20 Most Dangerous Stocks for May

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.

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

- **25 stocks from April's report declined at least 1% in the last month while the S&P500 rose +2.3%. See Figure 1 below.**
- **18 new stocks make our May 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.**
- **Go to www.newconstructs.com to buy reports on any of the 3000+ companies we cover.**
- **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: Twenty-Five Big Decliners From the April Report

Large Cap		Small Cap	
Ticker	Decline	Ticker	Decline
EBAY	-18%	NWRE	-18%
ADCT	-13%	EZEM	-15%
RMBS	-12%	SMTL	-15%
AFFX	-11%	IMGC	-9%
BRCM	-11%	ANDW	-8%
LAUR	-10%	ZQK	-8%
NFP	-9%	DPTR	-6%
RA	-8%	EPIQ	-6%
ADP	-6%	FLDR	-4%
DVA	-5%	SWKS	-3%
MHS	-4%		
VRSN	-3%		
KMI	-1%		
BRE	-1%		
IVGN	-1%		

Sources: New Constructs, LLC

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20 Most Dangerous Stocks: Monthly Updates

There are 25 stocks from our April Most Dangerous Large Cap and Small Cap lists that declined at least 1% (while the S&P500 rose +2.3%) since April 10th, 2006, the day we published the report. See Figure 2 for details.

Figure 2: 25 Big Decliners From Last Month's Report

Large Cap			Small Cap		
Ticker	Company Name	Decline	Ticker	Company Name	Decline
EBAY	eBay Inc.	-18%	NWRE	Neoware	-18%
ADCT	ADC Telecomm Inc	-13%	EZEM	E-Z-Em Inc Cl A	-15%
RMBS	Rambus Inc	-12%	SMTL	Semitool Inc	-15%
AFFX	Affymetrix	-11%	IMGC	Intermagnetics Gen Cp	-9%
BRCM	Broadcom Corporation	-11%	ANDW	Andrew Corp.	-8%
LAUR	Laureate Edu	-10%	ZQK	Quiksilver Inc	-8%
NFP	Natl Financial Partners	-9%	DPTR	Delta Petroleum Corp	-6%
RA	Reckson Associates Rl	-8%	EPIQ	Epiq Systems Inc	-6%
ADP	Automatic Data Processing Inc.	-6%	FLDR	Flanders Corp	-4%
DVA	Davita Inc	-5%	SWKS	Skyworks Solution	-3%
MHS	Medco Health Solutions	-4%			
VRSN	Verisign	-3%			
KMI	Kinder Morgan	-1%			
BRE	BRE Properties	-1%			
IVGN	Invitrogen Corp.	-1%			

Sources: New Constructs, LLC

Figure 3 shows the 18 new stocks that make our May Most Dangerous Stocks lists.

Figure 3: 18 New Additions for May

Large Cap		Small Cap	
Ticker	Company Name	Ticker	Company Name
KSU	Kansas City Sthrn Ind.	CBC	Capital Bancorp Ltd
NIHD	NII Holdings	CMO	Capstead Mortgage Corp
PENN	Penn Natl Gaming Co	JCOM	J2 Global Communications
SBUX	Starbucks Corp.	KAI	Kadant Inc
JEF	Jefferies Group	KYPH	Kyphon Inc
		LAYN	Layne Christensen Co
		MBHI	Midwest Banc Holdings Inc
		POWL	Powell Ind Inc
		RSAS	RSA Security Dynamics Technology
		SFNT	SafeNet Inc
		SLNK	Spectralink Corp
		SSYS	Stratasys
		TXCO	Exploration Co of Delaware Inc

Sources: New Constructs, LLC

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 $[(FCF_t + FCF_{t-1})/(\text{Current Enterprise Value} + \text{Enterprise Value}_{t-1})]$, 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
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

The 20 Most Dangerous Stocks for May – 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 5/8/06			
	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	BRCM	Broadcom Corporation	$193	($24)	Bottom Quintile	-1%	57.5	More than 100yrs	$20,923
2	DVA	Davita	$6	($168)	Bottom Quintile	-20%	29.5	18	$5,374
3	SBUX*	Starbucks Corp.	$103	($50)	4th	-1%	22.3	45	$31,291
4	CRE	Carramerica Realty	$55	($34)	Bottom Quintile	-2%	14.5	68	$2,506
5	NIHD*	NII Holdings	$117	($2)	4th	-5%	12.6	More than 100yrs	$9,316
6	IRM	Iron Mountain	$17	($2)	4th	-3%	9.4	29	$4,815
7	ASN	Archstone-Smith	$81	($75)	Bottom Quintile	-4%	7.6	83	$10,007
8	VRSN	Verisign	$220	($25)	Bottom Quintile	-4%	5.5	More than 100yrs	$6,105
9	EBAY	eBay Inc.	$304	($79)	3rd	-3%	5.5	More than 100yrs	$44,106
10	BRE	BRE Properties	$2	($2)	Bottom Quintile	0%	5.3	62	$2,759
11	RA	Reckson Associates Rl	$155	($9)	Bottom Quintile	-4%	4.6	49	$3,290
12	MMC	Marsh & McLennan	$228	($313)	Bottom Quintile	2%	4.2	55	$16,145
13	JEF*	Jefferies Group	$26	($10)	3rd	-3%	3.6	More than 100yrs	$4,185
14	KMI	Kinder Morgan	$33	($465)	Bottom Quintile	-16%	3.6	13	$10,903
15	NOV	National Oilwell Var	$177	($81)	4th	-21%	3.3	38	$11,170
16	ADCT	ADC Telecomm Inc	$94	($11)	Bottom Quintile	-9%	3.0	29	$2,590
17	KSU*	Kansas City Sthrn Ind.	$76	($129)	Bottom Quintile	-33%	-2.6	56	$2,072
18	PENN*	Penn Natl Gaming Co	$49	($141)	Bottom Quintile	-22%	-8.6	30	$3,406
19	IVGN	Invitrogen Corp	$43	($45)	Bottom Quintile	-12%	-13.2	72	$3,465
20	BCO	Brink's Co	$21	($94)	Bottom Quintile	-2%	-94.0	More than 100yrs	$3,194

* New on the Large Cap Most Dangerous list since April 10th, 2006.

Sources: New Constructs, LLC

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The 20 Most Dangerous Stocks for May – 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 5/8/06			
	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	KYPH*	Kyphon Inc	$8	($2)	Bottom Quintile	-1%	46.6	More than 100yrs	$1,862
2	SWKS	Skyworks Solution	$3	($10)	Bottom Quintile	1%	37.1	More than 100yrs	$1,137
3	CBC*	Capital Bancorp Ltd	$9	($19)	Bottom Quintile	-9%	12.2	More than 100yrs	$621
4	HIH	Highland Hospitality	$4	($4)	Bottom Quintile	-16%	11.7	89	$556
5	FLDR	Flanders Corp	$3	($1)	Bottom Quintile	-1%	11.2	74	$292
6	LAYN*	Layne Christensen Co	$5	($7)	Bottom Quintile	-19%	10.4	More than 100yrs	$404
7	ANDW	Andrew Corp.	$6	($2)	Bottom Quintile	-3%	10.3	42	$1,745
8	SMTL	Semitool Inc	$3	($4)	Bottom Quintile	-6%	10.2	35	$308
9	SLNK*	Spectralink Corp	$1	($8)	4th	-11%	9.7	More than 100yrs	$228
10	SSYS*	Stratasys	$1	($5)	4th	-3%	9.6	More than 100yrs	$351
11	WGII	Wahington Group Int'l	$7	($9)	Bottom Quintile	-3%	8.4	44	$1,512
12	CMO*	Capstead Mortgage Corp	$15	($28)	Bottom Quintile	-4%	8.2	47	$142
13	RSAS*	RSA Security Dynamics Technology	$7	($7)	4th	-3%	7.1	More than 100yrs	$1,446
14	TXCO*	Exploration Co of Delaware Inc	$11	($19)	Bottom Quintile	-2%	4.7	90	$334
15	KAI*	Kadant Inc	$6	($9)	Bottom Quintile	-12%	3.7	28	$362
16	JCOM*	J2 Global Communications	$20	($1)	Bottom Quintile	-116%	-0.1	57	$1,203
17	EPIQ	Epiq Systems Inc	$1	($9)	Bottom Quintile	-28%	-5.0	67	$314
18	SFNT*	SafeNet Inc	$1	($10)	Bottom Quintile	-39%	-5.2	68	$540
19	MBHI*	Midwest Banc Holdings Inc	$4	($19)	Bottom Quintile	-10%	-13.4	More than 100yrs	$443
20	POWL*	Powell Ind Inc	$1	($6)	Bottom Quintile	-7%	-16.4	More than 100yrs	$275

* New on the Small Cap Most Dangerous list since April 10th, 2006.

Sources: New Constructs, LLC

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