiatives

In order to improve the revenue growth and to narrow down performance gap between Asian paints (largest paint manufacturer in India), company has brought lot of developments in key areas. In the economy segment, Berger has pioneered in direct interaction with painters, rather than approaching them through dealers. In the premium segment, "Express Painting Service", training academy for painters and ad campaigns for "Silk" are helping Berger to convince dealers and painters to generate leads and stock its products in the channel. The firm is also pioneering IT initiatives like a mobile app that not only helps to improve account settlements for dealers but also improves the sales team's



performance measurement. Apart from that, company has also streamlined its HR process by rationalizing its sales hiring and performance measurement across the country, shaking out sales sluggishness by hiring younger, more agile personnel and altering incentive structures. Further, company has taken lot of operational initiatives which helped to improve the organization's work culture.

##### 5) Gradual recovery in Industrial segment

Indian industrial coatings market is estimated at Rs 120 billion, account for about 30% of overall paint demand in India. In auto segment, OEMs and refinishing together account for about 40% of demand, which is directly correlated with the growth of the auto sector. Powder and coating segment accounts for 10% of demand, which is closely linked to the consumer durable industry. Protective and general industrial coatings accounts for about 35% of industrial paint demand and its demand is linked to infrastructure growth. There has been gradual improvement in autos, consumer durables and infrastructure which are going to benefit from India's economic growth and lower interest rates. Industrial segment recovery is expected to sustain in FY17 as per the management. As per management, customers are demanding for price cuts, but the company has been able to counter this with better mix. In protective coatings, when the new projects will start getting approval it will boost the growth to high teen levels. The auto sector is recovering. Commercial vehicle sales have picked up in line with the overall economy, and 2-wheeler and 4-wheeler sales are likely to gather momentum, supported by lower interest rates and other income catalysts such the benefits of 7<sup>th</sup> pay commission and One Pension One Rank. Though the recent demonetization of Rs 1000 and Rs 500 notes have had adverse impact on the auto sales but it would not persists more than 2 months.

##### 6) Improving working capital efficiency to boost cash flows

Over the years, Berger has maintained healthy operating cash flows owing to better product mix, economies of scale through enhanced distribution reach and cost optimization in terms of better working capital management, supply chain efficiency, gains in raw material sourcing and productivity improvement.

Management intends to improve it further by focusing on working capital efficiency. Improvement in supply chain efficiency led to a lower inventory holding period and a decline in inventory days. In last 3-4 years, company has increased its focus on vendor management and increased the supplier base, which led to increased competition among raw material suppliers and resulted in better pricing and creditor terms for Berger paints. Management stated that company will continue to focus on further optimizing the inventory level and thus the working capital improvement has led to better cost economics for the business. Major capex programme for the company is largely completed which would accelerate the free cash flow of company going ahead.

##### 7) Key Risk

1. **Volatility in raw material prices:** Titanium dioxide is the key raw material and account for 18% of raw material costs which is a crude derivative, thus any volatility in crude oil prices could have adverse impact on its margins
2. **Demonetization impact:** Government recent move of demonetization of Rs 500 and Rs 1000 notes have pitfall on economic growth, directly affecting real estate, auto, metals etc. However, it is near term concern and would not last long and would have bigger benefits for economy in long run.
3. **Sluggish economy recovery:** As the demand for paint industry is directly linked with economic prospects, hence sluggish economic growth for a prolonged period of time can result in moderation in revenue growth of the company.

##### Conclusion

Berger paint is the second largest paint manufacturer in India having 18% market share in domestic organized paint market. Over the years, company has strengthened its distribution network and increased it to 19,000 dealers from 16,500 from FY14 and more than 90% have tinting machines. Higher addition of tinting machine help the company to tap the new customers, thus supporting the company to increase its domestic market share. Further, increasing urbanization, government's affordable housing program, product innovation and penetration of rural and semi-urban areas would drive the demand for paint industry.

Company is also bringing development in key areas such as improving channel connects through sales initiatives and rationalizing sales hiring thus making the company much competitive against its competitors. Management also intends to increase its working capital efficiency to improve its cash flows further. Recent, government's demonetization move have a large impact on paint industry in the near term. It is expected that the effects of demonetization will go for the coming on and half months on the paint industry, thus Berger paint has lowered its 3QFY17 revenue growth to 12-13% from earlier 17-18%. The stock has corrected over 19% from its 1 year high price owing to global uncertainties and recent demonetization move from government, thus making good entry point into the scrip. The study of paper reveals a positive view on the company given its strong distribution network, increasing market share, healthy cash flows and strong RoE. Thus it should be recommend to investors to BUY the scrip for implying a return of 16% from current level.

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