# 20 Most Dangerous Stocks for June

*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.

- **33 stocks from May's report dropped at least 1% in the last month. 23 stocks dropped more than the S&P 500 (-4.5%). See Figure 1 below.**
- **7 new stocks make our June 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 11th article.**

**Figure 1: Thirty-Three Big Decliners From the May Report**

| Large Cap | | Small Cap | |
|---|---|---|---|
| Ticker | Decline | Ticker | Decline |
| ADCT | -19% | SFNT | -27% |
| NIHD | -18% | SLNK | -25% |
| BRCM | -18% | RSAS | -23% |
| JEF | -13% | SWKS | -16% |
| PENN | -9% | KYPH | -15% |
| SBUX | -8% | WGII | -13% |
| NOV | -7% | POWL | -10% |
| MMC | -5% | KAI | -10% |
| VRSN | -4% | TXCO | -8% |
| DVA | -4% | EPIQ | -8% |
| IRM | -3% | SSYS | -8% |
| IVGN | -3% | FLDR | -7% |
| KSU | -2% | ANDW | -6% |
| BCO | -1% | CBC | -6% |
| CRE | -1% | SMTL | -5% |
| | | HIH | -3% |
| | | CMO | -2% |
| | | MBHI | -2% |

Sources: New Constructs, LLC



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## 20 Most Dangerous Stocks: Monthly Updates

There are 33 stocks from our April Most Dangerous Large Cap and Small Cap lists that declined at least 1%. 23 stocks dropped more than the S&P 500 (-4.5%) since May 9th, 2006, the day we published the report to subscribers. See Figure 2 for details.

**Figure 2: 33 Decliners From Last Month's Report**

| Large Cap | | | Small Cap | | |
|---|---|---|---|---|---|
| Ticker | Company Name | Decline | Ticker | Company Name | Decline |
| ADCT | ADC Telecomm Inc | -19% | SFNT | SafeNet Inc | -27% |
| NIHD | NII Holdings | -18% | SLNK | Spectralink Corp | -25% |
| BRCM | Broadcom Corporation | -18% | RSAS | RSA Security Dynamics Technology | -23% |
| JEF | Jefferies Group | -13% | SWKS | Skyworks Solution | -16% |
| PENN | Penn Natl Gaming Co | -9% | KYPH | Kyphon Inc | -15% |
| SBUX | Starbucks Corp. | -8% | WGII | Wahington Group Int'l | -13% |
| NOV | National Oilwell Var | -7% | POWL | Powell Ind Inc | -10% |
| MMC | Marsh & McLennan | -5% | KAI | Kadant Inc | -10% |
| VRSN | Verisign | -4% | TXCO | Exploration Co of Delaware Inc | -8% |
| DVA | Davita | -4% | EPIQ | Epiq Systems Inc | -8% |
| IRM | Iron Mountain | -3% | SSYS | Stratasys | -8% |
| IVGN | Invitrogen Corp | -3% | FLDR | Flanders Corp | -7% |
| KSU | Kansas City Sthrn Ind. | -2% | ANDW | Andrew Corp. | -6% |
| BCO | Brink's Co | -1% | CBC | Capital Bancorp Ltd | -6% |
| CRE | Carramerica Realty | -1% | SMTL | Semitool Inc | -5% |
| | | | HIH | Highland Hospitality | -3% |
| | | | CMO | Capstead Mortgage Corp | -2% |
| | | | MBHI | Midwest Banc Holdings Inc | -2% |

Sources: New Constructs, LLC

Figure 3 shows the 7 new stocks that make our June Most Dangerous Stocks lists.

**Figure 3: 7 New Additions for June**

| Large Cap | | Small Cap | |
|---|---|---|---|
| Ticker | Company Name | Ticker | Company Name |
| NFG | Nat'l Fuel and Gas Co. | FORM | Formfactor Inc |
| LAUR | Laureate Edu | BJRI | BJ Restaurants |
| VSH | Vishay Intertechnology | NFP | Nat'l Financial Partners |
| HCBK | Hudson City Bancorp Inc. | | |

Sources: New Constructs, LLC

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

## *20 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 [($FCF_t$ + $FCF_{t-1}$)/(Current Enterprise Value + 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 |
| **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:**

ADCT – Stock price decreased 19% since May report.

NIHD – Stock price decreased 18% since May report.

JEF – Stock price decreased 13% since May report.

SBUX – Stock price decreased 8% since May report.

**Additions:**

NFG – Stock price increased 1% since May report.

LAUR – Rank improved via departure of other stocks.

VSH – Rank improved via departure of other stocks.

HCBK – Rank improved via departure of other stocks.

**Most Dangerous Small Cap Stocks**

**Deletions:**

SFNT – Stock price decreased 27% since May report.

RSAS – Stock price decreased 23% since May report.

KAI – Stock price decreased 10% since May report.

**Additions:**

FORM – Rank improved via departure of other stocks.

BJRI – Rank improved via departure of other stocks.

NFP – Rank improved via departure of other stocks.

## *The 20 Most Dangerous Stocks for June – 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, $ in millions | | | as of 6/5/06 | | | |
| | Ticker | Company Name | Rising GAAP Earnings | Declining Economic Earnings | 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 | DVA | Davita | $6 | ($167) | Bottom Quintile | -20% | 27.8 | 18 | $5,310 |
| 2 | BRCM | Broadcom Corporation | $193 | ($22) | Bottom Quintile | -1% | 18.4 | More than 100 | $17,451 |
| 3 | CRE | Carramerica Realty | $55 | ($34) | Bottom Quintile | -2% | 14.4 | 67 | $2,493 |
| 4 | IRM | Iron Mountain | $17 | ($2) | 4 | -3% | 9.3 | 29 | $4,802 |
| 5 | ASN | Archstone-Smith | $81 | ($75) | Bottom Quintile | -4% | 7.7 | 85 | $10,123 |
| 6 | EBAY | eBay Inc. | $304 | ($79) | 3 | -3% | 5.5 | More than 100 | $44,433 |
| 7 | NFG* | Nat'l Fuel and Gas Co. | $23 | ($160) | Bottom Quintile | 7% | 5.3 | 75 | $3,018 |
| 8 | BRE | BRE Properties | $2 | ($2) | Bottom Quintile | 0% | 5.3 | 63 | $2,776 |
| 9 | VRSN | Verisign | $220 | ($24) | Bottom Quintile | -4% | 5.2 | More than 100 | $5,824 |
| 10 | RA | Reckson Associates Rl | $155 | ($9) | Bottom Quintile | -4% | 4.4 | 46 | $3,191 |
| 11 | MMC | Marsh & McLennan | $228 | ($307) | Bottom Quintile | 2% | 3.9 | 40 | $15,231 |
| 12 | NOV | National Oilwell Var | $177 | ($80) | 4 | -21% | 3.2 | 35 | $10,782 |
| 13 | LAUR* | Laureate Edu | $12 | ($2) | 4 | -7% | 3.1 | 44 | $2,386 |
| 14 | VSH* | Vishay Intertechnology | $18 | ($33) | Bottom Quintile | 2% | 2.9 | More than 100 | $2,955 |
| 15 | KMI | Kinder Morgan | $33 | ($351) | Bottom Quintile | -16% | 2.8 | 11 | $12,482 |
| 16 | HCBK* | Hudson City Bancorp Inc. | $37 | ($289) | 4 | -24% | 2.6 | 20 | $7,949 |
| 17 | KSU | Kansas City Sthrn Ind. | $76 | ($129) | Bottom Quintile | -33% | -2.7 | 56 | $2,081 |
| 18 | PENN | Penn Natl Gaming Co | $49 | ($139) | Bottom Quintile | -22% | -8.7 | 28 | $3,223 |
| 19 | IVGN | Invitrogen Corp | $43 | ($44) | Bottom Quintile | -12% | -13.3 | 69 | $3,423 |
| 20 | BCO | Brink's Co | $21 | ($94) | Bottom Quintile | -2% | -102.2 | More than 100 | $3,136 |

* New on the Large Cap Most Dangerous list versus our May 9th, 2006 report.

Sources: New Constructs, LLC



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

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

| | | | Misleading Earnings | | | Expensive Valuation | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | | As of Last Fiscal Year, $ in millions | | | as of 6/5/06 | | | |
| | 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 | FORM* | Formfactor Inc | $5 | ($12) | Bottom Quintile | -4% | 1617.8 | More than 100 | $1,615 |
| 2 | BJRI* | BJ Restaurants | $2 | ($4) | Bottom Quintile | -4% | 91.6 | More than 100 | $590 |
| 3 | KYPH | Kyphon Inc | $8 | ($2) | Bottom Quintile | -1% | 24.9 | 94 | $1,579 |
| 4 | SWKS | Skyworks Solution | $3 | ($6) | Bottom Quintile | 1% | 18.3 | More than 100 | $954 |
| 5 | CBC | Capital Bancorp Ltd | $9 | ($19) | Bottom Quintile | -9% | 12.5 | More than 100 | $627 |
| 6 | LAYN | Layne Christensen Co | $5 | ($7) | Bottom Quintile | -19% | 11.8 | More than 100 | $429 |
| 7 | HIH | Highland Hospitality | $4 | ($4) | Bottom Quintile | -17% | 10.8 | 72 | $524 |
| 8 | FLDR | Flanders Corp | $3 | ($1) | Bottom Quintile | -1% | 10.2 | 66 | $282 |
| 9 | SMTL | Semitool Inc | $3 | ($4) | Bottom Quintile | -7% | 9.2 | 26 | $285 |
| 10 | ANDW | Andrew Corp. | $6 | ($0) | Bottom Quintile | -3% | 9.1 | 30 | $1,616 |
| 11 | SSYS | Stratasys | $1 | ($5) | 4 | -3% | 8.3 | More than 100 | $322 |
| 12 | CMO | Capstead Mortgage Corp | $15 | ($28) | Bottom Quintile | -3% | 8.3 | 48 | $144 |
| 13 | WGII | Wahington Group Int'l | $7 | ($9) | Bottom Quintile | -3% | 7.5 | 33 | $1,432 |
| 14 | SLNK | Spectralink Corp | $1 | ($7) | 4 | -13% | 6.1 | 25 | $180 |
| 15 | NFP* | Nat'l Financial Partners | $16 | ($5) | 4 | -6% | 5.2 | 29 | $1,628 |
| 16 | TXCO | Exploration Co of Delaware Inc | $11 | ($19) | Bottom Quintile | -2% | 4.5 | 79 | $320 |
| 17 | JCOM | J2 Global Communications | $20 | ($17) | Bottom Quintile | -111% | -0.1 | 78 | $1,305 |
| 18 | EPIQ | Epiq Systems Inc | $1 | ($9) | Bottom Quintile | -29% | -5.1 | 53 | $292 |
| 19 | MBHI | Midwest Banc Holdings Inc | $4 | ($19) | Bottom Quintile | -10% | -13.4 | More than 100 | $444 |
| 20 | POWL | Powell Ind Inc | $1 | ($6) | Bottom Quintile | -8% | -16.1 | More than 100 | $254 |

* New on the Small Cap Most Dangerous list versus our May 9th, 2006 report.

Sources: New Constructs, LLC



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