

## Most Dangerous Stocks for February 2014

20 Large/Mid Cap and 20 Small Cap Stocks

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- **9 new stocks make our February lists.**
- **FREE Company Valuation Reports for 2 of the new stocks are in the Free Archive on our website.**
- **The Dangerous Stocks (-5.8%) fell more than the S&P 500 (-5.2%) and outperformed as a short portfolio last month.**
- **Figure 1 shows the 23 stocks from January's report that outperformed as shorts.**
- **Most Dangerous Stocks have misleading earnings, which means reported earnings are rising while true economic earnings are declining.**
- **Barron's recently highlighted our stock-picking as amongst the best of all Wall Street firms. See our website for details.**

**Figure 1: 30 Stocks with Negative Returns From January's Report**

Large Cap		Small Cap	
Ticker	Change From 01/08/14	Ticker	Change From 01/08/14
SHLD	-19.9%	ATSG	-20.6%
LKQ	-17.5%	CTHR	-17.9%
RS	-11.7%	KEYW	-15.4%
HBHC	-10.0%	NES	-14.1%
WTS	-9.9%	TCBK	-14.0%
CRS	-9.2%	SMRT	-13.2%
SCHW	-8.5%	HZO	-12.2%
XRAY	-7.8%	TG	-10.0%
CAB	-6.2%	OXM	-9.3%
BIN	-5.3%	RNWK	-8.2%
<b>S&amp;P 500</b>	<b>-5.2%</b>	ABM	-8.0%
KAR	-5.2%	GSBC	-7.7%
AMAT	-3.8%	RUSHA	-5.7%
KEX	-3.5%	<b>S&amp;P 500</b>	<b>-5.2%</b>
JDSU	-3.0%	ALCO	-4.0%
		RATE	-2.5%
		GOV	-2.4%

Sources: New Constructs, LLC,  
Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

**Most Dangerous Stocks: Monthly Updates**

The Dangerous Stocks (-5.8%) fell more than the S&P 500 (-5.2%) and outperformed as a short portfolio last month. 23 stocks from our January Most Dangerous Large Cap and Small Cap lists outperformed the S&P 500 as shorts, and 30 stocks had negative returns. See Figure 2 for details. For updates on the performance of all of last month's Most Dangerous stocks, see Appendix A. We measure our January performance based on closing prices from January 08, 2014 to February 03, 2014. We published last month's report to subscribers on January 08, 2014 and to the general public, for purchase, on January 16, 2014.

**Figure 2: 30 Stocks with Negative Returns From January's Report**

Large Cap			Small Cap		
Ticker	Company Name	Change From 01/08/14	Ticker	Company Name	Change From 01/08/14
SHLD	Sears Holdings Corp	-19.9%	ATSG	Air Transport Services Group	-20.6%
LKQ	LKQ Corporation	-17.5%	CTHR	Charles & Colvard, Ltd.	-17.9%
RS	Reliance Steel & Aluminum Co.	-11.7%	KEYW	KEYW Holding Corp	-15.4%
HBHC	Hancock Holding Company	-10.0%	NES	Nuverra Environmental Solutions	-14.1%
WTS	Watts Water Technologies, Inc.	-9.9%	TCBK	Trico Bancshares	-14.0%
CRS	Carpenter Technology Corp	-9.2%	SMRT	Stein Mart, Inc.	-13.2%
SCHW	The Charles Schwab Corp	-8.5%	HZO	Marinemax Inc.	-12.2%
XRAY	DENTSPLY International, Inc.	-7.8%	TG	Tredegar Corporation	-10.0%
CAB	Cabela's Inc.	-6.2%	OXM	Oxford Industries, Inc.	-9.3%
BIN	Progressive Waste Solutions	-5.3%	RNWK	RealNetworks Inc.	-8.2%
<b>S&amp;P 500</b>	<b>S&amp;P 500</b>	<b>-5.2%</b>	ABM	ABM Industries, Inc.	-8.0%
KAR	KAR Auction Services, Inc.	-5.2%	GSBC	Great Southern Bancorp, Inc.	-7.7%
AMAT	Applied Materials, Inc.	-3.8%	RUSHA	Rush Enterprises, Inc.	-5.7%
KEX	Kirby Corporation	-3.5%	<b>S&amp;P 500</b>	<b>S&amp;P 500</b>	<b>-5.2%</b>
JDSU	JDS Uniphase Corp	-3.0%	ALCO	Alico Inc.	-4.0%
			RATE	Bankrate Inc	-2.5%
			GOV	Government Prop. Income Trust	-2.4%

Sources: New Constructs, LLC,

Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

Figure 3 shows the 9 new stocks that make our February Most Dangerous Stocks Report.

**Figure 3: Additions for February**

Large Cap Additions		Small Cap Additions	
Ticker	Company Name	Ticker	Company Name
ASH	Ashland Inc.	CHFN	Charter Financial Corp
CSOD	Cornerstone OnDemand	MGPI	MGP Ingredients, Inc.
LUV	Southwest Airlines Company	PATR	Patriot Transportation Holding, Inc.
SWK	Stanley Black & Decker, Inc.		
URI	United Rentals, Inc.		
WMB	Williams Companies, Inc.		

Sources: New Constructs, LLC

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

Most Dangerous Stocks: Methodology

Stocks make our Most Dangerous list 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. *Free-Cash Flow Yields*<sup>1</sup> that are very low or negative;
  - b. *Price-to-Economic Book Value* (EBV)<sup>2</sup> ratios that are relatively high; and
  - c. *Growth Appreciation Periods*<sup>3</sup> (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’ or ‘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. For the most part, only Very Dangerous stocks qualify for our Most Dangerous Stocks lists.

**Figure 4: New Constructs Risk/Reward Rating for Stocks**

Overall Risk/Reward Rating	Quality of Earnings		Valuation		
	Economic vs Reported EPS	Return on Invested Capital (ROIC)	FCF Yield	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 EP	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

Sources: New Constructs, LLC

<sup>1</sup> 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/Current Enterprise Value.

<sup>2</sup> 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.

<sup>3</sup> 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 Rating System

Our Risk/Reward Rating System 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. See table that follows for details.

<b>Overall Risk/Reward Ranking</b>	<b>The Overall Risk/Reward Ranking provides a final rating based on the equal-weighted average rating of each criterion.</b>
<b>Very Dangerous</b>	FCF Yield is not included in the average.
<b>Dangerous</b>	FCF Yield is not included in the average.
<b>Neutral</b>	All criteria are equal-weighted in the average calculation.
<b>Attractive</b>	All criteria are equal-weighted in the average calculation.
<b>Very Attractive</b>	All criteria are equal-weighted in the average calculation.

<b>Economic vs Reported EPS</b>	<b>Rates stocks based on how their Economic Earnings compare to their Reported Earnings. Values based on Latest Fiscal Year.</b>
<b>Very Dangerous</b>	Negative and declining Economic Earnings despite positive and rising Reported Earnings
<b>Dangerous</b>	Same as above except Reported Earnings are not rising or Reported Earnings are not positive
<b>Neutral</b>	Negative Economic and Reported Earnings
<b>Attractive</b>	Economic Earnings are positive
<b>Very Attractive</b>	Economic Earnings are positive and rising

<b>Return on Invested Capital (ROIC)</b>	<b>Rates stocks based on their ROIC. Values based on Latest Fiscal Year.</b>
<b>Bottom Quintile</b>	Very Dangerous = the bottom 20% of Russell 1000 companies
<b>4th Quintile</b>	Dangerous = the bottom 40% of Russell 1000 companies
<b>3rd Quintile</b>	Neutral = the middle 20% of Russell 1000 companies
<b>2nd Quintile</b>	Attractive = the top 40% of Russell 1000 companies
<b>Top Quintile</b>	Very Attractive = the top 20% of Russell 1000 companies

<b>FCF Yield</b>	<b>Rates stocks based on their Free Cash Flow Yield. Values based on Latest Closing Stock price and Latest Fiscal Year.</b>
<b>&lt;-5%</b>	Very Dangerous = less than or equal to -5%
<b>-5%&lt;-1%</b>	Dangerous = more than -5% but less than or equal to -1%
<b>-1%&lt;3%</b>	Neutral = more than -1% but less than or equal to +3%
<b>3%&lt;10%</b>	Attractive = more than +3% but less than or equal to +10%
<b>&gt;10%</b>	Very Attractive = more than +10%

<b>Price-to-EBV Ratio</b>	<b>Rates stocks based on their Price-to-Economic Book Value Ratio. Values based on Latest Closing Stock price and Latest Fiscal Year.</b>
>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

<b>Growth Appreciation Period (yrs)</b>	<b>Rates stocks based on their Market-Implied Growth Appreciation Period. Values based on Latest Closing Stock price and Default Forecast Scenario.</b>
>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 – Performance of Stocks on January’s Report

Figure 5: Performance of All Stocks from January’s Report

Large Cap			Small Cap		
Ticker	Company Name	Change From 01/08/14	Ticker	Company Name	Change From 01/08/14
SHLD	Sears Holdings Corp	-19.9%	ATSG	Air Transport Services Group	-20.6%
LKQ	LKQ Corporation	-17.5%	CTHR	Charles & Colvard, Ltd.	-17.9%
RS	Reliance Steel & Aluminum Co.	-11.7%	KEYW	KEYW Holding Corp	-15.4%
HBHC	Hancock Holding Company	-10.0%	NES	Nuverra Environmental Solutions	-14.1%
WTS	Watts Water Technologies, Inc.	-9.9%	TCBK	Trico Bancshares	-14.0%
CRS	Carpenter Technology Corp	-9.2%	SMRT	Stein Mart, Inc.	-13.2%
SCHW	The Charles Schwab Corp	-8.5%	HZO	Marinemax Inc.	-12.2%
XRAY	DENTSPLY International, Inc.	-7.8%	TG	Tredegar Corporation	-10.0%
CAB	Cabela's Inc.	-6.2%	OXM	Oxford Industries, Inc.	-9.3%
BIN	Progressive Waste Solutions	-5.3%	RNWK	RealNetworks Inc.	-8.2%
<b>SPX</b>	<b>S&amp;P 500</b>	<b>-5.2%</b>	ABM	ABM Industries, Inc.	-8.0%
KAR	KAR Auction Services, Inc.	-5.2%	GSBC	Great Southern Bancorp, Inc.	-7.7%
AMAT	Applied Materials, Inc.	-3.8%	RUSHA	Rush Enterprises, Inc.	-5.7%
KEX	Kirby Corporation	-3.5%	<b>SPX</b>	<b>S&amp;P 500</b>	<b>-5.2%</b>
JDSU	JDS Uniphase Corp	-3.0%	ALCO	Alico Inc.	-4.0%
PLD	Prologis Inc.	1.3%	RATE	Bankrate Inc	-2.5%
SKT	Tanger Factory Outlet Centers	1.5%	GOV	Government Prop. Income Trust	-2.4%
ATO	Atmos Energy Corp	2.8%	XXIA	Ixia	0.6%
HSP	Hospira Inc.	2.9%	GLOW	Glowpoint Inc.	7.6%
ESRX	Express Scripts, Inc.	4.4%	OBAS	Optibase Ltd.	10.2%
EA	Electronic Arts, Inc.	11.9%	WPP	Wausau Paper Corp	11.8%
<b>Large Cap Portfolio Return</b>		<b>-4.8%</b>	<b>Small Cap Portfolio Return</b>		<b>-6.8%</b>
<b>Combo (Large and Small Cap) Return</b>		<b>-5.8%</b>			

Sources: New Constructs, LLC,

Note: Gain/Decline performance analysis excludes transaction costs, dividends and rebates.

## Appendix B – Additions and Deletions

### Most Dangerous Large/Mid Cap Stocks

#### Deletions:

- RS - Stock price decreased 11.7% since January report.
- HBHC - Stock price decreased 10.0% since January report.
- WTS - Stock price decreased 9.9% since January report.
- CRS - Stock price decreased 9.2% since January report.
- KAR - Stock price decreased 5.2% since January report.
- ATO - Displaced by decrease in rank of other stocks.

#### Additions:

- LUV - Stock price increased 1.2% since January report.
- ASH - Addition by improved rank of other stocks.
- CSOD - Addition by improved rank of other stocks.
- SWK - Addition by improved rank of other stocks.
- WMB - Addition by improved rank of other stocks.
- URI - New filing data on 01/22/14.

**Most Dangerous Small Cap Stocks**

**Deletions:**

- SMRT - Stock price decreased 13.2% since January report.
- ABM - Stock price decreased 8.0% since January report.
- RUSHA - Stock price decreased 5.7% since January report.

**Additions:**

- CHFNI - Addition by improved rank of other stocks.
- MGPI - Addition by improved rank of other stocks.
- PATR - Addition by improved rank of other stocks.

**The 20 Most Dangerous Large/Mid Cap Stocks for February**

We recommend that investors equal-weight holdings in all 20 Large/Mid Cap Most Dangerous Stocks.

**Figure 6: 20 Most Dangerous Large/Mid Cap Stocks for February**

Ticker	Company Name	Misleading Earnings			Expensive Valuation			Market Value (\$mm)
		As of Last Fiscal Year			as of 02/03/14			
		Rising GAAP Earnings (\$mm)	Declining Economic Cash Flows (\$mm)	Low-Ranking ROIC (by Quintile)	Low or Negative Free Cash Flow Yield	High or Negative Price-to-Economic Book Value	Long Market-Implied GAP (years)	
1 CAB	Cabela's Inc.	\$30.89	\$8	4th	-28%	33.6	Greater than 100	\$4,490
2 SKT	Tanger Factory Outlet Centers, Inc.	\$8.49	(\$1)	4th	1%	16.7	Greater than 100	\$3,117
3 LUV*	Southwest Airlines Company	\$246.00	(\$51)	Bottom Quintile	2%	16.2	Greater than 100	\$14,234
4 JDSU	JDS Uniphase Corp	\$112.60	(\$385)	Bottom Quintile	2%	11.5	Greater than 100	\$2,973
5 ESRX	Express Scripts, Inc.	\$37.10	(\$937)	4th	-42%	6.8	Greater than 100	\$59,751
6 EA	Electronic Arts, Inc.	\$22.00	(\$17)	Bottom Quintile	0%	5.7	Greater than 100	\$8,062
7 ASH*	Ashland Inc.	\$657.00	(\$145)	Bottom Quintile	7%	5.2	Greater than 100	\$6,905
8 LKQ	LKQ Corporation	\$50.96	\$5	3rd	-2%	4.6	Greater than 100	\$8,006
9 KEX	Kirby Corporation	\$26.41	\$5	3rd	-7%	4.4	Greater than 100	\$5,321
10 SCHW	The Charles Schwab Corp	\$19.00	(\$62)	4th	-2%	4.2	Greater than 100	\$30,490
11 BIN	Progressive Waste Solutions, Ltd.	\$290.49	(\$77)	Bottom Quintile	-6%	3.8	52	\$2,581
12 HSP	Hospira Inc.	\$53.60	(\$214)	4th	4%	3.3	Greater than 100	\$7,045
13 XRAY	DENTSPLY International, Inc.	\$69.69	(\$49)	4th	6%	2.8	78	\$6,412
14 AMAT	Applied Materials, Inc.	\$147.00	(\$442)	4th	3%	2.8	28	\$20,182
15 SWK*	Stanley Black & Decker, Inc.	\$209.40	(\$1)	4th	7%	2.3	53	\$11,741
16 SHLD	Sears Holdings Corp	\$2,210.00	\$22	Bottom Quintile	10%	-0.3	Greater than 100	\$3,750
17 PLD	Prologis Inc.	\$107.16	(\$673)	Bottom Quintile	-2%	-1.8	Greater than 100	\$19,036
18 CSOD*	Cornerstone OnDemand	\$37.72	(\$10)	Bottom Quintile	-1%	-4.7	Greater than 100	\$2,904
19 URI*	United Rentals, Inc.	\$312.00	(\$184)	4th	3%	-10.4	76	\$6,941
20 WMB*	Williams Companies, Inc.	\$483.00	\$2	4th	-13%	-31.4	Greater than 100	\$26,879

\* Addition to the Large/Mid Cap Most Dangerous list in February

Most Dangerous Stocks are Ranked by Price-to-Economic Book Value in Descending Order

Sources: New Constructs, LLC



**The 20 Most Dangerous Small Cap Stocks for February**

We recommend that investors equal-weight holdings in all 20 Small Cap Most Dangerous Stocks.

**Figure 7: 20 Most Dangerous Small Cap Stocks for February**

Ticker	Company Name	Misleading Earnings			Expensive Valuation			Market Value (\$mm)	
		As of Last Fiscal Year			as of 02/03/14				
		Rising GAAP Earnings (\$mm)	Declining Economic Cash Flows (\$mm)	Low-Ranking ROIC (by Quintile)	Low or Negative Free Cash Flow Yield	High or Negative Price-to-Economic Book Value	Long Market-Implied GAP (years)		
1	CHFN*	Charter Financial Corp	\$1.28	(\$4)	Bottom Quintile	-48%	164.2	Greater than 100	\$242
2	TG	Tredegar Corporation	\$3.40	(\$1)	Bottom Quintile	-1%	20.0	Greater than 100	\$776
3	PATR*	Patriot Transportation Holding, Inc.	\$7.58	(\$1)	Bottom Quintile	0%	10.5	Greater than 100	\$348
4	CTHR	Charles & Colvard, Ltd.	\$2.81	(\$0)	Bottom Quintile	1%	5.9	Greater than 100	\$78
5	XXIA	Ixia	\$21.69	(\$6)	3rd	-27%	4.2	Greater than 100	\$945
6	RATE	Bankrate Inc	\$42.75	(\$26)	Bottom Quintile	1%	3.9	39	\$1,630
7	OXM	Oxford Industries, Inc.	\$1.94	(\$2)	4th	-2%	3.9	Greater than 100	\$1,196
8	ALCO	Alico Inc.	\$1.16	(\$8)	Bottom Quintile	-1%	3.8	Greater than 100	\$267
9	TCBK	Trico Bancshares	\$0.40	(\$4)	4th	0%	3.6	Greater than 100	\$383
10	GSBC	Great Southern Bancorp, Inc.	\$21.84	(\$5)	Bottom Quintile	-6%	3.2	Greater than 100	\$376
11	GOV	Government Prop. Income Trust	\$3.96	(\$1)	Bottom Quintile	-7%	2.8	Greater than 100	\$1,331
12	OBAS	Optibase Ltd.	\$1.82	(\$1)	Bottom Quintile	3%	-0.3	75	\$23
13	NES	Nuverra Environmental Solutions	\$25.53	(\$13)	Bottom Quintile	-104%	-0.5	Greater than 100	\$368
14	MGPI*	MGP Ingredients, Inc.	\$2.74	(\$1)	Bottom Quintile	-22%	-1.8	Greater than 100	\$97
15	RNWK	RealNetworks Inc.	\$71.94	(\$10)	Bottom Quintile	-2%	-1.9	Greater than 100	\$259
16	WPP	Wausau Paper Corp	\$22.37	(\$4)	Bottom Quintile	-6%	-2.3	Greater than 100	\$693
17	GLOW	Glowpoint Inc.	\$0.68	(\$0)	Bottom Quintile	-25%	-2.5	Greater than 100	\$49
18	HZO	Marinemax Inc.	\$13.93	(\$5)	Bottom Quintile	-3%	-3.5	Greater than 100	\$345
19	ATSG	Air Transport Services Group, Inc.	\$17.68	(\$2)	Bottom Quintile	-4%	-4.7	Greater than 100	\$393
20	KEYW	KEYW Holding Corp	\$0.48	(\$3)	Bottom Quintile	-27%	-5.3	Greater than 100	\$549

\* Addition to the Small Cap Most Dangerous list in February

Most Dangerous Stocks are Ranked by Price-to-Economic Book Value in Descending Order

Sources: New Constructs, LLC

## New Constructs® – Profile

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Accounting data is not designed for equity investors, but for debt investors. [Accounting data must be translated into economic earnings](#) to understand the profitability and valuation relevant to equity investors. Respected investors (e.g. Adam Smith, Warren Buffett and Ben Graham) have repeatedly emphasized that accounting results should not be used to value stocks. [Economic earnings](#) are what matter because they are:

1. Based on the complete set of financial information available.
2. Standard for all companies.
3. A more accurate representation of the true underlying cash flows of the business.

### **Additional Information**

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