

# Why you should avoid investing in unloved stocks that are trading at very low prices

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Investors have made merry on [Dalal Street](#) since September 2013, when the tide turned decidedly bullish. While frontline [stocks](#) on the [Sensex](#) have since surged 56%, the broader set of stocks making up the BSE 500 clocked 70%.

However, the swelling tide has not lifted all the boats. Several stocks have witnessed a sharp erosion in price. These stocks are trading at very low prices, some of them well below their book value. With the current market valuations leaving investors with little scope for buying anything cheap, these stocks could be seen as value picks—the low price providing a good entry point. But could these stocks be value traps disguised as bargain bets?

Over the years, the price of as many as 160 stocks have fallen more than 50% off their peaks, with 23 stocks trading more than 90% below their all-time highs. In this losing set are [MMTC](#), [Unitech](#), [Opto Circuits](#), [Bhushan Steel](#) and [Videocon Industries](#), among others.

If you are a bargain hunter, these stocks may seem too good to resist. However, if you start comparing the current stock price with its lifetime high, and conclude that it is available at a substantial discount, you could be in for a unpleasant surprise. The lifetime high may not even have been justified. These levels are reached when the stocks markets are in a state of euphoria, with company fundamentals having little to do with the price rise. The true value of the stock may have been much lower than what the lifetime high suggests. [Unitech](#) hit an all time high of Rs 547 in January 2008, after which its stock price has shrunk by 97%.

Secondly, the huge discount is no guarantee that the stock price will not head even lower. Many of the stocks trading well off the lifetime high are still at a substantial premium to the respective lifetime low.



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## Are these value traps or bargain bets?

Investors may be lured into thinking that low prices provide a good entry point.

Company	Price change since 1 Sept 2013	Price change from lifetime high	Price to book value	Debt equity ratio	Current market price
Bhushan Steel	-81%	-83%	0.22	3.47	88.75
Reliance Communications	-41%	-91%	0.48	1.25	72.05
ABG Shipyard	-31%	-81%	0.76	3.33	197.6
Gitanjali Gems	-27%	-92%	0.18	1.78	52.45
Jaiprakash Associates	-26%	-93%	0.39	5.16	24.35
Jaiprakash Power Ventures	-18%	-93%	0.49	3.89	10.64
Reliance Power	-12%	-84%	0.98	1.51	59.2
Amtek India	-9%	-52%	0.74	2.39	65.7
Videocon Industries	-7%	-82%	0.5	5.38	159.55
Opto Circuits (India)	-6%	-91%	0.37	0.7	22.55

Source: ETG Database. Data as on 14 February, 2015

MMTC, for instance, trades more than 10,000% above its historic low of Rs 0.5 in December 1999. There are also some stocks like [Lanco Infotech](#) and [Shree Renuka Sugars](#) that are trading near their all-time lows, which might prompt some to believe that the downside in the stock is now limited. You may be tempted into buying now thinking that the decline will stop and you will gain when it bounces back. But this is like catching a falling knife. "The stock could be underperforming for the right reasons and could be a value trap disguised as a value bet," reckons [Pankaj Murarka](#), head, equities, [Axis Mutual Fund](#).

Many of the stocks that have tanked are also trading much below their book value. Reliance Communications, ABG Shipyard, Gitanjali Gems, Jaiprakash Associates, Jaiprakash Power Ventures, Reliance Power, Amtek India, Videocon Industries, [Opto Circuits](#) and Jammu & Kashmir Bank are the prominent names on this list. The book value might suggest these are undervalued, but this may not be the case. Companies may trade at a discount to book value when the earnings outlook is not bright or when there are other concerns surrounding the company. For instance, there are clouds over the future earnings of companies in the infrastructure and power sectors.

Murarka says investors could be misled by an overstated book value. "The book value should not be used as the sole metric to identify value. The reported book value could be higher than the actual book value as the company may not have taken into account impairment of assets over time," he says. So how do you judge if the stock is genuinely undervalued or if the low price or valuation is just a mirage? There is no easy way.

But you can safely avoid certain companies by looking at key parameters. If there is excessive debt on the company's books, steer clear of the stocks. "When debt is high, the book value is likely to be overstated, making the stock price seem cheap. Avoid looking at highly leveraged companies from the value perspective," says Vikas Gupta, executive vice president, Arthveda Fund Management.

Sankaran Naren, CIO, ICICI Prudential Mutual Fund, concurs, "A low book value means nothing in a company where the leverage is high. One has to be careful in assessment of intrinsic value of the stock." Apart from this, if the business is in a really bad shape or there are question marks over the governance standards at the company, the stock price may not bounce back any time soon. It may, in fact, keep heading lower. Thus, it would be wise to stay away from such stocks until there is visible improvement in the business fundamentals of the company.

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