



This 3DAdvisors Report Covers:

- ✓ **Insider Trading:** Insider Trading Behavior
- Accounting:** Quality of Earnings Issues
- Governance:** Corporate Governance Issues

Insider Research Bulletin

January 12, 2005

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

Insider Research Bulletin describes significant insider trading behavior that we have identified at the following companies and is a summary of the first step in our research process. The next step is that these same companies will undergo a review of accounting and governance behavior, and if we identify indicative behavior in one or both areas, then a "full 3DA research report" will be published on that company. Note: Inclusion of a company in this report by itself does not necessarily mean a full research report will be published.

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Companies in this Bulletin

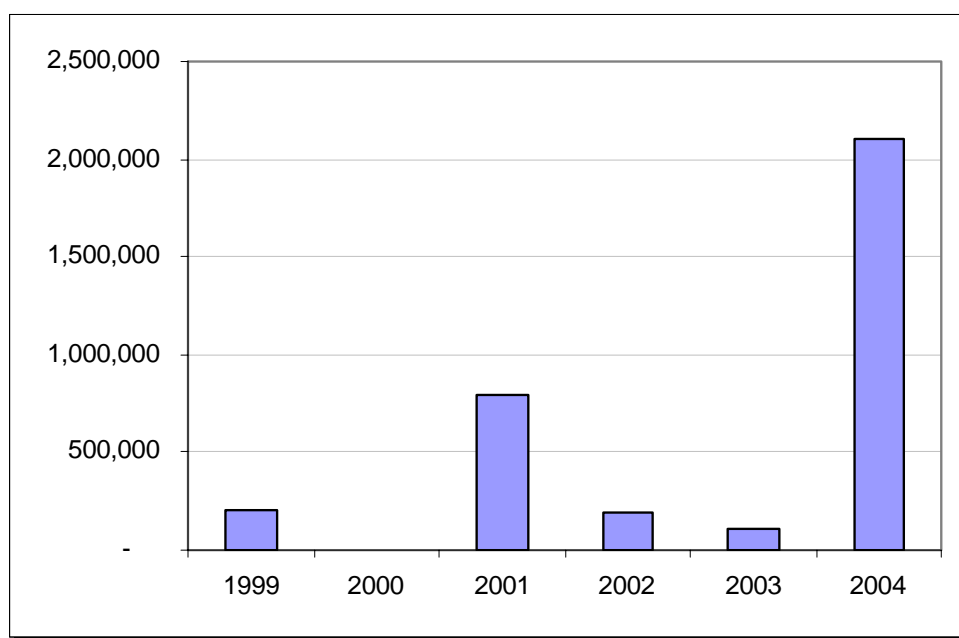
- ▶ Bebe Stores, Inc. (NASDAQ: BEBE)
- ▶ Comcast Corp. (NASDAQ: CMCSK)
- ▶ Western Digital Corp. (NYSE: WDC)

Discussion of 3DAdvisors Findings

Bebe Stores, Inc. (NASDAQ: BEBE)

We've been closely monitoring Bebe Stores, whose shares have raced ahead of not only itself, but the rest of the retail industry as well. After doubling since September, the issue now carries one of the highest P/Es in the industry, while it underperforms the industry average in both ROI and ROE. Though Bebe Stores continues to return value to its shareholders, one can not ignore the signals sent by Company insiders through their recent heavy distributions. From November 8th through December 16th ten insiders sold 843,206 shares (adjusted for a 3 for 2 split on December 30th) between the prices of \$24.08 and \$26.75. This is anything but normal profit taking for this management team and shouldn't be overlooked as such. Insiders sold more stock in a four week period than they had combined since the Company went public back in 1998. They've also significantly drained their actionable holdings in the process.

Figure 1. Shares Sold by Bebe Insiders, 1999 – 2004. Source: BEBE SEC Filings.



Founder and Chairman **Manny Mashouf** surfaced for the first time (along with his wife who he holds shares jointly with), while key execs such as CFO **Walter Parks** and V.P., Store Construction and Loss Prevention **M. Ferrell Ostrow** made their largest sales to date, unloading nearly their entire ownership position.

There's more to this story than just the selling, however, and we're talking about board structure. In the entire domestic Company universe, there are only thirty-nine companies with a market cap over \$1.5 billion that are deemed "controlled" companies as described in Rule 4350(c)(5) of the listing standards of the NASD and Section 303(A) of the NYSE Listed Company Manual. Controlled companies, which are defined as an issuer of which more than 50% of the voting power is held by an individual, group, or company, are exempt from certain listing standards issued under Sarbanes-Oxley, including the requirement that the majority of directors are independent and that the compensation and nominating committees are comprised solely of independent directors. Even so, out of the thirty-nine companies, Bebe Stores is only one of two that fails to meet board independence standards.

The heavy insider selling and the apparent lack of independent oversight by the Company's board combine to make an interesting picture. Not only has this board failed to meet independence standards met by nearly all other publicly traded companies, but through August 2004 both the Compensation and Nominating Committees included an "interested" director, which though it doesn't violate SEC requirements, is the first such instance of this that we have encountered in quite a while.

It is also interesting that, in this era that seems to value the alignment of insiders' fates with those of shareholders, there is an evident lack of effort on the board's part to require executives or directors to own shares of Company stock. Over the past seven years, not one director has purchased any shares on the open market, and we can't

pinpoint more than one instance of a board member that exercised their options and held even a portion of the shares. The table below shows the common stock holdings of each of the seven board members.

Table 1. Common Stock Holdings of BEBE Directors. Source: BEBE SEC Filings.

| Board Member | Joined Board | Common Stock Held (12/31/04) |
|------------------|--------------|------------------------------|
| Barbara Bass | 1997 | 30,000 |
| Cynthia Cohen | 2003 | 0 |
| Corrado Federico | 1996 | 0 |
| Manny Mashouf* | 1976 | 45,519,682 |
| Neda Mashouf* | 1985 | 45,519,682 |
| Gregory Scott | 2004 | 0 |
| Caden Wang | 2003 | 0 |

* Manny and Neda Mashouf hold their shares jointly.

But the directors themselves aren't the only ones who have failed to build a vested interest in the Company. Bebe's top executives have their entire positions tied up in stock options, a majority of which were recently monetized. In fact, Ostrow and VP, Human Resources **Michelle Perna** have each managed to sell nearly all of their holdings since late 2003, which at the time amounted to sizeable positions. Each of the four named execs below carry very few vested options, if any, and will not have many options vest until the third and fourth quarters of 2005. In fact, after selling 278,647 and 91,611 shares in 2004, Ostrow and Perna will only have 46,000 and 15,000 options vest in 2005, respectively, which will hardly be enough to replenish their holdings after the 2004 sell-off.

Table 2. Common Stock Holdings of Key Bebe Insiders. Source: BEBE SEC Filings.

| Named Executive | 9/1/02 | 8/31/03 | 8/31/04 | 1/5/05 |
|-------------------|---------|---------|---------|--------|
| Gregory Scott* | -- | -- | -- | 0 |
| Walter Parks** | -- | -- | 0 | 31 |
| M. Ferrell Ostrow | 256,801 | 323,997 | 127,791 | 0 |
| Michelle Perna | 122,598 | 147,903 | 46,017 | 13,113 |

* Gregory Scott was appointed chief executive in February 2004.

** Walter Parks filed as a Section 16 insider in December 2003.

- **Walter Parks (45)** – CFO. Since coming over from Wet Seal (NASDAQ: WTSLA) at the end of 2003, Parks was granted one series of options set to vest in December 2004. Instead of building up an ownership position as many new executives choose to do, Parks has done just the opposite. Between December 8th and December 10th he exercised nearly all of his newly-vested options (expiration date: December, 2013) and sold the underlying 67,469 shares at \$26. The transaction **wiped out his entire actionable position** (exercisable options and common stock), leaving him with just 31 vested options and no common stock. Parks will not have any new options vest until December 2005 (see Appendix), leaving us to question why he has failed to accumulate any shares during the first two years of his employment, that is unless he decides to change his behavior and buy stock out of his own pocket.

- **Corrado Federico (63)** – Director. Though Federico has been on Bebe's board since 1996, he has never acquired Company shares, either through open-market purchases or options acquisitions. Instead, he sold a total of 101,250 shares in 2001, which were his only sales dating back to the 1998 offering. His behavior became more aggressive in 2004, as he sold 30,000 shares in June at \$13, and then followed that up with his largest round of sales on record, selling a total of 157,500 shares between November 8th and December 16th at roughly \$25. The sales **liquidated 46% of his holdings**, which is made even more significant since the Company failed to grant its incumbent non-employee directors options in 2003. Should he continue to sell at this pace, Federico will burn through his remaining 191,000 vested options in short order.

- **M. Ferrell Ostrow (45)** – V.P., Store Construction and Loss Prevention. Add Ostrow to the list of Bebe executives and directors that choose not to hold shares in the Company. Though he did purchase 16,875 shares in March 2003, he immediately sold those shares in September 2003, following the lapse of the Section 16 six-month trading prohibition, netting a quick double on his investment. Since that time, he has shown a penchant for monetizing his options immediately upon vesting, leaving himself with few vested options and no common shares. Most recently, Ostrow exercised seven series of non-expiring options (expiration dates: 5/09, 8/10, 7/11, 2/12, 7/12, 4/13, 8/14) and then sold all of the newly-acquired 129,041 shares, equal to **90% of his ownership position**. Throughout 2005, Ostrow will gain access to 46,593 newly-vested options (see Appendix).

- **Manny Mashouf (66)** – Founder, Chairman and **Neda Mashouf (41)** – Vice Chairman. Considering the Mashoufs hold over 45 million shares jointly, any type of share distribution could be easily ignored. However, the couple surprisingly had never sold any shares since the 1998 public offering until this year. They executed their first-ever sale of 10,013 shares in March 2004 at \$14 and have since sold a total 1,211,814 shares, including the 241,806 shares sold between November 11th and December 10th at an average price of \$25.50. A majority of the shares sold during the year were distributed from September on, which is when the issue broke above the five-year high of \$15.

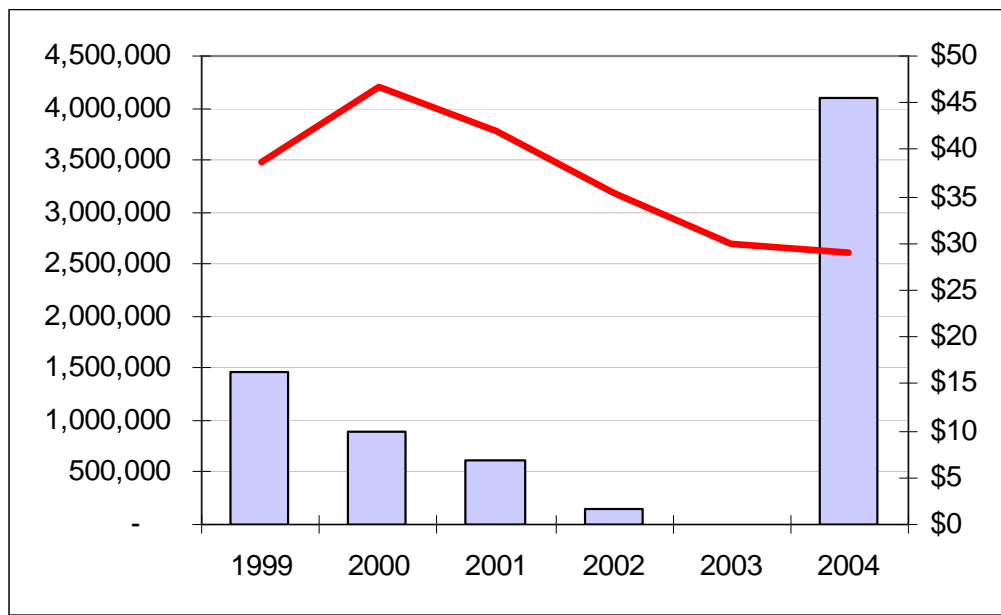
In addition to the above mentioned, there are two sellers we also wish to highlight: V.P., Human Resources **Michelle Perna (51)** exercised four series of options set to vest between November 2010 and December 2013 en route to selling 31,767 shares on November 8th. Perna sold a total of 91,611 shares throughout 2004, equal to

87% of her holdings, after only selling 27,070 shares between 2000, when she registered as a Section 16 insider, and 2003. Also selling was Director **Barbara Bass (53)**, who executed her largest-ever sale since the Company's 1998 offering. Bass sold a total of 97,500 shares on November 8th and November 11th, **reducing her holdings by 30%.**

Comcast Corp. (NASDAQ: CMCSK)

Though as a group they hold over 41 million shares of Comcast stock and average 2.44 million shares a piece, Comcast's executives and directors listed in the 2004 Proxy have been very quiet over the past couple years. The stock has hardly been on most analysts' "hot lists" as concerns over subscriber growth and increasing competition from telephone and satellite companies have kept the shares trading in a long downtrend since peaking at \$55 in early 2000. But from the look of a recent round of insider profit-taking, you would think that the issue has had a healthy upside run, which of course it hasn't.

Figure 2. Shares Sold by Comcast Insiders (left scale and blue bars) and Average Price of Sales (right scale and red line). Source: CMCSK SEC Filings



Insiders seemed quick to sell into the year-end rally that took Comcast shares to the \$33 level but still off their highs of earlier in the year. The convergence is interesting to us as eight sold a total of 2,288,808 shares from November 11th through January 10th at an average price of \$30. First of all, selling has been rare at Comcast these past few years. Then there's the fact that this was the largest round of sales in the past seven years, and by a considerable margin. Adding to the story, the sales occurred at the lowest prices insiders have accepted for their shares during that seven-year period. It's a fact that insiders have been willing to part with shares at decreasing prices since 2000, but have never sold at the magnitude, and with the attendant holdings reductions, that

we're seeing now. All of this becomes even more magnified when one considers that this rare convergence of activity occurred in the months prior to Comcast's unveiling of its strategic plan to aggressively enter into the phone business, a plan, cited by CEO **Brian Roberts**, expected to generate \$3.8 billion in revenues by 2010 and provide Comcast's reply to the increasing competitive pressures coming from both telephone and satellite companies. Needless to say, the timing of these recent sales has us intrigued.

The sales were predominantly executed by Comcast's highest-ranking executives, including those by Executive V.P., COO **Stephen Burke**, who sold for the first time since coming over from Disney back in 1998. Burke shed nearly 40% of his holdings with his transaction, while co-chief financial officers **John Alchin** and **Lawrence Smith**, who have been with the Company for over fifteen years, each made their largest-ever sales.

This might not come as new information, but Comcast has been scrutinized by corporate governance watchdogs, and for good reason. There's a laundry list of governance issues, many of which blatantly violate SEC and NASD requirements. Our strategic partner, Governance Metrics International (GMI), gives Comcast one of the lowest ratings we've seen, red-flagging two key areas, Board Accountability and Market for Control.

First and foremost, Comcast's board fails to meet a number of NASDAQ listing standards, such as board independence. Of the twelve current board members, Comcast deems eight of them to be independent. However, when we apply the NASD independence criteria, we find that only five of the twelve don't have any material relationship to the Company, well below the compulsory majority. Here are a few examples of directors the Company alleges are independent, but are far from it:

- ➡ **S. Decker Anstrom:** Anstrom is the president and chief operating officer of the Weather Channel's parent company, Landmark Communications, Inc. Comcast paid the Weather Channel nearly \$20 million in programming fees in 2003 to carry their products.
- ➡ **Julian Brodsky:** Brodsky's daughter is employed by Comcast and receives an annual salary and bonus of \$130,000. *(NASD rules state that any director who has a family member that receives in excess of \$60,000 during the current fiscal year is not independent.)*
- ➡ **J. Michael Cook:** Cook, who is the chairman of the Audit Committee, was the chairman and chief executive of Deloitte & Touche until 2001. Deloitte & Touche has been Comcast's independent auditor for over three years.
- ➡ **C. Michael Armstrong:** Through mid 2004, Armstrong had been Comcast's non-executive chairman and received 2003 compensation in excess of \$9 million.

Comcast is a perfect example of a company being run by the insiders. It is fairly obvious that Chairman, CEO **Brian Roberts**, a seller in the recent round, has had complete control of the Company. Roberts is the only holder of Class B shares, which carry 20 votes for each share (Class A stock only has 0.20 votes while Class A Special

shares, which constitutes most of the shares held by executives and directors, doesn't carry voting rights) and holds 33% of the voting stock. Not to mention, until the 2004 shareholder's meeting, Roberts was the chairman of the Governance and Directors Nominating Committee and had the final decision on director nominations. Again, in direct violation of NASD rules which states that a nominations committee be comprised solely of independent directors.

It leaves little to the imagination why Roberts is the third highest compensated chief executive in the media industry. And for that matter, why Comcast's executives are some of the highest paid amongst their peers. The Company currently offers cash bonuses under two separate plans (2002 Executive Cash Bonus Plan and 2002 Supplemental Cash Bonus Plan), which combined allow for awards up to 300% of an executive's base salary. The awards have become so large that just nine months after the board approved the Restricted Stock Plan in May 2003, it was amended to increase the number of authorized shares by 50%. In 2004, the Compensation Committee began utilizing restricted stock grants, which were now supposed to replace 25% of the total equity award mix. As you can see from the table below, option grants in 2004 were down by an average of only 17%, which allowed for an increase in total equity compensation.

Table 3. Equity Awards for Comcast Named Executives. Source: CMCSK SEC Filings.

| Named Executive | Options / Restricted Stock 2002 | Options / Restricted Stock 2003 | Options / Restricted Stock 2004 |
|------------------------|--|--|--|
| Brian Roberts | 750,000 / 0 | 950,100 / 0 | 800,000 / 110,000 |
| Ralph Roberts | 600,000 / 0 | 650,100 / 0 | 500,000 / 423,346 |
| Stephen Burke | 1,200,000 / 0 | 500,100 / 0 | 400,000 / 300,000 |
| Lawrence Smith | 420,000 / 0 | 450,100 / 0 | 375,000 / 50,000 |
| David Cohen | 610,100 / 20,000 | 400,100 / 0 | 375,000 / 100,000 |
| John Alchin | 310,000 / 0 | 400,100 / 0 | 325,000 / 45,000 |

Finally, we should point out that both the board structure and executive compensation have already triggered a few shareholder actions. Two proposals were submitted to the board to be voted on at the 2004 shareholder's meeting. One proposed that Comcast's board be comprised of two-thirds independent directors, and requested a change to the Company's independence criteria. The other was a proposal on executive compensation, basically asking that it be brought down closer to the mean compensation of management teams at peer companies. Both proposals were voted against by a substantial margin, which isn't surprising considering Brian Roberts' strangle hold on the voting stock.

This convergence of insider selling has one more extremely curious element to it. Virtually all of the selling occurred in the last two months of 2004. One would think, or at least their tax planners would, that these individuals would have waited until the New Year (and after the Company was to reveal its long-term strategic plans) before cashing

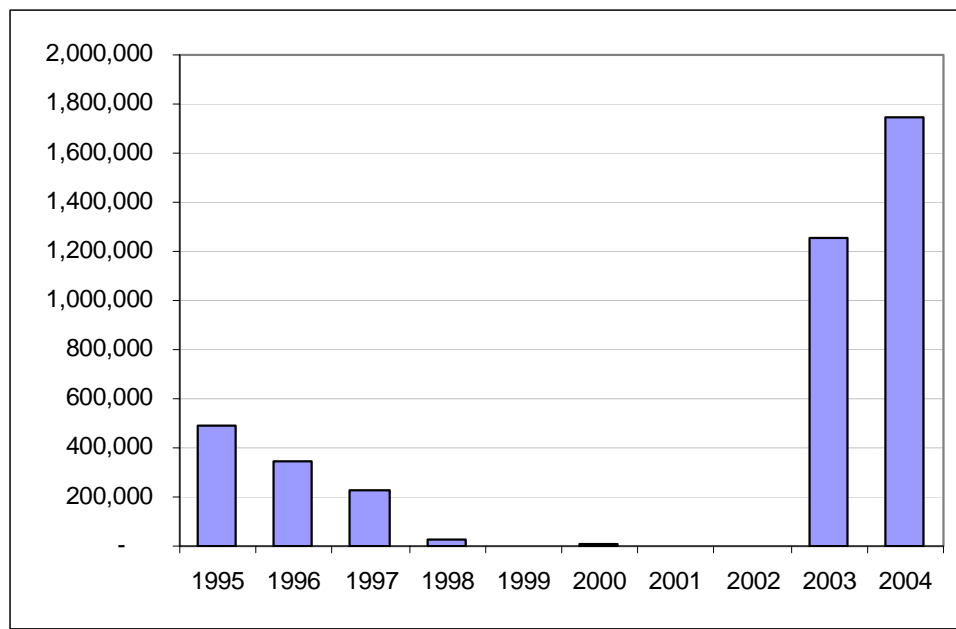
out the way they have. After all, if the new plans were expected to generate real interest, shouldn't they expect to see some premium creeping back into their share values?

- **Stephen Burke (45)** – Executive V.P., COO and President, COO, Comcast Cable. If you're looking for sentiment from a top executive that doesn't have the same amount of shares to play with as Roberts, look no further than the recent transaction of Burke, Comcast's second in command. Burke is the lone executive who hasn't ever sold during his seven-year tenure. Over the years he has accumulated a significant ownership position through the vesting of stock options. Apparently, Burke sensed it was time to finally begin diversifying his holdings, as he acquired 1.1 million shares from the combination of one option with a June 2008 expiration date and restricted shares. He then sold 941,808 shares from December 9th to January 3rd between \$30 and \$33, grossing \$28.7 million. Despite holding a small portion of the acquired shares, Burke's selling actually **shed nearly 40% of his holdings**. Following the activity, Burke holds 60,000 shares of common stock and 1.5 million vested options.
- **John Alchin (55)** – Executive V.P., Co-CFO. Not only did Alchin recently execute his largest sale on record, but did so at prices we haven't seen him sell at since 1998. On December 9th and December 10th Alchin exercised two options, one of which was expiring in January but accounted for only 4% of the total of options he exercised, the other was set to expire in July 2005. He then sold 318,003 of the 397,195 shares he acquired at \$30. Though he did acquire shares in the transaction, the sale ended up dropping his actionable position (vested options plus common stock) by 20%.
- **Lawrence Smith (56)** – Executive V.P., Co-CFO. Smith has been the most infrequent seller of the group, only having executed three sales between 1995 and most of 2004, including his last sale of 200,000 shares in January 2001 at \$42. But after nearly four years of sitting on the sidelines, Smith exercised two series of options set to expire in January 2005 and July 2005 and acquired 263,332 shares. The expiring options only amounted to 13,332 shares, which were a small fraction of the total and shouldn't cloud the bigger picture here. Smith then sold all the acquired shares and more (273,723 shares) between December 9th and January 10th at a weighted average price of \$31.21. Though the sale only reduced his holdings by less than 20%, it still augments the total insider movement over the past two months. Following the sale, Smith holds 125,000 shares of common stock and over 1 million vested options.
- **Brian Roberts (44)** – Chairman, CEO, President. Despite owning 33% of the Company's voting stock, Roberts has been stingy with his shares over the past ten years. With the exception of a 10.6 million-share sale in June 1998, Roberts had only sold a total of 775,000 shares since 1995. And his sales have been few and far between. Prior to 2004, his last sale of 56,537 shares was executed in March 2001 as the issue was trading in the mid \$40s. Recently though, Roberts surfaced with his second largest sale, dumping 734,071 shares on November 11th and November 12th at \$29, grossing \$21.4 million. The sale stemmed from the exercise of one option series set to expire in July 2005.

Western Digital Corp. (NYSE: WDC)

After months of voicing their concerns about the industry outlook, management teams within the computer storage/hard drive industry have been sending signals that they have worked through most of the issues. Executives at industry leaders Western Digital and Seagate Technology (NYSE: STX) have voiced new optimism regarding the pricing environment and customer demand, this after the doom and gloom that resonated from each company in November. But we've always followed the mantra that insiders' actions speak louder than words. Just one day after Western Digital filed a special report with the SEC raising its December quarter earnings expectations, and the ensuing 10% boost the stock received on the news, WDC insiders held their largest round of selling in the Company's history, as five insiders sold 1,743,354 shares from December 2nd through December 31st between the prices of \$10.20 and \$10.92. We acknowledge that, at just \$10 per share, WDC shares are not a likely short candidate. In spite of this we choose to highlight the insider picture here in case any of our clients have or are considering a long position.

Figure 3. Shares Sold by WDC Insiders. Source: WDC SEC Filings.



The insider picture at WDC is hardly a decisive endorsement of the Company's rosy forecast. After all the industry uncertainty that existed nearly two months ago, this recent turn of events seemed too good to be true. The Company's top execs, which had been very vague on the first quarter conference call and refused to give any EPS projections for the current quarter, are the same execs that led the recent selling. Chairman, CEO **Matthew Massengill** and President, COO **Arif Shakeel** executed their largest-ever sales, trimming their holdings by 42% and 56%, respectively. But in another example of saying one thing and doing another, since the first quarter of fiscal 2005 the Company has been buying back stock for the first time since 1998, which Massengill attributed to the issue trading at "reasonable prices". Investors should be on alert that

these execs believe repurchasing stock is a good use of the Company's capital, but they themselves find it an opportune time to diversify their holdings.

- **Matthew Massengill (43)** – Chairman, CEO. Since initially filing as a Section 16 insider back in 1999, Massengill's only prior selling came in April and May 2003, when he distributed a total of 323,000 shares between \$9 and \$11. Since that time, the issue has bounced between \$7 and \$14, but once the stock rebounded back to \$10 from the October 2004 lows, he surfaced to cash out, only this time, more aggressively. From December 2nd through December 15th Massengill exercised four series of non-expiring options (expiration dates: 1/10, 10/10, 9/11, 9/12) and sold the underlying 959,829 shares for a total of \$10 million. Not only is this his largest selling to date, but he **reduced his holdings by 42%**, considerably more than the 15% reduction triggered by his 2003 sales. Following the sales, Massengill still holds 825,671 vested options and 340,000 shares of common stock.
- **Arif Shakeel (49)** – President, COO, Director. Shakeel executed his largest sale since becoming a registered insider back in 1999. On December 3rd and December 6th, he sold 653,525 shares between \$10.65 and \$10.92, **trimming his holdings by 56%**. The shares were acquired from the exercise of six different series of options which set to expire between July 2009 and September 2012. Prior to this activity, Shakeel had sold 33% of his position in April and May 2003, when he sold just fewer than 500,000 shares at similar prices. After having an actionable position (common stock plus exercisable options) of nearly one million shares in October 2003, Shakeel now owns 10,000 shares of common stock and less than 200,000 vested options.
- **Thomas Pardun (60)** – Director. Pardun cleared out five series of non-expiring options (expiration dates: 11/05 @ \$7.68, 11/05 @ \$8.00, 11/09, 5/10, 11/10) on December 8th, selling the 85,000 shares at \$10.20. Including the sale of 150,000 shares between April and June 2003, Pardun has now **sold 62% of his ownership position** since early 2003. With the exception of 5,000 shares held in a family trust, the remainder of Pardun's holdings is tied up in vested and unvested options.
- **Raymond Bukaty (47)** – Senior V.P., General Counsel, Secretary. Bukaty has been relatively quiet since initially filing as a Section 16 insider back in 2002, only having previously sold 50,000 shares in May 2003. But despite having little to base his trading pattern on, it is evident to us that his recent activity is, most likely, a sign that he feels there is limited upside potential in the stock. From December 8th through January 1st, he sold a total of 76,681 shares at 17% lower prices (roughly \$10.70) than he accepted for his shares in 2003. Not only did he exercise four series of non-expiring options (3/10, 10/10, 3/12, 9/12), but sold an additional 16,681 shares out of his common stock holdings. The selling **shed only 25% from his position**, but this sale accounted for a larger percentage of his holdings than his 2003 selling, which again, occurred at higher prices.

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Appendix

Option Vesting Schedules for selected Bebe Stores, Inc. Insiders

| Grant Date | Options | Price | Date Exercisable | Expiration Date | Remaining Options in Series | Unvested Options in Series | Vesting Dates of Remaining Options |
|--|---------|---------|------------------|-----------------|-----------------------------|----------------------------|---|
| M Ferrell Ostrow, VP, Store Construction and Loss Prevention. Common stock holdings: 0 shares | | | | | | | |
| 07/21/01 | 56,250 | \$13.61 | 07/21/02 | 07/21/11 | 11,569 | 9,844 | Vests 2.5% each month |
| 07/31/02 | 22,500 | \$7.73 | 07/31/02 | 07/31/12 | 14,316 | 5,625 | 07/31/05 |
| 04/14/03 | 112,500 | \$6.24 | 04/14/04 | 04/14/13 | 88,128 | 84,375 | 04/14/05, 04/14/06, 04/14/07 |
| 08/12/04 | 15,000 | \$11.56 | 08/12/05 | 08/12/14 | 15,000 | 15,000 | Vests 20% on 08/12/05 and 08/12/06 and 30% on 08/12/07 and 08/12/08 |
| Walter Parks, CFO. Common stock holdings: 0 shares | | | | | | | |
| 12/08/03 | 337,500 | \$11.45 | 12/08/04 | 12/08/13 | 270,031 | 270,000 | Vests 20% on 12/08/05 and 30% on 12/08/06 and 12/08/07 |
| 12/08/04 | 112,500 | \$26.16 | 12/08/05 | 12/08/14 | 112,500 | 112,500 | Vests 20% on 12/08/05 and 12/08/06 and 30% on 12/08/07 and 12/08/08 |
| Michelle Perna, VP, Human Resources. Common stock holdings: 0 shares | | | | | | | |
| 07/21/01 | 22,500 | \$13.61 | 07/21/02 | 07/21/11 | 5,064 | 3,938 | Vests 2.5% each month |
| 07/31/02 | 11,250 | \$7.73 | 07/31/02 | 07/31/12 | 5,799 | 2,812 | 07/13/05 |
| 12/18/03 | 45,000 | \$7.63 | 12/18/04 | 12/18/13 | 45,000 | 36,000 | Vests 20% on 12/18/05 and 30% on 12/18/06 and 12/18/07 |
| Gregory Scott, CEO. Common stock holdings: 0 shares | | | | | | | |
| 02/17/04 | 750,000 | \$19.42 | 02/17/05 | 02/17/14 | 750,000 | 750,000 | Vests 20% on 12/08/05 and 12/08/06 and 30% on 12/08/07 and 12/08/8 |