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

Insider Research Bulletin

April 7, 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.

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

Companies in this Bulletin

- Mattel, Inc. (NYSE:MAT)
- Walter Industries Inc. (NYSE:WLT)
- Movie Gallery Inc. (NASDAQ:MOVI)

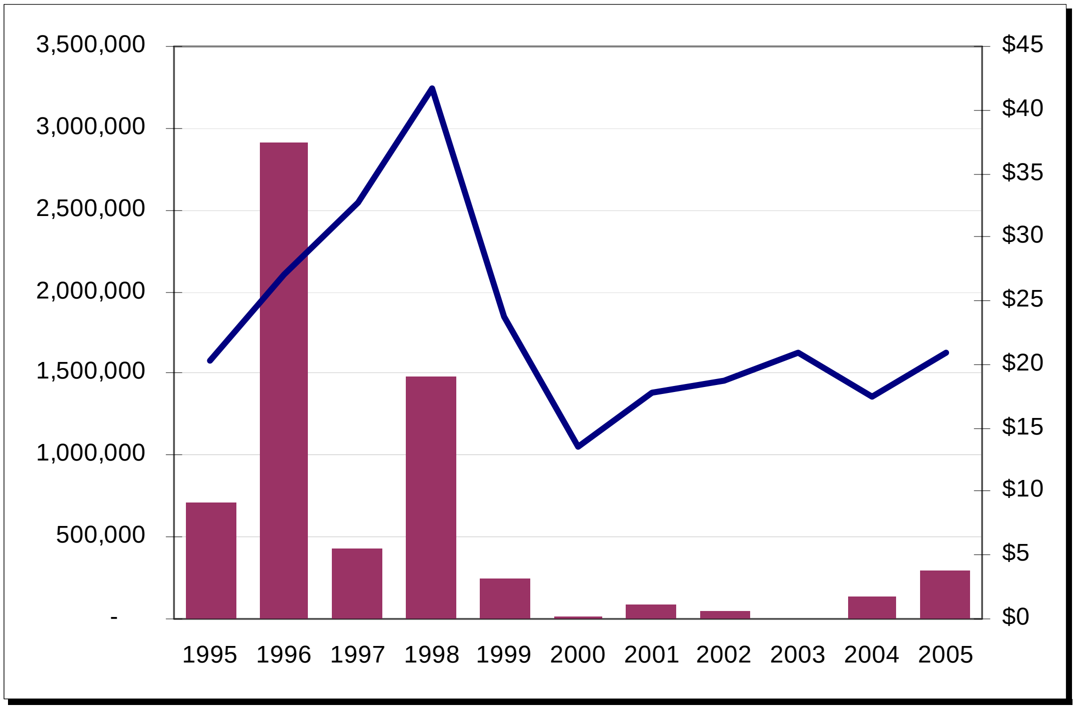
Discussion of 3DAdvisors Findings

Mattel, Inc. (NYSE: MAT)

Though Mattel was able to beat analyst expectations in the fourth quarter of last year, prospects for 2005 remain unchanged, which was confirmed by the Company's chief executive who went on record saying, "As we look forward, the business environment in 2005 doesn't look that different from 2004. We expect input costs to go up primarily as a result of oil-based revenue and transportation prices, as well as other commodity and labor costs." Surprisingly, investors traded the stock higher on the earnings news despite the tepid forecast, prompting insiders to lock in gains on the bounce. From February 10th through February 25th, four insiders sold a total of 287,990 shares at an average price of $20.90.

Though none of the sellers sold more than 20% of their actionable holdings, one has to look back to early 1998 to find a round of selling that included not only this many participants, but an equivalent share volume. Equally revealing is the fact that even though the issue has exhibited some short-term momentum, these sales were executed at prices 50% less than they had been in 1998.

Figure 1. Shares Sold by MAT Insiders (Red Bars and Left Scale) and Average Price of Shares (Blue Line and Right Scale). Source: MAT SEC Filings.



It is our belief that these sales were not motivated by individual cash indigence, as this executive team has the most lucrative compensation packages within its peer group. The Company's compensation philosophy aims to provide "compensation packages at or above the average for global consumer product companies," which they justify as being "essential to attract executive talent." But at what point does this become excessive? In addition to receiving cash and restricted stock valued at $28.2 million between 2000 and 2003, Mattel's chief executive **Robert Eckert** received 3.75 million stock options. To put this into perspective, Hasbro's chief executives received cash compensation of $6.83 million and 1.14 million stock options over the same period. Employment agreements for Mattel's top execs provide many of the same benefits given to the chief executive, so we can infer that their compensation levels also greatly outpace those in parallel positions at other peer companies. Since Mattel's 2004 compensation figures won't be released for another few weeks, we will have to wait and see if there are any material changes. However, the Company granted Eckert a stock option for 375,000 shares in April 2004, which is in line with prior years.

In addition to hefty salaries and bonuses, there are, notably, other liberal components to Mattel's compensation picture that should be highlighted:

➲ The Company provided non-recourse loans to nearly all its top execs in 1999 and 2000, including $10.9 million loan to Eckert that was forgiven. These loans, and the related taxes, did not have to be repaid as long as the executive remained with Mattel through 2003.

- The Compensation Committee has the ability to grant departing executives severance packages that "significantly exceed the severance benefits required under an executive's contract." This holds true for executives that are terminated due to poor performance.

Table 1. Cumulative Compensation of Toy Industry Chief Executives for 2000-2003. Source: Respective Company SEC Filings.

Chief Executive	Co.	Base Salary	Annual Bonus	Restricted Stock	Options	LTIP
R. Eckert[1]	MAT	$4,538,986	$7,971,372	$7,711,516	3,750,000	$8,000,000
A. Verrecchia[2]	HAS	$3,925,586	$2,911,170	- -	1,145,000	- -
A. Lipson[3]	MVL	$2,716,730	$812,500	$1,190,000	410,000	- -
J. Friedman	JAKK	$3,403,000	$6,076,627	$2,524,800	200,000	- -

[1] Eckert joined MAT in May 2000
[2] Verrecchia became CEO in May 2003. Figures include the compensation of his predecessor.
[3] Lipson became CEO in January 2003. Figures include the compensation of his predecessor.

- Severance agreements provide for three years of salary, two years of bonus, three years of health insurance, outplacement services, financial counseling and tax preparation services, country club membership, and the continued use of leased automobiles.

- On March 16th of this year, the Compensation Committee amended Eckert's employment agreement to include the use of a Company aircraft for *personal use* up to 60 hours per year.

- Though the chief executive's employment agreement provides for an initial term of three years, each day that he is employed his contract is extended for an additional day. For other top executives, their three-year term is extended an extra month for each month they are employed.

It would appear that, given such generous compensation packages, it is doubtful that these executives were relying on equity profits in order to finance their lifestyles. Some other motivation, most likely, lies behind their selling. At the very least, they could be feeling that their shares may have less upward potential than downside risk for the intermediate term.

- **Matthew Bousquette (46)** – President, Mattel Brands. Bousquette heads Mattel's largest division, which includes Barbie fashion dolls and the "Wheels" products. This also happens to be the division dragging down the Company's profits, as domestic sales, primarily those of Barbie products, were down in 2004. Despite his business unit's troubles, Bousquette was issued a special restricted stock grant on March 16th, provided as an incentive for his "critical leadership." But prior to receiving the grant, he executed only his second sale since initially filing as a Section 16 insider back in 1999. On February 25th, Bousquette sold 37,990 shares at $20.99, which was considerably larger than his 3,906-share sale in November 2004 at $17. Prior to the November sale, he had purchased 38,000 shares in late 1999 at an average price of $17.50. Bousquette still has the second largest ownership position of all named executives.

- **Kevin Farr (47)** – CFO. Between 1996 and 2004, Farr executed only five sale transactions, none larger than 6,250 shares, at an average price of $28. That's why his sales totaling 100,000 shares at $20 on February 10th and February 11th caused us to take a deeper look. Farr has been a director at Beckman Coulter (NYSE: BEC) since October 2004, which gave us the idea that he might be diversifying his Mattel holdings and redirecting the money towards shares of BEC, as we see on occasion from new directors building their ownership position. So far, this hasn't been the case, as Farr has made no purchases of Beckman Coulter, leading us to believe that this sudden behavioral change may be related to his lack of confidence in the potential for further upside for Mattel shares.

- **Joseph Eckroth (46)** – Chief Information Officer. On February 22nd, Eckroth sold 50,000 shares at $20.75, marking his first transaction since becoming a registered filer back in 2000. Eckroth acquired the shares from the exercise of an option with over five years remaining before expiration. Due to a lack of disclosure on Eckroth's options holdings, the sale's effect on his actionable position (exercisable options and common stock) is indefinable; however, he is the only seller that currently doesn't own any common shares.

- **Alan Kaye (51)** – Senior V.P., Human Resources. Like Eckroth, Kaye has been with the Company since 2000, and only recently surfaced with his first transaction. On February 17th and February 18th he exercised one option series with a February 2010 expiration and monetized the newly-acquired 100,000 shares at $21. Kaye hasn't reported his options holdings on any of his SEC filings, but does disclose that he holds a total of 2,438 shares of common stock, all of which are in his 401(k).

Walter Industries Inc. (NYSE: WLT)

Walter Industries, formerly known as the Jim Walter Corp., has had a tumultuous run since Kohlberg, Kravis, Roberts (KKR) took the Company private back in 1987. A class action lawsuit in1989 forced the company into Chapter 11, which it finally emerged from in 1995, and later resumed trading on the NYSE two years later. But Wall Street never really warmed up to the Company, which had been defined by its stodgy homebuilding and pressure pipe divisions. Shares of Walter failed to trade above $15 between 1999 and mid 2004.

That was until late 2004 when the Company finally caught a break, as an increasing demand for steel boosted coal prices. The Company's coal division, which produces metallurgical coal used to manufacture steel, went from being the worse performing division in 2003 with an operating loss of over $25 million, to becoming the best performing, most profitable division, contributing over $69 million to operating income. This remarkable turnaround has prompted the Company to redefine its business strategy, which in past years had focused on its homebuilding and industrial products divisions – both of which have struggled due to increasing supply costs.

Table 1. Business Segment Operating Income 2002-2004 ($000). Source: WLT SEC Filings.

Business Segment	2002 Oper. Inc.	2003 Oper. Inc.	2004 Oper. Inc.	% of 2004 Total Revenue
Homebuilding	$17,100	$1,450	($33,347)	15.9%
Financing	$55,000	$51,891	$54,838	16.6%
Industrial Products	$41,900	($11,946)	$7,609	37.2%
Nat. Resources (Coal)	$22,400	($25,564)	$69,702	24.0%
Other (Sloss Div.)	($28,500)	($17,394)	($20,253)	7.5%

In the 2003 Proxy, Walter headlined its low-sulfur steam coal operations, which sells primarily to a mix of energy companies, as its largest revenue generator within the division. However, the language changed in the 2004 Proxy, shifting focus to its $100 per ton metallurgical coal operations, and made no mention of its $38 per ton low-sulfur steam coal mining. The Company not only elected to extend operations in Mine 5 (one of its three active mines), but announced that it would be investing $135 million, its largest capital investment into any one business segment in a number of years, into Mine 7, which should be in full production from the expansion in 2008. Walter has clearly redefined itself as a coal play, and a metallurgical one at that.

Despite a skyrocketing stock and new identity, Chairman, President, CEO **Don DeFosset**, who had only been on the job for four years, abruptly resigned from the Company on February 22nd, leaving the board to find a new chief executive. Scrambling to keep the departing exec around through the transition, the board amended his severance agreement. The original agreement dated November 2, 2000, provided compensation under two circumstances: if DeFosset was involuntarily terminated for "no cause", or, he resigned due to a significant reduction in pay or responsibilities. Since DeFosset apparently didn't leave for either reason, it would appear that he was not entitled to any benefits. However, the board amended his employment agreement on March 2nd to allow for not only the full benefits under the original severance agreement, but also added new components (in red) not originally included in his employment agreement. The severance package provides for:

- Twenty-four months of salary equal to $1.45 million, no matter how long the search takes
- His prorated 2005 bonus plus an extra year's bonus
- Two years worth of health insurance
- Car allowance for two years
- Three year extension on options vesting
- Participation in both profit sharing and Employee Stock Purchase (ESPP) plans

- Country club membership and financial/tax planning services for two years
- Career service expenses up to $250,000

Shortly after announcing his resignation, DeFosset exercised all of his vested options and unloaded 81% of his holdings, valued at $22.7 million. But he wasn't alone, as between February 25th (three days after DeFosset resigned) and March 15th eleven insiders (including DeFosset) sold a total of 897,452 shares from $38 to $39.96. We're not willing to simply write this off as run-of-the-mill profit taking.

These insiders distributed four times the amount of shares they sold *in total* between 1996 and 2004, and though the shares have moved up dramatically and as a result we would expect to see some profit taking, there could be additional underlying catalysts for the activity. It has been made clear on the Street that the board has opened its chief executive search exclusively to outside candidates, leaving us to question the morale of any insiders that thought they were in line for the position, specifically CFO **William Ohrt**, General Counsel **Victor Patrick**, and President, COO of Jim Walter Resources (coal division) **George Richmond**, who sold 53%, 63% and 47% of their actionable holdings, respectively.

While a number of shareholders, including KKR which liquidated its entire 10 million share position and relinquished its two seats on the Walter board in October 2004, apparently would have rather held cash than Walter shares, there is one investor who clearly feels the opposite. In November 2004, **David Tepper** of Appaloosa Management picked up 5.89 million shares, positioning it as the Company's largest shareholder with a 15.6% stake. Appaloosa has been making some sizeable moves into both coal and steel, buying up shares of Consolidated Energy (OTC: CEIW.OB), Massey Energy (NYSE: MEE), and International Steel Group (NYSE: ISG), to name a few, and now has 61.6% of its portfolio tied up in coal and steel stocks.

It is quite possible that DeFosset's resignation is a result of Appaloosa's newly-acquired influence over the Company, as Tepper is known for being a hand's-on investor. Tepper has already convinced both Walter and International Steel Group to make some hefty investments in their coal operations, and is even involved in an unrelated, but telling hostile takeover of Beverly Enterprises (NYSE: BEV), which the board is attempting to fend off. The pickup in insider selling could be a clear indication that Walter's incumbent executives are not only disenchanted with the external chief executive search, but might fear their executive team is being stripped of its authority as well, despite assurances from the board that it would not be adding a new member from Appaloosa.

A few points of interest: it should be noted that Walter's disclosure of its executives' beneficial ownership is inaccurate and misleading. The Company includes unvested restricted stock holdings in the reported common stock ownership in both the annual Proxy and Form 4s. Typically, the only shares to be included in these holdings are common stock and any equity that is exercisable within 60 days of the record date. By including the unvested restricted shares, which do make up a material amount of their *reported* holdings, they give the impression that their *actionable* holdings are much larger than they actually are.

- **Don DeFosset (55)** – Chairman, President, CEO. DeFosset is credited for resuscitating the Company since being brought over in 2000. Shortly after coming on board, he purchased 20,000 shares in February 2001 at $8 and never sold any shares thereafter. However, following his abrupt resignation on February 22nd and the Company's subsequent release of its full-year financials, DeFosset exercised all of his vested options (expiration dates: 11/10, 2/12, 2/13, 2/14) and monetized the acquired 576,272 shares at $39. The sales, which occurred between February 25th and March 15th, **trimmed his holdings by 81%** and leave him with 123,000 shares of common stock. Though the selling by a departing executive doesn't normally grab our attention, under the terms of his retirement agreement, DeFosset was given three years to exercise his vested options. Therefore, there is no retirement-related urgency to cash out.

- **George Richmond (54)** – President, COO, Jim Walter Resources. It appears as if the DeFosset resignation, and forces causing it, has possibly spooked George Richmond. Richmond took over as head of the Jim Walter Resources (coal) division in 1997 and had only sold a total of 8,000 shares between that time and 2004. In fact, after the stock climbed over 65% between November 2004 and December 2004, Richmond sold a mere 5,000 shares. But just days after DeFosset announced his resignation, he began dumping his shares. From February 25th through March 15th, Richmond exercised six series of options with expiration dates ranging between July 2005 and February 2013 and even cleared out four of the series. He then sold 84,593 shares, or roughly **47% of his holdings**, at an average price of $39.06. We are definitely interested to see the head of Walter's most promising division, the division receiving a large capital investment, showing the most trepidation.

- **William Ohrt (56)** – Executive V.P., CFO. On February 25th and March 11th Ohrt executed his first sales since joining the Company back in 2001. First, he exercised three non-expiring options with expiration dates between January 2011 and February 2013, and then monetized all 45,817 shares at $38. He also reached into his common stock holdings to sell an additional 8,486 shares, which is unusual considering he does hold more vested options. Then in March, he exercised 30,000 more options out of the January 2011 series and sold those shares at $39.50. Following the sales, Ohrt's position was **53% lighter** than it was a few weeks earlier and he will not have any new options vest until January 2006.

- **Victor Patrick (47)** – Senior V.P., General Counsel, Secretary. Patrick joined the Company in August 2002, but didn't surface with any transactions until he began distributing shares in August 2004. After having sold 22,460 shares through November, Patrick resumed his activity, first exercising two series with expiration dates in August 2012 and February 2013, and then sold the 30,191 shares between February 25th and March 15th. The sales, which comprised **63% of his actionable position**, were executed at an average price of $39.26. Patrick will have 16,666 new options vest in August, but no additional options will vest until February 2006.

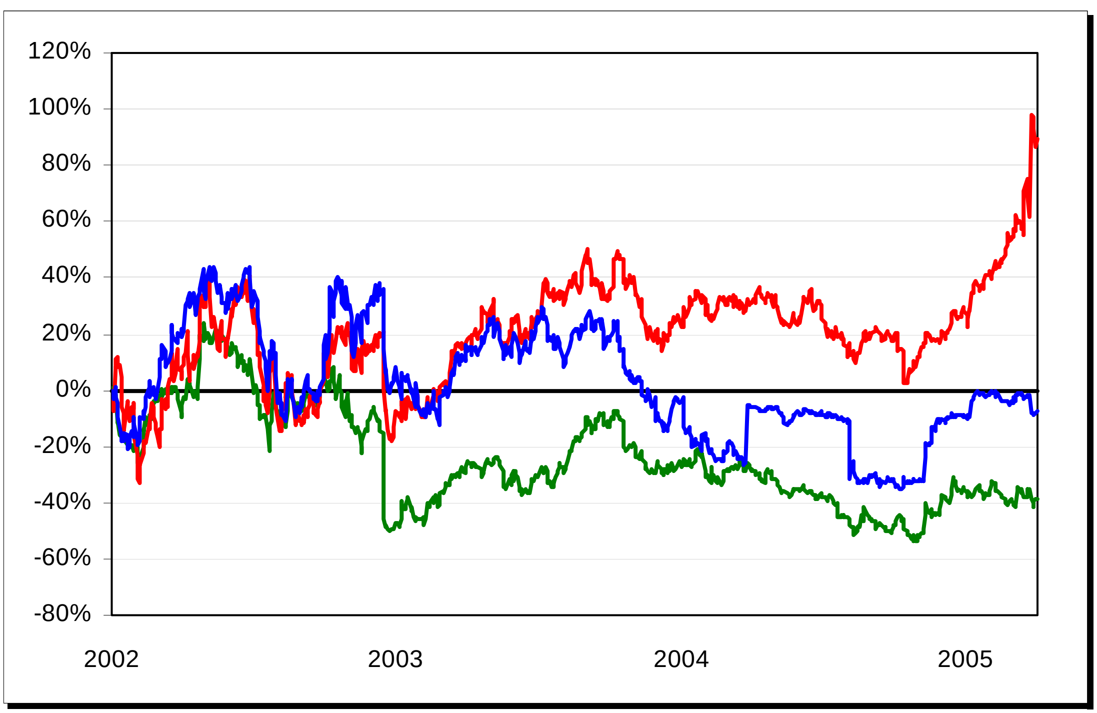
- **Joseph Troy (41)** – Senior V.P., Financial Services; President, Mid-State Homes. Troy joined the Company as treasurer in 1998 and assumed his current position in November 2000. Prior to 2004, Troy had only purchased 2,000 shares back in 1998. From August 2004 to December 2004, Troy sold a total of 4,445 shares as the issue climbed from $13 to $27. His activity picked up on February 25th and March 15th when he **shed over 90% from his ownership stake** with sales totaling 45,414 shares.

In addition to the selling execs, there are two directors that joined the round of selling. On March 9th **Neil Springer (66)** exercised two series of non-expiring options (expiration dates: 4/02, 4/03) and sold the 4,001 shares at $38.20. The sale was his first since joining the board in August 2000 and pared back his holdings by 47%. Springer sits on the boards of IDEX Corp. (NYSE: IEX) and USF Corp. (NASDAQ: USFC), but has only acquired shares of both companies in the past year. **Jerry Kolb (69)** sold 36% of his holdings on March 11th with a 1,333-share sale – his first since joining Walter in June 2003.

<u>Movie Gallery Inc. (NASDAQ:MOVI)</u>

Movie rental retailers are definitely on their heels due to increasing competition from retail DVD sellers, subscription services, and those offering video on demand. Anyone looking for confirmation need only to read through Blockbuster Inc.'s (NYSE: BBI) recent bleak 10-K, which is filled with market risk disclosures and a cautious 2005 forecast. In a move the Company believes will increase store traffic, Blockbuster terminated its "late fee" policy, which in the short-term, will trim 2005 revenues by nearly $450 million. Meanwhile, competitors Movie Gallery Inc. (NASDAQ: MOVI) and Hollywood Entertainment Corp. (NASDAQ: HLYW) haven't fared much better. Movie Gallery reported flat net income for the past two years; while Hollywood's net income has been in a tailspin over the same period.

Figure 2. BBI, MOVI and HLYW Stock Performance (Percent Change Since 01/02/02). BBI=Green; MOVI=Red; HLYW=Blue. Source: Reuters



In an attempt to breathe new life into their respective businesses, each company has been weighing both internal and external initiatives for a quick fix, but what's transpired over the past three months is eerily reminiscent of some of the notorious 1980's-era takeover battles. First, Hollywood's founder and chief executive, **Mark Wattles**, unsuccessfully attempted to take his Company private last March. After meeting resistance from the board, he began shopping the Company around. Blockbuster, smelling blood in the water, made an offer in November, but Movie Gallery, sensitive to the fact that a Blockbuster acquisition could put it out of business, jumped into the fray. Hollywood accepted MOVI's offer on January 10th, forcing Blockbuster to proceed with hostile takeover tactics.

The following day, February 3rd, industry frustration boiled over as Wattles resigned from the company he had founded in 1987. Meanwhile, MOVI insiders, displaying something other than confidence, sold 152,938 shares on March 23rd and 24th, just a week after reporting full-year earnings below Wall Street consensus expectations. Either believing that their bid for Hollywood would fall short, or just severely misjudging the Street's reaction to a potential win, the group converged to sell material amounts of their holdings, including Chief Financial Officer **Ivy Jernigan**, Chief Administrative Officer **Mark Loyd**, and Chief Operating Officer **Jeffrey Stubbs**, who monetized 67%, 50% and 37% of their holdings, respectively.

At the same time that MOVI execs were cashing out, Wattles dumped his entire position in Hollywood, equal to 6.14 million shares, or 9.6% of the Company's outstanding shares. Apparently, these industry insiders are either oversensitive or quite possibly are unconvinced that the pending consolidation is enough to inspire a turnaround in their results. In any case, just days after cashing out, pressure from the FTC forced Blockbuster to rescind its bid and shares of MOVI jumped over 20% on the news.

Table 3. Holdings Reductions by MOVI Insiders. Source: MOVI SEC Filings.

Insider	Position	Holdings Reduction
K. Cousins	EVP	26.2%
I. Jernigan	EVP, CFO	67.2%
J. Jump	Director	33.3%
M. Lewis	SVP, Treasurer	48.1%
M. Loyd	EVP, CAO	49.7%
J. Stubbs	EVP, COO	37.2%

We must point out that as stand-alone companies, Movie Gallery ($882 million) and Hollywood Entertainment ($853 million) fall below our mid-cap size criteria. However, should the merger receive shareholder approval later in the month, the combined entity will be the second largest company in its industry with combined sales topping $2.6 billion. Though we often overlook insider sales that surface out of merger-related antics, this recent activity from players from each company involved is too compelling for us to ignore.

One interesting industry note: on March 21st, Blockbuster announced that Chairman, CEO **John Antioch** would forgo $751,823 in deferred compensation as part of the Company's "cost containment efforts." The move made sense considering Blockbuster recently announced an operating loss of $1.25 billion in 2004 and would see further deterioration stemming from the abolition of its "late fees" policy. To further reduce costs, the Company issued a press release on March 31st disclosing that it would be cutting 20% of its workforce in its corporate headquarters. Antioch justified the layoffs as they were designed to "compensate for a planned $70 million increase in marketing spending this year to promote the company's new online rental business."

But what he apparently forgot to mention was that the same day as the layoff announcement, the Company released its 2004 Proxy which included an amendment to Antioch's employment agreement. Not only did he receive a 25% base salary increase, but was given a $5 million annual bonus, which is based on the attainment of a "requisite level of operating income." It seems outlandish that the Company can slide from an operating profit of $347 million in 2002 to a **loss** of $1.25 billion in 2004 and Antioch receives $10 million in bonuses over two years. In addition to the cash compensation, he was granted 5 million stock options and restricted stock valued at $26.7 million. Where do we sign up?

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