

20 Most Attractive Stocks for March

20 Large/Mid Cap and 20 Small Cap Stocks

Investment Perspective

The report presents unique investment ideas produced by our analysis of SEC Filings for over 3500 companies.

- **Key Highlights:** price gains in the past month move 5 stocks off the lists: PPG (10%), ACF (6%), MRK (4%), TCB (4%) and HAMP (3%).
- **Figure 1** details all additions and deletions to the list. **Figure 2** highlights 8 stocks with price gains greater than 5% that remain on the list.
- **Figures 3 and 4** provide the full list of 20 Large Cap and 20 Small Cap Attractive stocks.
- **Institutional Investor Magazine** highlighted our #1 ranking for stock-picking in an October 11th article.

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Note

This document is available to clients in the **Research** area of our site www.newconstructs.com.

Figure 1: Most Attractive List Changes for March

Market Cap	Drops	Adds	Reason for Turnover
Large Cap	PPG ACF MRK TCB ALV F SAFC SVM UST		Meaningful Price Appreciation: +10% Meaningful Price Appreciation: +6% Meaningful Price Appreciation: +4% Meaningful Price Appreciation: +4% New 10K reveals declining economics in latest year. New 10K reveals declining economics in latest year. New 10K reveals declining economics in latest year. New 10K reveals declining economics in latest year. New 10K reveals declining economics in latest year.
		HB DOW KRI MAS PAS TBL	Meaningful Price Depreciation: -1% New 10K reveals improving economics in latest year Rank improved via departure of other stocks. Rank improved via departure of other stocks. Rank improved via departure of other stocks. Rank improved via departure of other stocks.
Small Cap	HAMP GRT WNC BHS		Meaningful Price Appreciation: +3% New 10K reveals declining economics in latest year. New 10K reveals declining economics in latest year. Currently Updating with New 10K Data
		GFR WSFS RESC OMG	Meaningful Price Depreciation: -6% Rank improved via departure of other stocks. Rank improved via departure of other stocks. Rank improved via departure of other stocks.

Sources: New Constructs, LLC

Figure 2: Price Gains for Stocks Still on the List

Large Cap		Small Cap	
Ticker	Price Gain	Ticker	Price Gain
IR	8%	NAFC	8%
AT	8%	RHB	8%
HBAN	5%	ATAC	8%
		IDA	6%
		TRMK	5%

Sources: New Constructs, LLC

20 Most Attractive Stocks: Methodology

We determine the Most Attractive Stocks based on three criteria. The stocks exhibit:

1. **Cheap valuations** because their *Price-to-Economic Book Value* (EBV) ratios are less than or equal to 1.6 and greater than 0, and they have *Growth Appreciation Periods* (GAP) less than 10 years.
2. **Strong economic performance** because their Returns on Invested Capital are rising (Upward Trend in ROIC) and they generated positive Economic Earnings in the last fiscal year.
3. **Hidden value** because their (unlevered) Free-Cash-Flow Yield is greater than 5%. Free-Cash-Flow Yield equals unlevered Free Cash Flow divided by Enterprise Value.

We do not predict the future value of stocks.

Identifying Cheap Valuations. The Most Attractive stocks have valuations that reflect reasonable expectations for future financial performance compared to historical performance. In fact, many of the Most Attractive companies need to grow their profits very little to satisfy the expectations embedded in their valuations. Rather than predicting a warranted or future value for a company or stock, we measure **the market's** prediction for the financial performance of companies as reflected in stock prices. Our measures of valuation are intentionally objective. Our goal is to position investors to make informed decisions about whether or not they agree with the market's prediction for the future financial performance of companies.

Our valuation analysis focuses on assessing the feasibility of future financial performance requirements embedded in stock price.

In our opinion, a more rigorous way to assess the valuation of stocks is to look at two metrics: the ratio of *Price-to-Economic Book Value* (EBV)¹ per share and the market-implied *Growth Appreciation Period* (GAP). The ratio of Price-to-EBV highlights the degree of difference between the company's current level of cash flow and the level of future cash flow that the market expects. Economic Book Value essentially measures the perpetuity value of the company's current annual after-tax cash flow (NOPAT). The smaller the Price-to-EBV ratio, the less improvement in cash flow is required to justify the stock price. The market-implied GAP measures the number of years the company must grow its economic profits in order to justify its stock price. The shorter the GAP, the fewer years a company must maintain a competitive advantage and earn returns above its cost of capital on new investments.

New Constructs rectifies accounting distortions in GAAP financial statements.

Identifying Strong Economic Performance. The most Attractive stocks also have reported profits that tell a different story than the economics of their businesses. There are many ways that GAAP profits can differ from Economic Profits. Scandals at Enron, Worldcom, Adelphia, and others provide evidence of just how far companies can stretch accounting rules in order to appear more profitable than they truly are. New Constructs

¹ Economic Book Value (EBV) measure the no-growth value of the business based on its annual after-tax cash flow. The Formula for EBV is: $(\text{NOPAT} / \text{WACC}) + \text{Excess Cash} + \text{Non-operating assets} - \text{Debt (incl. Operating Leases)} - \text{Value of Outstanding Stock Options} - \text{Minority Interests}$.

rectifies accounting distortions in order to provide investors with a cleaner and truer analysis of a company's profitability. Our process involves digging vigorously into SEC filings, especially the Notes to the Financial Statements in order to gather, model, and deliver the economic results of a company's performance.

The metrics we use to measure the economic performance of companies are Economic Profit Margin and Economic Earnings. The Economic Profit Margin for a company equals its Return on Invested Capital (ROIC) minus its Weighted-Average Cost of Capital (WACC). The Economic Earnings of a company equal its Economic Profit Margin multiplied by its Invested Capital. We believe our measures of economic performance are substantially more accurate than accounting metrics because we make adjustments for all the issues listed in Figure 1.

Cash is king.

When reported earnings and economic cash flow diverge, the market follows cash.

Identifying Hidden Value. Attractive stocks exhibit higher Economic EPS growth than GAAP EPS growth. In addition, these stocks have hidden value since their Free-Cash-Flow Yields are at least 5% of their market value. We calculate Free Cash Flow according to our economic (as opposed to traditional accounting) methodology, which account for all the accounting issues in Figure 1. .

Conclusion

Companies that have cheap valuations, strong economics and hidden value present investors with lower risk of downside and greater potential for upside performance. We believe these stocks present investors with stock that offer attractive risk/reward.

We consider companies whose Price-to-EBV ratios are less than or equal to 1.6 but greater than 0 and whose market-implied GAPs are less than 10 years to have **cheap valuations**.

We consider companies with rising returns on capital and positive Economic Earnings to have **strong economics**.

We see **hidden value** in companies whose Economic Earnings growth is positive and whose Free-Cash-Flow represents more than 5% of Enterprise Value.

The top 20 companies that exhibit all of these characteristics are the Most Attractive in the market, in our opinion.

The 20 Most Attractive Stocks for March – Large and Mid-Cap Stocks

Figure 3: Ranked by 2-yr Average Free-Cash-Flow Yield in Descending Order

Ticker	Company Name	Cheap Valuation		Strong Economics		Hidden Value	Market Value (\$mm)
		as of 3/1/06		Last Fiscal Year		2yr Average	
		Price-to-EBV	Market-Implied GAP (years)	Upward Trend in ROIC	Positive Economic Earnings per share	FCF Yield Greater than 5%	
1 LPX	Louisiana-Pacific	0.4	Less than 1	11%	\$3.06	24%	\$3,031
2 TMK	Torchmark	1.1	4	1%	\$1.73	11%	\$6,027
3 FMC	FMC	1.0	7	3%	\$1.37	10%	\$2,243
4 IR	Ingersoll-Rand	1.4	8	3%	\$0.57	8%	\$14,543
5 TSO	Tesoro	0.5	Less than 1	7%	\$5.98	8%	\$4,037
6 HBAN	Huntington Bancshares	1.1	1	0%	\$0.47	7%	\$5,516
7 L XK	Lexmark International	1.0	Less than 1	7%	\$2.81	7%	\$6,194
8 APC	Anadarko Petroleum	0.9	Less than 1	3%	\$3.53	7%	\$24,745
9 TAP	Molson Coors Brewing	0.8	Less than 1	1%	\$0.57	6%	\$2,325
10 AT	Alltel	1.2	7	0%	\$0.42	6%	\$19,593
11 PAS*	PepsiAmericas	1.3	9	0%	\$0.34	6%	\$3,367
12 TBL	Timberland	1.3	5	6%	\$1.62	6%	\$2,463
13 HB*	Hillenbrand Industries	1.2	2	2%	\$1.72	5%	\$3,198
14 MAS*	Masco	1.2	4	1%	\$0.30	5%	\$13,888
15 IR	Ingersoll-Rand	1.4	8	3%	\$0.57	8%	\$14,543
16 KRI*	Knight-Ridder	1.4	6	0%	\$0.66	5%	\$4,857
17 DOW*	Dow Chemical	0.7	Less than 1	2%	\$1.36	4%	\$42,342
SPX	S&P 500	1.6	25	-1%	\$0.29	0%	

* Denotes stocks that have not appeared on the Most Attractive list within the last 3 months.

Sources: New Constructs, LLC

The 20 Most Attractive Stocks for March – Small-Cap Stocks

Figure 4: Ranked by 2-yr Average Free-Cash-Flow Yield in Descending Order

Rank	Ticker	Company Name	Cheap Valuation		Strong Economics		Hidden Value	Market Value (\$mm)
			Price-to-EBV	Market-Implied GAP (years)	Upward Trend in ROIC	Positive Economic Earnings per share	FCF Yield Greater than 5%	
			as of 3/1/06	Last Fiscal Year		2yr Average		
1	NL	NL Industries	0.1	Less than 1	102%	\$6.40	65%	\$638
2	OMG	OM Group	0.4	Less than 1	11%	\$2.41	32%	\$604
3	IDA	IdaCorp	0.7	2	5%	\$1.03	30%	\$1,195
4	GFR	Great American Financial Resour	0.8	Less than 1	7%	\$0.54	30%	\$932
5	WLDA	World Air Holding	0.5	2	3%	\$1.28	25%	\$114
6	TRMK	Trustmark	1.4	8	3%	\$0.47	18%	\$1,749
7	NAFC	Nash Finch	0.6	Less than 1	2%	\$1.35	17%	\$386
8	CTCO	Commonwealth Tel. Ent.	0.7	Less than 1	5%	\$2.00	16%	\$688
9	MBVT	Merchants Bancshares	1.0	1	6%	\$1.01	14%	\$152
10	MFW	M & F Worldwide	0.6	Less than 1	2%	\$0.61	12%	\$307
11	ELNK	Earthlink	0.8	4	15%	\$0.53	12%	\$1,530
12	FNLY	Finlay Enterprises	0.2	Less than 1	0%	\$0.60	11%	\$74
13	RHB	RehabCare Group	0.9	9	2%	\$0.46	10%	\$329
14	RSC	Rex Stores	0.8	8	5%	\$0.29	9%	\$170
15	TNH	Terra Nitrogen	0.8	Less than 1	26%	\$1.67	9%	\$422
16	RESC*	Roanoke Electric Steel Cp	0.6	Less than 1	5%	\$2.03	8%	\$311
17	MRD	MacDermid	1.1	3	1%	\$1.00	8%	\$891
18	CAO	CSK Auto	0.4	3	7%	\$2.18	8%	\$727
19	WSFS*	WSFS Financial	1.5	7	1%	\$0.79	8%	\$432
20	ATAC	Aftermarket Technology	1.3	5	0%	\$0.58	8%	\$458
	SPX	S&P 500	1.6	25	-1%	\$0.29	0%	

* Denotes stocks that have not appeared on the Most Attractive list within the last 3 months.

Sources: New Constructs, LLC

Appendix 1 – Additions/Deletions from Lists

Most Attractive Large and Mid Cap Stocks

Deletions:

- PPG – Stock Price Increased 10% since February publication.
- ACF – Stock Price Increased 6% since February publication.
- MRK – Stock Price Increased 4% since February publication.
- TCB – Stock Price Increased 4% since February publication.
- ALV – New 10-K revealed declining economics in latest year.
- F – New 10-K revealed declining economics in latest year.
- SAFC – New 10-K revealed declining economics in latest year.
- SVM – New 10-K revealed declining economics in latest year.
- UST – New 10-K revealed declining economics in latest year.

Additions:

- HB – Stock Price Decreased 1% since February publication.
- DOW – New 10-K revealed improving economics in latest year.
- KRI – Rank Improved via Departure of other Stocks.
- MAS – Rank Improved via Departure of other Stocks.
- PAS – Rank Improved via Departure of other Stocks.
- TBL – Rank Improved via Departure of other Stocks.

Most Attractive Small Cap Stocks

Deletions:

- HAMP – Stock Price Increased 3% since February publication.
- GRT – New 10-K revealed declining economics in latest year.
- WNC – New 10-K revealed declining economics in latest year.
- BHS – Currently Updating with New 10-K Data.

Additions:

- GFR – Stock Price Decreased 6% since February publication.
- WSFS – Rank Improved via Departure of other Stocks.
- RESC – Rank Improved via Departure of other Stocks.
- OMG – Rank Improved via Departure of other Stocks.

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