# Most Dangerous Stocks for October 2012

*20 Large/Mid Cap and 20 Small Cap Stocks*

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- **9 new stocks make our October lists.**
- **FREE Company Valuation Reports for 2 of the new stocks are in the Free Archive on our website.**
- **The Dangerous Stocks (+0.7%) rose less than the S&P 500 (+0.9%) and outperformed as a short portfolio last month.**
- **Figure 1 shows the 23 stocks from September's report that outperformed as shorts.**
- **Most Dangerous Stocks have misleading earnings, which means reported earnings are rising while true economic earnings are declining.**
- **Barron's recently highlighted our stock-picking as amongst the best of all Wall Street firms. See our website for details.**

**Figure 1: 23 Stocks that Outperformed as Shorts From September's Report**

| Large Cap | |
|---|---|
| Ticker | Change From 09/06/12 |
| LTM | -8.7% |
| BRE | -7.6% |
| DLR | -7.4% |
| ACC | -7.0% |
| VRX | -6.7% |
| ESS | -5.1% |
| ASH | -4.8% |
| EQY | -4.5% |
| O | -3.4% |
| BXP | -3.1% |
| AIG | -2.8% |
| BMR | -2.6% |
| TEG | -0.2% |
| IDA | -0.2% |
| KOG | 0.1% |
| EQIX | 0.7% |
| **S&P 500** | **0.9%** |

| Small Cap | |
|---|---|
| Ticker | Change From 09/06/12 |
| CRZO | -5.4% |
| SUSQ | -3.3% |
| PEB | -3.3% |
| PCO | -2.6% |
| HBOS | -2.5% |
| SHO | -1.3% |
| CWT | -0.2% |
| **S&P 500** | **0.9%** |

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.



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## *Most Dangerous Stocks: Monthly Updates*

The Dangerous Stocks (+0.7%) rose less than the S&P 500 (+0.9%) and outperformed as a short portfolio last month. 23 stocks from our September Most Dangerous Large Cap and Small Cap lists outperformed the S&P 500 as shorts, and 21 stocks had negative returns. See Figure 2 for details. For updates on the performance of all of last month's Most Dangerous stocks, see Appendix A. We measure our September performance based on closing prices from September 06, 2012 to October 01, 2012. We published last month's report to subscribers on September 06, 2012 and to the general public on September 12, 2012.

**Figure 2: 23 Stocks that Outperformed as Shorts From September's Report**

| Large Cap | | |
|---|---|---|
| Ticker | Company Name | Change From 09/06/12 |
| LTM | Life Time Fitness, Inc. | -8.7% |
| BRE | BRE Properties, Inc. | -7.6% |
| DLR | Digital Realty Trust, Inc. | -7.4% |
| ACC | American Campus Comm. | -7.0% |
| VRX | Valeant Pharma. Intl. | -6.7% |
| ESS | Essex Property Trust, Inc. | -5.1% |
| ASH | Ashland Inc. | -4.8% |
| EQY | Equity One, Inc. | -4.5% |
| O | Realty Income Corp | -3.4% |
| BXP | Boston Properties, Inc. | -3.1% |
| AIG | American Intl. Group, Inc. | -2.8% |
| BMR | Biomed Realty Trust, Inc. | -2.6% |
| TEG | Integrys Energy Group, Inc. | -0.2% |
| IDA | IDACORP Inc. | -0.2% |
| KOG | Kodiak Oil & Gas Corp | 0.1% |
| EQIX | Equinix Inc. | 0.7% |
| **S&P 500** | **S&P 500** | **0.9%** |

| Small Cap | | |
|---|---|---|
| Ticker | Company Name | Change From 09/06/12 |
| CRZO | Carrizo Oil & Gas, Inc. | -5.4% |
| SUSQ | Susquehanna Bancshares | -3.3% |
| PEB | Pebblebrook Hotel Trust | -3.3% |
| PCO | Pendrell Corporation | -2.6% |
| HBOS | Heritage Financial Group, Inc. | -2.5% |
| SHO | Sunstone Hotel Investors | -1.3% |
| CWT | California Water Service | -0.2% |
| **S&P 500** | **S&P 500** | **0.9%** |

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

Figure 3 shows the 9 new stocks that make our October Most Dangerous Stocks Report.

**Figure 3: Additions for October**

| Large Cap Additions | |
|---|---|
| **Ticker** | **Company Name** |
| HOLX | Hologic Inc. |
| PL | Protective Life Corp |
| SPG | Simon Property Group, Inc. |
| TCO | Taubman Centers, Inc. |
| WTM | White Mountains Insurance |

| Small Cap Additions | |
|---|---|
| **Ticker** | **Company Name** |
| DRH | Diamondrock Hospitality Co. |
| EVBS | Eastern Virginia Bankshares |
| PMTI | Palomar Medical Tech. |
| PRK | Park National Corp |

Sources: New Constructs, LLC

Please see Appendix B for explanations of additions and deletions to the large and small cap lists.

## *Most Dangerous Stocks: Methodology*

Stocks make our Most Dangerous list because they have:

1. **Poor-Quality Earnings** based on:
    a. Misleading earnings: rising and positive GAAP earnings while economic earnings are negative and falling; and
    b. Low Returns on Invested Capital (ROIC).

AND

2. **Expensive Valuations** based on:
    a. *Free-Cash Flow Yields*[1] that are very low or negative;
    b. *Price-to-Economic Book Value* (EBV) [2] ratios that are relatively high; and
    c. *Growth Appreciation Periods*[3] (GAP) that are relatively high.

**Only stocks that earn an Overall Rating of Very Dangerous are allowed on our Most Dangerous Stocks lists.**

The above characteristics also qualify stocks for a 'Very Dangerous' or 'Dangerous' Rating, according to our Risk/Reward Rating system. Figure 4 shows our Risk/Reward Rating analysis, which we apply to the 3000+ companies that we cover. Stocks get a grade of 1 to 5 for each criterion, 5 being the worst and 1 being the best score. The Overall score is based on the average score of all five criteria. Stocks must get an average score of 4.25 or above to be rated Very Dangerous. For the most part, only Very Dangerous stocks qualify for our Most Dangerous Stocks lists.

**Figure 4: New Constructs Risk/Reward Rating for Stocks**

| Overall Risk/Reward Rating | Quality of Earnings | | Valuation | | |
|---|---|---|---|---|---|
| | Economic vs Reported EPS | Return on Invested Capital (ROIC) | FCF Yield | Price-to-EBV Ratio | Growth Appreciation Period (yrs) |
| Very Dangerous | Misleading Trend | Bottom Quintile | <-5% | > 3.5 or -1 > 0 | > 50 |
| Dangerous | False Positive | 4th Quintile | -5%<-1% | 2.4 > 3.5 or < -1 | 20 > 50 |
| Neutral | Neutral EP | 3rd Quintile | -1%<3% | 1.6 > 2.4 | 10 > 20 |
| Attractive | Positive EP | 2nd Quintile | 3%<10% | 1.1 > 1.6 | 3 > 10 |
| Very Attractive | Rising EP | Top Quintile | >10% | 0 > 1.1 | 0 > 3 |

Sources: New Constructs, LLC

[1] Free-Cash Flow Yields measure the % of the total value of the firm for which the Free Cash Flows of the firm account. The formula is FCF/Current Enterprise Value.
[2] Economic Book Value (EBV) measures the no-growth value of the business based on its annual after-tax cash flow. The Formula for EBV is: (NOPAT / WACC) + Excess Cash + Non-operating assets – Debt (incl. Operating Leases) - Value of Outstanding Stock Options – Minority Interests.
[3] Growth Appreciation Period measures the number of years, implied by the market-price, that a company will grow its economic earnings. This measure assigns a numerical value to the width of the moat around a firm's business.

## *Explanation of Risk/Reward Rating System*

Our Risk/Reward Rating System assigns a rating to every stock under our coverage according to what we believe are the 5 most important criteria for assessing the risk versus reward of stocks. See table that follows for details.

| Overall Risk/Reward Ranking | **The Overall Risk/Reward Ranking provides a final rating based on the equal-weighted average rating of each criterion.** |
|---|---|
| **Very Dangerous** | FCF Yield is not included in the average. |
| **Dangerous** | FCF Yield is not included in the average. |
| **Neutral** | All criteria are equal-weighted in the average calculation. |
| **Attractive** | All criteria are equal-weighted in the average calculation. |
| **Very Attractive** | All criteria are equal-weighted in the average calculation. |

| Economic vs Reported EPS | **Rates stocks based on how their Economic Earnings compare to their Reported Earnings. Values based on Latest Fiscal Year.** |
|---|---|
| **Very Dangerous** | Negative and declining Economic Earnings despite positive and rising Reported Earnings |
| **Dangerous** | Same as above except Reported Earnings are not rising or Reported Earnings are not positive |
| **Neutral** | Negative Economic and Reported Earnings |
| **Attractive** | Economic Earnings are positive |
| **Very Attractive** | Economic Earnings are positive and rising |

| Return on Invested Capital (ROIC) | **Rates stocks based on their ROIC. Values based on Latest Fiscal Year.** |
|---|---|
| **Bottom Quintile** | Very Dangerous = the bottom 20% of Russell 1000 companies |
| **4th Quintile** | Dangerous = the bottom 40% of Russell 1000 companies |
| **3rd Quintile** | Neutral = the middle 20% of Russell 1000 companies |
| **2nd Quintile** | Attractive = the top 40% of Russell 1000 companies |
| **Top Quintile** | Very Attractive = the top 20% of Russell 1000 companies |

| FCF Yield | **Rates stocks based on their Free Cash Flow Yield. Values based on Latest Closing Stock price and Latest Fiscal Year.** |
|---|---|
| **<-5%** | Very Dangerous = less than or equal to -5% |
| **-5%<-1%** | Dangerous = more than -5% but less than or equal to -1% |
| **-1%<3%** | Neutral = more than -1% but less than or equal to +3% |
| **3%<10%** | Attractive = more than +3% but less than or equal to +10% |
| **>10%** | Very Attractive = more than +10% |

| Price-to-EBV Ratio | Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year. |
|---|---|
| >3.5 or -1>0 | Very Dangerous = greater than or equal to 3.5 or less than 0 but greater than -1 |
| 2.4>3.5 or <-1 | Dangerous = greater than or equal to 2.4 but less than 3.5 and less than or equal to -1 |
| 1.6>2.4 | Neutral = greater than or equal to 1.6 but less than 2.4 |
| 1.1>1.6 | Attractive = greater than or equal to 1.1 but less than 1.6 |
| 0>1.1 | Very Attractive = greater than or equal to 0 but less than 1.1 |

| Growth Appreciation Period (yrs) | Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario. |
|---|---|
| >50 | Very Dangerous = greater than or equal to 50 years |
| 20>50 | Dangerous = at least 20 years but less than 50 |
| 10>20 | Neutral = at least 10 years but less than 20 |
| 3>10 | Attractive = at least 3 years but less than 10 |
| 0>3 | Very Attractive = at least 0 years but less than 3 |

## Appendix A – Performance of Stocks on September's Report

**Figure 5: Performance of All Stocks From September's Report**

| Large Cap | | |
|---|---|---|
| Ticker | Company Name | Change From 09/06/12 |
| LTM | Life Time Fitness, Inc. | -8.7% |
| BRE | BRE Properties, Inc. | -7.6% |
| DLR | Digital Realty Trust, Inc. | -7.4% |
| ACC | American Campus Comm. | -7.0% |
| VRX | Valeant Pharma. Intl. | -6.7% |
| ESS | Essex Property Trust, Inc. | -5.1% |
| ASH | Ashland Inc. | -4.8% |
| EQY | Equity One, Inc. | -4.5% |
| O | Realty Income Corp | -3.4% |
| BXP | Boston Properties, Inc. | -3.1% |
| AIG | American Intl. Group, Inc. | -2.8% |
| BMR | Biomed Realty Trust, Inc. | -2.6% |
| TEG | Integrys Energy Group, Inc. | -0.2% |
| IDA | IDACORP Inc. | -0.2% |
| KOG | Kodiak Oil & Gas Corp | 0.1% |
| EQIX | Equinix Inc. | 0.7% |
| **SPX** | **S&P 500** | **0.9%** |
| NUAN | Nuance Communications, Inc. | 1.6% |
| MGM | MGM Resorts International | 3.5% |
| CRS | Carpenter Tech. Corp | 8.7% |
| COG | Cabot Oil & Gas Corp | 9.9% |
| **Large Cap Portfolio Return** | | **-2.0%** |
| **Combo (Large and Small Cap) Return** | | **0.7%** |

| Small Cap | | |
|---|---|---|
| Ticker | Company Name | Change From 09/06/12 |
| CRZO | Carrizo Oil & Gas, Inc. | -5.4% |
| SUSQ | Susquehanna Bancshares | -3.3% |
| PEB | Pebblebrook Hotel Trust | -3.3% |
| PCO | Pendrell Corporation | -2.6% |
| HBOS | Heritage Financial Group, Inc. | -2.5% |
| SHO | Sunstone Hotel Investors | -1.3% |
| CWT | California Water Service | -0.2% |
| **SPX** | **S&P 500** | **0.9%** |
| TRAK | DealerTrack Holdings, Inc. | 1.9% |
| KALU | Kaiser Aluminum Corp | 1.9% |
| GEO | The GEO Group, Inc. | 2.2% |
| CVCO | Cavco Industries, Inc. | 2.8% |
| TRNO | Terreno Realty Corp | 3.3% |
| ASTE | Astec Industries, Inc. | 3.4% |
| POWR | Powersecure Intl., Inc. | 5.0% |
| TVL | LIN Television Corp | 5.4% |
| CSFL | Centerstate Banks, Inc. | 7.1% |
| TIVO | TiVo Inc. | 7.2% |
| WCBO | West Coast Bancorp | 11.5% |
| MOSY | MoSys Inc. | 11.5% |
| CT | Capital Trust, Inc. | 22.2% |
| **Small Cap Portfolio Return** | | **3.3%** |

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

## Appendix B – Additions and Deletions

**Most Dangerous Large/Mid Cap Stocks**

**Deletions:**

LTM - Stock price decreased 8.7% since September report.
VRX - Stock price decreased 6.7% since September report.
AIG - Stock price decreased 2.8% since September report.
IDA - Displaced by decrease in rank of other stocks.
TEG - Displaced by decrease in rank of other stocks.

**Additions:**

HOLX - Stock price increased 1.3% since September report.
PL - Addition by improved rank of other stocks.
SPG - Addition by improved rank of other stocks.
TCO - Addition by improved rank of other stocks.
WTM - Addition by improved rank of other stocks.

## Most Dangerous Small Cap Stocks

**Deletions:**

CWT - Displaced by decrease in rank of other stocks.
TVL - Displaced by decrease in rank of other stocks.
WCBO - Removed due to announced acquisition.
TRNO - Temporarily dropped from coverage pending new filing.

**Additions:**

EVBS - Stock price increased 13.2% since September report.
PMTI - Stock price increased 10.0% since September report.
PRK - Stock price increased 1.0% since September report.
DRH - Addition by improved rank of other stocks.

## *The 20 Most Dangerous Large/Mid Cap Stocks for October*

We recommend that investors equal-weight holdings in all 20 Large/Mid Cap Most Dangerous Stocks.

**Figure 6: 20 Most Dangerous Large/Mid Cap Stocks for October**

| | | | Misleading Earnings | | | Expensive Valuation | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | As of Last Fiscal Year | | | as of 10/01/12 | | | |
| | Ticker | Company Name | Rising GAAP Earnings ($mm) | Declining Economic Cash Flows ($mm) | Low-Ranking ROIC (by Quintile) | Low or Negative Free Cash Flow Yield | High or Negative Price-to-Economic Book Value | Long Market-Implied GAP (years) | Market Value ($mm) |
| 1 | ACC | American Campus Comm. | $40.42 | ($1) | Bottom Quintile | -6% | 32.4 | Greater than 100 | $3,228 |
| 2 | BRE | BRE Properties, Inc. | $24.89 | ($35) | Bottom Quintile | -1% | 27.2 | Greater than 100 | $3,553 |
| 3 | NUAN | Nuance Communications, Inc. | $57.34 | ($7) | Bottom Quintile | -3% | 23.5 | Greater than 100 | $7,426 |
| 4 | CRS | Carpenter Tech. Corp | $49.90 | ($41) | Bottom Quintile | -22% | 16.2 | Greater than 100 | $2,762 |
| 5 | EQIX | Equinix Inc. | $45.65 | ($7) | 4th | -4% | 13.9 | Greater than 100 | $9,482 |
| 6 | BXP | Boston Properties, Inc. | $113.61 | ($106) | 4th | 2% | 13.6 | Greater than 100 | $15,770 |
| 7 | DLR | Digital Realty Trust, Inc. | $72.53 | ($11) | 4th | -3% | 12.4 | 86 | $7,395 |
| 8 | SPG* | Simon Property Group, Inc. | $411.04 | ($40) | 3rd | 1% | 8.4 | Greater than 100 | $45,017 |
| 9 | O | Realty Income Corp | $26.25 | ($6) | 4th | -8% | 4.6 | 19 | $5,437 |
| 10 | HOLX* | Hologic Inc. | $219.96 | ($4) | Bottom Quintile | 1% | 4.5 | 26 | $5,368 |
| 11 | PL* | Protective Life Corp | $78.83 | ($57) | 4th | -14% | 2.1 | Greater than 100 | $2,138 |
| 12 | MGM | MGM Resorts International | $4,552.03 | ($13) | Bottom Quintile | -29% | -0.4 | 66 | $5,226 |
| 13 | EQY | Equity One, Inc. | $7.18 | ($73) | Bottom Quintile | -12% | -3.5 | Greater than 100 | $2,382 |
| 14 | ASH | Ashland Inc. | $82.00 | ($38) | Bottom Quintile | -20% | -5.3 | Greater than 100 | $5,614 |
| 15 | TCO* | Taubman Centers, Inc. | $129.10 | ($19) | 3rd | -7% | -6.3 | Greater than 100 | $4,412 |
| 16 | BMR | Biomed Realty Trust, Inc. | $4.14 | ($33) | Bottom Quintile | -7% | -8.8 | Greater than 100 | $2,841 |
| 17 | ESS | Essex Property Trust, Inc. | $6.60 | ($2) | Bottom Quintile | -2% | -9.0 | Greater than 100 | $5,090 |
| 18 | KOG | Kodiak Oil & Gas Corp | $6.28 | ($28) | Bottom Quintile | -36% | -10.0 | 77 | $2,447 |
| 19 | WTM* | White Mountains Insurance | $675.70 | ($57) | Bottom Quintile | 7% | -39.4 | Greater than 100 | $3,836 |
| 20 | COG | Cabot Oil & Gas Corp | $19.02 | ($27) | Bottom Quintile | -1% | -87.9 | Greater than 100 | $9,589 |

* Addition to the Large/Mid Cap Most Dangerous list in October

Most Dangerous Stocks are Ranked by Price-to-Economic Book Value in Descending Order

Sources: New Constructs, LLC



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## *The 20 Most Dangerous Small Cap Stocks for October*

We recommend that investors equal-weight holdings in all 20 Small Cap Most Dangerous Stocks.

**Figure 7: 20 Most Dangerous Small Cap Stocks for October**

| | | | Misleading Earnings | | | Expensive Valuation | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | As of Last Fiscal Year | | | as of 10/01/12 | | | |
| | Ticker | Company Name | Rising GAAP Earnings ($mm) | Declining Economic Cash Flows ($mm) | Low-Ranking ROIC (by Quintile) | Low or Negative Free Cash Flow Yield | High or Negative Price-to-Economic Book Value | Long Market-Implied GAP (years) | Market Value ($mm) |
| 1 | SUSQ | Susquehanna Bancshares | $38.63 | ($36) | Bottom Quintile | -13% | 51.5 | Greater than 100 | $1,639 |
| 2 | POWR | Powersecure Intl., Inc. | $20.59 | ($2) | Bottom Quintile | -21% | 13.6 | Greater than 100 | $110 |
| 3 | GEO | The GEO Group, Inc. | $15.16 | ($33) | Bottom Quintile | -14% | 10.0 | 49 | $1,708 |
| 4 | HBOS | Heritage Financial Group, Inc. | $2.42 | ($3) | Bottom Quintile | -5% | 8.3 | Greater than 100 | $115 |
| 5 | KALU | Kaiser Aluminum Corp | $11.10 | ($35) | Bottom Quintile | -18% | 6.8 | Greater than 100 | $1,124 |
| 6 | PEB | Pebblebrook Hotel Trust | $10.70 | ($34) | Bottom Quintile | -48% | 6.7 | Greater than 100 | $1,191 |
| 7 | CVCO | Cavco Industries, Inc. | $12.41 | ($1) | Bottom Quintile | -19% | 6.5 | Greater than 100 | $322 |
| 8 | TRAK | DealerTrack Holdings, Inc. | $92.97 | ($1) | Bottom Quintile | -13% | 5.0 | Greater than 100 | $1,175 |
| 9 | ASTE | Astec Industries, Inc. | $7.49 | ($13) | Bottom Quintile | -8% | 3.3 | Greater than 100 | $724 |
| 10 | CT | Capital Trust, Inc. | $443.49 | ($57) | Bottom Quintile | -451% | 0.0 | Greater than 100 | $86 |
| 11 | MOSY | MoSys Inc. | $34.32 | ($2) | Bottom Quintile | -24% | -0.4 | Greater than 100 | $154 |
| 12 | SHO | Sunstone Hotel Investors | $35.21 | ($90) | Bottom Quintile | -23% | -1.1 | Greater than 100 | $1,288 |
| 13 | TIVO | TiVo Inc. | $186.67 | ($26) | Bottom Quintile | -39% | -1.1 | Greater than 100 | $1,277 |
| 14 | PCO | Pendrell Corporation | $321.54 | ($24) | Bottom Quintile | -108% | -1.4 | Greater than 100 | $295 |
| 15 | CSFL | Centerstate Banks, Inc. | $13.45 | ($15) | Bottom Quintile | -12% | -1.6 | Greater than 100 | $267 |
| 16 | CRZO | Carrizo Oil & Gas, Inc. | $26.68 | ($2) | Bottom Quintile | -12% | -2.4 | 58 | $1,018 |
| 17 | DRH* | Diamondrock Hospitality Co. | $1.49 | ($23) | Bottom Quintile | -14% | -2.4 | Greater than 100 | $1,599 |
| 18 | EVBS* | Eastern Virginia Bankshares | $12.53 | ($1) | Bottom Quintile | -6% | -4.1 | Greater than 100 | $29 |
| 19 | PMTI* | Palomar Medical Tech. | $16.20 | ($4) | Bottom Quintile | -27% | -4.8 | Greater than 100 | $183 |
| 20 | PRK* | Park National Corp | $23.99 | ($96) | Bottom Quintile | -6% | -4.9 | Greater than 100 | $1,088 |

* Addition to the Small Cap Most Dangerous list in October

Most Dangerous Stocks are Ranked by Price-to-Economic Book Value in Descending Order

Sources: New Constructs, LLC



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1. **Superior Recommendations** – Our stock picks consistently outperform. See our track record in our stock-picking accolades and Proof Is In Performance reports.
2. **More Accurate Research** – Our patented Research Platform for reversing accounting distortions and discounted cash flow analysis leverages better data to deliver smarter research.
3. **Time Savings** – We check the fine print in thousands of corporate filings so you don't have to. As reported by Barron's, our expertise in analyzing SEC filings delivers Hidden Gems and Red Flags that drive long-term stock-picking success.
4. **Transparency** – We are proud to share the results of our analysis of over 50,000 10Ks. See the Corporate Disclosure Transgressions report we provided the SEC. Our reports detail all data and assumptions. Company Models enable users to change them.
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Accounting data is not designed for equity investors, but for debt investors. Accounting data must be translated into economic earnings to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. Economic earnings are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

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