20 Most Dangerous 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.

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Note
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- **Key Highlights: price decreases in the past month move 2 stocks off the lists: VRNT (-4%) and KWK (-21%).**
- **Figure 1 details all additions and deletions to the list.**
- **Figure 2 highlights 2 stocks with price drops greater than 5% that remain on the list.**
- **Figures 3 and 4 show the 20 Large Cap and 20 Small Cap Dangerous stocks.**
- **Our Most Dangerous Stocks have MISLEADING EARNINGS, which means reported profits are positive and rising while actual profits are negative and falling.**
- **Pages 2-4 explain our stock selection methodology.**
- **Institutional Investor Magazine highlighted our #1 ranking for stock-picking in an October 11th article.**

Figure 1: Most Dangerous List Changes for March

Market Cap	Drops	Adds	Reason for Turnover
Large Cap	KWK		Meaningful Price Depreciation: -21%
	ARG		Displaced - Price Appreciation of other stocks
	REG		Displaced - Price Appreciation of other stocks
		PLCM	Meaningful Price Appreciation: +10%
		SPN	Meaningful Price Appreciation: +9%
		IRM	Meaningful Price Appreciation: +3
Small Cap	VRNT		Meaningful Price Depreciation: -4%
	WMGI		New 10-K revealed declining GAAP EPS
	CRAI		New 10-K revealed positive economic earnings
	MANH		Displaced - Price Appreciation of other stocks
		CCC	Meaningful Price Appreciation: +14%
		SINT	Meaningful Price Appreciation: +13%
		DTAS	Meaningful Price Appreciation: +7%
		CLP	Meaningful Price Appreciation: +7%

Sources: New Constructs, LLC

Figure 2: Price Drops for Stocks Still on the List

Large Cap		Small Cap	
Ticker	Price Drop	Ticker	Price Drop
NBG	-6%	POWI	-5%

Sources: New Constructs, LLC

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20 Most Dangerous Stocks: Methodology

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

1. **Expensive valuations** because their *Price-to-Economic Book Value* (EBV) ratios are greater than 2 or less than zero, and they have *Growth Appreciation Periods* (GAP) greater than 15 years.
2. **Poor economic performance** because they generated negative economic earnings in the last fiscal year, and their Economic Profit Margins have been negative on average during the past 3 years.
3. **Misleading accounting performance** because they reported positive GAAP Earnings and GAAP Earnings Growth while their economic profits declined in their latest fiscal year.

We do not predict the future value of stocks.

Identifying Expensive Valuations. The most dangerous stocks have valuations that imply that the company's future financial performance will meaningfully exceed anything the company has done in the past 3 years. 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 larger the Price-to-EBV ratio (whether or not it is positive or negative), the greater is the improvement in cash flow 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 longer the GAP the longer 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 Poor Economic Performance. The most dangerous 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: (NOPAT / WACC) + Excess Cash + Non-operating assets – Debt (incl. Operating Leases) - Value of Outstanding Stock Options – 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 Misleading Accounting Performance. When accounting results do not jibe with economic results, the market follows economic results, which provide a much better reflection of cash flow. Dangerous stocks report positive GAAP Earnings and Earnings Growth while their economic profits are negative and declining.

Conclusion

Companies that have expensive valuations, poor economics and misleading earnings present investors more risk of downside than upside price performance. We believe these stocks present investors with stocks that offer dangerous risk/reward.

We consider companies whose Price-to-EBV ratios and market-implied GAPs exceed the thresholds stated above to have **expensive valuations**.

We consider companies with negative economic earnings and a negative economic profit margin on average over the past 3 years to have **poor economics**.

We consider companies whose GAAP Earnings and GAAP Earnings trends contradict their economic performance to have **misleading earnings**.

The 20 Most Dangerous Stocks for March – Large and Mid Cap

Figure 3: Ranked by Price-to-EBV Ratio in Descending order

			Expensive Valuation		Poor Economics		Misleading Earnings			
			as of 3/1/06		Last Fiscal Year		Last Fiscal Year			
	Ticker	Company Name	Price-to-EBV	Market-Implied GAP (years)	Economic Profit Margin (3yr avg)	Economic Earnings Per Share	Positive EPS	Positive EPS Growth	Negative Economic Earnings Trend ($mm)	Market Value ($mm)
1	IRM*	Iron Mountain	41.4	35	-2%	($0.77)	$0.72	10%	($3)	$5,609
2	UDR	United Dominion Realty Trust	17.4	Greater than 100	-4%	($0.49)	$0.56	160%	($38)	$3,436
3	TSCO	Tractor Supply	16.6	Greater than 100	0%	($0.10)	$1.57	12%	($10)	$2,458
4	ROP	Roper Industries	15.5	Greater than 100	-2%	($0.83)	$1.24	75%	($28)	$3,408
5	ANDW	Andrew	15.1	Greater than 100	-8%	($0.90)	$0.24	18%	($3)	$2,214
6	USM	United States Cellular	12.2	Greater than 100	-5%	($3.13)	$1.26	79%	($71)	$4,795
7	CAKE	Cheesecake Factory	7.8	Greater than 100	-1%	($0.15)	$0.84	13%	($6)	$2,816
8	MAR	Marriott International Inc	6.0	62	-1%	($0.67)	$2.48	21%	($117)	$15,592
9	CVS	CVS	6.0	70	-1%	($0.33)	$1.09	7%	($203)	$23,167
10	ARI	Arden Realty	5.3	Greater than 100	-3%	($0.83)	$1.12	22%	($6)	$2,970
11	WTR	Aqua America	5.1	28	-2%	($0.39)	$0.64	7%	($4)	$3,679
12	SPN*	Superior Energy Services	4.8	Greater than 100	0%	($0.09)	$0.47	16%	($11)	$2,027
13	FCEA	Forest City	4.7	86	0%	($0.19)	$0.84	98%	($13)	$4,008
14	BJ	BJ's Wholesale Club	4.7	52	-1%	($0.59)	$1.63	11%	($14)	$2,118
15	NFG	National Fuel Gas	4.5	39	0%	($1.34)	$2.23	11%	($158)	$2,716
16	PLCM*	Polycom Inc	4.4	Greater than 100	-9%	($0.61)	$0.35	53%	($13)	$2,084
17	ACXM	Acxiom	4.4	Greater than 100	-3%	($0.34)	$0.70	17%	($11)	$2,258
18	XLNX	Xilinx	3.9	Greater than 100	-1%	($0.02)	$0.87	2%	($52)	$9,746
19	ADS	Alliance Data Systems	3.7	Greater than 100	-3%	($0.55)	$1.22	45%	($16)	$3,574
20	NBG	National Bank of Greece SA	-89.4	Greater than 100	-6%	($0.18)	$0.16	106%	($315)	$16,171
	SPX	S&P 500	1.6	25	5%	$0.29	$2.51	25%	$341	

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

Sources: New Constructs, LLC

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The 20 Most Dangerous Stocks for March – Small Cap

Figure 4: Ranked by Price-to-EBV Ratio in Descending order

			Expensive Valuation		Poor Economics		Misleading Earnings			
			as of 3/1/06		Last Fiscal Year		Last Fiscal Year			
	Ticker	Company Name	Price-to-EBV	Market-Implied GAP (years)	Economic Profit Margin (3yr avg)	Economic Earnings Per Share	Positive EPS	Positive EPS Growth	Negative Economic Earnings Trend ($mm)	Market Value ($mm)
1	NWRE	Neoware Systems	114.0	Greater than 100	-5%	($0.41)	$0.46	36%	($4)	$400
2	CELL	Brightpoint	91.8	Greater than 100	-6%	($0.39)	$0.38	38%	($2)	$1,178
3	EPIQ	EPIQ Systems	35.4	59	-1%	($0.57)	$0.49	2%	($10)	$387
4	POWI	Power Integrations Inc	26.8	Greater than 100	-14%	($0.34)	$0.63	11%	($2)	$782
5	ARXX	Aeroflex	23.3	Greater than 100	-8%	($0.60)	$0.22	29%	($5)	$996
6	MATR	Matria Healthcare	20.8	Greater than 100	-4%	($0.70)	$1.74	271%	($1)	$676
7	XXIA	Ixia	19.4	92	-15%	($0.15)	$0.29	108%	($2)	$731
8	SWKS	Skyworks Solutions	13.3	59	-9%	($0.68)	$0.16	11%	($9)	$857
9	CKH	Seacor Holdings	13.2	46	-4%	($3.72)	$1.07	72%	($12)	$1,341
10	MDCC	Molecular Devices	12.7	Greater than 100	-8%	($2.85)	$1.04	104%	($6)	$521
11	ANEN	Anaren	12.6	Greater than 100	-10%	($0.70)	$0.37	2%	($6)	$354
12	SIVB	Silicon Valley Bancshares	9.4	Greater than 100	-4%	($1.00)	$1.74	442%	($5)	$1,817
13	EZEM	E-Z-Em	8.9	Greater than 100	-30%	($0.45)	$0.63	0%	($1)	$218
14	PKTR	Packeteer	8.8	Greater than 100	-11%	($0.21)	$0.42	31%	($3)	$412
15	LOJN	LoJack	8.5	Greater than 100	-2%	($0.02)	$0.64	26%	($2)	$361
16	KEYW	Essex	8.4	Greater than 100	-66%	($0.36)	$0.13	830%	($4)	$353
17	DTAS	Digitas	8.1	Greater than 100	-5%	($0.16)	$0.39	61%	($2)	$992
18	CLP*	Colonial Properties Trust	7.7	Greater than 100	-1%	($1.44)	$1.45	13%	($26)	$1,322
19	SINT*	SI International	7.7	Greater than 100	-4%	($0.88)	$1.14	32%	($7)	$295
20	CCC*	Calgon Carbon	7.7	Greater than 100	-5%	($0.35)	$0.15	30%	($1)	$301
	SPX	S&P 500	1.6	25	5%	$0.29	$2.51	25%	$341	

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Appendix 1 – Additions/Deletions from Lists

Most Dangerous Large and Mid Cap Stocks

Deletions:

KWK – Stock Price Decreased 21% since February publication and new 10-K Data revealed Increasing Economic Earnings.

ARG – Displaced – Price Appreciation of other stocks.

REG – Displaced – Price Appreciation of other stocks.

Additions:

PLCM – Stock Price Increased +10% since February publication.

SPN – Stock Price Increased +9% since February publication.

IRM – Stock Price Increased 3% since February publication.

Most Dangerous Small Cap Stocks

Deletions:

VRNT – Stock Price Decreased 4% since February publication.

WMGI – New 10-K Data revealed declining GAAP EPS.

CRAI – New 10-K Data revealed positive Economic Earnings.

MANH – Displaced – Price Appreciation of other stocks.

Additions:

CCC – Stock Price Increased 14% since February publication.

SINT – Stock Price Increased 13% since February publication.

DTAS – Stock Price Increased 7% since February publication.

CLP – Stock Price Increased 7% since February publication.

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