




## Research Notes

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*Research Notes* are a brief description of the insider trading, accounting, or governance behaviors that we have been investigating for possible inclusion in standard 3DA reports, and may also include other information of general interest to 3DA subscribers. The  symbol indicates that we have observed management behavior that suggests a bullish sentiment.

### Companies in this Research Notes

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## 3DAdvisors Research Notes

### Beazer Homes USA Inc. (NYSE: BZH)

- Many on the Street have disregarded bearish comments issued in recent months by homebuilder executives concerning market conditions. One such exec, Beazer Homes CEO **Ian McCarthy** (53), emphatically stated on the Company's November 7<sup>th</sup> fiscal 4Q earnings call that, "Despite recent references to signs of a bottoming or even the beginning of a recovery, we have not yet seen any meaningful evidence to suggest that a rebound in the housing market is imminent." If his candid prediction is not enough to make the investor community more cautious, his actions, along with those of his peers, should be all the validation needed.

- Beginning just one week after the Company reported a 44% decline in fiscal 4Q earnings on November 7<sup>th</sup> and carrying through December 5<sup>th</sup>, four insiders sold a total of 235,000 shares at an average price of \$44, **nearly 50% off the 12-month high** (see Figure 1 below).
- McCarthy led all sellers with his 180,000 share sale on November 14<sup>th</sup>, which shed roughly one-fifth of his ownership. Just as significant though were the actions of CFO **James O'Leary** (43), who monetized the majority of his vested options en route to liquidating nearly 65% of his holdings.
- Also selling were two members of the Audit Committee, **Maureen O'Connell** (committee chairperson) and **Laurent Alpert**, who sold 30% and 40% of their holdings, respectively. O'Connell last sold in June 2005 at 18% higher prices, while Alpert recently sold some of his shares for a 15% loss, as he was last a buyer in February and May of 2005 at \$50.

**Figure 1.** BZH Daily Closing Price, 12/01/05 through 12/14/06. Red shaded area is where four insiders sold 235,000 shares. Source: Reuters and BZH SEC Filings.



#### Brocade Communications Systems Inc. (NASDAQ: BRCD)

- Brocade's shares have more than doubled this year on three consecutive quarters of strong earnings and are approaching \$10 for the first time since 2002. The current stock price has opened the door for insiders, who during the past three years have for the most part been unable to profitably monetize their underwater, or close to the money, stock options. Two prominent executives wasted little time clearing out significant amounts of their ownership into the rally.

- CEO, Director **Michael Klayko** (51) tapped into five different options series on November 27<sup>th</sup> that were not scheduled to expire until August 2010 at the earliest. He immediately sold all 1,079,943 exercised for shares plus liquidated nearly all of the common stock held in both a Limited Partnership and separate Trust. In total, he diversified away 1.67 million shares, equal to 67% of his ownership. After owning more than 1 million common shares at the beginning of the year, he now holds just 21,000, excluding those held by his children.
- One day later (November 28<sup>th</sup>), V.P., Worldwide Sales **Ian Whiting** (41) similarly liquidated nearly 70% of his actionable holdings when he exercised options from seven different series, some of which carried strike prices of \$6.54, which he sold at \$8.81. Whiting distributed 339,164 shares under a 10b5-1 trading plan he adopted on the same day – a move most Section 16 attorneys would say puts at risk his safe harbor protection under Rule 10b5-1. As a result of his sales, Whiting no longer owns any common stock.
- We find the timing of these trades to be quite interesting, as two days after Whiting's sales, McData Corp. (NASDAQ: MCDT), which will be acquired by Brocade pending government and shareholder approval, reported widening losses in the third quarter. Brocade's shares were down 5% on the announcement and the issue is yet to recover.
- Brocade is being investigated by the SEC for options backdating, which forced former CEO **Gregory Reyes** to resign in January 2005. Reyes and two other former executives were some of the first to have criminal and civil charges filed against them in the backdating scandal era. The Company had to restate several years of financial results because of irregularities regarding stock-option grant dates and is still being investigated by the SEC and DOJ.

#### Coach Inc. (NYSE: COH)

- We reported anomalous bullish insider behavior at Coach in a 05/26/06 Research Notes report focusing on the 10b5-1 plan *termination* by Chairman, CEO **Lew Frankfort** (60) and complete discontinuation of the relentless selling we had grown accustomed to seeing over the past two years. Shortly after, COH shares bottomed and then staged one of the more impressive rallies in the apparel industry during the second half of the year. Things have changed. Now, recent behaviors suggest investors should be on the lookout for potential downside movement.
- On November 3<sup>rd</sup>, the Company reported CEO Frankfort reversed course, **entering into a new sales plan to sell approximately 682,000 shares between November and February 2007**. We are yet to see him commence the plan distributions, but he had sold all shares reserved in the prior six plans he traded under since 2003.
- Insider open market selling has resumed, with the majority of shares coming out in the fourth quarter. Leading the charge was President, COO **Keith Monda** (60), who sold 600,000 shares throughout October. The pre-tax proceeds of \$22 million were reportedly used to purchase a primary residence and pay the taxes associated with the vesting of restricted stock. In all, five insiders sold a total of 811,000 shares at consecutively higher prices from \$35 to \$42.

- We will continue to monitor this situation, but at the present time, there are not any significant ownership reductions that have resulted from the recent sales.

**Figure 2.** COH Daily Closing Price, 12/01/05 through 12/14/06. Diamonds are the dates CEO Lew Frankfort initiated 10b5-1 trading plans (yellow diamonds) and where he cancelled them (red diamond). Source: Reuters and COH SEC Filings.



#### CROCS Inc. (NASDAQ: CROX)

- At this time, we suspect all insider and business model risks associated with CROCS are well known. With nearly 45% of the float currently shorted, it is evident that interested parties have absorbed most of the information by the media and analysts. However, this has not deterred us from closely monitoring the insider behavior.
- Since the February IPO, insiders have sold 6.3 million shares, equal to 50% of the total owned by executives and directors, including the 1.4 million shares sold in the fourth quarter at an average price of \$42.
- CEO **Ronald Snyder** (49) and Compensation Committee Chairman **Michael Marks** (55) were the most aggressive sellers in the fourth quarter based on volume, with both having sold 50% of their ownership since the IPO. Audit Committee member **Raymond Croghan** (57) was a heavy seller through the first three quarters of the year and following the 80,023 shares sold over the past three weeks, has shed 70% of his total ownership. Finally, V.P., Sales & Marketing **Michael Margolis** (55) executed nine separate sale transactions in November alone, leading to a 70% holdings reduction year-to-date.

- Two additional points of interest: none of the above mentioned will have more than 150,000 options and restricted shares become actionable in 2007, and Company co-founder **George Boedecker**, who resigned earlier in the year, filed an SEC SC 13G on November 13<sup>th</sup> disclosing that he had recently sold 1.21 million shares, equal to 35% of his remaining ownership. He has now sold 50% of his holdings since the IPO.

#### Hewlett-Packard Co. (NYSE: HPQ)

- It was reported in the media last week that HPQ CEO **Mark Hurd** received a letter from Reps. John Dingell (D., Mich.) and Bart Stupak (D., Mich.) asking for an explanation of Hurd's decision on 08/25/06 to cash in 100,000 options for a pre-tax profit of \$1.3M just before the boardroom spying scandal broke at the Company. Hurd has until 12/21/06 to respond. However, the media coverage continues to miss a key aspect of Hurd's trading behavior that we feel is extremely important: Hurd was part of a group of 5 executives who **sold on average 40% of their actionable holdings**, much of the selling just prior to the breaking news on the spying scandal, which is a very noteworthy block of trading under any circumstance. We covered the details in an issue of Research Notes back on 09/19/06.
- Just days before Mr. Hurd returned to the headlines because of questions surrounding the timing of recent trades, it was announced on 12/11/06 that CFO **Robert Wayman** (60) would be stepping down at the end of the year. Wayman, a 37-year veteran, served as interim CEO before Hurd's arrival. In congressional testimony about the spying scandal, former HP Chairwoman **Patricia Dunn** said she had approached then-interim CEO Wayman for advice about how to conduct the investigation, prompting a company representative to issue a statement asserting that Wayman "had no involvement whatsoever" in the scandal. We also note that Wayman was among the sellers just prior to the scandal making headlines, clearing \$1.5M from an option-related sale of 100,000 shares, and subsequently selling an additional 150,000 shares in November.
- All of this has a real déjà vu feeling to us as we had previously followed the behavior of Mark Hurd during his tenure at NCR Corp. Just as at HPQ, Hurd made his mark primarily as a cost-cutter, and was given credit for turning NCR around. But we not only observed some timely trades by Mr. Hurd and his management team just prior to and immediately after his abrupt departure for HPQ, we also observed a marked increase in aggressive accounting behavior under Mr. Hurd and a subsequent deterioration in earnings quality. We covered these behaviors in two reports on 06/02/05 and 09/09/05. Given Mr. Hurd's historical behavior, and the imminent departure of Mr. Wayman, we will be monitoring HPQ for any significant changes in accounting behavior.

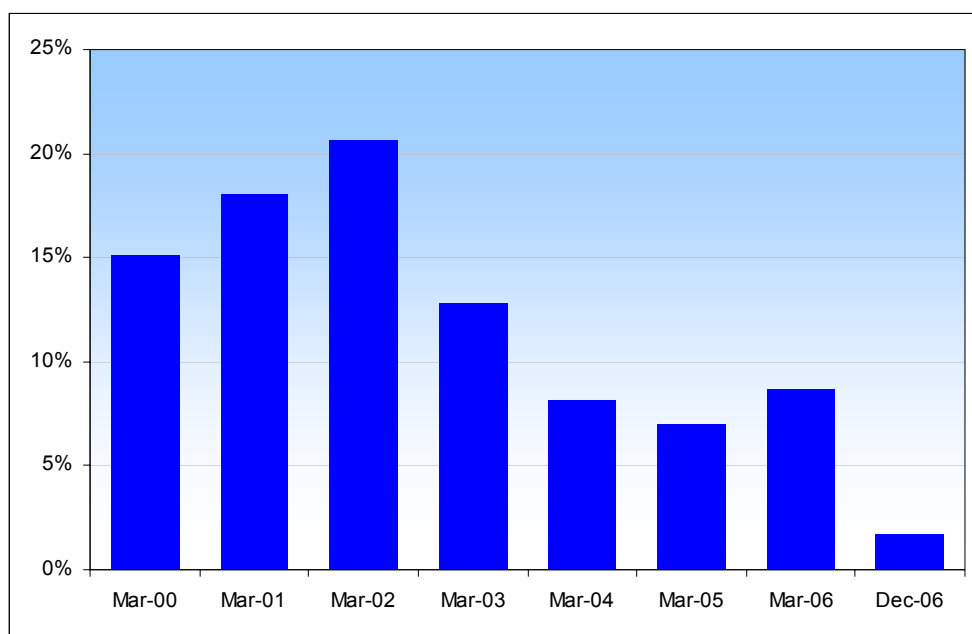
#### Marvel Entertainment Inc. (NYSE: MVL)

- Three of Marvel's four largest inside shareholders entering this year have now liquidated significant percentages of their ownership. In a Research Notes report dated 06/13/06, we reported the sale of 3.1 million shares by departing studio head

**Avi Arad**, and are now seeing further diversification by key insiders who have not given any notice they are leaving.

- Between November 7<sup>th</sup> and November 9<sup>th</sup> Vice Chairman **Peter Cuneo** (62) sold 56% of his ownership, 916,000 shares, on the open market at \$26, while also gifting an additional 60,000 shares to an undisclosed party. The trades netted him pre-tax profits of \$21.8 million. In addition to monetizing 500,000 options, Cuneo divested all of his directly owned common stock, leaving him with 640,000 vested stock options.
- Also selling 50% of his ownership was the Company's third in command, Executive V.P. **David Maisel** (44). Maisel exercised and sold the majority of his vested options just before another batch was scheduled to vest, while also selling roughly one third of his common stock. This was his first sale since joining Marvel in January 2004.
- The total beneficial ownership of executives and directors, excluding CEO **Isaac Perlmutter** who holds 32% of the shares, has fallen from 8.7% in May to 1.7% in December.

**Figure 3.** MVL Beneficial Ownership of Executives and Directors (Excluding CEO Isaac Perlmutter) as a Percentage of Shares Outstanding, 2000-2006. Source: MVL SEC Filings.



#### Monsanto Co. (NYSE: MON)

- Following our recent coverage on Monsanto (Insider Research Bulletin on 12/08/06), in which we highlighted insider distributions covering 358,880 shares following the Company's fiscal 4Q earnings miss, there have been new developments that contradict the bullish sentiment of some sell side analysts.

- Monsanto competitors are making a big push, both internally and externally, to combat the Company's growing market share.
- DuPont announced that it would redirect resources to its seed business in 2007. "We are aggressively adjusting our capital and resource allocation to the highest value growth opportunities for our customers and shareholders," said **Erik Fyrwald**, group vice president, DuPont Agriculture & Nutrition.
- DuPont and Syngenta AG are prodding regulators and cotton farmers to block Monsanto's second attempt at acquiring Delta & Pine Land Co. (NYSE: DLP). The Company has been promoting this acquisition and Monsanto's current valuation figures in the growth expectations associated with the deal.
- It is very telling that insiders at farming industry suppliers such as Monsanto, and now Bunge Ltd. (NYSE:BG), where CEO **Alberto Weisser** adopted a 10b5-1 trading plan on December 12<sup>th</sup>, have become more active at the same time a deep pocket competitor such as DuPont announced its intent to become a major player in the marketplace.

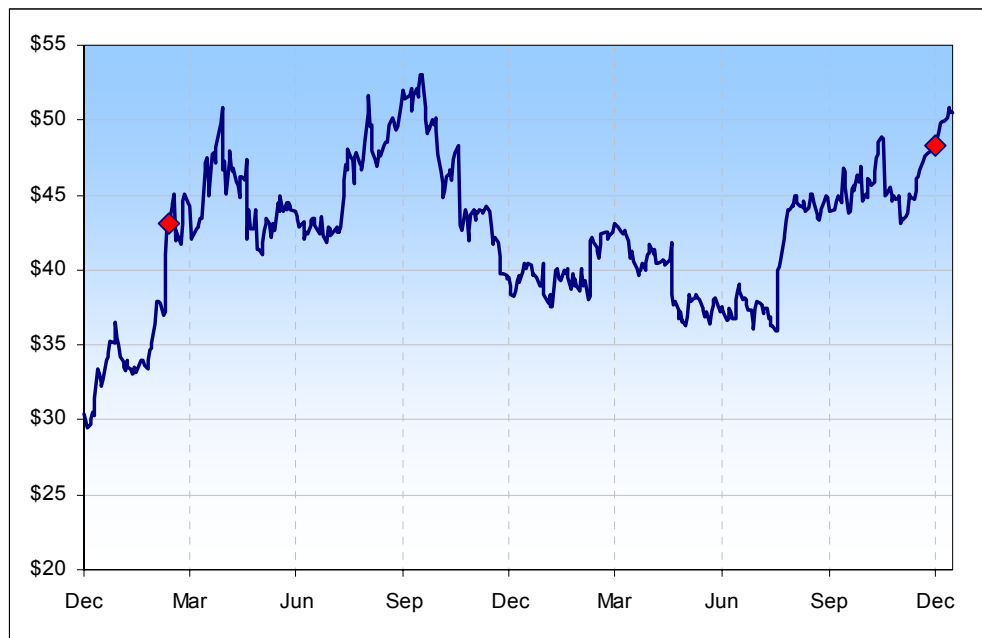
#### Phillips-Van Heusen Corp. (NYSE: PVH)

- PVH insiders have resurfaced for the first time since we covered a number of governance, insider trading, and earnings quality issues in several 3DA reports between February and June, most notably on 03/03/06 and 05/05/06. From November 24<sup>th</sup> through December 6<sup>th</sup>, five insiders sold a total of 75,045 shares at an average price of \$50.
- The selling volume might appear light compared to past activity, but that is a direct result of their low holdings levels due to the 950,000 shares distributed in 4Q05 and 1Q06. The impact of these recent sales on their holdings is significant, to say the least.
- Notable sellers in the recent round include **Tom Murry** (55), president and chief operating officer of the Calvin Klein division that drives PVH's earnings. Murry monetized options not set to expire until 2014 and 2015 in order to sell 60% of his ownership, including common stock he acquired from options back in October. After beneficially owning nearly 150,000 shares and vested options in 2005, the past year of sales, including the 22,110 sold in November, have reduced Vice Chairman-Wholesale Apparel **Kenneth Duane's** (49) ownership by 70% down to 42,030 shares. Finally, CFO **Michael Shaffer** sold 40% of his remaining holdings, which is now comprised of just 7,500 vested options.
- PVH stock options will vest every two months between January and May, so we have some expectations of further profit taking in the near term as the shares continue to establish new highs.

#### USANA Health Sciences Inc. (NASDAQ: USNA)

- USNA shares have been prone to excessive price fluctuations over the past two years and now, with the shares at a 52-week high, certain executives are hedging their positions. In addition to the seven insiders who sold a total of 209,450 shares in the fourth quarter, the heaviest quarterly selling volume since 4Q04, President **David Wentz** (35), son of Company founder and chief executive **Myron Wentz**, took several measures to protect his position.
- After selling just 30,000 shares this year, President Wentz pledged 50,000 shares to an undisclosed third party through a “prepaid variable forward contract” on December 1<sup>st</sup>. This is now his second forward sale agreement since February 2005, and between the two, he has nearly 30% of his ownership under contract to be sold. The component of his recent transaction that stands out most is the discount from market he accepted. After taking a 12.4% discount for his shares under his 2005 forward sale, he recently gave away 30.4% of his stock’s value to close the deal. And there’s more. On December 6<sup>th</sup> he entered into a “zero-premium collar” arrangement pursuant to which he wrote a covered call option and purchased a put option, each covering 50,000 shares. By doing so, he effectively limited his downside risk should the issue fall below \$39.72. So in total, he has effectively hedged 43% of his holdings out to at least March of 2009.

**Figure 4.** USNA Daily Closing Price 12/01/05 through 12/14/06. Red diamonds are the dates that President David Wentz entered into forward sales contracts. Source: Reuters and USNA SEC Filings.



- The insider selling this year has been persistent, and although the individual sales are relatively small, so are their ownership levels. Executive V.P. of Operations **Fred Cooper** (43) shed nearly 75% of his holdings this year, while Executive V.P. of Customer Relations **Mark Wilson** (41) pared his ownership back by 55%. Two



board members, **Jerry McClain** (65) and **Denis Waitley** (72) also sold substantial amounts of their shares, 60% each. McClain holds a seat on both the Audit and Compensation Committees.

- Two analysts downgraded USNA after the Company issued stagnant 3Q earnings on October 18<sup>th</sup> and issued fourth quarter guidance that fell short of the consensus.

#### ValueClick Inc. (NASDAQ: VCLK)

- ValueClick's chairman, president, and chief executive **James Zarley** (61) liquidated nearly the remainder of his actionable holdings on November 30<sup>th</sup>.
- Zarley monetized the remainder of his vested options, comprised solely of a grant awarded to him in 2005 that vests on a monthly basis through July 2009. In addition to selling the 156,250 exercised for shares, he also sold 100,000 shares and gifted another 100,000 out of his common holdings to an undisclosed recipient. He received \$24 a share for his stock, which was a 40% premium to his exit price on the 518,750 shares sold in September.
- After having beneficial ownership of 2.1 million shares and vested options in mid-2004 and 950,000 to start the third quarter this year, Zarley now owns just 101,000 shares of common. It is a rare occurrence when we see a chief executive with sizeable holdings, who is not leaving the company, who clears out 90% of his/her ownership, yet alone, in such a short timeframe.
- In addition to the above mentioned sales, there were a number of additional high-level executives who sold majority stakes of their ownership in November (see Insider Research Bulletin dated 11/21/06). CFO **Scott Ray** (41) monetized all of his ownership, while Chief Accounting Officer **Samuel Paisley** (56) and Chief Technology Officer **Peter Wolfert** (42) liquidated 85% and 75%, respectively, of their holdings.

#### Warren Resources Inc. (NASDAQ: WRES) ↑

- The average investor might look at Warren Resources' recent insider activity and see the recent sales by only two execs covering 12,500 shares, but a closer inspection reveals stealthy bullish behavior that in our opinion outweighs the intimation of the sales. Director **Marshall Miller** (55), whose earlier actions we covered in a Research Notes dated 10/16/06, surfaced once again to aggressively acquire stock by selling put contracts, which is perhaps one of the rarest of bullish insider actions we've highlighted for our clients.
- In addition to acquiring stock through the exercise of options, Miller first wrote 500 short-term puts on a dip in June and the issue quickly rebounded from \$12 to nearly \$15. He would then act again at the first sign of price weakness, writing another 1,018 contracts on September 5<sup>th</sup>. After buying the 50,000 shares from the first set of contracts on November 20<sup>th</sup> at \$12.50, he would **go on to sell 2,000 more contracts, for a total obligation of 200,000 shares, on November 21<sup>st</sup> and December 5<sup>th</sup>**. Most notable about the new contracts, which will expire in May 2007,

is the fact that after writing puts with \$12.50 strike prices earlier, he sold 1,000 of the newer puts with a \$15 strike price, effectively demonstrating his willingness to accumulate shares at a premium.

- Warren Resources shares were clipped on November 13<sup>th</sup> when the Company announced it was increasing 2007 capital expenditures by 32%, prompting one analyst to downgrade the Company from “buy” to “hold”. The issue was down as much as 11% on the day, presenting a buying opportunity for those who have an interest in the name.
- On a final note, we should point out that the average ownership reduction stemming from the sales of five insiders since August is just 15%.

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