

20 Overvalued Stocks to Sell Now

When selecting stocks for the Cabot Benjamin Graham Value Letter, we look for: (1) quality companies with strong balance sheets; (2) management teams with sound plans for the future; and (3) undervalued stock prices. We believe that the companies listed below are missing at least one important item on our checklist and should therefore be avoided.

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- [1] **American Woodmark (AMWD)** is the third largest US manufacturer of kitchen cabinets and bathroom vanities. AMWD sells over 60% of its products to Home Depot and Lowe's. In recent years AMWD's sales have increased rapidly because of the homebuilding boom. AMWD's earnings, however, have lagged noticeably. Earnings will likely decline 33% in 2006 because of high overhead costs and unused plant capacity. Avoid AMWD.
- [2] **Amerigroup Corp. (AGP)** is a managed healthcare company that focuses on serving individuals receiving benefits from federal and state programs such as Medicaid, State Children's Health Insurance Program, and FamilyCare. Revenues are increasing by more than 10% per year, but EPS are declining. Management is concentrating on revenue growth without a solid plan to increase earnings. Avoid AGP.
- [3] **Blyth, Inc. (BTH)** designs and markets candles, home décor products, and seasonal decorations. Consumer demand is weak and raw material and freight costs are escalating causing profits to sag. BTG plans to spin off its wholesale division to shareholders. The wholesale division contributes almost 50% of sales. Avoid BTH.
- [4] **Cendant Corp. (CD)** is in the hotel, real estate, and travel business. Brand names include Ramada, Days Inn, Howard Johnson, Avis, and Orbitz. The company is reorganizing by selling low margin businesses that don't align with CD's core business. CD is also acquiring businesses to enhance its operations. The changes are causing revenues and earnings to shrink. We view the future as unclear. Avoid CD.
- [5] **Conmed Corp. (CNMD)** manufactures medical instruments and equipment for doctors and hospitals. Revenue and earnings growth have slowed because of a recent decline in elective surgeries and a rise in material costs. The slower growth trends will likely continue and could be exacerbated by CNMD's cutbacks on spending for research and development. Avoid CNMD.
- [6] **Cott Corp. (COT)** produces carbonated soft drinks and bottled water and sells to grocers and retailers in North America such as Wal-Mart. COT's revenues and earnings are suffering because of operating inefficiencies, higher costs, and the shift by consumers away from soft drinks. The management team is being reorganized and operations are being restructured, but the changes will take time and major costs will be incurred. Avoid COT.
- [7] **Cubic Corp. (CUB)** derives 68% of revenues from defense electronics and 32% of revenues from automatic fare collection systems used on highways. Cost over-runs on new fare collection systems caused earnings to drop to barely break-even last year. The over-runs are expected to continue in 2006, although new defense contracts will help revenues and earnings to recover somewhat. Avoid CUB.
- [8] **Domtar, Inc. (DTC)** based in Canada, produces printing and writing paper and lumber and wood products. Demand for DTC's products is weak and getting worse. Freight and energy costs are escalating and the value of the Canadian dollar is falling. DTC has run deficits in each of the past 3 years and will likely run additional deficits in 2006 and 2007. Management has had to eliminate the dividend to shareholders and is cutting DTC's production and workforce. Avoid DTC.
- [9] **ESCO Technologies (ESE)** produces engineered products and systems for industrial and commercial applications. The company's primary product line includes electric meters and automated meter readers. ESE announced that it will be required to change its accounting procedures, and that the changes will adversely affect EPS from this point forward. Avoid ESE.

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[10] Flagstar Bancorp (FBC) operates 125 banking centers in Michigan, Indiana, and Georgia plus home loan centers in 27 states. Earnings plummeted in 2005 and are likely to decline again in 2006. High short-term interest rates, low long-term interest rates, and high operating expenses are contributing to FBC's woes. The company cut its dividend by 40% recently. Avoid FBC.

[11] Foot Locker (FL) sells athletic footwear and apparel throughout most of the world. The company's European operations have suffered because of weak demand. FL management has failed to keep up with changes in customer demands and marketing efforts have fallen short of the competition. FL has installed new management, but improvements will take time before progress is noticeable. Avoid FL.

[12] Friedman Billings (FBR) is a real estate investment trust (REIT) that provides investment banking, institutional brokerage, and asset management services. FBR's earnings dropped sharply in 2005 due to a difficult interest rate environment and high costs associated with a recent acquisition. FBR slashed its dividend in the most recent quarter. A meaningful earnings recovery is several quarters away. Avoid FBR.

[13] Hutchinson Technologies (HTCH) is the world's leading manufacturer of magnetic hard-disk drives. Sales and earnings have recently slowed because of excess customer inventory and a shift in demand to lower priced disk drives. These problems continue to persist and will likely drag down sales growth and earnings in 2006. Avoid HTCH.

[14] International Rectifier (IRF) makes semiconductor and power conversion devices for computers and electronic applications. A recent shift by customers away from IRF's mix of products and capabilities has caused sales and earnings to fall. Management seems vague concerning plans to improve IRF's product mix. Avoid IRF.

[15] Invacare Corp. (IVC) designs and manufactures wheelchairs, hospital beds, and oxygen equipment for the home and extended care facilities. IVC earnings were down considerably in 2005 because of lower Medicare and Medicaid reimbursements for IVC's products. To make matters worse, Congress is considering further cuts in health care equipment reimbursements that could cause IVC's sales and earnings to fall further. Avoid IVC.

[16] Lone Star Steakhouse (STAR) operates 300 casual dining restaurants throughout most of the US. Weak restaurant sales and higher costs for beef, advertising, and overhead led to sharply lower earnings in 2005. The problems will likely plague the company again in 2006. Avoid STAR.

[17] NBTY, Inc. (NTY) makes and markets a full line of nutritional supplements through wholesale, mail order, and its Vitamin World and Nutrition Warehouse stores. Unexpectedly weak consumer demand has forced the company to lower prices sending profits down sharply in 2005. Recovery will be slow to develop. Avoid NTY.

[18] Nu Skin Enterprises (NUS) sells toiletries and nutritional products throughout the world. NUS sales in Japan are weak because of stiff competition. Japanese sales account for almost 50% of NUS total sales. The company is expanding in China, but it will take a couple of years before significant sales materialize. Meanwhile, earnings were flat in 2005 and will remain flat in 2006. Avoid NUS.

[19] Pier 1 Imports (PIR) is North America's leading retailer of imported furniture, home furnishings, housewares, and bed and bath products. The company sells affordable, quality items that are now readily available through mass merchandisers such as Wal-Mart and Target. PIR management has implemented several new marketing strategies in recent years that have failed, resulting in deficits during the past 3 quarters. We doubt that PIR can solve its problems soon. Avoid PIR.

[20] Take-Two Interactive (TTWO) develops, publishes, and distributes interactive entertainment software games for computers, Playstations, Xboxes, and other leading game machines. Sales and earnings growth have slowed considerably because TTWO has failed to introduce successful new products. We see the slower growth trends continuing in 2006. Avoid TTWO.

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