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

- Aeropostale Inc. (NYSE: ARO)
- Bunge Limited (NYSE: BG)
- Digital Realty Trust Inc. (NYSE: DLR)
- Dun & Bradstreet Corp. (NYSE: DNB)
- ITT Educational Services Inc. (NYSE: ESI)

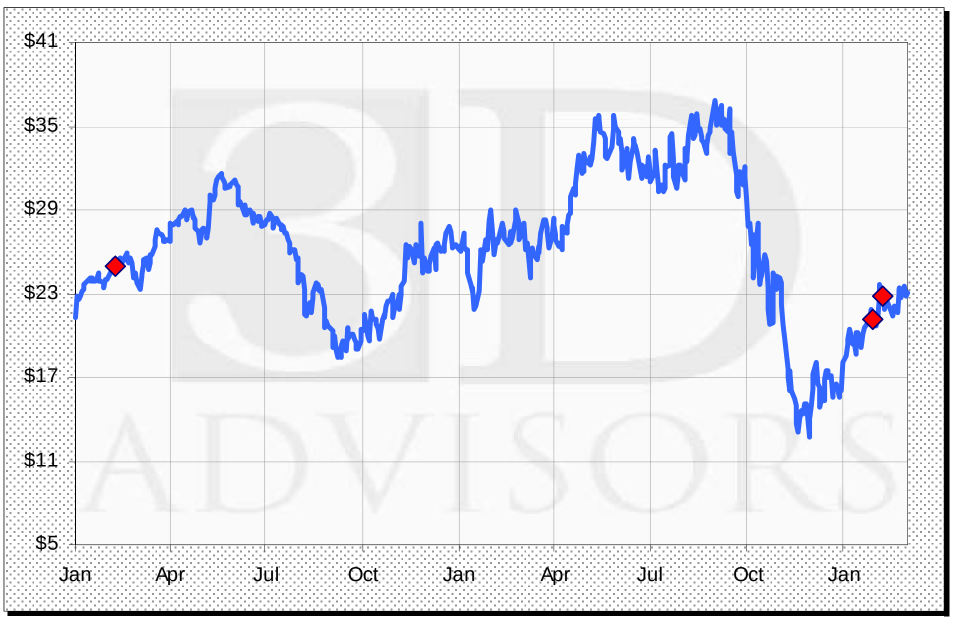
3DAdvisors Research Notes

Aeropostale Inc. (NYSE: ARO)

- Although the trades have been in the public space for a few weeks now, we feel the activity of one well-known retail executive has managed to slip under the watchful eye of analysts and the media. We have been following the trading behavior of Aeropostale's Chairman and Chief Executive, **Julian Geiger** (63), since March 2004 when he stealthily monetized 740,000 shares (adjusted for 3-for-2 splits in April 2004 and August 2007) with a forward sale contract and sold another 600,000 shares on the open market three months later, erasing nearly half of his actionable ownership. Over the last five years he has been a fairly infrequent trader, especially when compared to the regular trading activity of key insiders at competitors such as Abercrombie & Fitch Co. (NYSE: ANF) and American Eagle Outfitters Inc. (NYSE: AEO), but Geiger stands out from the group for having executed a number of deceptive but timely sales. Add to this Geiger's current employment agreement, which includes a number of self-serving arrangements we have never before seen, and the trading and governance profiles become even more riveting.

- Geiger's attempts to hide the 2004 forward sale transaction were effective. Instead of calling it a "Forward Sale", which it indeed was, the footnote on his Form 4 called 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 complement the detail of the forward sale, which usually appears on Table II. Geiger did 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. We found a similar obfuscation in a later Form 4 filed on 06/13/07 covering the diversification of his entire actionable position (457,000 shares and vested options). In this case Geiger used a "D" transaction code for the sales indicating a "disposition to the issuer of issuer equity securities", or in layman's terms, Aeropostale bought the shares back from him in a non-open market transaction. We have seen a number of open market sales that are erroneously filed using a "D" transaction code, but this does not seem to be a mistake. Since Aeropostale's 2Q07 SEC Form 10-Q reports only 241,500 shares having been repurchased during this timeframe, it would seem they either misrepresented the amount of stock repurchased, or more likely, this was a calculated attempt to keep these trades under the radar since "D" code transactions are not reported as sales on insider trade reporting websites.

Figure 1. ARO Daily Closing Price, 01/03/07 through 03/04/09. Red diamonds are the dates of the last sales by CEO Julian Geiger. Source: Reuters and ARO SEC Filings.



- Besides the fact Geiger cleared out all of his stock and options with those sales, there appear to be other reasons he would not want to draw attention to his trades. Just weeks before his sales ARO traded at an all-time high of $31 after a series of earnings guidance increases. But the shares lost momentum when June 2007 comp sales came in almost flat after the Company had been reporting double-digit gains and would continue to deteriorate over the next few months with July comp sales reversing course and *declining* by double digits. Come August the shares were down to $21 and would fall to $18 by September after the Company's 3Q07 guidance missed analysts' expectations. Geiger not only managed to unload his entire position before the shares lost 42% in three months, but managed to do so without detection thanks to his stealthy filing practices.

- Geiger's track record for specious trading behavior puts his recent sales back on our radar. Before discussing his trades, however, it is necessary for us to provide some background on his current employment agreement. In January 2008 the Compensation Committee awarded him with a new three-year employment agreement that ranks right up there with some of the most lucrative and unusual deals we have ever seen. In addition to a base salary of $1 million, an annual bonus potential reaching $3 million, and 186,000 restricted shares with a market value of $5 million that vest fully in just one year, there were a number of uncommon handouts which we have outlined below:

  - On the first day of each month from 02/01/09 to 01/31/11, ARO will pay Geiger in cash an amount equal to one-twelfth of the value of the above mentioned restricted stock award (roughly $415,000 per month).

  - On the last business day of each month from 02/27/09 to 01/31/11, ARO will pay Geiger in cash the amount of $233,000.

  - Geiger can terminate his employment at any time before 01/31/11, at which time an "Advisory Period" will begin and extend to 01/31/11. Geiger will then serve as a part-time consultant for which he will receive an annual fee of $250,000 and between 20,000 and 40,000 restricted shares per year.

  - Should Geiger elect to terminate his employment, all of his unvested restricted stock and options will immediately vest. This differs from the provisions in the Company's long-term incentive plans, which stipulate unvested derivative equity, held by a retiring participant, shall be forfeited immediately.

  Another component of the agreement disclosed in the 8-K that jumped out to us was the accelerated vesting of all Geiger's un-exercisable stock options and restricted stock granted to him prior to 02/01/08, which amounted to unvested derivative equity of 423,000 shares. This would be the most egregious element in the contract, particularly taking into account his penchant for selling substantial percentages of his ownership over the years. But a closer examination of the agreement itself (filed as an exhibit to the 8-K) leads us to believe the 8-K disclosure[1] provided a false account since the only reference to accelerated vesting applies to a contract termination. Even without this acceleration element, if we are indeed right with our assessment, the cash component of his new agreement is profuse enough, as he stands to receive $8.7 million in guaranteed cash each of the remaining years of the contract with the potential for an additional $3 million annual bonus. With all the cash being thrown Geiger's way and taking into account his past timeliness, we are more inclined to believe these trades were sentiment driven rather than routine diversification.

- On 01/30/09 and 02/06/09 Geiger once again monetized all of his actionable holdings, consisting of 280,000 vested options and common shares. The sales were executed at prices of $21 and $23, the lowest he has accepted for his shares in three years. Included in the holdings sold were 68,000 shares acquired from non-expiring

[1] The new employment agreement also provides for accelerated vesting of stock options and restricted shares of common stock granted to Mr. Geiger prior to February 1, 2008.

options, some of which were not set to expire for five years and carried a $19 strike price. The 19% spread between market and the strike price of certain options exercised was the smallest associated with any of his past option-related sales. He also cleared out all of his common stock, including all of the shares he was awarded as part of the new employment agreement which had just vested in full on 01/30/09. Investors should be paying close attention any time a chief executive clears out all of his or her holdings and this is even more applicable for Geiger. As we mentioned before, the only time he previously did so (June 2007) occurred immediately before Aeropostale's sales eroded and the shares were accordingly punished.

- Since Geiger's activity Aeropostale has received upgrades from a number of analysts, including two from prominent investment houses. One upgrade was a valuation call while the other came on the heels of the announced closing of the Jimmy'Z concept stores and the expected cost savings. We feel it would be naïve for investors to ignore Geiger's behavior as the trades send a strong signal he is not on board with the sell-side thesis. During this period of economic and market instability, particularly in the fickle retail industry, corporate leaders are conscientious of the risks associated with a significant stock sale. His trades suggest to us his desire to monetize his holdings outweighed any possible downward pressure on the shares from an investor overreaction to his activity.

<u>Bunge Limited (NYSE: BG)</u>

- Upon reviewing the Company's recently filed 2008 SEC Form 10-K (filed 03/02/09) it struck us that virtually the entire document had been re-written. Although the general format remained the same, most sections were re-crafted in a way that makes a page-by-page comparison (for disclosure deltas) very difficult to perform. Whether this was omission or commission is up for grabs. We will complete a "K-to-K" comparison review in due time. We have already found, however, some significant details in the new 10-K that are worth commenting on sooner rather than later.

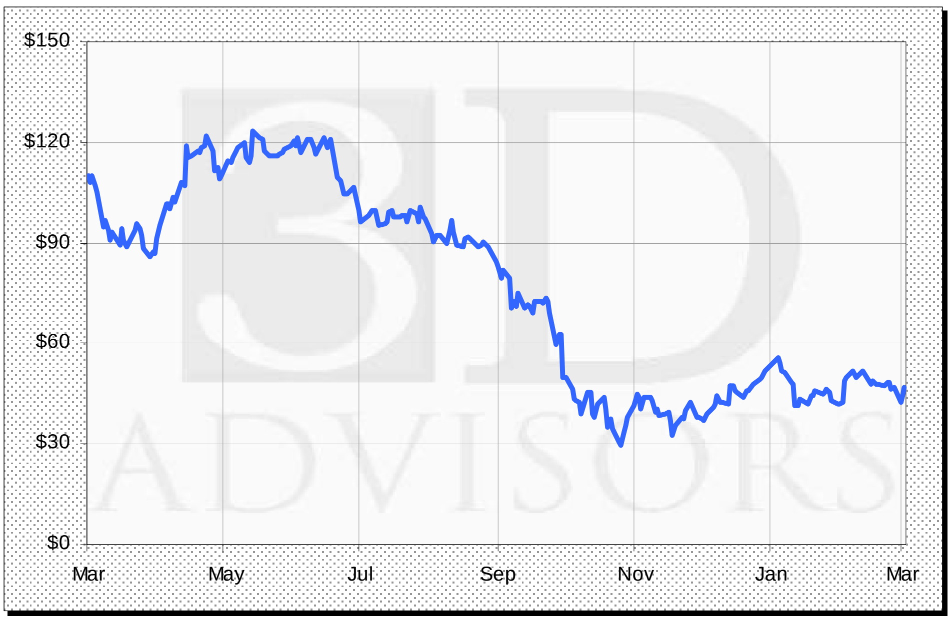
- At first glance, it would appear that the Company's key exposures in Brazil, fertilizer receivables and advances to farmers, have been significantly reduced, suggesting that farmers have made significant payments to Bunge against their debts. For instance, recorded total accounts receivable (both current and non-current) declined from $857 million (as of 12/31/07) to $586 million at 12/31/08. Ditto for advances to farmers which ended 2007 at $1.14 billion and whose recordings dropped to $742 million by 12/31/08.

  It is important to understand that Bunge records these values in *local currency* (Brazilian real) which is then translated into dollars for reporting purposes. The 10-K states this as follows: "Because Brazilian farmer credit exposures are denominated in local currency, reported values are impacted by movements in the value of the Brazilian real against the U.S. dollar. In 2008, the real devalued by 24%, decreasing the reported translated U.S. dollar balances". Consequently, the apparent "improvements" in Bunge's Brazilian farmer exposure can be misleading.

  The apparent 32% and 35% respective drops in fertilizer receivables and advances to farmers are, most likely, significantly affected not only by the devaluation of the real but also the significant drop in soybean prices year-over-year. In view of our in-country knowledge that both fertilizer receivables and farmer advances are not being liquidated, neither through cash payments nor receipt of soybeans from farmers, in any manner resembling a normal timeframe (or if at all, in may cases) one wonders if the substantial decrease in the related recorded balances in 2008 is, in fact, real or if additional amounts have been written off and not disclosed in keeping with normal accounting and disclosure practices.

Having stated this, it is important to keep in mind that 2008 was a period where tight credit conditions forced Bunge and other processors to significantly curtail further credit to Brazilian farmers during the year. The net result of this is that Bunge was still sitting on the vast majority of its "sub-prime" Brazilian exposure as of year-end 2008. Our Brazilian contacts have confirmed our thoughts that there is no chance that Bunge has been repaid any significant amounts owed to it by Brazilian farmers. If they had, we would wager that CEO **Alberto Weisser** would have been crowing about it on the 4Q08 conference call.

Figure 2. BG Daily Closing Price, 03/03/08 through 03/04/09. Source: Reuters.



- As we have reported previously, but it is worth repeating, Bunge continues to show declines in Shareholders' Equity. The Company's S/E declined from $8.7 billion to $7.44 billion sequentially from 3Q08 to year-end. The key culprit here was the big $1.34 billion loss in OCI generated by the Company's foreign exchange translation adjustments. Retained interests on Bunge's asset securitizations remained high at 28%, reflecting the low quality of its receivables. Additionally, with regards to advances to farmers, Bunge recorded $48 million in related interest income during 2008. Whether this will ever be collected is an item of much speculation.

- *Recorded* fertilizer inventories have more than doubled from $924 million as of 12/31/07 to $1.88 billion at year-end, 2008. *Keep in mind this is prior to calculating the real devaluation that occurred between 2007 and 2008*. The fact that Bunge seems awash in fertilizer inventories finds confirmation in a detail we learned from our in-country contacts about six weeks ago: At that time, we were informed that a Cargill sales representative (the number one salesman in Bahia for the past two years) was upset because Bunge was selling potash at prices cheaper in Bahia than what Cargill was buying it for in Saskatchewan. This went on much through 4Q08, causing the Cargill rep much grief. Whether Bunge's aggressive price efforts were related to cash needs or just a strategy to draw down fertilizer inventories is another one up for grabs.

- It is still of great interest to us that the European Commission, whose agents raided Bunge's offices in Italy last July, continues with its investigation at the time of the publishing of the 2008 10-K. Also, further liquidity issues loom as Bunge's $850 million syndication of its revolving credit facility, downsized from its previous $1 billion size and entered into in late 2008, is for only one year and expires in November of 2009. To that, add the five-year revolving credit facility that expires in June. The Company intends to renew both, but also discloses that it expects "to face increased borrowing spreads as well as higher bank fees in connection with these renewals." Additionally, a $300 million facility for North American receivables securitizations expires in 2009.

- The 2007 10-K disclosed the following: "Bunge's agribusiness segment is participating in developing private placement vehicles to invest in business complementary to its agribusiness operations and received $80 million from investors in 2007 in a private investment fund controlled by the Company." To date, including the 2008 10-K, there has never been a further mention of this initiative.

Digital Realty Trust Inc. (NYSE: DLR)

- In spite of its high 20%+ open short position, we remain compelled to focus on DLR as it has all the ingredients facing cash-strapped REITs in this environment plus the added kicker of very significant insider activity (details below). Such behavior is highlighted not only by significant holdings reductions but shortened lock-up periods following certain of the Company's equity offerings, not to mention selling just prior to the recent February 13th secondary offering of 2.5 million common shares; rare events indeed.

- In our read-through of the recently filed 2008 SEC Form 10-K, the fact immediately becomes evident that the 20-page risk section makes up a significant portion of the overall filing. When comparing the 2008 10-K to the 2007 version, one can easily get the impression that they were written about different companies. Indeed, much has changed in between filings. That aside, however, the Company has a very narrow operating/investment base in that data-center related real estate is so dominant in its portfolio. Single-tenant properties add further to concentration as they make up half of all tenants, and the top 7 tenants account for 58% of the annualized rentals for the top 20 tenants. Also, the risk section contains a comment that the bankruptcy of a single customer could have a significant adverse effect on the Company. As of 12/31/08 only one tenant, Lyondell Chemical Company, was in bankruptcy accounting for rental space of just 15,500 feet. We suspect, however, that these two elements (data center-related real estate and single tenant occupancy) in the Company's business model represent very real risks in the present milieu.

- When one looks at the geographic metropolitan locations of the Company's properties in the US and Europe, impairment risks abound: In the period October 2007 through the early months of 2008 DLR engaged in rapid- fire buying of properties and equity financing to repay revolver takedowns used in the purchases. The Euro and Pound Sterling were involved in many of such purchases. We strongly suspect that some of those deals have taken on a different hue by now, given what has happened in foreign exchange markets, as well as in credit and real estate markets. Thus far, the Company has yet to recognize impairment losses on any of its properties since its inception.

- There is also risk disclosure concerning the possible difficulties in SEC reporting, Sarbanes-Oxley and NYSE requirements as they may relate to possible deficiencies in disclosure controls or internal control over financing. Though not new (such disclosures also appeared in the 2007 10-K) we cannot imagine that a company would point out such potential problems unless they had already grappled with issues in that regard or were close to the edge and fearful of slipping over. The Company goes on to say that such potential deficiencies could negatively affect cash available for dividend distribution; a situation we find unusual.

- Although the Company has a substantial revolving credit facility, because it is used for acquisitions as well as everything else (including working capital) a number of equity issues, as well as secured financing on properties and other long-term borrowings, have been necessary to maintain liquidity. Expectations of capital expenditures of $350 million for the redevelopment program in 2009 will no doubt require additional equity and debt financing. The Company's plans and growth expectations are going to be strictly a function of financing availability as they certainly do not have a cash hoard on hand. Accordingly one can envision growth slowing considerably, based on current credit market conditions. Also, the cash demands of meeting REIT qualification requirements and distributions could hamper growth in 2009. The current credit market conditions are not very favorable to a company that has to keep rolling the dice and counting on picking up a sizable pot of new cash regularly to stay in the game. And, of course, they have already put a large amount of debt on the balance sheet in order to get in and stay in that game up until now. Thus far in 2009, the Company has tapped the equity markets for $83 million (this well below its capital raise through this point of 2007), selling shares at $33 each, well off their mid-2008 trading range between $40 and $50.

- For more than a year now we have been closely monitoring the insider trading activity at the Company. Our clients might recognize that we have never issued comprehensive coverage on the name with the exception of a few Watch List inclusions. Digital Realty has been somewhat of an enigma to us due to the complexity of their derivative equity grants and holdings along with their Section 16 disclosures in SEC filings. But while their activity and ownership might be difficult to follow, the fact remains the Company's executives have been regular sellers who have scaled back their holdings in the last few years and continue monetizing stock units and options immediately upon vesting, even into recent share weakness. We want to make our clients aware of this situation now, especially since this unusual and aggressive trading profile is put in the context of above items gleaned from the Company's 2008 SEC Form 10-K. Not only that, but we anticipate seeing renewed profit taking in the very near future, even at the current depressed price levels.

- In 2007 and 2008 DLR insiders sold a whopping 2.2 million shares valued at $87 million; an impressive figure considering the top 13 executives and directors beneficially owned 2.5 million shares on 01/01/07 with nearly 75% of the total held by Chairman **Richard Magnuson**. Despite having vested in a large amount of stock and options over the last two years, management's ownership has been depleted below those early 2007 levels. Take for example the activity of Chief Executive, and Director **Michael Foust** (53), who has been with DLR since its inception. After selling 31,000 shares in August at $45, Foust increased his volume to 137,000 shares in the fourth quarter, accepting his lowest prices yet ($23) which were nearly 50% below those he sold at three months earlier. These shares came from a performance award that vested in full on 10/27/08 which he cleared out in less than two months. In 2008 alone Foust monetized 71% of his actionable equity holdings (common stock plus vested in-the-money options).

- The pattern is pretty consistent across the senior executive team. Senior V.P. of Acquisition Activities **Scott Peterson** (47), a named executive officer, sold only 3,000 shares in August when the shares traded at $45. He would then resurface in December to sell 20,000 shares at $32, which he followed up with a 43,000 share sale on 01/28/09 at $34. The last two sales erased 50% of his actionable holdings. General Counsel **Joshua Mills** executed five sales between November 2007 and August 2008 with an average volume and sale price of 1,000 shares and $42, respectively. Since 11/21/08 he has executed four sales at five times higher volume, only at a lower average sale price of $29. These four sales wiped out 92% of his actionable holdings, leaving him with just 1,700 vested stock units (no common stock). And then there is Senior V.P. of Portfolio and Technical Operations **James Trout**, who has been selling under a 10b5-1 plan since May 2008. Trout consistently sold roughly 313 shares per month under this plan, but suddenly dropped 55,000 shares in October before resuming his regular volume the following month. The curious October sales combined with the other plan sales since the beginning of the fourth quarter contributed to a 91% decline in his holdings. Digital Realty does not provide any information on individuals' 10b5-1 trading plans, but it appears SVP Peterson and GC Mills each entered into a new plan in January 2009 under which they commenced selling immediately.

- The selling schedule of DLR insiders can be best described as 'lumpy', which seems to be attributed to a few factors. One reason lies in the vesting of their derivative equity, which consists of stock options and Class C Profit Interest Units along with Long-Term Incentive Units (both units convert to common on a one-for-one basis). These grants have different vesting schedules, with some becoming actionable 20% one year from the grant date and then in much smaller monthly amounts thereafter and others vesting annually in equal mounts over four years. Hence, they typically have more actionable holdings to monetize upfront when derivative equity vests. Another reason is their earnings blackout periods, which prohibit selling for a period of nearly 30 days around earnings release dates. There have also been lock-up periods associated with secondary offerings, but these have not hindered executives from taking profits as they are intended to. Insider selling should have been halted for a period of 45 days after the Company sold 5 million shares in a mid-July 2008 offering. Yet, on 08/14/08 three insiders, including Chairman Magnuson and CEO Foust, sold a total of 234,000 shares right after the issue reached all-time high prices ($45). From what we can see in the registration statement, it would have taken an underwriter exemption for them to sell on this date.

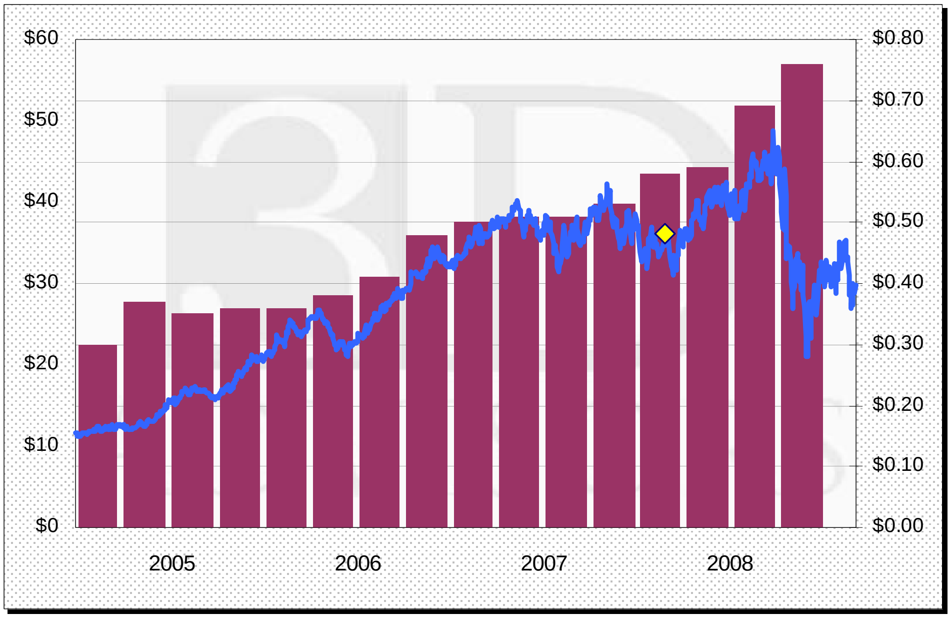
- It does not seem to be a coincidence that Digital Realty's secondaries and the resultant lock-up periods are timed in accordance with earnings blackout windows, aiding insiders in profiting on any stock price advances after earnings releases. While this did not necessarily apply to the July offering, since insiders sold during the blackout period anyhow, it should have just as it did for the latest offering last month. Digital Realty sold another 2.5 million shares on 02/11/09, only this time the lock-up period was shortened to 25 days, not the 45 days for the July offering or even the more standard 90 days for most corporate stock offerings. By setting it at just 25 days, insiders will be able to sell immediately at the opening of the 4Q08 earnings trading window, which will take place roughly 10 days after the 02/26/09 report date. With equity at their disposal, and a proclivity to sell most of the equity they hold, we fully anticipate sales hitting the wire beginning on 03/08/09.

- Equity compensation is another area where the Company has made subtle adjustments to seemingly inconsequential metrics that benefited the executives. A large percentage of the stock and options mix granted to executives annually has come in the form of Class C Stock Units, which only vest if certain *shareholder return* targets (i.e. stock price gains) are met. These particular performance awards made up 80% of the stock and options CEO Foust was issued in 2005 and 91% of his 2007 awards (executives did not receive grants in 2006). But after years of consistent share price gains, DLR began trading sideways in 2007, which persisted into mid-2008, leading to a yet-to-be-disclosed portion of these 2007 Class C Units being forfeited. So, with the issue stumbling, the Compensation Committee stopped issuing awards with the shareholder return vesting condition in early 2008, instead granting performance shares tied to Funds From Operations (FFO).

  As the Figure 3 below illustrates, this was a pretty slick move because on 02/25/08 when these FFO shares were awarded, it was becoming apparent the shareholder return target from the prior year award would be difficult to meet. And at this same moment the Company was nearing the end of the first quarter and probably aware they would be reporting the largest sequential FFO increase (9%) in nearly four years. This move will clearly be advantageous as FFO has increased by an average of 10% over the last four quarters while the stock price has declined 28% over the same period. It would be a tough sell for the Company to claim this compensation setup aligns the interests of executives with those of the shareholders.

- We also came across an amendment to their sizeable October 2005 Class C Stock Unit awards buried in an exhibit in the 3Q08 10-Q (filed on 11/10/08) that had significant bearing on their holdings and ability to take profits. These stock unit awards were initially set to vest at a rate of 60% on 10/27/08 and then monthly over the next two years. Digital Realty accelerated the vesting whereas they became 100% actionable on 10/27/08, two years ahead of schedule. Within two months CEO Foust, SVP Crosby, and SVP Trout took advantage of the acceleration, clearing out all of the shares from the award. Two other execs already began monetizing these shares as well.

Figure 3. DLR Daily Closing Price, 01/03/05 through 03/04/09 (Blue Line and Left Scale) and Quarterly FFO per Share (Red Bars and Right Scale). Yellow diamond is the date of the 2008 stock awards. Source: Reuters and DLR SEC Filings.



Dun & Bradstreet Corp. (NYSE: DNB)

- From time to time we happen upon out of character trading activity by a single individual that is so unusual we feel compelled to report it to our clients despite the lack of additional sellers to corroborate the behavior. Such is the case at business information provider Dun & Bradstreet (D&B), where the recent sales of Chairman and Chief Executive **Steven Alesio** (54) not only fly in the face of his past trade execution tendencies, but appear to violate the Company's internal executive trading policies. Such sudden behavioral deviations, particularly during a period of market volatility, provide strong, albeit isolated evidence that management confidence in the shares has waned and additional volatility may lie ahead.

- On 01/28/09 D&B issued fourth quarter and full-year diluted EPS increases of 6% and 12%, respectively. Sales for the two periods increased a more modest 2% and 8% after the effect of foreign exchange, with full-year revenue meeting the revised (lowered) guidance issued on the third quarter earnings release. Guidance issued for 2009 was not nearly as healthy as the prior year, with sales, operating income and diluted EPS each projected to trail the 2008 percentage gains, prompting the following forewarning from CEO Alesio: "As we ended the year, however, the economic headwinds started to have a significant impact on our US marketing-related businesses, which is continuing into 2009, and is reflected in our guidance." Two weeks later Alesio initiated a fairly ordinary-looking diversification effort, but a closer inspection of the trades prove this was far from routine.

- Steven Alesio joined D&B in January 2001 after a 19-year career with American Express Co. and has served as the Company's chief executive since January 2005.

Despite the issue's having appreciated nearly 50% during the first two years under his leadership, Alesio did not take any profits on his holdings until June and July of 2007 once the issue topped $100, a new all-time high. This round of sales, which took place under a pre-arranged 10b5-1 trading plan, was first disclosed in an SEC Form 8-K filed on 05/21/07. Over a four month period, from 06/20/07 to 09/20/08, Alesio robotically sold 40,000 shares on the twentieth of each month, selling exactly 20% of his actionable holdings at an average price of $100. He would resurface exactly one year later, after another 8-K issued on 05/27/08 reported Alesio intended to distribute another 160,000 shares under a new 10b5-1 plan between June and August of 2008. These sales were carried out to the exact specifications detailed in the 8-K, with 20% of his actionable ownership being distributed at an average price of $94. Now let's discuss his latest sales that followed the fourth quarter earnings release.

- Alesio filed Form 4s on 02/12/09 and 02/17/09 showing he exercised all 108,200 options from his November 2011 option series between 02/10/09 and 02/12/09 and immediately sold the shares for $78, prices 17% below those associated with his 2008 10b5-1 plan dispositions. Also reported on the second Form 4 was the monetization of June 2012 and February 2013 options through a new 10b5-1 plan, 80,000 in all, sold on 02/13/09 and 02/17/09 at prices as low as $74. This is where things get real interesting. It is clearly explained on the Form 4s that the first 108,200 shares Alesio sold were not part of a trading plan. In fact, the second Form 4 filed on 02/17/09 includes a footnote that spells out this fact. This brings us to a new disclosure found in the current Proxy Statement that establishes Alesio likely violated current D&B trading policies [bolding is ours]:

  > **A second change made in 2007 is that all transactions in D&B securities by a covered executive can only take place through a written trading agreement. Requiring use of trading plans that comply with Rule 10b5-1 of the Securities Exchange Act further demonstrates our effort to ensure that D&B and its executives comply with insider trading laws.**

  Between the May 2007 Annual Meeting when this new rule was established and Alesio's recent activity, there was a total of 44 sales filed by Section 16 executives, all of which were executed through 10b5-1 sales plans, with Alesio's recent dispositions being the first to occur outside of a trading plan. We have seen similar trading rules put in place by companies, many of which are little more than suggestions, but in this case D&B seems to be fairly rigid with the policy. We suspect his trades had to be approved by the Company's counsel, which makes this activity even more interesting to us. But this was just one of many trading aberrations that give us the impression Alesio wanted to trim his exposure in a hurry.

- Dun & Bradstreet has issued seven SEC Form 8-Ks over the last three years reporting new 10b5-1 plans of its senior officers. We have found that these disclosures covered every individual to sell under a plan thus far. Alesio's new trading plan entered into on 02/12/09 was the first not disclosed by D&B. This is a significant exception, especially as it relates to the chief executive, and we suspect it was not an inadvertent oversight. Secondly, Alesio adhered to the recommended 30 day wait period from the time he opened a plan and the date he initiated the sales under both his 2007 and 2008 trading plans. The same cannot be said for this newer plan, which he began selling under just one day after the adoption date. And while his last plans called for a steady diversification over a three or four month period, he reportedly sold all 80,000 shares reserved by this new plan in just three trading sessions.

Figure 4. DNB Daily Closing Price, 03/03/08 through 03/04/09. Red shaded area is where CEO Alesio sold 188,200 shares. Source: Reuters and DNB SEC Filings.

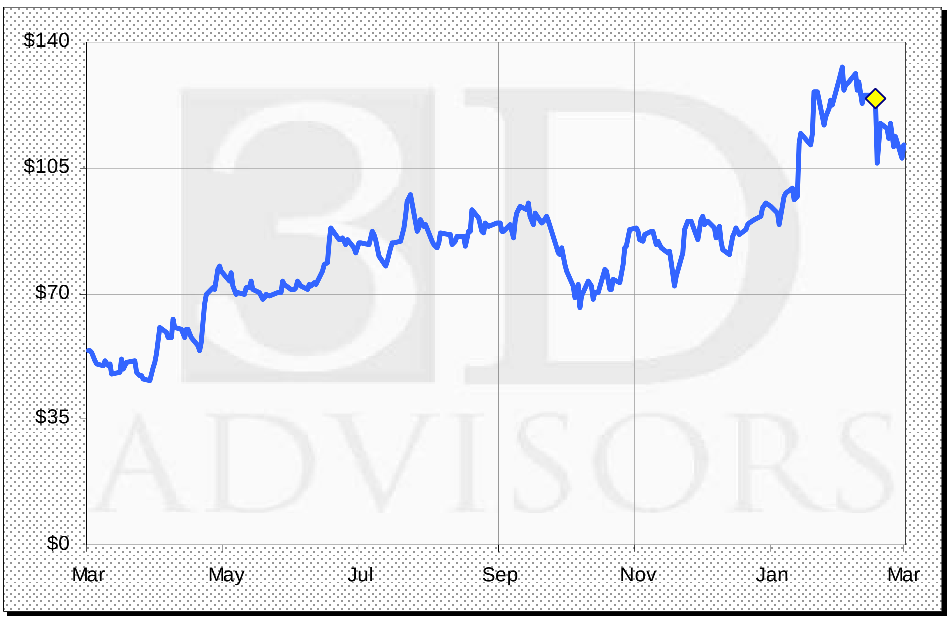
- As a precursor to these Form 4 filings, Alesio issued two 144s making public his intent to sell a total of 230,000 shares over a 90-day period (beginning 02/10/09). Having already sold 188,200 shares, including all 80,000 shares reserved under his 10b5-1 plan, it would appear he either intends to sell another 41,800 without a plan (violating D&B's trading policies) or will promptly establish a new plan to sell the remainder. With either outcome his behavior signals an unprecedented rush to unload his shares. Lastly, Alesio disposed of exactly 20% of his actionable holdings with each of his last two rounds of sales. Once he distributes all 230,000 shares reported on his 144 filings, he will have shed 33% of his holdings in this period and 45% over the last seven months.

<u>ITT Educational Services Inc. (NYSE: ESI)</u>

- In our ESI update on 02/10/09, we focused on a spate of new selling following the release of 4Q08 results by both executives and mid-level managers, the growing impact of providing direct student loans on the Company's balance sheet, and continued obfuscation and lack of clarity in the 4Q08 conference call regarding direct student loans. We mentioned in the introduction to the update that we were initially inclined to wait for the filing of the Company's 2008 SEC Form 10-K, but had decided to publish the update covering the above items "in front of any new disclosures that might appear in the upcoming 10-K". As it turns out, when the Company did file its 10-K after the close on 02/18/09, the shares sold off nearly 15% the following session on well over three times the normal trading volume. While there were several interesting items in the filing, it was the disclosure of preliminary cohort default rates for 2007 that caused the volatility.

- While there were several interesting disclosures in the 10-K, we believe the market was reacting to the risk section under the heading "One or more of our institutes may lose its eligibility to participate in Title IV Programs, if its student loan default rates are too high".[2] There were several things in this section of interest. First, the Company acknowledged that the DE was intending to change the formula used in calculating cohort default rates that would likely cause the default rates to increase, although the Company could not estimate the impact the change would have on its own default rates. If defaults rates are equal to or over 25% for three consecutive federal fiscal years, or 40% for any one year, the Company's eligibility to receive Title IV funds under the Higher Education Act would be lost. The three consecutive year default rate threshold is being increased to 30% in 2009. In 2008, 72% of the Company's revenue was derived from student loans under Title IV.

Figure 5. ESI Daily Closing Price, 03/03/08 through 03/03/09. Yellow diamond is the date that the Company filed its 2008 SEC Form 10-K (02/18/09); the stock declined 15% in the ensuing trading session. Source: Reuters and ESI SEC Filings.



Second, and more importantly, the market was reacting to the release of the Department of Education "preliminary" cohort default rates for the 2007 Federal fiscal year ended 09/30/07. In the table below, to the first two columns, which are taken directly from the 10-K, we've added two of our own columns, one showing the mid-point of the default rate range, and the second showing the percentage change in the mid-point from the prior year.

[2] ITT Education Services Inc. 2008 SEC Form 10-K, Filed 02/18/09, page 13.

Federal Fiscal Year	FFEL/FDL Cohort Default Rate Range	Range Mid-Point	% Chg In Mid-Point From Prior Year
2007 (a)	9.7% to 15.3%	**12.5%**	**35.9%**
2006 (b)	5.5% to 12.9%	9.2%	-0.5%
2005	5.9% to 12.6%	9.25%	0.0%
2004	5.8% to 12.7%	9.25%	N/A

(a) The most recent year for which the De has published FFEL/FDL preliminary cohort default rates.
(b) The most recent year for which the DE has published FFEL/FDL official cohort default rates.

From this enhanced table it is clear that default rates remained almost constant between 2004 and 2006, but then suddenly increased nearly 36% in 2007. And while the 12.5% mid-point is far from the 25/30% or 40% thresholds, its worth keeping in mind that the period measured ended on 09/30/07 when employment and overall economy were still strong. Just as a proxy for the state of the economy at the end of the 2007 measurement period, the S&P 500 closed on 09/28/07 (a Friday) at 1526, or about 53% below where it currently trades.

The Company concludes this portion of the risk section with the following assessment of the impact of economic conditions on default rates [bolding is ours]:

> **Current and future economic conditions in the United States could also adversely affect our cohort default rates. Increases in interest rates, declines in individuals' incomes, and job losses for our students and graduates or their parents could contribute to higher default rates on student loans.**
>
> **If any of our campus groups lost its eligibility to participate in FFEL, FDL and Pell programs and we could not arrange for alternative financing sources for the students attending the institutes in that campus group, we would probably have to close those institutes, which could have a material adverse effect on our financial condition, results of operations and cash flows.**

- Before moving on to other noteworthy items in the 10-K, we thought it worth mentioning that the Company responded to the market's concern about student financing by issuing an 8-K on 02/24/09 announcing that it had disclosed during a Credit Suisse analyst conference that it was negotiating with an un-named third-party to provide private financing to students that would reduce its needs to make student loans directly, from a previously estimated $75 million down to a range of $50 to $70 million. It also said that as a result, it anticipated slight improvements in DSO and bad debt expense metrics, and that is was also raising its earnings per share guidance for the year, from $6.25 to $6.45 per share to $6.50 to $6.75 per share. The stock did not seem to react much to the news and ended down over 2% from the prior day's close.

We noted that a Reuters story that morning quoted Trace Urdan from Signal Hill, who had been bullish on several for-profit education names, including ESI, as saying the raised guidance seemed "somewhat imprudent as it appears to come just a few weeks after the prior guidance, not from a meaningful change in market conditions, but from the desire to affect the share price." From our perspective, it was a rather weak effort to sooth investor concerns over uncertainty related to student financing and the impact direct lending has started to have on the Company's balance sheet.

- The impact of the Company's having to make direct students loans is evident in several new disclosures in the 10-K, starting with a fairly dramatic change in the source of funds that make up the revenue line:

Source of Funds	2008	2007
Title IV Programs	73%	63%
Internal Student Financing	10%	--
Unaffiliated Private Education Loans	8%	29%
Other	9%	8%
Total	100%	100%

Because of the well documented tightening of credit standards for private student loans over the past year, the Company has been forced to rely more heavily on Title IV (with risks outlined above) but also internal student financing. We knew the latter had and would continue to impact the balance sheet and cash flow, but in the 10-K we can see more clearly what is happening.

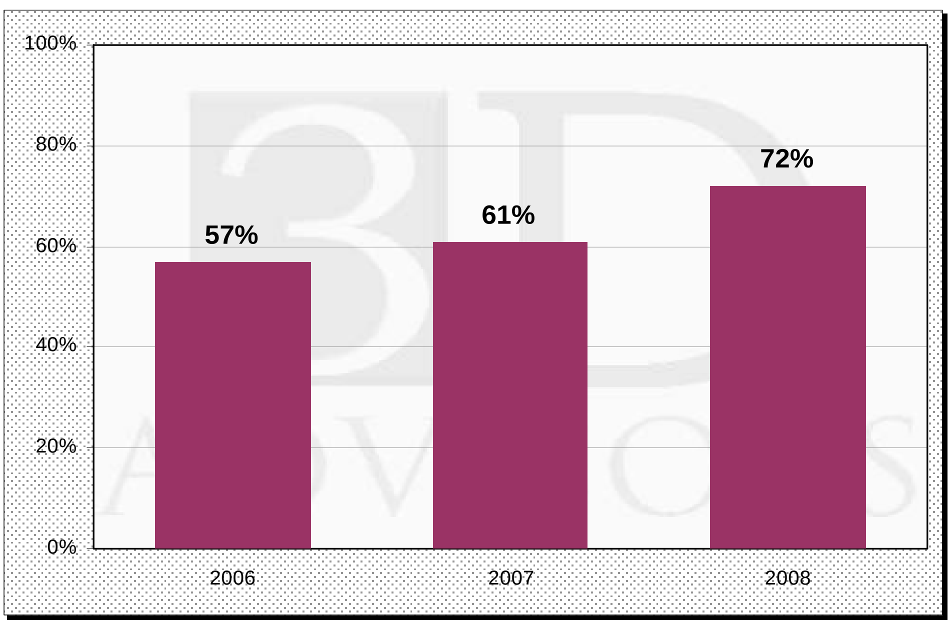
Bad debt expense as a percentage of revenues reflected quite an increase at 4.3% in 2008 as compared to 2.1% in 2007, but had they recorded an allowance that was probably more appropriate the percentage increase would have been much more eye catching. As we have mentioned previously the write-offs in 2008 were $32.6 million, which was charged to the allowance, but it was then necessary to charge to expense $43.3 million just to get the allowance back up to $16.2 million, which is still probably way short of where it should be. DSO rose to 9.8 from 6.0 one year ago, but again, it is well to remember that internal funding is provided to students who do not qualify for private financing. Also keep in mind that the employment picture has weakened considerably since 12/31/08.

The Company would no doubt argue that receivables are not a significant asset on the balance sheet. However, the cash flow gives a better reflection of how much receivables actually increased before any changes in the allowance. The receivables increase in the cash flow statement is $57.9 million, which is exclusive of any changes in the allowance.

- Finally, the shares took another broadside last week with the release of the 2010 federal budget by the Obama Administration, which includes a proposal to eliminate the giant Federal Family Education Loan Program, or FFELP, which is the biggest part of Title IV (Stafford Loans) under which ESI derived 59% of its revenue. The stated rationale for doing so is that by providing loans directly to students rather than through third-party lenders under FFELP, the government would save $4 billion. Proponents of the measure say that FFELP is a windfall for private student lenders. Stocks such as SLM Corp. (NYSE: SLM) and Student Loan Corp. (NYSE: STU) got clobbered on the news and were down over 30 and 21%, respectively. The for-profit education stocks took a hit too, including ESI, which was down 5.6% on the session. This, no doubt, because of the increased uncertainty the proposal creates regarding federal student loans, which provide the majority of the Company's revenue.

We also wonder if the sub-text to this story is that this move by the new administration is the first in a series of efforts to rein in the for-profit education companies, who under the Bush Administration found a very friendly ally. It is now well known that the cost of an associates or bachelors degree obtained through several of the for-profit companies can easily exceed the cost of a degree from many of the top community colleges and public universities in the country, while the students in some cases are taking on $30, $40 or even $50,000 in debt to get a degree that they find really doesn't improve their employment credentials. And the amount for which these firms are relying on Title IV funding is only increasing, as Figure 2 demonstrates. The new administration is well aware that the current regime of federal student loan financing is as much a windfall for the for-profit education companies as it is for the banks. That may be changing sooner rather than later.

Figure 6. Percentage of Total ESI Revenue Sourced From Title IV Financing. Source: ESI SEC Filings.



- In the 2008 10-K, ESI dropped two elements of its disclosure concerning its Annual Compliance Review of its institutes regarding their adherence to Title IV Program requirements and conduct. In 2007, the Company's 10-K listed the following compliance areas addressed:

The internal audit function of our compliance department reviews our institutes' compliance with Title IV Program requirements and conducts an annual compliance review of each of our institutes. The review addresses numerous compliance areas, including:

- Student tuition refunds and return of Title IV Program funds;
- Student academic progress;
- Student admission;
- Graduate employment;
- Student attendance;
- Student financial aid applications;
- **Implementation of prior audit recommendations; and**
- **A general review of student recruiting practices relating to the presentations that the recruiters make to prospective students and the execution and completion of enrollment agreements.**

The bolded items above are absent from the Company's 2008 10-K. Given the fact that a page-by-page comparison of the 2007 and 2008 10-K filings reveals much word-for-word repetition, especially in its "Risk" section (from where the above disclosure comes), we can only assume that the above items have been purposefully omitted for reasons other than simple re-writing or streamlining purposes.

- ESI found a way to lower its pension benefit obligation in 2008 by actually raising its discount rate assumption for the liability during a year when the obvious trend in interest rates was down. They managed this by changing their model for discount rate assumption during the period: In 2007, the Company determined the discount rate "by using the Moody's Aa corporate bond rate as of our actuarial valuation date". In 2008 however, the methodology changed to determining the discount rate "by performing a yield curve analyses which reflects estimated pension cash flows as of our actuarial valuation date". No reason is offered for the change which actually raised the discount rate assumption from 6% to 6.5% for 2008. The act of raising the rate served to reduce the amount of pension benefit liability on the Company's books from what would have been recorded had the rate been left at last year's 6% level. Perhaps it's no surprise that ESI made no contribution to its pension plan during 2008.