Most Dangerous Stocks for August

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:
Go to www.newconstructs.com to access our research on individual companies and our Most Attractive and Most Dangerous Stocks reports.

- **19 stocks from July's report dropped at least 1% in the last month while the S&P 500 rose 0.7%. See Figure 1 below.**
- **18 new stocks make our August 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.**
- **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: 19 Decliners From the July report

Large Cap		Small Cap	
Ticker	Decline from July 5th	Ticker	Decline from July 5th
VRSN	-21%	JCOM	-20%
BRCM	-20%	DRS	-19%
EBAY	-15%	BJRI	-17%
PENN	-15%	SSYS	-17%
VSH	-15%	B	-14%
IVGN	-12%	EPIQ	-9%
ANN	-9%	AHT	-6%
MMC	-5%	CMO	-4%
		FLDR	-4%
		CPKI	-3%
		KSU	-2%

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes dividends.

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Most Dangerous Stocks: Monthly Updates

There are 19 stocks from our July Most Dangerous Large Cap and Small Cap lists that declined at least 1% (while the S&P 500 rose 0.7%) since July 5th, 2006, the day before we published the report to subscribers. See Figure 2 for details.

Figure 2: 19 Decliners From Last Month's Report

Large Cap			Small Cap		
Ticker	Company Name	Decline from July 5th	Ticker	Company Name	Decline from July 5th
VRSN	VERISIGN INC	-21%	JCOM	J2 GLOBAL COMMUNICATIONS	-20%
BRCM	BROADCOM CORP	-20%	DRS	DRS TECHNOLOGIES INC	-19%
EBAY	EBAY INC.	-15%	BJRI	BJ RESTAURANTS	-17%
PENN	PENN NATL GAMING CO	-15%	SSYS	STRATASYS	-17%
VSH	VISHAY INTERTECH	-15%	B	BARNES GROUP INC	-14%
IVGN	INVITROGEN CORP	-12%	EPIQ	EPIQ SYSTEMS INC	-9%
ANN	ANN TAYLOR INC	-9%	AHT	ASHFORD HOSPITALITY TR INC	-6%
MMC	MARSH & MCLENNAN	-5%	CMO	CAPSTEAD MORTGAGE CORP	-4%
			FLDR	FLANDERS CORP	-4%
			CPKI	CALIFORNIA PIZZA KITCHEN INC	-3%
			KSU	KANSAS CITY STHRN IND.	-2%

Sources: New Constructs, LLC,
Note: Gain/Decline performance analysis excludes dividends.

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

Figure 3: 18 Additions for August

Large Cap		Small Cap	
Ticker	Company Name	Ticker	Company Name
CELG	Celgene Corp	BDY	Bradley Pharmaceutical
DRE	Duke Realty	CHDN	Churchill Downs
DTE	DTE Energy Co.	CTS	CTS Corporation
MGM	MGM Mirage	KYPH	Kyphon Inc
RGC	Regal Entertainment Group	MEAS	Measurement Specialties Inc
SGMS	Scientific Games Corp	NHC	Natl Healthcare Corp
SRP	Sierra Pac Res Hldg	SHEN	Shenandoah Telecommun Co
SWY	Safeway Inc.	SLNK	Spectralink Corp
WMB	Williams Cos.	VMI	Valmont Ind Inc

Sources: New Constructs, LLC

Please see Appendix A for explanations of additions and deletions to the large and small cap lists.

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 or Reported Earnings are not positive
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

Appendix A – Additions/Deletions from Lists

Most Dangerous Large and Mid Cap Stocks

Deletions:

PENN – Stock price decreased 15% since June report.
ANN – Stock price decreased 9% since June report.
BCO – Displaced by increase in rank of other stocks.
IRM – Displaced by increase in rank of other stocks.
KMI – Displaced by increase in rank of other stocks.
NOV – Displaced by increase in rank of other stocks.
RA – Displaced by increase in rank of other stocks.
XRX – Displaced by increase in rank of other stocks.
CRE – Ticker/company is no longer traded.

Additions:

SWY – Stock price increased 13% since June report.
DRE – Stock price increased 8% since June report.
SRP – Stock price increased 7% since June report.
WMB – Stock price increased 5% since June report.
DTE – Stock price increased 3% since June report.
CELG – Addition by improved rank versus other stocks.
MGM – Addition by improved rank versus other stocks.
RGC – Addition by improved rank versus other stocks.
SGMS – Addition by improved rank versus other stocks.

Most Dangerous Small Cap Stocks

Deletions:

JCOM – Stock price decreased 20% since June report.
DRS – Stock price decreased 19% since June report.
SSYS – Stock price decreased 17% since June report.
EPIQ – Stock price decreased 9% since June report.
AHT – Stock price decreased 6% since June report.
CMO – Stock price decreased 4% since June report.
MBHI – Displaced by increase in rank of other stocks.
POWL – Displaced by increase in rank of other stocks.

RSAS – Displaced by increase in rank of other stocks.

Additions:

VMI – Stock price increased 11% since June report.

CHDN – Stock price increased 2% since June report.

NHC – Stock price increased 1% since June report.

BDY – Addition by improved rank versus other stocks.

CTS – Addition by improved rank versus other stocks.

KYPH – Addition by improved rank versus other stocks.

MEAS – Addition by improved rank versus other stocks.

SHEN – Addition by improved rank versus other stocks.

SLNK – Addition by improved rank versus other stocks.

The 20 Most Dangerous Stocks for August – 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 8/6/06			
	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	DVA	Davita	$6	($166)	Bottom Quintile	-19%	35.0	15	$5,632
2	SGMS*	Scientific Games Corp	$14	($27)	4	-2%	9.5	31	$2,617
3	ASN	Archstone-Smith	$81	($74)	Bottom Quintile	-4%	8.2	98	$10,767
4	BRCM	Broadcom Corporation	$193	($20)	Bottom Quintile	-2%	6.7	More than 100	$12,086
5	BRE	BRE Properties	$2	($2)	Bottom Quintile	0%	5.9	82	$3,064
6	DRE*	Duke Realty	$158	($12)	4	4%	5.0	63	$5,367
7	EBAY	eBay Inc.	$304	($80)	3	-3%	3.8	More than 100	$32,953
8	VRSN	Verisign	$220	($23)	Bottom Quintile	-4%	3.7	More than 100	$4,525
9	SWY*	Safeway Inc.	$1	($9)	4	5%	3.6	21	$12,908
10	MMC	Marsh & McLennan	$228	($318)	Bottom Quintile	2%	3.4	21	$13,450
11	MHS	Medco Health Solutions	$120	($59)	4	-6%	2.9	29	$17,473
12	LAUR	Laureate Edu	$12	($3)	4	-7%	2.9	38	$2,263
13	WMB*	Williams Cos.	$150	($160)	Bottom Quintile	-1%	2.2	33	$13,947
14	VSH	Vishay Intertechnology	$18	($25)	Bottom Quintile	2%	2.2	41	$2,373
15	RGC*	Regal Entertainment Group	$9	($16)	4	3%	-4.2	21	$2,855
16	MGM*	MGM Mirage	$31	($527)	Bottom Quintile	-20%	-7.6	17	$9,953
17	DTE*	DTE Energy Co.	$106	($85)	Bottom Quintile	-2%	-8.5	22	$7,366
18	SRP*	Sierra Pac Res Hldg	$54	($42)	Bottom Quintile	-3%	-9.4	22	$2,681
19	CELG*	Celgene Corp	$11	($71)	Bottom Quintile	-2%	-10.7	18	$15,413
20	IVGN	Invitrogen Corp	$43	($43)	Bottom Quintile	-13%	-14.3	46	$2,962

* New on the Large Cap Most Dangerous list versus our July 6th, 2006 report.

Sources: New Constructs, LLC

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The 20 Most Dangerous Stocks for August – 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 8/6/06			
	Ticker	Company Name	Rising GAAP Earnings	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	CPKI	California Pizza Kitchen	$2	($11)	Bottom Quintile	-8%	35.0	21	$506
2	BJRI	BJ Restaurants	$2	($3)	Bottom Quintile	-5%	22.2	56	$419
3	KYPH*	Kyphon Inc	$8	($2)	Bottom Quintile	-1%	20.8	80	$1,482
4	HIH	Highland Hospitality	$4	($4)	Bottom Quintile	-16%	12.7	More than 100	$590
5	CBC	Capital Bancorp Ltd	$9	($19)	Bottom Quintile	-9%	11.8	More than 100	$612
6	LAYN	Layne Christensen Co	$5	($7)	Bottom Quintile	-20%	9.5	93	$388
7	WGII	Washington Group Int'l	$7	($9)	Bottom Quintile	-3%	7.8	36	$1,457
8	FLDR	Flanders Corp	$3	($1)	Bottom Quintile	-1%	7.6	46	$250
9	EMBT	Embarcadero Tech Inc	$2	($0)	Bottom Quintile	1%	5.6	61	$158
10	BDY*	Bradley Pharmaceutical	$0	($0)	Bottom Quintile	-36%	5.4	52	$168
11	TXCO	Exploration Co of Delaware Inc	$11	($18)	Bottom Quintile	-2%	4.7	90	$334
12	SLNK*	Spectralink Corp	$1	($8)	4	-13%	4.5	44	$151
13	CHDN *	Churchill Downs	$68	($1)	Bottom Quintile	3%	4.3	59	$483
14	VMI*	Valmont Ind Inc	$12	($17)	4	-3%	4.2	62	$1,263
15	NHC*	Natl Healthcare Corp	$5	($4)	4	-22%	4.1	28	$553
16	SHEN*	Shenandoah Telecommun Co	$0	($2)	4	-6%	4.1	28	$331
17	MEAS*	Measurement Specialties Inc	$10	($4)	4	-9%	4.0	37	$275
18	B	Barnes Group Inc	$27	($10)	Bottom Quintile	-3%	3.9	32	$792
19	CTS*	CTS Corporation	$2	($0)	Bottom Quintile	-1%	3.8	53	$523
20	KSU	Kansas City Sthrn Ind.	$76	($128)	Bottom Quintile	-33%	-2.5	51	$1,961

* New on the Small Cap Most Dangerous list versus our July 6th, 2006 report.

Sources: New Constructs, LLC

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