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

- Cisco Systems, Inc. (NASDAQ: CSCO)
- CIT Group, Inc. (NYSE: CIT) ⬆
- SunPower Corp. (NASDAQ: SPWR)
- Tarragon Corp. (NASDAQ: TARR)
- VeriFone Holdings, Inc. (NYSE: PAY)

3DAdvisors Research Notes

Cisco Systems, Inc. (NASDAQ: CSCO)

- Chief Executive **John Chambers** has attracted attention since the Company's fiscal Q4 earnings release on August 8th, lobbying to The Street, media and investors, that a "robust economy" translates to higher than expected growth rates for the computer networking giant moving forward. Sell-side analysts have taken the bait, with many raising their ratings and price targets, along with technical analysts who predict further near-term momentum for the shares. But insiders paint a very different picture, giving us reason to suspect the stock might run out of steam here at the five-year highs. While the ownership of high level executives has eroded at an accelerated rate over the past 12 months, we are much more interested in the uncharacteristic option-related trades of three senior officers in recent weeks.

- Cisco shares gained as much as 10% in the aftermath of the latest earnings report, enticing four insiders to take profits on 1.3 million shares at an average price of $30.65. Included in the distribution count were 774,000 shares (60% of total) that were monetized from non-expiring options yielding pre-tax profits between 8% and 15%. We performed an extensive review of Cisco's option trading history and these proved to be the first cases on record of option "skimming", or monetization of options with strike prices very close to market. All of the options were scheduled to expire by April or June of next year, giving the holder two or three more quarters to expand the options' profit margins if they anticipated further earnings surprises. By monetizing these options in August, it suggests there were concerns the options could be in jeopardy of slipping under water over the next six to eight months.

- In addition to tapping into five options with expiration dates ranging between October 2011 and September 2014, Senior V.P., Worldwide Field Operations **Richard Justice** (57), a named executive, cleared out his April 2008 series covering 640,000 options that yielded a 12% profit. These sales were all executed under a 10b5-1 trading plan adopted in May. Dating back to 2001, Justice had never monetized options (more than 20 transactions) for a profit narrower than 25% and historically recognized an average pre-tax return of nearly 100% on his options. He has now sold 62% of his actionable holdings over the past 52 weeks. Similarly, Cisco's principal accounting officer and controller, **Jonathan Chadwick** (41), tapped into 11 different option series in August, two of which were not set to expire until April at the earliest and yielded slim profits of 8% and 17%. This is a sudden change for Chadwick who just months earlier (May) held on to options until the last moment (open trading window) before their expiration.

- Obviously, the key here is the skimming of stock options, but just as importantly, the fact these executives had in the past shown a preference for holding their soon-to-be-expiring options until the last possible date but are now cashing out months in advance is a subtle but potentially important behavioral shift. Take for example General Counsel **Mark Chandler** (51), an 11-year Company veteran, who exercised a series not set to expire until 2Q08. Over the past few years he held individual option series (July 2005 and April 2006) right up to their expiration date in order to recognize the most optimal returns. His five prior option-related trades generated an average pre-tax profit of nearly 200% compared to the 15% spread on those options he acted on in August, months ahead of the expiration date. The table below lists the profit margins on the recently exercised options and a historical comparison to their past option-related sales.

Executive	Min. Profit Margin 3Q07	Min. Profit Margin Historical	Avg. Profit Margin Historical
J. Chadwick	**8%**	33%	82%
M. Chandler	**15%**	40%	193%
R. Justice	**12%**	25%	96%

- We are currently in the earliest stage of analyzing Cisco's insider profile and suspect we will move forward on their earnings quality profile as well. One event that we feel needs to be addressed, especially in light of the recent insider behavior, is the August 8th resignation announcement of CFO **Dennis Powell** (59). Powell has been in his current position since 2003 (joined in 1997) and plans to retire around February 2008. None of Cisco's executive officers has an employment or severance agreement, and there is no formal retirement age, so at this time it is unclear what severance benefits he will be entitled to. While Powell said on the Q4 conference call that his retirement has been an ongoing discussion and attributed it to his age and "recent back problems", it does seem to be a curious time to step away as he even stated that the Company "is at the top of its game". The insider actions might really be a sign that Cisco has reached the proverbial top without room to advance.

CIT Group Inc. (NYSE: CIT) ⬆

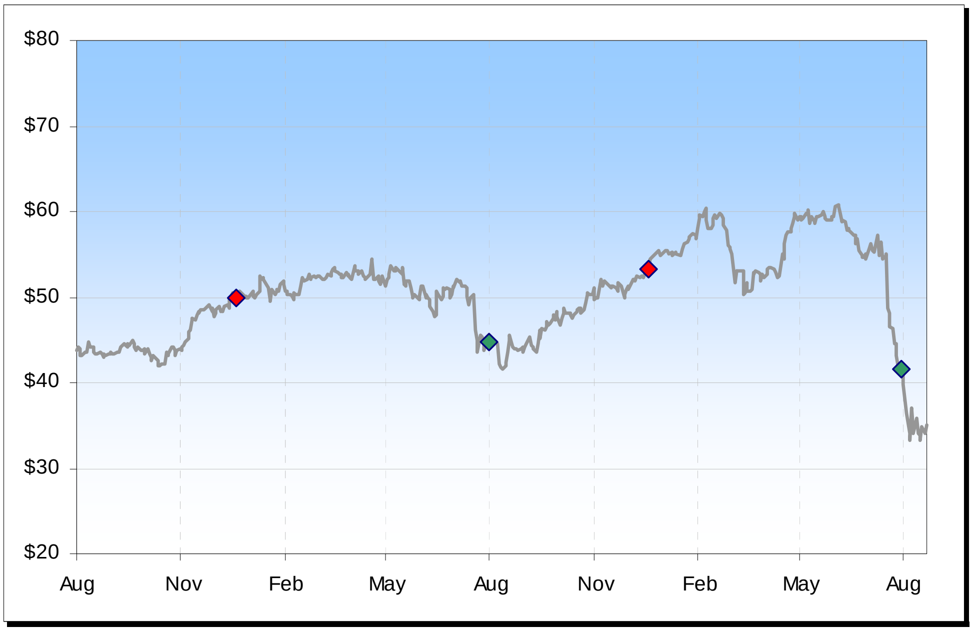
- Few bullish insider actions we cover have consistently returned better results than 10b5-1 plan terminations. In fact, the last occurrence we highlighted, GEO Group (see Research Notes dated 07/20/07), preceded a blowout earnings release and hiked guidance that resulted in gains of 20% following the plan cancellation. We now have another Company to call our clients' attention to, which has been a name we covered with much success in the past. We recommend revisiting the July report for further details on the bullish implications of 10b5-1 terminations and a list of examples from the past year.

- Shares of commercial and consumer finance company CIT Group have lost 35% of their value since July 1st due to the Company's distressed mortgage lending operations. In an effort to right the ship, albeit a little late as second half of the year guidance was slashed, CIT announced the closing of the loss-making division on August 28th. Sell-side analysts have not turned on the stock just yet, with many maintaining their recommendations and price targets owing to the Company's other profitable business units. Company insiders have also signaled their confidence in a turnaround by halting their 10b5-1 plan sales and turning to the open market to enlarge their positions. This is a significant reversal from the selling that transpired earlier in the year and might even support the circulated rumors that the Company could be taken out. Irrespective of the catalyst, management is betting the shares are headed for higher prices.

- The salient insider action here is the plan termination (SEC Form 8-K filed on 08/03/07) of Vice Chairman, Specialty Finance **Thomas Hallman** (54), who had been taking profits under a plan adopted in December 2006. We covered the same maneuver by Hallman in a Research Notes report dated August 8, 2006, which proved to be quite timely. Hallman terminated his prior plan after CIT reported a decline in second quarter 2006 earnings, which set the shares back 20%. Shortly after, the shares would stage a fierce comeback, gaining 45% over the next five months. Hallman, and those of his peers who did not formally terminate their plans but discontinued the sales, reaped higher profits by exercising patience and adopting new plans at a later date.

- By terminating his plan, Hallman is no longer permitted to sell until early 2008. We suspect the other executives who put the brakes on their 2007 sales plans (Chief Lending Officer **Lawrence Marsiello**, General Counsel **Robert Ingato**, and Controller **William Taylor**), did not terminate their respective plans altogether because they anticipate profit taking opportunities before the plans' January 31st expiration dates. It becomes even more apparent that the insiders see value at the current lows based on the open market buys of Chairman, Chief Executive **Jeffrey Peek** (59) and Director **Gary Butler** (60). Peek spent $830,000 purchasing 24,300 shares to fund a Grantor Retained Annuity Trust and Qualified Annuity Trust, his first trades, acquisitions or dispositions, since joining the Company in 2003. Butler's 5,000-share purchase ($35 range) was his third since joining the board in 2004, accounting for the only CIT buys in the past four years. It should also be noted that even with the plan selling over the past year, the total actionable holdings of the Company's top five executives grew nearly 25%, proving this management team has exercised judgment in their use of Rule 10b5.

Figure 1. CIT Daily Closing Price, 08/01/05 through 08/21/07. Red diamonds are where Hallman (and others) adopted trading plans; Green diamonds are where Hallman terminated his trading plans. Source: Reuters and CIT SEC Filings.



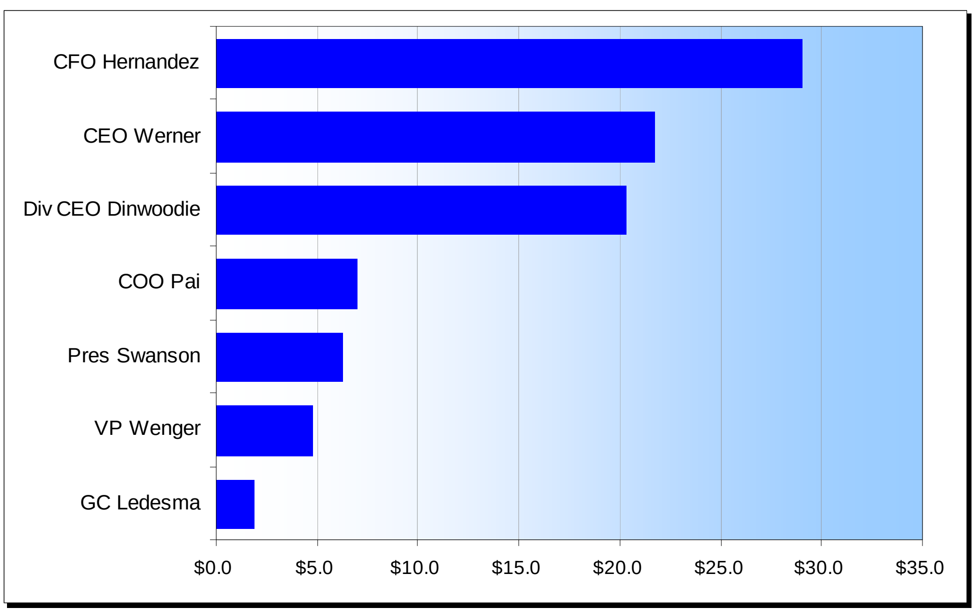
- In a related note, we are also monitoring the insider profile at small-cap communications equipment manufacturer Acme Packet (NASDAQ: APKT), where three executive officers, who collectively control 23% of the outstanding stock, terminated their own personal sales plans on August 6th. We were not as convinced these actions hold the same significance since the three Acme insiders have taken $25 million off the table over the past 10 months despite the shares having lost 40% of their value since the October 2006 IPO. What's more, the trading plans called for the sale of 15% of their respective ownership positions and were cancelled after 13% had already been distributed. Yet, in predictable fashion, APKT has gained 22% since the plans were cancelled. We will continue to monitor the situation.

<u>SunPower Corp. (NASDAQ: SPWR)</u>

- Solar power firms remain hot commodities on Wall Street despite their inflated valuations. Industry frontrunner SunPower maintains its prominent spot on our radar as well, albeit for very different reasons, as Company managers continue to shed their ownership at every turn. It has become increasingly more apparent that 10b5-1 plans of all seven of the Company's Section 16 officers call for the monetization of all derivative equity immediately upon vesting, regardless of share price. The insider behavior is shifting away from profit taking resulting from the unbridled momentum towards a "get out at all costs" approach, suggesting an increasingly bearish tilt to their behavior. Since first issuing coverage on the Company in an Insider Research Bulletin dated 06/05/07 and subsequent update in a June 15, 2007 Research Notes report, eight insiders have sold a total of 473,011 additional shares at prices ranging from $57 to $75.

- SunPower insiders have traded under personal sales plans since May 2006, diversifying away derivative equity that was exercisable prior to the November 2005 IPO and those which have become actionable on a monthly basis since. Although the Company has never provided any plan specifics, such as adoption and termination dates and shares subject for sale, we are able to decipher enough information from their actual trades to confirm the nuances of their goals. For one, it would appear trading plans have been formulated to monetize options and restricted stock at the earliest opportunity. The most obvious cases involve CFO **Emmanuel Hernandez** and COO **P.M. Pai**, whose sales are executed on or immediately after the options' vesting date each month. We have encountered fewer than five similar cases during our years of tracking 10b5-1 activity where multiple trading plans included this directive over a prolonged timeframe.

Figure 2. SPWR Executives' Pre-Tax Profit from Stock Sales Since May 2006 IPO (Millions of $). Source: SPWR SEC Filings.



- We also know these sales plans were established to limit insiders' exposure to SPWR shares, both common and vested derivative equity. The Company's seven registered officers have sold more than 70% of their cumulative actionable ownership year-to-date, while two independent directors sold 90% and 100% of their holdings. Notable sellers are: General Counsel **Bruce Ledesma (100%)**, COO Pai **(98%)**, and CFO Hernandez **(90%)**. Additionally, four of the seven officers currently do not hold any common stock. Bear in mind, it is not an effortless feat for SunPower insiders to maintain these low ownership levels with options and shares vesting at a monthly rate. The total profits (less option exercise costs) received from 10b5-1 trades since May 2006 are impressive to say the least and these figures are escalating at a steady clip (see Figure 2 above).

- Although the sales of **Betsy Atkins**, one of the Company's three independent board members, occur on a much smaller scale (9,201 shares sold YTD), her behavior bears as much significance as that of key operating officers. Atkins is a highly regarded corporate board presence, who currently also holds board memberships at Reynolds American, Polycom and Chico's FAS. A historically active profit taker at all four companies, she ceased all trading at each company *except* SPWR in May. Atkins has been regularly selling her SunPower shares since kicking off her own 10b5-1 plan in April, selling all newly-vested derivative equity each month since. The shares have come from four separate option series, as well as two restricted stock awards that vest quarterly. Her commitment to taking profits is so boundless she even tapped into her newest option series, not set to expire for another 10 years, which yielded a 14% profit. She had never previously accepted a spread less than 30% on her options, and over the past year, her option-related sales averaged more than a 300% return. We did not think it was possible, but the disparity between insider and sell-side analysts' sentiment does in fact continue to expand.

<u>Tarragon Inc. (NASDAQ: TARR)</u>

- We have been monitoring some companies that have been caught up in the current housing and sub-prime mortgage meltdown where certain trading behaviors of large shareholders may have contributed significantly to the extreme volatility and downward spiral experienced by the companies. Specifically, we are focused on situations where insiders, with large personal stakes, have pledged their shares to financial institutions as collateral for loans or margin accounts where the financial institution may "call" the loan if the share price falls below a certain level and sell the pledged shares on the open market. The two recent examples we cite here are Tarragon Inc. and American Home Mortgage, and how the behavior of insiders may have contributed to the nearly complete loss of value as the shares began to experience extreme volatility. Both Tarragon and American Home Mortgage have lost almost their entire value at this point, so we include them here only as examples. But we also wanted let our clients know we are considering a study to examine the extent to which these behaviors may represent additional but unseen risk in other companies and industries that could come under pressure as the debt crisis unfolds.

- For those not familiar with the name, Tarragon is an apartment and condominium developer/renovator that jumped into the frenzied South Florida market at its peak. The decline in the region's housing market and problems securing credit have ravished the Company, which earlier in the year had a market cap of $400 million and now is valued at just $27 million. While Tarragon's woes have received plenty of media attention, including clipped mentions of the recent sales by the Company's controlling stakeholders, Chairman, Chief Executive **William Friedman** (63) and his wife **Lucy Friedman**, the reporting does not paint the full picture.

- The Friedman's collectively held 12.4 million shares on August 1st, equal to 43% of Tarragon's outstanding stock. But what most are not aware of is that 12 million of these shares (97%) were pledged as collateral for margin accounts. In effect, 42% of Tarragon's outstanding shares, a staggering and dangerous amount by any measure, were in jeopardy of being sold by financial institutions in the event the Friedmans' personal accounts fell below the minimum margin requirement. And this is exactly what happened when Tarragon shares traded below $4 per share in early August. Between August 7th and August 22nd the Friedmans received margin calls covering 8.3 million shares, or 67% of their total holdings (30% of TARR outstanding stock). It is presumed the brokers sold the shares on the open market, putting additional downward pressure on the already distressed shares. We suspect this is the most extreme case to be uncovered.

- American Home Mortgage's chairman and chief executive, **Michael Strauss**, faced a similar fate when he received a margin call on 62% of his ownership (2.9 million shares) on August 1st after AHM shares fell from $10 to $1 in late July. Another by-product of both Strauss' and the Friedman's activity will be the potential regulatory scrutiny that may arise from the timing of their sales. While margin calls are typically at the discretion of the broker, investigators might follow-up to verify the insiders did not accelerate the actual sale dates based on non-public information in their possession (in both cases, the sales preceded further price deterioration). The likelihood of regulatory agencies becoming actively involved in these situations will increase if more instances of distressed margin call activity surfaces. With the amount of shareholder value lost at Tarragon and American Home Mortgage, we do not suspect this issue will fade away.

<u>VeriFone Holdings Inc. (NYSE: PAY)</u>

- Since issuing coverage on VeriFone Holdings in an August 1, 2007 full report, there has not been any basis for reconsideration of our analysis of the Company's fundamental or earnings quality profile as we draw closer to the September 6th fiscal Q3 earnings release date. Nonetheless, the exhaustive profit taking by each of the Company's key operating executives has persisted despite the issue's August volatility, exaggerating the already diluted ownership picture. Add to this a rather puzzling new take on the termination of a senior executive and resignation of a board member and we can only wonder how many skeletons VeriFone is hiding in its closets.

- This management team has sold without pause for the better part of 18 months now, executing new 10b5-1 trading plans along the way to continue its aggressive profit taking. While all of the same execs covered in our prior report surfaced in August, Vice Chairman **Jesse Adams** (55), a named executive, stands out as he monetized the remainder of his position, 81,000 shares, after never having sold more than 21,000 shares in any prior month dating back to January 2006. It is looking more likely he could be on his way out after having his responsibilities reduced.

- Another seller of interest is Executive V.P., Global Operations **Isaac Angel** (50), the former Lipman chief executive, who continues to sell 15,000 shares per month without a trading plan and has now liquidated 60% of his position since coming on board in January. **Elmore "Bud" Waller** (57), Executive V.P., Integrated Solutions, has accelerated his pace within his plan, selling 20,000 shares per month since June after selling at a 10,000-share per month clip dating back to January 2006. For the most part, holdings reductions have yet to breach the most severe 75% range, but we fully expect this would be the case if the majority of their remaining actionable ownership was not comprised of a high-priced option series that would yield a pre-tax profit of roughly 20% at the current market price. Most executives have been reluctant to tap into this partially vested series, instead opting to cash out their common stock. The common holdings have declined drastically for a few execs this year despite the quarterly vesting of restricted stock (see table below). Should the issue tread in its current range, there might be a sharp drop in selling as they have very little remaining equity to monetize outside of the expensive option series.

Executive	Position	Common Stock 01/01/07	Common Stock 08/25/07
D. Bergeron	CB, CEO	3,412,483	2,112,935
J. Adams	VC (exec)	79,522	2,007
I. Angel	EVP	101	101
E. Waller	EVP	24,715	7,840
B. Zwarenstein	CFO	0	2,007

- Also in our last report we covered the very public termination of **William Atkinson**, who was Executive V.P., Payment Systems and CEO **Douglas Bergeron's** closest colleague. It was reported that he solicited peers to join a competitor and violated both his Executive Stock Agreement and the Company's Code of Business Conduct and Ethics. Since he did not have a severance agreement in place, it appeared as though he was pushed out the door with just the clothes on his back. Two weeks later, however, the Company provided him with an ad hoc "Confidential Severance Agreement", filed in an SEC Form 8-K dated August 3rd, which outlined a very different set of circumstances. In effect, if Atkinson agrees to not discuss the reasons for his departure with anyone in the media, shareholders, analysts, board members or investor community, or join forces with any competitor for two years, he will receive a $350,000 payout, paid unused vacation days and holidays, full medical coverage, and paid outplacement services. This clearly smells of a hush money pay off, preventing Atkinson from airing any of the Company's dirty laundry.

- It was also reported that Director **Craig Bondy** (33) resigned from the board on August 14th. This move does not appear to be unexpected, as a replacement was simultaneously named. But this is actually a pretty interesting move as Bondy is a principal of GTCR, VeriFone's largest shareholder, which is entitled to hold two board seats under the Stockholders Agreement as long as they control more than 11.9 million shares. With a June 2007 sale of 3.5 million shares, GTCR's ownership is now down to 12.9 million from 31.8 million shares in 2005, entitling them to still hold the two board seats. Our best guess would be GTCR already has plans for another large distribution and pulled their principal off the board sooner rather than later.