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

Insider Research Bulletin

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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.

Insider Research Bulletin is published periodically and exclusively for 3DA Research subscribers.

Companies in this Bulletin

- Career Education Corp. (NASDAQ: CECO)
- Cott Corp. (NYSE: COT)
- PG&E Corp. (NYSE: PCG)
- Sepracor Inc. (NASDAQ: SEPR)

Discussion of 3DAdvisors Findings

Career Education Corp. (NASDAQ: CECO)

During the past few years we've been lulled to sleep by the selling at Career Education. Not only has the stock continued to trend upward for the better part of four-plus years, but three stock splits have augmented insiders' ownership levels, somewhat camouflaging the significance of any selling. Now, however, after years of heavy selling (insiders sold 6.6 million shares between 2000 and 2003) it appears as if the activity has finally caught up with them. Insiders now have smaller holdings of vested options to tap into, and at the current selling pace the holdings reductions are starting to stick out. This was recently evidenced by a round of selling that took place between April 23rd and May 28th when ten execs and directors sold 1,008,400 shares between $62.80 and $68.60. But the story here doesn't revolve around the size of each insider's sale or the past timing of their activity; instead it is the toll these sales are taking on their actionable positions (common stock plus vested options). Three division presidents, **Nick Fluge**, **Jacob Gruver**, and **Todd Steele**, and two directors, **Keith Ogata** and **Thomas Lally** sold between 30% and 96% of their positions. Over the years they have wiped out their options reserves by exercising options immediately upon vesting and long before expiration and selling the underlying shares. It doesn't help that the size of their annual long-term compensation grants has been decreasing year-over-year. For example, Steele was granted 200,000 options in 2001, but only 48,000 in 2002, while Fluge and Gruver received 55,000 fewer options in 2002 than they had the previous year.

- **Nick Fluge (52)** – President, Online Education Group. Between 2001 and 2003 Fluge dumped over 650,000 shares. Like his peers, he has hastily exercised his vested options and sold the shares promptly after the vesting date. This type of behavior would be more acceptable if their annual option grants remained constant, but with the declining grant size, we question their aversion to hold the options longer. Nevertheless, between April 23rd and May 28th Fluge exercised every last option he had access to, which included five different series with expiration dates ranging from May 2010 to May 2019. He immediately sold all 193,000 shares between the prices of $66 and $67.71, resulting in a **96% reduction of his actionable holdings**. There are no reports coming from the Company that Fluge is planning on leaving.

- **Jacob Gruver (49)** – President, College East & West, Universities Division. Gruver, a Section 16 filing insider since 1999, has sold nearly 1 million shares since 2001. As mentioned above, this doesn't bode well considering his options are drying up. In fact, from April 23rd through May 20th he exercised nearly all of his vested options and sold the 225,000 shares he received, grossing $14.5 million. Not only did he wipe out his vested options position, but also **trimmed his total actionable holdings by 79%**.

- **Todd Steele (41)** – President, International and Startup Divisions. Like Gruver, Steele joined the Company in 1999. Only Steele has been a much more subdued seller. The only time he surfaced was between May and September 2003, when on three separate dates he sold a combined 262,246 shares as the stock climbed from $30 to $47. Those sales took a toll on his holdings, but not as much as the 150,000-share sale he executed on April 23rd, grossing $10.1 million. This sale **wiped out 46% of his actionable position**. Steele has a more substantial amount of vested options than Gruver, but if he continues to sell at this pace he too will drain his option reserves.

- **Keith Ogata (49)** – Director. On May 4th and May 5th Ogata exercised half of his vested options and sold the underlying 42,000 shares between $67.36 and $68.60. This was his first sale since August 2001 when he sold 72,000 shares in the $40s. The recent sale **dropped his actionable holdings by 35%**. Career Education's outside directors are granted 24,000 options annually, which vest over two years.

<u>Cott Corp. (NYSE: COT)</u>

On May 20th, Cott Corp.'s largest shareholder, Thomas H. Lee Partners, distributed nearly 6 million shares to its limited and general partners. The transaction cut THL's ownership stake in half. The 34% share of the Company they owned just three years ago is now less than 10%. Yet, we're more intrigued with the mounting dispositions by Cott insiders over the past few months. In all, twelve insiders have now sold 798,639 shares between February 2nd and May 14th at prices ranging from $27.53 to $32.47. We've grown accustomed to seeing insiders selling Cott, as they should be considering the stock's momentum over the past few years. However, as we highlighted with Career Education above, the aggressive sales have begun to take their toll on the ownership levels of numerous high-ranking insiders. Led by Chairman and CEO **Frank Weise**, between 2001 and 2003 insiders sold over 3.5 million shares, which is especially significant when you consider that executives and directors beneficially owned a total of 3.37 million shares three years ago. Weise's intense selling over the past few years has drained his holdings despite having received pretty generous option grants (500,000 options in 2001 and 200,000 options in both 2002 and 2003). But his behavior is negligible compared to the conduct demonstrated by others on his team. President, Cott Beverages USA **Paul Richardson**, Executive V.P. **Mark Benadiba** and two veteran directors sold on average 72% of their actionable positions (common stock plus all exercisable options). Director **Colin Adair's** sale actually leaves him below the mandatory ownership guidelines established by the Company for board members.

- **Frank Weise (59)** – Chairman, CEO. Weiss joined the Company in 1998 as President and CEO. As recently as 2001 he had an ownership position in excess of 1.7 million shares. This changed between 2001 and 2003 as he sold off, after acquiring additional shares by exercising options, a total of 2.19 million shares, including one million shares last year. His aggressive behavior has led to the attenuation of his holdings, which were yet again decreased between February 2nd and May 5th when he sold 310,000 shares between $28 and $31.54. Included in the sale were 150,000 shares he acquired from the exercise of options that weren't set to expire until July 2008, with the remainder being sold out of his common stock holdings. The activity **reduced his actionable position by 31%**, leaving him with less than 600,000 shares. While this might appear to be a sizeable stake, the fact that he has shed 65% of his holdings over the past few years suggests that more than simple profit taking is driving his behavior.

- **Paul Richardson (47)** – Executive V.P.; President, Cott Beverages USA. Richardson, one of the Company's top execs, apparently has little desire to hold Cott stock. Between March 5th and May 14th he held his largest round of sales since filing as a Section 16 insider back in 1999. In all, he dumped 197,362 shares from $29.43 to $31.77, grossing $5.6 million. Like Weise, he sold shares out of his common stock position in addition to the shares he acquired from the exercise of four series of non-expiring options (expiration dates: 7/07, 12/07, 7/08, and 5/09). There is no word of Richardson leaving the Company, which would seem to be the issue here considering he **sold off 98% of his holdings**. Throughout 2003 Richardson had sold a total of 112,000 shares as the stock climbed from $17 to $26. Prior to that he had only sold 76,000 shares in November 2001 at roughly $16.

- **Mark Benadiba (50)** – Executive V.P., Canada & International. Between February 26th and May 6th Benadiba sold 45,156 shares from $29.78 to $32.47. The sale wasn't as large as transactions by the above-mentioned execs, but had a very similar effect on his holdings. In 2003 he sold a total of 146,300 shares, which cut his ownership significantly. This led to the recent 45,000 plus share sale, which **reduced his holdings by 78%**.

- **Colin Adair (61)** – Director. Only one other director, **Serge Gouin** (sold 48,000 shares on March 5th), has been on the board as long as Adair. Adair, Chairman of the Human Resources and Compensation Committee, was elected in 1986 and has been an infrequent seller since. In the past ten years, he had only disposed of a combined 109,900 shares in August and November 2001. He recently joined his peers in the recent months, selling 25,000 shares on February 5th and 6th at $27.53. His sale, in a fashion similar to those mentioned above, substantially **reduced his actionable holdings, in this case by 71%**. But even more conspicuous than the reduction is the effect the sale had on his ability to meet the Company's mandated ownership guidelines. Directors are required to hold 10,000 shares of COT common stock within twelve months of joining the board. Adair refrained from exercising options to acquire the shares for this sale, and instead sold all the common shares he owned, which we thought was curious behavior given the 10,000-share holding requirement for directors.

- **Stephen Halperin (54)** – Director. Whereas Adair sold his common shares, Halperin exercised *all* of his exercisable options (which weren't set to expire until July 2007) and sold the underlying 25,000 shares on May 5th at $31.50. Since joining the board in 1992, his only prior transaction was a 12,500-share sale back in November 2001. Halperin's decision to exercise shares left him with enough common stock to meet Company requirements. However, he still **parted with 43% of his actionable position**, which tells us that he's satisfied with just meeting the Company's established base target requisite. Cott directors receive less than 10,000 shares of compensation options annually, which will prolong both Adair and Halperin's attempts to restore their holdings should they choose not to turn to the open market. It should be noted that Halperin is one of three directors on the Human Resources and Compensation Committee chaired by Adair.

Perhaps the most interesting thread between the above insiders is the fact that such large reductions in holdings, when viewed on an individual basis, are more typical of departing insiders. The collective behavior of this group of insiders, with no indication that any of them are leaving, leaves one to speculate about what is driving this very rare and significant activity. We continue to monitor their trading behavior closely and have begun a review of accounting and governance behavior as well.

<u>PG&E Corp. (NYSE: PCG)</u>

Back in August 2000 we had detected very subtle signs of insider trepidation at PG&E. For the first time in five years, two insiders had sold in unison – shedding 32,500 shares at $28. Little did we know that they had every right to feel the need to act, as just a few months later PCG would be entangled in the California energy crisis. The Company entered 2001 below $9 a share. The stock managed to rebound throughout the year despite continued energy concerns, which is when three new insiders again converged to sell 15,500 shares in December. Many overlooked this activity as well, which preceded the Company's utility division's bankruptcy. The issue, which was trading in the low $20s in March, fell to just above $10 by July. The lesson learned is that selling by PG&E insiders should be monitored, regardless of the size of their transactions. This was made more apparent when the Company abandoned its ownership guidelines for executives in 2002. For these reasons we immediately began investigating the recent behavior of two of the Company's top execs. On May 6th, PG&E's CFO and general counsel sold 295,634 shares at $27.40 to $27.60.

The more recent uncharacteristic activity by PG&E execs actually began in January. Six execs took advantage of the December 31st vesting of restricted stock awards granted in 2001 for the purpose of retaining executives through the bankruptcy proceedings and proposed reorganization. However, execs were given the opportunity to defer the award payments and receive phantom stock units, which they would receive at a later date. Not only did they jump at the opportunity to cash out the restricted shares (they received $44.1 million cash for turning in 1.58 million shares), but also took advantage of a Company sponsored, one-time 10b5-1 trading plan apparently established to exercise non-expiring options and sell the underlying shares. A total of 328,503 shares were sold – excessive considering insiders had sold only 108,280 shares, in total, between 1997 and 2003. Then, just two days after the Company's first quarter earnings report in which they reported a turnaround attributed to favorable terms provided by the government to end its bankruptcy, Senior V.P., CFO **Peter Darbee** sold 40% of his holdings and Senior V.P., General Counsel **Bruce Worthington** trimmed his position by nearly 30%. It seems too early to be thinking about retirement for either of these execs. All additional details are highlighted below.

- **Peter Darbee (50)** – Senior V.P., CFO. After participating in the January round of sales for which he grossed $8.4 million, Darbee's more recent behavior is quite conspicuous. As mentioned above, not only did he sell 40% of his holdings when he dumped 177, 834 shares on May 6th grossing an additional $4.9 million, but has now **reduced his holdings by 64% since the beginning of the year**. Since joining the Company in 1999, his only prior transaction to this year's activity was a 35,000-share open-market purchase in November 1999 at $23.12. His willingness to sell such a substantial stake at only $4 more than what he considered "value" in 1999 forces us to question his motives.

- **Bruce Worthington (54)** – Senior V.P., General Counsel. Worthington also participated in the January selling, cashing in 128,205 shares of restricted stock and selling 72,874 shares of common. In order to acquire the common shares to sell he exercised five series of options, four of which were not set to expire in the upcoming year (expiration dates: 1/05, 1/07, 5/07, 1/13). After all was said and done, Worthington walked away grossing $5.9 million. Then, on May 6th he sold 117,800 shares for another $3.2 million. The sale drained his holdings by nearly 30%, but more attention grabbing is the fact that he has now **sold 52% of his position since January**. Since joining PG&E in 1997 and prior to this year he had only sold 3,000 shares in December 2001 ahead of the bankruptcy announcement.

<u>Sepracor Inc. (NASDAQ: SEPR)</u>

Sepracor stock looked unstoppable in 2000, climbing to highs of $140. The last time we saw a group of SEPR insiders converge to sell was in September 2000, just before the stock dropped from $116 to under $30 in the ensuing six months. Insiders remained quiet over the next three years as the issue slid below $4. However, the stock rebounded and has again gained attention since the FDA approved the Company's sleep-disorder medication ESTORRA on February 27th. The news propelled the issue from $28 to $48 in a matter of days. But investors weren't the only ones on cloud nine.

In 2002, Company execs were given “special” option grants in addition to their annual incentive option grants. The top five execs listed in the proxy had been granted on average 100,000 options with a strike price of $6.24, which vested upon the FDA’s approval of any of three drugs, one of which was ESTORRA. Eight insiders jumped at the opportunity to lock in gains and take advantage of the newly vested options (and more), selling 1,401,098 shares between May 11th and May 19th at $45 to $46.99, grossing $64.9 million. The shares sold in this one-week period totaled more than we saw insiders dispose of between 2000 and 2003, even as the stock traded at equivalent or considerably higher prices. But while we can understand profit taking after a 70% stock bounce, insiders sold significant portions of their holdings – a sign of apprehension with regards to the sudden volatility. Led by President, COO **William O’Shea**, four execs sold between 28% and 66% of their actionable positions (common stock plus vested options). If nothing else, these sales should quell the recent Street speculation that Sepracor is a takeover target at least, that is, speculation of a take over at a significant premium.

- **William O’Shea (54)** – President, COO. Considering his sizeable holdings, O’Shea has been relatively inactive since joining the Company in 1999. His only prior transaction was a 117,204-share sale in December 2000 at $79, just before the stock dropped below $30 by March. Recently, he exercised three series of options with plenty of time before expiration (expiration dates: 10/09, 5/11, and 8/12) and sold the underlying 436,919 shares on May 12th. The sale not only grossed $20 million, but also **reduced his holdings by 41%**.

- **David Southwell (43)** – Executive V.P., CFO, Secretary. Back in September 2000 Southwell sold 160,000 shares between $100 and $108, just ahead of the stock’s devaluation over the ensuing months. That was the last we had heard from him before surfacing to sell 275,000 shares on May 11th and 12th at roughly $46. His willingness to part with more shares at 50% lower prices caught our attention. Even more compelling is that he **sold 30% of his position**. Not only did he immediately exercise the options received from the approval of ESTORRA, selling those shares and more, he also executed a very uncommon transaction. On May 27th Southwell moved nearly the entire lot of SEPR shares he indirectly held for his children in a Grantor Retained Annuity Trust into an exchange fund. Typically insiders move their company shares into an exchange fund to diversify the risk of having a sizeable percentage of their assets tied up in one stock. However, this move may signal his apprehension in having his children’s trust fund in Sepracor.

- **Timothy Barberich (56)** – Chairman, CEO. Like Southwell, Barberich was last a seller in September 2000, dumping 200,000 shares at $100 before the stock dropped below $30 in the subsequent six months. After the stock’s descent, he reversed his sentiment and purchased 25,000 shares on the open market in March 2001 at $40. It appears that the issue’s recent strength has him yet again changing his outlook, as he sold 346,000 shares on May 11th at roughly $46 and grossing $15.8 million. Just a few years ago $40 seemed to be a bargain while $46 is now an acceptable price to carry out his largest-ever sale.

- **Mark Corrigan (46)** – Executive V.P., Research & Development. Corrigan is rather new to the Sepracor team having made his initial Section 16 filing just last year. In 2003 he was granted 425,000 options, of which 25,000 immediately vested on his first day of employment, 350,000 vests over a five-year period and the remaining

50,000 vested after the approval of ESTORRA. He wasted little time getting his hands on those shares as on May 11th he exercised a large portion of his vested options and **sold 66% of his newly acquired holdings**. Corrigan currently doesn't own any Sepracor common stock, which is contrary to a more typical approach where new executives spend their early years building an ownership stake.

- **Douglas Reedich (46)** – Senior V.P., Legal Affairs, Chief Patent Counsel. On May 18th and 19th Reedich executed his first sale since filing as a Section 16 insider back in 1999. The sale of 112,179 shares at roughly $45 **trimmed his actionable position by 40%**.