20 Most Dangerous Stocks for January

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

- **Key Highlights: price decreases in the past month move 3 stocks off the lists: BYD (-3%), ADP (-2%) and SIVBE (-4%).**
- **Figure 1 details all additions and deletions to the list.**
- **Figure 2 highlights stocks with meaningful price drops 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 January

Market Cap	Drops	Adds	Reason for Turnover
Large Cap	BYD		Meaningful Price Depreciation: -3%
	ADP		Meaningful Price Depreciation: -2%
	AVB		Displaced - Price Appreciation of other Stocks
		ACXM	Meaningful Price Appreciation: +5%
		TSCO	Meaningful Price Appreciation: +1%
		NFG	New Financial Data
Small Cap	SIVBE		Meaningful Price Depreciation: -4%
	MANH		Displaced - Price Appreciation of other Stocks
	RBC		Displaced - Price Appreciation of other Stocks
	CHFN		Temporary Drop from Coverage
		MATR	Meaningful Price Appreciation: +16%
		DTAS	Meaningful Price Appreciation: +8%
		ANDW	Meaningful Price Appreciation: +3%
		SWKS	New Financial Data

Sources: New Constructs, LLC

Figure 2: Price Drops for Stocks Still on the List

Large Cap		Small Cap	
Ticker	Price Drop	Ticker	Price Drop
CVS	-3%	XXIA	-18%
CAKE	-2%	VRNT	-7%

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 January – Large and Mid Cap

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

			Expensive Valuation		Poor Economics		Misleading Earnings			
			as of 1/11/06		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	KWK	Quicksilver Resources	5444.8	Greater than 100	-1%	($0.22)	$0.41	72%	($16)	$3,241
2	UDR	United Dominion Realty Trust	15.9	Greater than 100	-4%	($0.49)	$0.56	160%	($38)	$3,141
3	ROP	Roper Industries	12.7	70	-2%	($0.83)	$1.24	75%	($28)	$3,097
4	USM	United States Cellular	10.6	67	-5%	($3.13)	$1.26	79%	($71)	$4,447
5	TSCO*	Tractor Supply	10.2	Greater than 100	0%	($0.10)	$1.57	12%	($10)	$2,010
6	CAKE	Cheesecake Factory	7.1	Greater than 100	-1%	($0.11)	$0.84	13%	($2)	$2,877
7	MAR	Marriott International Inc	6.0	62	-1%	($0.67)	$2.48	21%	($117)	$15,529
8	ARI	Arden Realty	5.2	Greater than 100	-3%	($0.83)	$1.12	22%	($6)	$2,940
9	WTR	Aqua America	4.7	25	-2%	($0.39)	$0.64	7%	($4)	$3,487
10	CVS	CVS	4.6	23	-1%	($0.33)	$1.09	7%	($203)	$21,636
11	FCEA	Forest City	4.5	Greater than 100	0%	($0.19)	$0.84	98%	($13)	$3,857
12	NFG*	National Fuel Gas	4.5	37	0%	($1.34)	$2.23	11%	($158)	$2,691
13	XLNX	Xilinx	4.1	Greater than 100	-1%	($0.02)	$0.87	2%	($52)	$10,128
14	ACXM*	Acxiom	3.9	77	-3%	($0.34)	$0.70	17%	($11)	$2,090
15	REG	Regency Realty	3.5	Greater than 100	-1%	($0.26)	$2.08	0%	($11)	$3,839
16	AGE	A.G. Edwards	3.5	Greater than 100	-3%	($1.94)	$2.37	20%	($93)	$3,650
17	HPQ	Hewlett-Packard	3.4	70	-4%	($0.38)	$1.14	38%	($65)	$91,446
18	WEC	Wisconsin Energy	3.3	20	-2%	($2.04)	$2.57	25%	($2)	$4,728
19	NBG	National Bank of Greece SA	-79.7	Greater than 100	-6%	($0.18)	$0.16	106%	($315)	$14,404
20	ADS	Alliance Data Systems	3.1	49	-3%	($0.55)	$1.22	45%	($16)	$3,129
	SPX	S&P 500	1.5	20	5%	$0.12	$2.48	26%	$372	

* 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 January – Small Cap

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

			Expensive Valuation		Poor Economics		Misleading Earnings			
			as of 1/11/06		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	411.7	Greater than 100	-5%	($0.41)	$0.46	36%	($4)	$433
2	POWI	Power Integrations Inc	37.0	Greater than 100	-14%	($0.34)	$0.63	11%	($2)	$831
3	EPIQ	EPIQ Systems	30.1	48	-1%	($0.57)	$0.49	2%	($10)	$374
4	AML	Amli Residential Properties Trust	25.3	Greater than 100	-4%	($1.51)	$2.08	109%	($20)	$930
5	CELL	Brightpoint	24.3	Greater than 100	-6%	($0.39)	$0.38	38%	($2)	$836
6	VRNT	Verint Systems	23.2	53	-8%	($0.89)	$0.81	33%	($10)	$751
7	XXIA	Ixia	18.6	Greater than 100	-15%	($0.15)	$0.29	108%	($2)	$722
8	MATR*	Matria Healthcare	18.0	Greater than 100	-4%	($0.70)	$1.74	271%	($1)	$643
9	ARXX	Aeroflex	15.1	Greater than 100	-8%	($0.60)	$0.22	29%	($5)	$860
10	SWKS*	Skyworks Solutions	13.6	63	-9%	($0.68)	$0.16	11%	($9)	$863
11	CKH	Seacor Holdings	11.9	40	-4%	($3.72)	$1.07	72%	($12)	$1,273
12	EZEM	E-Z-Em	11.8	Greater than 100	-30%	($0.45)	$0.63	0%	($1)	$259
13	ANDW*	Andrew Corp	10.9	52	-8%	($0.90)	$0.24	18%	($3)	$1,808
14	ANEN	Anaren	10.3	Greater than 100	-10%	($0.70)	$0.37	2%	($6)	$322
15	MDCC	Molecular Devices	9.6	Greater than 100	-8%	($2.85)	$1.04	104%	($6)	$461
16	LOJN	LoJack	9.6	Greater than 100	-2%	($0.02)	$0.64	26%	($2)	$380
17	WMGI	Wright Medical Group	8.6	59	-2%	($0.35)	$0.68	35%	($9)	$668
18	DTAS*	Digitas	8.3	Greater than 100	-5%	($0.16)	$0.39	61%	($2)	$1,000
19	FLDR	Flanders	8.2	94	-3%	($0.20)	$0.36	22%	($1)	$310
20	CRAI	Charles River Associates	8.1	43	-1%	($0.27)	$1.55	34%	($4)	$461
	SPX	S&P 500	1.5	20	5%	$0.12	$2.48	26%	$372	

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

Sources: New Constructs, LLC

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Appendix 1 – Additions/Deletions from Lists

Most Dangerous Large and Mid Cap Stocks

Deletions:

BYD – Stock Price Decreased 3% since December publication.

ADP – Stock Price Decreased 2% since December publication.

AVB – Displaced – Stock Price Appreciation of other Stocks.

Additions:

ACXM – Stock Price Increased 5% since December publication.

TSCO – Stock Price Increased 1% since December publication.

NFG – New Published 10K – December 12, 2005.

Most Dangerous Small Cap Stocks

Deletions:

SIVBE – Stock Price Decreased 4% since December publication.

MANH – Displaced – Stock Price Appreciation of other Stocks.

RBC – Displaced – Stock Price Appreciation of other Stocks.

CHFN – Temporary Drop from Coverage.

Additions:

MATR – Stock Price Increased 16% since December publication.

DTAS – Stock Price Increased 8% since December publication.

ANDW – Stock Price Increased 3% since December publication.

SWKS – New Published 10K – December 14, 2005.

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