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CUT TO BARE BONES

The equities crash has left many stocks with market-caps that are far below their cash balances. Many of these could be good bets for the long term

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Stock price is rarely an accurate representation of a company's valuation. For, it does not always reflect the fundamentals of a business and tends to build in an additional element of broader market sentiment, be it bullish or bearish.

The sharp correction in the domestic equity market, triggered by weak global sentiments, has left several stocks at multi-year lows, and their market capitalisations have fallen drastically. The bellwether Sensex is now trading at an 18-month low.

Investors hunting for investment opportunities should look at valuation parameters to select stocks that now stand attractively priced. Price-to-earnings (P/E) ratios of many stocks have fallen to single-digit levels, indicating that they have become cheaper. But some analysts say P/E ratio cannot be a standalone valuation parameter in a situation like this, as earnings are getting downgraded constantly due to a difficult business environment.

The price-to-book value (P/BV) ratio, which is calculated by dividing the stock-price with the latest quarter's book value per share, is another valuation matrix that can indicate if a stock has reached the 'buy' zone. Stocks trading below their book values are considered good buying opportunities. However, some analysts have a problem with this approach, as share prices often carry an unjustified premium.

Market watchers say there are opportunities in mid-cap and small-cap segments, as a number of stocks are quoting at market capitalisations that are far lower than the cash and cash equivalents they possess.

Data compiled by Capitaline shows there are at least 20 companies in the BSE 500 basket, whose cash equivalents, after adjusting for net debt, are higher than their market caps. Asian Hotels, Borosil Glass, Kirloskar Industries, Hindustan Composites and Thinksoft Global are among the companies whose market caps have fallen below their cash balances in this market correction.

However, some experts differ in their views on buying these stocks.

"High liquidity on balance sheets is a big positive for a company in this environment of rising interest rates as fund raising has become difficult. But quantitative aspects apart, one should take a look at qualitative aspects of a company before investing in it," said Jagannadham Thunuguntla, strategist and head of research at SMC Global Securities.

Value mismatch

Five of the 20 scrips that have seen m-caps drop below cash balances

Company name	Cash* as on Mar 2011 (Rs crore)	Market cap (Rs in crore)
Asian Hotels (E)	607	329.64
Nucleus Software	190	200.76
Kirloskar Industries	521	263.29
Hindustan Composites	272	232.72
Allsec Technologies	31	21.34

*Cash and cash equivalents and liquid assets; factoring in total debt

Source: Capitaline

Issues such as management quality, corporate governance standards, order book size and execution capabilities can play a key role in determining the quality of a stock. "One should not look at cash equivalents alone," Thunuguntla said.

In the recent selloff, Asian Hotels' market capitalisation fell to Rs 343 crore as of August 25, while its cash equivalents stood at Rs 607 crore as of March 2011. Similarly, Borosil Glass' cash balances were at Rs 506 crore compared with its market cap of Rs 303 crore. In case of Kirloskar Industries, total cash balance was at Rs 521 crore while its market cap stood at Rs 266 crore. Hindustan Composites saw its market cap fall to Rs 233 crore while its total cash reserve stood at Rs 272 crore.

TrustLine Holdings, a Chennai based equity research and asset management company, said there are select mid-cap software firms whose market caps have taken a beating in the ongoing slump.

"They offer good value due to strong cash balances and product positioning. The economic situation in the US and Europe has created a lot of uncertainty among investors, and this has caused these stocks to tumble," said Arunagiri, CEO of TrustLine.

The BSE IT index has plunged 20 per cent so far this month compared with a 13 per cent drop in Sensex. Shares of big IT companies such as Infosys and Wipro fell to their one-year lows amid worries that a likely double-dip recession in developed economies may prompt cuts in IT spends and hurt revenues of local IT firms.

Arunagiri said product-based IT companies can be good bets as their clients are spread across markets beyond the US and Europe. For instance, Nucleus Software has clients in West Asia and East Asia apart from the domestic market. In case of large-cap IT firms, US and European markets dominate their portfolios.

Nucleus Software's market cap stood at Rs 154 crore as of August 19, while its cash balances were pegged at Rs 190 crore as of June 30. Polaris Software, Infinite Computer and NIIT Technology are other notable stocks in this space that have seen sharp erosion in prices, but offer good long-term advantage due to their business positioning.

At times, a cash reserve higher than market capitalisation may still not justify investing in a stock. "There could be stocks that have a price-to-earning ratio of 20, but may still be cheap, while others may be expensive with a PE ratio of 5. Thus, the approach of judging a stock by comparing its cash balance with market capitalisation may go wrong at times," said Apurva Shah, head of institutional research at Prabhudas Lilladher.

A few years ago, VSNL (now Tata Communication) had a cash balance of over Rs 1,000 crore, but in an industry where the company had to invest in a big way, that cash balance counted for nothing.

If one wants to take a long-term view of a company, cash equivalents do provide a better picture. "The fundamentals of a company are very important. There are several real estate companies that are available at very cheap valuations, but they lack corporate governance and are embroiled in scams," Thunuguntla pointed out.

Harendra Kumar, managing director and head of institutional equities at Elara Capital, said one should look at price-to-book value of a company, as it shows how much the shareholders were paying for the company's net assets. This can act as a floor price.

Kumar said if a company is making losses consistently, its networth may get eroded and it may be left with no cash. In certain cases, cash balances of a company may deplete because of a dividend payout or working capital requirement.

Ambareesh Baliga, chief operating officer of Way2Wealth, said a healthy cash balance shows the company's relationship to its business fundamentals while stock prices may not always reflect the fundamentals of a company, especially in a crisis situation.

(With inputs from Rajesh Abraham)

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