3D ADVISORS

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

Accounting Behavior Helps Explain Insider Selling Oshkosh Truck Corp. (NYSE:OSK)

June 23, 2005

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

Oshkosh Truck Corporation engages in the design, manufacture, and marketing of various trucks and truck bodies. The company operates in three segments: Commercial, Fire and Emergency, and Defense. The Commercial segment offers concrete mixer systems; refuse truck bodies; mobile and stationary compactors, and waste transfer units; portable and stationary concrete batch plants; and truck components to ready-mix companies, and commercial and municipal waste haulers primarily in the United States, as well as in Europe. The Fire and Emergency segment provides commercial and custom fire trucks and equipment; towing and recovery equipment; aircraft rescue and firefighting trucks; snow removal trucks; ambulances; and other emergency vehicles to fire departments, airports, and other governmental units in the U.S. and abroad. The Defense segment offers heavy- and medium-payload tactical trucks and supply parts to the U.S. military and to other foreign militaries. Oshkosh Truck also offers lease financing services in the United States. In addition, the company provides service for carriers and wreckers. It offers its products primarily in the United States and Italy, as well as in Europe, the Middle East, and North Africa through salespeople, representatives, and distributors.

Summary of 3DAdvisors Findings for OSK

- **Accounting:** Avoiding lower forecasts and impairment for faltering acquisition
- **Accounting:** Another subsidiary fails to deliver promised results
- **Insider Trading:** Things look good on the surface, but insiders head for exits
- **Accounting:** Timely application of “catch-up” adjustments boosts earnings
- **Accounting:** Lowered product and general liability reserves
- **Accounting:** If steel prices rise again, the impact could be material

---

Discussion of 3DAdvisors Findings

As we indicated in the *Insider Research Bulletin* published on 06/06/05, Oshkosh Truck represents a great example of a company whose insider behavior contrasts sharply from what the general investing public, and the media, seem to have embraced. There is a small, and shrinking, short position in the shares and press reports read like analyst "buy" recommendations. Indeed, with 33% of OSK's revenues coming from the U.S. Government (mostly Dept. of Defense), the Company's windfall "Iraq Dividend" appears far from over. So what's not to like about the Company's prospects? We had to ask ourselves this question over and over while reviewing several accounting issues and before our decision to highlight OSK in a 3DA report. The fact, however, that insiders show such a proclivity towards monetizing their existing holdings, while everything seems to be going so swimmingly well, is not something we're inclined to ignore.

Our search to provide some explanation for the persistent selling and big holdings reductions in the face of good news has revealed a number of other interesting executive behaviors and risks. These include ongoing problems in the Company's commercial segment (mainly in Europe), interesting timing issues related to the application of Percentage of Completion accounting methods that have had a material impact on earnings, low-balling of management earnings forecasts and some timely movement in certain reserves. In addition, analysts have raised questions about lingering production problems and exposure to steel prices. From this mosaic of behaviors and risks a picture has begun to emerge where the trading behavior is starting to make much more sense.

Accounting: Avoiding lower forecasts and impairment for faltering acquisition

Geesink Norba is a European subsidiary serving the refuse hauling market. When OSK first acquired the company in July of 2001, management was projecting that refuse product sales for the manufacturing subsidiary would grow at 2.8% annually, even assuming no recovery in the European markets. By Q1 of 2004, however, OSK began projecting "relatively flat" refuse sales for the year. By Q2 of 2004, OSK began referring to "low production volumes" at Geesink Norba, continuing, however, its forecast of flat sales for the year. By Q3 of 2004, the "flat" forecast for 2004 had been changed to a 3.1% decline in sales, moving out the "flat" sale projection to F/Y 2005.

By the end of F/Y 2004 it became apparent that impairment loomed as a possibility when OSK admitted that sales volumes in the refuse collection vehicle market had declined over 20% from 2001 levels (the year Geesink was acquired) including the more ominous detail that 15% of this had occurred in 2004 alone. In spite of these declines, and mounting losses at Geesink, Oshkosh management staved off an impairment charge based on "the Company's estimates of improving European refuse market conditions beginning in fiscal 2006".

By Q1 of 2005, Geesink had sunk deeper into the red, forcing the Company to reduce its earnings estimate for the subsidiary from operating income of $3 million to an operating loss of $4.5 million. This again prompted an impairment review of the $133 million Goodwill number associated with Geesink but impairment was avoided by convincing auditors that "the Company made a number of management changes at the Geesink Norba Group, and in January 2005 assigned a team of Company representatives to support the turnaround activities of the business full-time for a minimum of a four-month period. Based on the investigations and work performed since September 30, 2004, the Company presently believes that it will be able to return the business to acceptable profitability over a nine to eighteen month period…"

At Q2 (F/Y 2005), however, Geesink Norba had already incurred an operating loss of $4.2 million but Oshkosh management claimed that it expected only “minimal operating losses in the remaining two quarters of fiscal 2005”. Interestingly enough, the same nine-to-eighteen month period was cited (same period of time estimated in the previous quarter) for Geesink to return to profitability. Still, no impairment charge, however, the Company repeatedly refers to the risk of impairment here, impairment that is not included in management’s forecast going forward.

Of course, in cases such as these, it is interesting to note how Oshkosh refers to looming impairment as a non-cash charge. Never mind the fact that real cash was used to purchase Geesink in the first place. What interests us most is the *behavior* exhibited by management in this case, rather than the absolutely impact in dollar terms. Perhaps an even more poignant fact is that the very person in charge of turning around the European situation is none other than **Michael Wuest**, who has recently converted about 70% of his holdings to cash (see below).

Accounting: Another subsidiary fails to deliver promised results

Fueling analyst frustration, in Q2, was unexpected margin erosion in the Commercial segment which emerged not from Geesink, but McNeilus, the OSK subsidiary which makes and markets commercial specialty truck bodies, including concrete mixers and related equipment. The Company was prompted to admit that margins were held down by the fact that there were more lower margin items shipped than expected during the period. Due to this, the expected doubling of margins never materialized. To us, and to at least one clearly frustrated analyst (on the conference call), the answer that the miss was a result of lower priced items in the backlog just does not wash. If they had any kind of order entry system, they should have been able to price their backlog to find out what is in there, and at what price.

Insider Trading: Things look good on the surface, but insiders head for exits

As our June 6th *Insider Research Bulletin* highlighted, there was nothing subtle about the pace and magnitude of insider selling after the May 3rd (second quarter, see Figure 1 below) earnings release, when trading in OSK shares revealed a classic “sell on the news” pattern.

But the news did look good, at least on the surface, as Oshkosh posted strong Q2 results and raised its 2005 guidance from $3.85 per share to $4.25. Further inspection, however, caused us to suspect that OSK had been “low balling” its previous guidance and it was the defense divisions that drove the results. In fact, the entire guidance lift came from catch-up adjustments associated with percentage of completion accounting for its medium-tactical vehicle replacement (MTVR) contract (see below). Also hidden in the numbers were the above-mentioned issues with the Commercial segment: The looming impairment charges associated with Geesink Norba and, for the first time, strong indications that all was not well at McNeilus. It didn’t take too long for us to note that investors were not the only crowd selling on the news. Insiders, including two of the four audit committee members, had joined in as well:

Figure 1. OSK Daily Closing Price, June 1, 2003 through June 22, 2005. Blue shaded area is where 9 insiders sold 486,933 shares (May 13 through June 2). Source: Reuters and OSK SEC Filings.

- **Michael Wuest (45)** – Executive V.P., President, McNeilus Companies. Not lost on us is the fact that Wuest is the executive in charge of turning things around in Oshkosh's suspect Geesink Norba division. Since he heads up McNeilus as well, you might say he's the person in the "hot seat" for now. His recent sale of 77,000 shares (he had sold just 9,750 between 2000 and 2004) **cleared out somewhere between 66% and 72% of his holdings**. Due to the poor disclosure of Wuest's option grants over the years, it is tough for us to completely assess his holdings deterioration, but we know it is significant. Even devoid of the information we are still able to make some pretty accurate deductions. We know that Wuest recently cleared out all four of his options series granted between 1997 and 2000 (none in danger of expiration any time soon). Though we are not sure how many options he was awarded in 2001 and 2002, judging from what those at his executive level received, it is a pretty safe assumption that he now holds between 15,000 and 25,000 fully-vested options from those years, and will have just another 17,933 restricted shares vest by year-end. Not a strong statement from the person in charge of a critical-path segment turnaround.

- **Charles Szews (47)** – Executive V.P., CFO. Szews has been a relatively infrequent trader since joining the Company in 1996. Since assuming his present position in 1997, he had only sold 63,000 shares in July 2003 at $32 and 118,000 shares in November 2004 at $62. His recent sales on May 18th and May 19th totaling 140,000 shares come at higher prices, which are expected, but carry a much different effect: Whereas Szews' past sales have had an immaterial effect on his holdings, the **recent**

activity has put a serious dent (60%) in his personal holdings. The difference lies in his incentive awards, which were down 50% from 2002 to 2004. Since 2005 awards will not be issued until October, we will have to see if this declining trend continues.

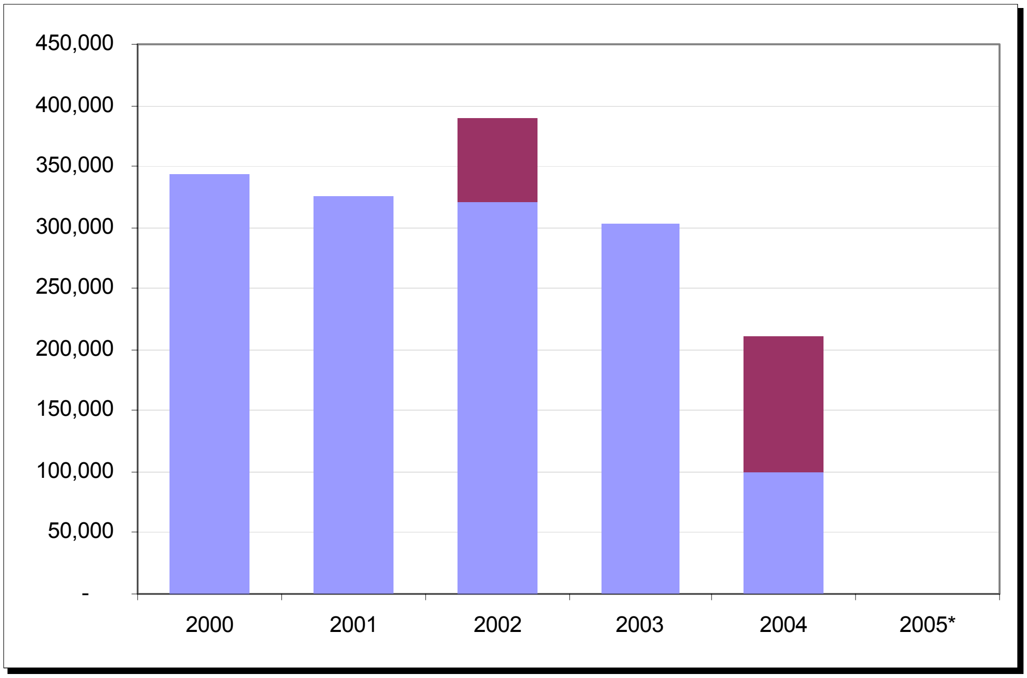
- **J. William Andersen (66)** – Director. On May 23rd Andersen, a board member since 1976 (currently on the Audit committee), exercised his March 2011 and March 2012 option series and sold the underlying 9,000 shares at $80. Andersen has now sold more shares through the first half of 2005 (he sold 5,000 shares in February) than he had in any prior year. The **year-to-date sales have trimmed his holdings by 67%** and now leave his ownership position at its lowest level since 1995. OSK directors are granted a total of 2,150 options and restricted shares per year which vest annually over a three-year period. Andersen does not sit on the boards of any other publicly-traded companies.

- **Richard Sim (60)** – Director (Chairman of the Audit Committee). Though he's served on the board since 1997, it wasn't until August 2004 that Sim surfaced with his first (and only) distributions as he cleared out all 16,000 shares of his common holdings at roughly $50. Sim resurfaced on May 20th to sell 18,000 shares at $79.82. This time, with his common holdings drained, Sim turned to his options, as he monetized three long-held series (expiration dates: 3/08, 3/09, 2/10). **The sale liquidated 60% of his holdings** compared to the 35% of his position he sold in August 2004 – his position is now at its lowest level since 2000. Both Sim and Anderson were elected for an additional one-year term in February.

Equally as compelling is the behavior exhibited by the **Mosling** brothers, **Stephen (58) and Peter (60)**, descendents of Company co-founder Bernhard Mosling. Until a May 3rd conversion, the Moslings were the only holders of Class A Common Stock which carried full voting rights as opposed to Common Stock which has limited voting rights. The Company gave no reason for the early conversion, which according to a special agreement wasn't supposed to take place until either their "deaths or earlier incapacities" and now gives full voting rights to all shareholders of Common Stock. Shortly after the conversion, both brothers began actively selling their shares. Though the fact that selling from the pair isn't a new event, the reality that they now collectively hold 52% fewer shares than they did just three years ago certainly is material. We are always interested to see family members with a vested interest in a Company selling off a substantial amount of their holdings, especially in this case where they prematurely surrendered their voting control.

On a final note, we've highlighted a number of cases in the past where senior executives at other companies saw their incentive compensation waning year-over-year, but continued to sell, or even intensified their selling behavior, which led to holdings deterioration at an accelerated pace. We believe we are seeing the early signs of this transpiring at Oshkosh, where stock option and restricted share awards have regressed since 2002. The Company started to implement a more balanced mix between restricted shares and options in 2004, but the awards were still well below 2003 levels.

Figure 2. Incentive Awards Provided to Oshkosh Truck Named Executives. (Blue is option grants and red is restricted stock). Source: OSK SEC Filings.



* Options are granted annually in October

New grants will not be seen until October, but we expect to see the attenuating trend continue. Should insiders continue to take profits at this pace, not only will the holdings burn rate accelerate, but they will be setting in motion an irreversible trend once their vesting periods begin yielding fewer shares to replenish their already record-low ownership positions.

<u>Accounting: Percentage of completion accounting used to manage earnings</u>

It's certainly no secret that 33% of OSK's revenues come from the U.S. government, primarily from the defense truck market. The Company uses Percentage of Completion accounting methods for these contracts. In doing so, Oshkosh recognizes the existence of unbilled receivables but provides absolutely no quantification of their actual levels. What OSK does provide, however, is detail concerning recorded cumulative catch-up adjustments utilized to increase the overall margin percentages of its MTVR (Medium Tactical Vehicle Replacement) contract. These adjustments reflect favorable cost performance compared to previous estimates. In fiscal 2004, the adjustment was 2.1 percentage points (1.2 in 2003). These changes increased operating income by $19.5 million and net income per share by $0.34 in 2004 (12% of EPS).

Of course, the interesting component to this is the timing of the application of the adjustments. The effect was quite dramatic in Q2 of 2005 when catch up adjustments padded EPS by $0.24 per share (or 23% of EPS). This certainly helped quarterly comps as there was no such adjustment in Q2 of F/Y 2004. Oshkosh says that any future adjustments under the MTVR contract will not be material. Material or not, it would appear that there may be some additional adjustments in these margin estimates next quarter as well.

Year to date, there have been $22.6 million of MTVR margin adjustments recorded under the MTVR contract. With this contract winding down there will be no adjustments in F/Y 2006 which will make year to year comparisons rather interesting next year.

It seems to us that if inadequate systems, as implied by OSK management, truly caused the Company to not know the value of what was in the backlog at McNeilus (above), perhaps similar systematic problems prevent determining realistic margins on the MTVR contract. The requirements of Sarbanes Oxley that systems of internal controls be such that no significant misstatement in the preparation of financials is likely to occur ought to be a concern for both investors and independent observers.

Accounting: Lowered product and general liability reserves

Oshkosh is self-insured for future Product and Liability claims up to $1 million per claim and a reserve is maintained for the estimated costs of such claims. The Company lowered this reserve from $17.2 million (as of 09/30/04) to $10.8 million in Q1 (F/Y 2005), then took it a bit lower in Q2 to $10.5 million. The benefit to income, in Q1 to doing this, was hardly insignificant, as it provided $0.18 per share to Q1 earnings or 16% of EPS.

Accounting: If steel prices rise again, the impact could be material

It should be no revelation that Oshkosh is a heavy user of steel and aluminum. We find it interesting that the Company does not use commodity financial instruments to hedge commodity prices. This has burned Oshkosh in recent periods when steel prices have shot up, causing some of the Company's suppliers to break firm-fixed price contracts. Making this matter worse, Oshkosh's fixed price contracts with the government are not subject to adjustment to reflect its actual costs. Consequently, the Company was unable to pass along rapidly rising steel costs on to the Department of Defense.

Even though steel price advances have abated of late, there should be no doubt that the effects of previously-rising steel prices have impacted not only Oshkosh directly, but indirectly through its suppliers of truck chassis and other key components. Though Oshkosh has been raising its prices in the Commercial segment (2% in 2004, 5% in 2005), earlier orders in the backlog, such as those affecting McNeilus' margins (above), continue to not only penalize margins but embarrass company management to the extent that it claims it has not been able to effectively quantify their effect. Should steel prices resume their climb, these attendant pressures will, no doubt, endure.

Since rising prices have affected profitability in OSK's defense department business, Oshkosh "has sought substantially higher pricing for all new defense contracts executed….to recover the higher steel and component costs experienced to date".

Whether this affects Oshkosh's ability to procure future contracts remains to be seen. What is known is that the Company was not the selected bidder in a recent competition for a very large $2 billion U.K. contract calling for 8,500 cargo support vehicles.