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 integrated research database and platform.

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

- **Our Most Dangerous Stocks provide investors with unique investment ideas generated by our forensic analysis of 10K filings for over 3000 companies.**
- **4 new stocks make our June Large Cap list as recent price appreciation elevated them to more dangerous ranking than 4 companies on the May list.**
- **3 new stocks make our June Small Cap list after price decreases took 3 others off the list.**
- **Our Most Dangerous Stocks have MISLEADING EARNINGS, which means reported profits are positive and rising while actual profits are negative and falling.**
- **We identify the most expensive stocks by looking for stocks with the highest expectations for future cash profits versus true, historical profits.**
- **Figure 1 shows the 10 Most Dangerous Large Cap Stocks for June.**
- **Figures 2 and 3 provide the full list of 20 Large Cap and 20 Small Cap Dangerous stocks.**
- **Pages 2-4 explain our Most Dangerous Stocks selection methodology.**

Figure 1: 10 Most Dangerous Large Cap Stocks

Ticker	Company Name	Ticker	Company Name
BYD	BoydGaming	TIN	Temple-Inland
KWK	QuicksilverResources	ROP	RoperIndustries
UDR	UnitedDominionRealtyTrust	MAR	MarriottInternationalInc
EDMC	EducationManagementCorp	CAKE	CheesecakeFactory
USM	UnitedStatesCellular	CVS	CVS

* Denotes stocks that have not appeared on the Most Dangerous list within the last 2 months.

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 -/+ Under/Over-Funded Pensions.

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 June – Large and Mid Cap

Figure 2: Ranked by Price-to-EBV Ratio in Descending order

			Expensive Valuation		Poor Economics		Misleading Earnings			
			as of 05/31/05		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	BYD	Boyd Gaming	126.6	45	0%	($0.92)	$1.42	130%	($82)	$4,116
2	KWK	Quicksilver Resources	20.2	71	0%	($0.28)	$0.61	72%	($14)	$2,632
3	UDR	United Dominion Realty Trust	13.1	Greater than 100	-3%	($0.45)	$0.56	160%	($37)	$2,933
4	EDMC	Education Management Corp	10.3	27	-1%	($0.23)	$1.03	33%	($15)	$2,315
5	USM	United States Cellular	9.5	38	-5%	($3.06)	$1.26	79%	($49)	$4,028
6	TIN	Temple-Inland	6.2	31	-3%	($1.37)	$1.47	66%	($56)	$3,908
7	ROP	Roper Industries	6.0	60	-1%	($1.50)	$2.48	75%	($24)	$2,607
8	MAR	Marriott International Inc	5.8	58	-1%	($0.67)	$2.48	21%	($115)	$15,282
9	CAKE	Cheesecake Factory	5.5	73	0%	($0.03)	$0.84	13%	($2)	$2,720
10	CVS	CVS	4.6	Greater than 100	-1%	($0.66)	$2.18	7%	($211)	$21,907
11	ARI	Arden Realty	3.6	70	-3%	($0.74)	$1.12	22%	($6)	$2,218
12	FCEA*	Forest City	3.4	22	0%	($0.26)	$1.67	98%	($12)	$3,189
13	PNR	Pentair	3.2	71	-1%	($0.45)	$1.68	19%	($37)	$4,363
14	ADS	Alliance Data Systems	2.9	33	-2%	($0.49)	$1.22	45%	($13)	$3,040
15	REG	Regency Realty	2.9	Greater than 100	0%	($0.16)	$2.08	0%	($10)	$3,340
16	SDS	SunGard Data Systems	2.8	26	-1%	($0.09)	$1.54	21%	($19)	$9,993
17	HPQ*	Hewlett-Packard	2.3	Greater than 100	-4%	($0.35)	$1.14	38%	($61)	$68,856
18	MNI	McClatchy	2.1	25	-1%	($0.54)	$3.33	3%	($4)	$3,247
19	AGE*	A.G. Edwards	2.0	32	-2%	($1.27)	$2.37	20%	($57)	$3,214
20	ITT*	ITT Industries	2.0	19	-1%	($0.22)	$4.58	7%	($3)	$8,740
	SPX	S&P 500	1.9	18	1%	$0.21	$2.49	23%	$157	

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Sources: New Constructs, LLC

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The 20 Most Dangerous Stocks for June – Small Cap

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

			Expensive Valuation		Poor Economics		Misleading Earnings (Latest Fiscal Year)			
			as of 05/31/05		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 (Last Fiscal Year)	Positive EPS	Positive EPS Growth	Negative Economic Earnings Trend ($mm)	Market Value ($mm)
1	XXIA	Ixia	252.6	Greater than 100	-16%	($0.11)	$0.29	108%	($1)	$1,125
2	SYKE	Sykes Enterprises	63.6	Greater than 100	-7%	($0.53)	$0.27	18%	($3)	$330
3	AML	Amli Residential Properties Trust	19.7	42	-3%	($1.40)	$2.08	109%	($19)	$694
4	CNT	Centerpoint Properties Trust	18.8	78	-3%	($0.87)	$1.84	17%	($38)	$1,990
5	POWI	Power Integrations Inc	15.2	Greater than 100	-12%	($0.30)	$0.63	11%	($2)	$732
6	WMGI	Wright Medical Group	15.1	96	-1%	($0.31)	$0.68	35%	($8)	$917
7	GBP	Gables Residential Trust	14.4	Greater than 100	-2%	($0.98)	$2.47	58%	($14)	$1,055
8	LAD*	Lithia Motors	13.0	Greater than 100	-2%	($1.59)	$2.07	8%	($4)	$496
9	CKH	Seacor Holdings	12.8	55	-4%	($3.59)	$1.07	72%	($10)	$1,059
10	EPIQ	EPIQ Systems	11.7	Greater than 100	-1%	($0.54)	$0.49	2%	($10)	$291
11	CRAI	Charles River Associates	10.5	Greater than 100	0%	($0.16)	$1.55	34%	($4)	$569
12	CCC	Calgon Carbon	10.1	Greater than 100	-4%	($0.33)	$0.15	30%	($1)	$351
13	MATR*	Matria Healthcare	9.9	60	-3%	($0.23)	$1.16	147%	($2)	$669
14	ASF*	Administaff	8.4	Greater than 100	-3%	($0.09)	$0.72	52%	($6)	$552
15	CAI	CACI International	7.9	62	-1%	($0.47)	$2.13	40%	($10)	$1,845
16	DRS	DRS Technologies	7.6	55	-1%	($1.07)	$1.80	14%	($15)	$1,143
17	CHFN	Charter Financial	7.4	Greater than 100	-5%	($0.55)	$0.42	166%	($6)	$669
18	MOBI	Mobius Management Systems	6.0	24	-16%	($0.11)	$0.24	7%	($3)	$113
19	PKTR	Packeteer	5.5	35	-10%	($0.14)	$0.42	31%	($3)	$375
20	VRNT	Verint Systems	5.4	Greater than 100	0%	($0.33)	$0.81	33%	($8)	$778
	SPX	S&P 500	1.9	18	1%	$0.21	$2.49	23%	$157	

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