# Most Dangerous Stocks for December

*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 3000 companies.

## Contributors

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**Note:**
Go to www.newconstructs.com to access our research on individual companies and our Most Attractive and Most Dangerous Stocks reports.

- **16 stocks from last month's report underperformed the S&P 500 (+1.5%). 13 stocks had negative returns. See Figure 1 below.**
- **9 new stocks make our December lists. See Figure 3 below.**
- **All of our Most Dangerous Stocks have a 'Very Dangerous' rating, the worst score in our Risk/Reward Rating system.**
- **Very Dangerous Stocks have Misleading Earnings, which means reported earnings are rising while economic earnings and ROIC are declining.**
- **Figures 5 and 6 on pages 6 and 7 show this month's stocks.**
- **Institutional Investor Magazine highlighted our #1 ranking for stock-picking in an October, 2005, article.**

**Figure 1: 16 Under-Performers From Last Month's Report**

| Large Cap | |
|---|---|
| Ticker | Decline From 11/06/06 |
| IVGN | -3.7% |
| KSU | -3.1% |
| DVA | -2.2% |
| RJF | -1.5% |
| EBAY | -1.3% |
| NFG | -0.8% |
| LAUR | 0.4% |
| S&P 500 | 1.5% |

| Small Cap | |
|---|---|
| Ticker | Decline From 11/06/06 |
| SLNK | -15.0% |
| SUNH | -8.1% |
| CHDN | -6.8% |
| KYPH | -4.5% |
| FLDR | -2.4% |
| POWL | -0.4% |
| CBC | -0.0% |
| LKQX | 1.3% |
| WGII | 1.4% |
| S&P 500 | 1.5% |

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes dividends.



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## Most Dangerous Stocks: Monthly Updates

16 stocks from our November Most Dangerous Large Cap and Small Cap lists underperformed the S&P 500, which rose 1.5%. 13 of those stocks had negative returns. We measure performance based on closing prices from November 6th, 2006, the last trading day before we published the report to subscribers. See Figure 2 for details.

**Figure 2: 16 Under-Performers From Last Month's Report**

| Large Cap | | |
|---|---|---|
| Ticker | Company Name | Decline From 11/06/06 |
| IVGN | Invitrogen Corp | -3.7% |
| KSU | Kansas City Sthrn Ind. | -3.1% |
| DVA | Davita Inc | -2.2% |
| RJF | Raymond James | -1.5% |
| EBAY | Ebay Inc. | -1.3% |
| NFG | Natl Fuel Gas Co | -0.8% |
| LAUR | Laureate Edu | 0.4% |
| S&P 500 | S&P 500 | 1.5% |

| Small Cap | |
|---|---|
| Ticker | Company Name |
| SLNK | Spectralink Corp |
| SUNH | Sun Healthcare Grp |
| CHDN | Churchill Downs |
| KYPH | Kyphon Inc |
| FLDR | Flanders Corp |
| POWL | Powell Ind Inc |
| CBC | Capital Bancorp Ltd |
| LKQX | Lkq Cp |
| WGII | Washington Grp Intl Inc |
| S&P 500 | S&P 500 |

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes dividends.

Figure 3 shows the 9 new stocks that make our December Most Dangerous Stocks lists.

**Figure 3: 9 Additions for December**

| Large Cap Additions | |
|---|---|
| Ticker | Company Name |
| CVG | Convergys Corp. |
| LKQX | Lkq Cp |
| PMTC | Parametric Technology Corp. |

| Small Cap Additions | |
|---|---|
| Ticker | Company Name |
| ANDW | Andrew Corp. |
| CDE | Coeur D'Alene Mines Cp |
| EPIQ | Epiq Systems Inc |
| INMD | Integramed America Inc |
| PSB | Ps Business Parks Inc |
| SSYS | Stratasys |

Sources: New Constructs, LLC

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

## Most Dangerous Stocks: Methodology

Our Most Dangerous Stocks have Very Dangerous ratings 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. *2-year Average 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' 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. Only Very Dangerous stocks are allowed on our Most Dangerous Stocks lists.

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

| Overall | Quality of Earnings | | Valuation | | |
|---|---|---|---|---|---|
| Risk/Reward Rating | Economic vs Reported EPS | Return on Invested Capital (ROIC) | FCF Yield 2yr Avg | 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 | 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 |
| Actual Values | -$1.55/$0.65 | 8% | 2.3% | 3.1 | 39yrs |

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 $[(FCF_t + FCF_{t-1})/(\text{Current Enterprise Value} + \text{Enterprise Value}_{t-1})]$, where 't' is the latest fiscal year.

[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 Grading Scale*

Our Risk/Reward grading scale 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.

| **Overall Risk/Reward Ranking** | **The Overall Risk/Reward Ranking provides a final ranking based on the equal-weighted average ranking of each criterion.** |
|---|---|
| **Very Dangerous** | 2yr Average FCF Yield is not included in the average. |
| **Dangerous** | 2yr Average 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** | **Ranks 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)** | **Ranks stocks based on their ROIC. Values based on Latest Fiscal Year.** |
| **Bottom Quintile** | Very Dangerous = in the bottom 20% of all companies |
| **4th Quintile** | Dangerous = in the bottom 40% of all companies |
| **3rd Quintile** | Neutral = in the middle 20% of all companies |
| **2nd Quintile** | Attractive = in the top 40% of all companies |
| **Top Quintile** | Very Attractive = in the top 20% of all companies |
| | |
| **FCF Yield 2yr Avg** | **Ranks stocks based on their 2-year average 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 | **Ranks 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)** | **Ranks 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 – Additions/Deletions from Lists*

### Most Dangerous Large and Mid Cap Stocks

**Deletions:**

NFG - Stock price decreased 0.8% since November report.
LM - Displaced by decrease in rank of other stocks.
TE - Displaced by decrease in rank of other stocks.

**Additions:**

CVG - Stock price increased 9.7% since November report.
LKQX - Stock price increased 1.3% since November report.
PMTC - Stock price increased 3.6% since November report.

### Most Dangerous Small Cap Stocks

**Deletions:**

SLNK - Stock price decreased 15.0% since November report.
CHDN - Stock price decreased 6.8% since November report.
LKQX - Displaced by decrease in rank of other stocks.
MBHI - Displaced by decrease in rank of other stocks.
VMI - Displaced by decrease in rank of other stocks.
ZQK - Displaced by decrease in rank of other stocks.

**Additions:**

ANDW - Stock price increased 8.0% since November report.
CDE - Stock price increased 11.0% since November report.
EPIQ - Stock price increased 2.9% since November report.
INMD - Stock price increased 32.8% since November report.
PSB - Stock price increased 11.1% since November report.
SSYS - Stock price increased 7.3% since November report.

## *The 20 Most Dangerous Stocks for December – Large and Mid-Cap Stocks*

**Figure 5: Ranked by Price-to-Economic Book Value in Descending Order**

| | | | Misleading Earnings | | | Expensive Valuation | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | As of Last Fiscal Year | | | as of 11/30/06 | | | |
| | Ticker | Company Name | Rising GAAP Earnings ($mm) | Declining Economic Cash Flows | Low-Ranking ROIC (by Quintile) | Low or Negative Free Cash Flow Yield (2yr Avg) | High or Negative Price-to-Economic Book Value | Long Market-Implied GAP (years) | Market Value ($mm) |
| 1 | NDAQ | Nasdaq Stock Market Inc | $56.92 | ($0) | 4th | -13% | 372.9 | 38 | $3,234 |
| 2 | PSYS | Psychiatric Solutions Inc | $11.02 | ($27) | Bottom Quintile | -15% | 42.6 | Greater than 100 | $3,260 |
| 3 | UTIW | Uti Worldwide Inc | $20.90 | ($17) | 3rd | -2% | 31.7 | Greater than 100 | $8,417 |
| 4 | DVA | Davita Inc | $6.39 | ($166) | Bottom Quintile | -20% | 29.1 | 14 | $5,362 |
| 5 | LKQX* | Lkq Cp | $10.31 | ($1) | 3rd | -7% | 15.9 | Greater than 100 | $2,018 |
| 6 | NTAP | Network Appliance | $40.70 | ($40) | 4th | -1% | 15.9 | Greater than 100 | $14,575 |
| 7 | SGMS | Scientific Games Corp | $14.30 | ($27) | 4th | -2% | 9.0 | 43 | $2,595 |
| 8 | ESS | Essex Property Trust | $0.02 | ($2) | 4th | 1% | 8.1 | Greater than 100 | $3,042 |
| 9 | VRSN | Verisign Inc | $220.24 | ($23) | Bottom Quintile | -3% | 6.2 | Greater than 100 | $6,715 |
| 10 | EBAY | Ebay Inc. | $303.82 | ($80) | 3rd | -3% | 5.5 | Greater than 100 | $44,038 |
| 11 | MMC | Marsh & Mclennan | $228.00 | ($318) | Bottom Quintile | 2% | 4.4 | 52 | $16,904 |
| 12 | RJF | Raymond James | $23.47 | ($30) | 3rd | -6% | 3.6 | Greater than 100 | $3,473 |
| 13 | LAUR | Laureate Edu | $12.17 | ($3) | 4th | -7% | 3.4 | 27 | $2,579 |
| 14 | PMTC* | Parametric Technology Corp. | $48.78 | ($4) | 4th | 0% | 2.8 | Greater than 100 | $2,101 |
| 15 | S | Sprint Corp | $2,806.00 | ($3,372) | Bottom Quintile | -57% | 2.6 | 13 | $39,664 |
| 16 | CVG* | Convergys Corp. | $11.10 | ($10) | 4th | -2% | 2.5 | Greater than 100 | $3,377 |
| 17 | KSU | Kansas City Sthrn Ind. | $75.70 | ($128) | Bottom Quintile | -33% | -2.6 | 57 | $2,043 |
| 18 | CELG | Celgene Corp | $10.90 | ($25) | Bottom Quintile | -2% | -11.8 | Greater than 100 | $18,698 |
| 19 | IVGN | Invitrogen Corp | $43.22 | ($43) | Bottom Quintile | -13% | -14.6 | 43 | $2,874 |
| 20 | BCO | Brink'S Co | $20.90 | ($89) | Bottom Quintile | -2% | -98.5 | Greater than 100 | $3,161 |

* New on the Large Cap Most Dangerous list since 11/06/06

Sources: New Constructs, LLC



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## *The 20 Most Dangerous Stocks for December – Small-Cap Stocks*

### Figure 6: Ranked by Price-to-Economic Book Value in Descending Order

| | | | As of Last Fiscal Year | | | as of 11/30/06 | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Ticker | Company Name | Rising GAAP Earnings ($mm) | Declining Economic Cash Flows | Low-Ranking ROIC (by Quintile) | Low or Negative Free Cash Flow Yield (2yr Avg) | High or Negative Price-to-Economic Book Value | Long Market-Implied GAP (years) | Market Value ($mm) |
| 1 | INMD* | Integramed America Inc | $0.54 | ($0) | Bottom Quintile | -3% | 61.2 | 72 | $81 |
| 2 | SWKS | Skyworks Solution | $3.20 | ($8) | Bottom Quintile | 1% | 36.8 | Greater than 100 | $1,140 |
| 3 | BDY | Bradley Pharmaceutical | $0.01 | ($0) | Bottom Quintile | -28% | 28.5 | Greater than 100 | $337 |
| 4 | KYPH | Kyphon Inc | $8.12 | ($2) | Bottom Quintile | -1% | 19.5 | 90 | $1,446 |
| 5 | SMTL | Semitool Inc | $2.70 | ($4) | Bottom Quintile | -5% | 14.9 | Greater than 100 | $394 |
| 6 | CBC | Capital Bancorp Ltd | $9.21 | ($19) | Bottom Quintile | -9% | 14.4 | Greater than 100 | $666 |
| 7 | PSB* | Ps Business Parks Inc | $3.16 | ($10) | 4th | -4% | 13.9 | 58 | $1,555 |
| 8 | LAYN | Layne Christensen Co | $4.93 | ($7) | Bottom Quintile | -19% | 11.1 | 48 | $417 |
| 9 | CDE* | Coeur D'Alene Mines Cp | $27.41 | ($3) | Bottom Quintile | -8% | 9.4 | Greater than 100 | $1,324 |
| 10 | ANDW* | Andrew Corp. | $6.35 | ($3) | Bottom Quintile | -3% | 9.1 | 29 | $1,613 |
| 11 | WGII | Washington Grp Intl Inc | $7.23 | ($9) | Bottom Quintile | -3% | 8.6 | 48 | $1,530 |
| 12 | FLDR | Flanders Corp | $2.74 | ($1) | Bottom Quintile | -1% | 8.3 | 41 | $260 |
| 13 | SSYS* | Stratasys | $1.47 | ($5) | 4th | -3% | 8.1 | Greater than 100 | $317 |
| 14 | CDR | Cedar Shop Centers | $0.33 | ($9) | Bottom Quintile | -30% | 4.9 | 26 | $438 |
| 15 | SUNH | Sun Healthcare Grp | $43.39 | ($46) | Bottom Quintile | -22% | -0.7 | 27 | $161 |
| 16 | RNWK | Realnetworks | $335.34 | ($137) | Bottom Quintile | -8% | -1.8 | Greater than 100 | $1,957 |
| 17 | SMSC | Standard Microsystems | $10.43 | ($40) | Bottom Quintile | -18% | -2.7 | Greater than 100 | $662 |
| 18 | EPIQ* | Epiq Systems Inc | $1.22 | ($9) | Bottom Quintile | -29% | -4.3 | 52 | $283 |
| 19 | SFNT | Safenet Inc | $0.85 | ($12) | Bottom Quintile | -38% | -5.4 | 90 | $577 |
| 20 | POWL | Powell Ind Inc | $0.58 | ($6) | Bottom Quintile | -7% | -16.2 | Greater than 100 | $257 |

* New on the Small Cap Most Dangerous list since 11/06/06

Sources: New Constructs, LLC


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