20/20 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 integrated research database and platform.

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Note
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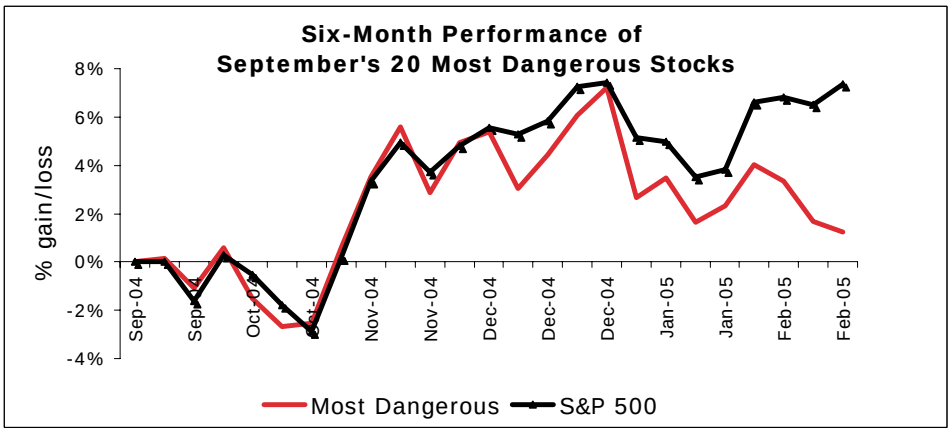
- **The September Most Dangerous Large/Mid Cap Stocks (+1%) have meaningfully under-performed the S&P 500 (+7%) over the past 6 months. See Figure 1.**
- **1 new Large/Mid-Cap stocks make our Most Dangerous list for March. The top 5 are: STN, IVGN, DNA, EDMC, and BA.**
- **4 new Small-Cap stocks make our Most Dangerous list. The top 5 are: CWTR, JLL, AMHC, COKE, and BONT.**
- **Stocks dropped from the list are: large cap- BGP; small cap – DRX, MOBI, WDHD and CSH.**
- **Our 20 Most Dangerous Large/Mid Cap Stocks are on page 4, and the 20 Most Dangerous Small Cap Stocks are on page 5.**
- **A detailed description of how we identify the Most Dangerous Stocks is on pages 2 and 3.**

Figure 1: Most Dangerous Stocks Performance – Past 6 Months



Sources: New Constructs, LLC

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40 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 20 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 five 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 5 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 five 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 2: Ranked by Price-to-EBV Ratio in Descending order

			as of 02/27/05		Last Fiscal Year		Last Fiscal Year			
	Ticker	Company Name	Price-to-EBV	Market-Implied GAP (years)	Economic Profit Margin (5yr avg)	Economic Earnings Per Share	Positive EPS	Positive EPS Growth	Negative Economic Earnings Trend ($mm)	Market Value ($mm)
1	STN	Station Casinos Inc	339.5	60	-1%	($0.34)	$0.72	143%	($3)	$3,598
2	IVGN	Invitrogen	101.5	Greater than 100	-13%	($3.48)	$1.17	30%	($31)	$3,588
3	DNA	Genentch	36.1	Greater than 100	-8%	($0.48)	$0.53	775%	($193)	$49,903
4	EDMC	Education Management Corp	9.2	25	-1%	($0.21)	$1.03	34%	($14)	$2,180
5	BA	Boeing	8.7	80	-2%	($3.40)	$0.89	46%	($1,506)	$43,998
6	UVN	Univision	8.7	21	-4%	($1.62)	$0.55	62%	($271)	$6,722
7	CAM	Cooper Cameron	8.5	99	-3%	($1.16)	$1.29	28%	($2)	$3,188
8	SPLS	Staples Inc	6.4	62	-2%	($0.24)	$0.99	5%	($143)	$15,535
9	WPO	Washington Post	4.8	66	-2%	($8.09)	$25.12	18%	($36)	$8,663
10	EQR	Equity Residential	4.4	29	-1%	($0.64)	$1.44	32%	($149)	$8,938
11	MAR	Marriott International Inc	4.1	34	-1%	($0.20)	$2.05	88%	($28)	$14,910
12	ORLY	O'Reilly Auto	3.8	26	-1%	($0.04)	$1.84	20%	($6)	$2,687
13	TEK	Tektronix	3.1	Greater than 100	-2%	($0.50)	$1.35	365%	($39)	$2,487
14	AVB	AvalonBay Communities	3.1	77	-2%	($0.78)	$3.71	69%	($4)	$4,739
15	PNR	Pentair	2.9	32	0%	($0.19)	$1.42	9%	($5)	$4,040
16	AXP	American Express	2.8	Greater than 100	-2%	($0.28)	$2.30	15%	($1,041)	$70,081
17	WEC*	Wisconsin Energy	2.3	20	-3%	($1.73)	$2.06	44%	($38)	$2,264
18	NIHD	NII Holdings	2.2	Greater than 100	-13%	($0.15)	$2.54	3%	($256)	$4,101
19	RJF	Raymond James Financial	2.0	Greater than 100	0%	($0.29)	$1.71	46%	($4)	$3,617
20	CTX	Centex	-7.6	21	-1%	($2.07)	$6.40	45%	($88)	$2,230
	SPX	S&P 500	1.8	24 yrs	5%	($0.08)	$2.15	179%	$562	

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

			Expensive Valuation		Poor Economics		Misleading Earnings (Latest Fiscal Year)			
			as of 02/27/05		Last Fiscal Year		Last Fiscal Year			
	Ticker	Company Name	Price-to-EBV	Market-Implied GAP (years)	Economic Profit Margin (5yr avg)	Economic Earnings Per Share (Last Fiscal Year)	Positive EPS	Positive EPS Growth	Negative Economic Earnings Trend ($mm)	Market Value ($mm)
1	CWTR	Coldwater Creek	90.9	89	-2%	($0.13)	$0.34	32%	($0)	$1,000
2	JLL	Jones Lang LaSalle	18.5	Greater than 100	-6%	($0.87)	$1.12	32%	($33)	$1,316
3	AMHC	American Healthways	17.2	29	-3%	($0.01)	$0.75	34%	($2)	$1,106
4	COKE	Coca-Cola Bottling	15.1	67	-3%	($3.51)	$3.40	33%	($23)	$482
5	BONT	Bon-Ton Stores	12.9	Greater than 100	-3%	($1.14)	$1.33	113%	($5)	$260
6	ARXX	Aeroflex	9.0	Greater than 100	-18%	($0.54)	$0.17	65%	($15)	$701
7	MRGE*	Merge Technologies	7.7	Greater than 100	-14%	($0.10)	$0.50	42%	($2)	$210
8	ANSI	Advanced Neuromodulation Systems	7.4	33	-4%	($0.33)	$0.64	71%	($1)	$569
9	TOA	Technical Olympic USA	7.3	Greater than 100	-1%	($0.43)	$1.94	13%	($24)	$1,235
10	LIN	Linens 'N Things	7.1	37	-2%	($1.13)	$1.67	4%	($6)	$1,212
11	RS	Reliance Steel and Aluminum	6.9	98	0%	($0.95)	$1.07	13%	($18)	$1,475
12	ARJ*	Arch Chemicals	6.4	44	-4%	($1.68)	$1.21	813%	($1)	$633
13	CAI	CACI International	5.8	33	0%	($0.47)	$2.13	40%	($10)	$1,553
14	ACMR	AC Moore Arts & Crafts	5.7	Greater than 100	-1%	($0.21)	$0.88	14%	($2)	$490
15	ROG	Rogers	5.6	91	-1%	($0.39)	$1.61	39%	($1)	$721
16	FORR	Forrester Research	5.6	36	-30%	($0.46)	$0.10	285%	($14)	$354
17	WMAR	West Marine Products	5.3	71	-3%	($0.55)	$0.99	2%	($2)	$477
18	HYSL*	Hyperion Solutions Corp	4.8	55	-8%	($1.52)	$1.10	15%	($13)	$1,890
19	SSYS	SSYS	4.6	Greater than 100	-2%	($0.03)	$0.64	72%	($1)	$267
20	PRXL*	PAREXEL International	3.6	Greater than 100	-4%	($0.25)	$0.51	24%	($1)	$590
	SPX	S&P 500	1.8	24 yrs	5%	($0.08)	$2.15	179%	$562	

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