3D ADVISORS

This 3DAdvisors Report Covers:
✓ **Insider Trading**: Insider Trading Behavior
✓ **Accounting**: Quality of Earnings Issues
✓ **Governance:** Corporate Governance Issues

With Stealthy Moves, CEO Avoids Disclosing Sales
Aeropostale Inc. (NYSE:ARO)

September 10, 2004

Contact: Bob Gabele (954) 779-3974 or bgabele@3DAdvisors.com

Aeropostale, Inc., together with its wholly owned subsidiary, Aeropostale West, Inc., is a mall-based specialty retailer of casual apparel and accessories that target both young women and young men aged 11 to 20 years. The Company provides its customers with a selection of active-oriented, fashion basic merchandise. Aeropostale maintains control over its proprietary brand by designing and sourcing all of its merchandise. The Company's products can be purchased only at its stores or organized sales events at college campuses. During the fiscal year ended January 31, 2004 (fiscal 2003), Aeropostale operated 459 stores in 41 states. The Company plans to open approximately 95 new stores in fiscal 2004.

Summary of 3DAdvisors Findings for ARO

- **Governance:** CEO uses sophisticated techniques to obfuscate stock sales
- **Insider Trading:** Like CEO, other insiders significantly reduce holdings
- **Other:** Despite limited disclosure, some accounting and governance issues

---

Discussion of 3DAdvisors Findings

Nothing quite gets our attention like efforts by key insiders to obfuscate their selling behavior. Consequently, the unusual actions by Aeropostale Chairman and CEO **Julian Geiger** have placed ARO smack in the middle of our radar. Further probing reveals a Company that, in spite of its claims of being in full compliance with Sarbanes-Oxley, sets the standard for brevity in its public disclosures. Case in point: Its two most recent 10-Q filings were just 17 pages in length and provided minimal detail. Such limited disclosure, which we consider noteworthy governance behavior, makes items that have been disclosed that much more important to consider. Indeed, Aeropostale appears to us like it is being run like a private company, very much in the control of key insiders who keep tight reigns on all disclosure. It will be interesting, at the end of 2004, when independent auditors have to present their opinion of the quality of management's compliance with Sarbanes-Oxley. Such independent evaluations could be a source of major embarrassment to a company that chooses to reveal as little as possible to the investment community.

Governance: CEO uses sophisticated techniques to obfuscate stock sales

To the casual observer, it would appear that Geiger sold 400,000 shares (all share amounts adjusted for ARO's 4/26/04 3 for 2 split), in June, at prices between $28 and $29. This transaction, however, gains much significance in light of an earlier transaction that we believe few people have seen: In March, Geiger, in an extremely stealthy fashion, executed a forward sale agreement (with Deutsche Bank) in which he pledged 492,798 shares in exchange for an upfront cash payment of $20.38 per share. Under the terms of the agreement, if ARO shares are below $22.33 each (the market price on the day of the forward contract) on March 26, 2007 (the expiration date of the contract) Geiger will re required to turn the shares over to Deutsche Bank. If the shares are above $22.33 each, Geiger will forfeit the majority of the shares but will be able to keep, pursuant to a formula, enough shares to amount to "up to 20% of the price appreciation between $22.33 and the share price on March 26, 2007."

Geiger's attempts to hide this transaction were effective and are a governance as well as insider trading issue to us. Instead of calling this a "Forward Sale", which it indeed is, the footnote on his Form 4 calls it a "Forward Purchase Contract". But there's more. Most insiders, when disclosing forward sales on their Form 4's include some reference to the transaction on Table 1 (the front) of the filing, to compliment the detail of the forward sale, which usually appears on Table II. Geiger does not do this, leaving Table I blank and burying the transaction in the text on Table II (the derivative section), disguising it in a fashion which most data services would not pick up on. Indeed, you will not find reference to this March transaction in any of the insider data services.

So, in effect, Geiger has effectively monetized 492,798 of his ARO shares then sold another 400,000 in the open market just a few months later. Since the 2002 Proxy, Geiger has managed to **monetize 86% of his actionable holdings**.

But the story does not stop here. It seems that Geiger has been successful in segregating another block of stock from his personal holdings and, in the process, has found a loophole exempting him from reporting the sale of any of those shares. To trace this, one must go back to the prospectus from ARO's IPO back in 2002. That document reveals that, outside of Julian Geiger's personal holdings, the Geiger Family Irrevocable Trust held 6.4% of Aeropostale shares outstanding. The trustee of this trust was not Julian Geiger, but Stephen A. Geiger (relationship unknown as our calls to the Company have yet to be returned). There is no doubt that Stephen Geiger is related, however, since at the time of the initial registration statement it was revealed that the trust's shares were registered in the name of Julian Geiger. After the IPO, however, the Geiger Family Trust shares were no longer included in Julian Geiger's holdings totals, nor did they show up as indirect holdings on any of his subsequent Form 4 filings.

The next reference to these Geiger Family Trust shares appears in the ARO 2003 proxy as the trust held, at the time, 5.3% of Aeropostale shares. It is quite evident, however, that Julian Geiger had no intentions of linking these shares to himself, and the associated filing requirements. We say this because, by the time of the 2004 Proxy, all reference to the Geiger Family Trust disappeared from ARO's public filings. This was accomplished when, in ARO's August 2003 secondary, the Trust sold enough shares to drop its holdings to 4.1%, low enough to be excluded from the Proxy's listing of large beneficial owners unless, of course, the shares could be linked to Geiger. Clearly, Geiger had found a way to de-link himself from these shares.

The one remaining reference to these shares shows up in a 13G filed in February of 2004 by the Geiger Family Irrevocable Trust. This filing showed that the Trust's holdings were down to 3.8% of shares outstanding (2.1 million shares), or about 105,000 shares less than the Trust held at the time of the August secondary. So it would seem that the Trust was successful in selling shares without including them on Julian Geiger's Form 4's. This was, most likely, masterfully accomplished by making the Trust irrevocable, making sure that Julian Geiger was not a beneficiary. Also, by naming a trustee, Stephen Geiger, that does not live in the household of the named insider (Julian Geiger), any transaction by the Trust is considered exempt from Julian Geiger's Section 16 requirements.

This is one of the very few times we have ever seen a large family block of stock disappear from insider disclosure. Making this even more interesting is that, in our 23 years of studying insiders, this is the only time we have ever seen one individual involved in both behaviors (the forward sale and the exemption of the family block). It would appear that Julian Geiger has effectively managed to keep the Geiger Family Trust from having to disclose the sale of any of its shares.

Insider Trading: Like CEO, other insiders significantly reduce their holdings

Making the entire Geiger activity that much more fascinating is the fact that so many other key Aeropostale insiders have been selling as aggressively during the same time period (as we pointed out in our *Insider Research Bulletin* dated August 13). As of this writing, twelve insiders (including Geiger) have unloaded a total of 1.68 million shares, between May 24th and September 7th, at prices ranging from $25.60 to $30.08 each.

Insiders' holdings are truly eroding at the company and in fact the top five named executives have reduced their holdings by an extremely aggressive average of 73% since early 2003.

Table 1. Holdings Reductions of Key ARO Insiders. Source: ARO SEC Filings

Named Executive	2/1/2003	2/1/2004	8/1/2004	Reduction since 2003 Proxy
J. Geiger	2,986,299	1,300,824	408,026	86%
J. Mills	3,465,681	2,200,107	870,621	75%
C. Finazzo	705,615	502,365	272,543	61%
T. Johnson	321,760	172,449	123,699	62%
M. Cunningham	465,706	282,707	95,207	80%

We can't think of another case where we uncovered such large reductions by *all* top company executives over such a short period of time. But there's more to these reductions than meets the eye. Execs have been cashing in a substantial portion of their vested options over the past year, which is significant considering they hold relatively small positions in vested options. Over the next four years, the five named execs have an average of 54,000 options set to vest, which is considerably less than the 1.03 million average of unvested options held by the top five exes at Abercrombie and American Eagle Outfitters (NASDAQ: AEOS).

Table 2. Vested and Unvested options held by Aeropostale Executives as of 8/10/04. Source: ARO SEC Filings

Named Executive	Exercisable	Unexercisable
Julian Geiger	407,876	108,000
John Mills	0	0
Christopher Finazzo	307,043	57,750
Thomas Johnson	9,514	51,750
Michael Cunningham	58,808	51,750

- **Michael Cunningham (46)** – Executive V.P., CFO. Cunningham's activity appears to be rather straightforward pre-arranged selling under a 10b5-1 trading plan (terms undisclosed) which began in late 2003. Since then he has sold 37,500 shares routinely each month, with 75,000 shares being sold on June 9th and July 14th at $28.77 and $30.01. But the selling has dramatically lowered his holdings: since the 2003 Proxy Cunningham has **sold 80% of his holdings**. At this pace, he will burn through all of his vested options in the next month and will drain his entire position by October.

- **John Mills (55)** – former President, Director. Mills was the Company's President and COO until he announced his retirement effective July 2004. Though he is no longer an exec, he still remains active on the board and is the largest inside shareholder, which is why his resignation does not mask the significance of his recent sales. Between June 8th and July 27th Mills sold 650,454 shares, grossing $15.6 million and adding to his year-to-date sales of 1.81 million shares. Over the course of the year Mills exercised *all* of his vested options under a 10b5-1 trading plan, which is very significant considering he doesn't have any unvested options and hasn't been granted any during the past three years. Between January and April Mills had been selling 56,586 shares per month, but increased his volume under the plan in June and continued his pace in July after he either terminated the plan or it expired. Since February, Mills has **sold 60% of his ownership stake**.

- **Laura Moran (54)** – Senior V.P., Director of Human Resources. Moran's recent selling was small compared to her peers, but her trading history is definitely noteworthy. Since taking on her current role in 1998, Moran began selling in

November 2003 and sold 395,709 by February 2004. But what's unusual about the trades is the fact that she didn't touch any of her vested options, instead selling all shares out of her common holdings. Her last sale of that period drained her common holdings, leaving her with only 150 shares. With the exception of unvested restricted shares, Moran's remaining holdings were tied up in a total of 187,479 vested and unvested options. On July 13th she exercised an option series set to expire in 2007 and sold the underlying 56,450 shares at $30. Since the Company hasn't provided vesting schedules for her options it is impossible to compute a holdings reduction.

In addition to the above-mentioned executives, two directors, **Bodil Anderson** and **Mary Burton**, made their first-ever sales and reduced their holdings by 60% and 100%, respectively, while Director **John Howard** sold 200,000 shares on June 9th and 10th, resulting in a 51% reduction since February. An interesting sidebar to all this activity is that another key insider, and major shareholder, **Christopher Finazzo**, held a number of shares in a family trust. Unlike Geiger, however, Finazzo continued to disclose their existence on his Form 4 filings. Interestingly enough, Finazzo had sold all of the shares held by the Finazzo Family Trust by February of this year.

Other: Despite limited disclosure, some noteworthy accounting and governance items

As we mentioned earlier, when a company engages in limited disclosure, the likes of which we see at ARO, one must pay special attention to those details that are revealed. Despite the very limited disclosure, we observed the following accounting and governance items that are worth noting:

- **Stretching amortization for every dollar?** In 2001, Aeropostale changed its amortization schedules for store fixtures and equipment by adjusting their estimated useful lives from 7 years to 10. A similar move was accomplished with Computer Equipment and Software where their estimated useful lives were adjusted, from 3 years, to 5. The Company does not provide estimates for how much it is benefiting from these changes currently. We found this interesting in that certain company peers, such as Abercrombie and Fitch and Chico's FAS, continue to use ranges of useful lives between 2 and 10 years for store fixtures and equipment assets, while ARO chooses a blanket ten-year period for the same.

- **An interesting director shuffle.** An On August 21st of 2003, Aeropostale named **Lance Ford** as a new director last year. Ford, a founding member of the U.S. operations of The Dennis Publishing Group, was awarded, on September 10, 2003 options for 10,000 shares. He seemed firmly in the director's seat. On September 31, however, he resigned from the board "due to a conflict with the policies of my current employer". The reasoning for his departure seemed curious. One would think that any potential conflicts would have been checked into before his taking the position or at least before the granting of options. We are left to wonder why the quick resignation?

- **Restrictive covenants.** ARO makes it a point, in a recent new disclosure, to stress that it hasn't had to use its credit facility since November of 2002. The new disclosure, appearing on its Q2 Form 10-Q, may have been a result of questions relating to concerns about a particularly restrictive covenant that could affect things should the company start needing to use the $25 million facility. The Company is required to keep two times inventory on hand for any outstanding balances under the facility. This seems to reflect the Company's being viewed as a fairly high credit risk.

- **Cash from operations looks somewhat illusory.** Despite Aeropostale's tendency to tout its healthy cash flow from operations and attendant absence of debt, it should be noted that tax benefits from options and regular run-ups of accounts payables at the end of fiscal periods account for large portions of cash from operations in recent periods. These two items accounted for 32% of cash from operations at F/Y end 2003. At the end of Q2, 2004, without the $40.5 million of cash provided from these two items, Net cash from operations would have been negative to the tune of $31.4 million.

- **A tough August?** ARO shares fell about 10% on the day the Company announced August sales numbers, as same store comps came in lower than expectations (6.2% vs. an expected 10% to 11%). We found another disclosure, in the August numbers, to be revealing. In the Q2 conference call, which was held on August 19th, ARO management mentioned, on a number of occasions, how they were "excited that the current fashion cycle has given young men a reason to shop more often." This point was reiterated throughout the call by management. Interestingly though, when the August sales numbers were released, a ***decrease*** in men's apparel was evident, quite in contrast to what was implied in the earlier conference call.

- **John Mills' sudden retirement.** The July 31 retirement of President and COO John Mills, age 55, was never really announced but was disclosed in an April 7th 8-K filing titled "Aeropostale Announces Executive Promotions". Whether the retirement of long-time insider and large Company shareholder Mills was caused by some shakeup or disagreement is unclear. What is clear, however, is that his "early retirement" (as the company puts it) triggered a $2.4 retirement plan contribution in August of 2004.

- **The proposal to adopt a classified board structure.** Another example of Aeropostale's pattern of trying to run the Company as a private one was the recent proposal, adopted by the board of directors, to amend the Company's Certificate of Incorporation to provide for the classification of the Company's Board of Directors into three classes of directors with staggered terms of office. This type of board structure serves to give the board more inside and less outside control. It was rejected by shareholders by a 3 to 1 margin.