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Accounting: Quality of Earnings Issues
Governance: Corporate Governance Issues

Insider Research Bulletin

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Insider Research Bulletin is a summary of significant insider trading behavior that 3DA has identified at the following companies. None of the companies in this Bulletin have been previously covered in a full 3DA Research Report, and because the insider trading behavior described here has been deemed significant, 3DA has initiated a review of accounting and governance behavior at these companies. These new companies may or may not become the subject of full 3DA Research Reports in the future.

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

Companies in this Bulletin

- Apple Computer Inc. (NASDAQ: AAPL)
- Cummins Inc. (NYSE: CMI)
- MGM Mirage Inc. (NYSE: MGG)

Discussion of 3DAdvisors Findings

Apple Computer Inc. (NASDAQ: AAPL)

Despite sizeable stock holdings and having received large option grants in the late 90's, Apple insiders have been very quiet over the past two years. Contrary to behavior displayed by executives at competitors, while Apple stock climbed from $15 in May 2003 to $25 by October, not one insider locked in gains. This all changed in dramatic fashion as from April 19th through April 22nd, just days after releasing second-quarter earnings, six insiders cashed out of 3,653,400 shares valued at $102.6 million. Executives sold more shares in a three day period than they had between 2000 and 2003, when the issue traded at times over $60, and also rallied twice off yearly lows to levels equivalent to today's. Even more concerning than the absence of selling last year and sudden recent sell-off is the fact that Apple insiders have been known to converge to sell ahead of earnings warnings in the past. In August 2000 four executives (including three of the recent sellers) sold 370,000 shares at roughly $56, just weeks before the Company warned that they would miss earnings expectations by 10%. Eight weeks later the issue was trading below $19. Two years after that incident, in April and May 2002, six insiders (including four of the recent sellers) sold 2.04 million shares valued at $50 million. The stock was trading at around $24 at the time of the activity. On June 18, 2002 the Company warned that revenues wouldn't meet previous guidance, sending the stock below $15 in the ensuing months. It should be noted that the selling was infrequent and comparatively light in volume before and after these rounds.

Also compelling about this behavior is that three of Steve Jobs' highest in command – CFO Fred Anderson, Executive V.P. Tim Cook and Senior V.P. Jonathan Rubenstein – sold 47%, 87%, and 30% of their actionable positions (common stock plus exercisable options), respectively. What's more, none of the three received option grants over the past two years due to a Company initiative to reduce outstanding options, which will force them to turn to the open market to buy shares should they choose to replenish their positions.

- **Tim Cook (43)** – Executive V.P., Worldwide Sales & Operations. Cook has been a major player in Apple's executive ranks since becoming a Section 16 filer back in 1998. Due to his past behavior, we were very surprised to see him dump 1.2 million shares between April 19th and April 22nd, grossing $33.6 million. We were even more taken back by the fact that his sale **wiped out 89% of his actionable position**. This activity is uncharacteristic of Cook, who had sold 1.4 million shares total over the past six years. Also, the selling was reported as part of a 10b5-1 trading plan adopted in August 2003. It is uncommon to see insiders dumping such a large percentage of their holdings with a 10b5-1 in place. One might think that this type of behavior would be displayed by a departing exec; however the Company hasn't indicated that Cook is leaving. Cook is one of the sellers from the August 2000 and April/May 2002 rounds.

- **Fred Anderson (59)** – Executive V.P., CFO. One exec that has made known his intention to retire is Anderson. It was announced on February 5th that he'd be ending his nine-year career with the Company, effective June 1st. But while we typically discount selling by outgoing insiders, this might be a different case. Steve Jobs stated in a company press release "we'll continue to benefit from Fred's contributions as a member of Apple's Board." Anderson also stated in the Company's fourth quarter earnings conference call that he "looks forward to staying involved with Apple after his retirement." Anderson currently is not a board member, and there is no mention in the recent proxy of him having been nominated, but it is apparent that Jobs intends on keeping Anderson around. The reason this is important is because Anderson sold 800,000 shares on April 19th through the 22nd, grossing $22.4 million. The activity **trimmed his holdings by 47%**. Like Cook, Anderson entered into a 10b5-1 trading plan last August and is now making his first sales under the plan. Between 1996 and 2003, Anderson had sold a total of 1.29 million shares. Anderson sold in the April/May 2002 round.

- **Jonathan Rubenstein (47)** - Senior V.P., Hardware Engineering. Since filing in 1997, Rubenstein had sold a total of 521,402 shares. He recently managed to dump more stock in a week than he had during those seven years, as from April 15th through 22nd he sold 525,000 shares, grossing $14.8 million and **giving up 30% of his holdings** in the process. Last time we saw Rubenstein sell was back in August 2000 (a member of the group that sold ahead of the earnings warning), when he disposed of 100,000 shares ahead of a seven-week, 70% slide.

- **Sina Tamaddon (46)** – Senior V.P., Applications. Tamaddon's actions are similar to the above mentioned, as he stepped up to sell atypical amounts. From 1997 through

2003 he had sold a combined 496,000 shares. More recently, he dumped 678,400 shares on April 19th, grossing $19 million. The last time we saw Tamaddon sell was back in August 2002 when he disposed of 250,000 shares.

- **Nancy Heinen (47)** – Senior V.P., General Counsel, Secretary. Heinen sold 200,000 shares on April 19th at $28. Like the rest of the selling execs, she has displayed a knack for timing her sales. After selling 50,000 shares in August 2000 at $57, ahead of an eight-week slide down to $19, she then dumped 200,000 shares in April and May 2002 at roughly $24, before the issue slid to $15 in eleven weeks. Heinen sold ahead of both earnings warnings.

Cummins Inc. (NYSE: CMI)

Though insiders at other companies in this Insider Research Bulletin sold more shares, no story is as compelling as what we uncovered at Cummins. First off, the insider selling was off the charts based on the Company's past selling history. In all, from March 17th through April 6th, eight insiders sold 329,650 shares between $55 and $65. This might not look like that many shares on the surface, but when you take into account that from 1995 through 2003 insiders only sold 191,536 shares, the numbers take on new significance. The selling was so unusual that the Company issued an 8-K to report the selling, highlighting the fact that the increased aggressiveness is attributed to 10b5-1 trading plans that many of the senior execs entered into since the beginning of the year. We feel that this selling is more noteworthy than the Company's simple explanation suggests. What's more, insiders immediately began selling shares after initiating the trading plans and are using them to dump significant percentages of their holdings. Company CFO Jean Blackwell, V.P., President-Power Generations Business Thomas Linebarger, and V.P., Group President-Filtration Rick Mills dumped 66%, 40%, and 54% of their actionable positions (common stock plus exercisable options).

There are a handful of reasons that these reductions are especially telling. After not granting any stock options or medium-term performance bonuses (cash payments) in 2002, only a very small amount of options were granted in 2003. The three above-mentioned execs that sold large percentages of their stock received less than 8,000 options each. The sales not only wiped out nearly all of their exercisable options, but also left them with only the unexercisable options granted during 2003. This got our attention because the Company has stock ownership guidelines in place, which requires senior execs to hold three times their base salary in Common Stock by 2006. Blackwell currently is below her requirement while the other two are barely meeting theirs. Should they continue to sell, they will be short of complying with the terms of the guidelines and not have options vesting to replenish their holdings. Company directors also have ownership guidelines, which require them to hold Common Stock equal to three times their annual retainer fee ($94,000). They have six years to meet this requirement.

A few points of interest: the Company used to loan executives money to purchase company stock pursuant to the Company's Key Employee Stock Investment Plan. While they no longer issue loans due to Sarbanes-Oxley, one executive and current seller, Chief Technology Officer J.C. Wall still owes nearly $300,000. CEO Solso paid off his remaining balance of $255,938 in February 2004. Finally, there are suspicious board relationships with Solso and Irwin Financial CEO William Miller. Each sits on the other's board, and they also sit together on the boards/committees of a handful of funds and partnerships. There are a few membership fees and donations that have gone back and forth between the two. Not to mention, Irwin Financial has an ownership stake in Cummins' business aircraft, which they make payments to the Company for. Solso also is a board member at Ball Corp. (NYSE: BLL), and he and Ball's CEO both sit on the board at Irwin Financial.

- **Jean Blackwell (49)** – V.P., CFO, Chief of Staff. From March 18th through April 6th, Blackwell cleared out six series of non-expiring options (expiration dates: 4/07, 9/08, 2/09, 2/4/10, 2/8/10, 1/11) to acquire shares to sell. She then sold the underlying 52,150 shares as the stock leapt from $56 to $65. The exercising of multiple series tells us that there might be a sense of urgency to sell. That she **sold 66% of her holdings** in the process supports the assumption. However, Blackwell, like most of the Company's execs, entered into a 10b5-1 trading plan. She made her first 10b5-1 sales in January 2004 when she sold 700 shares. Trading plans call for a more consistent pattern of selling than 700 one month and 66% of one's ownership stake in another. Finally, it should be noted that prior to the January selling, Blackwell's only prior activity since joining the Company in 1997 was a 1,000-share open-market purchase on September 21, 2001 at $29. On March 21, 2001 she sold those shares and more at $45. The significance of this activity is that she was about as close to violating short-swing rules as one can get – not something you want to see from the Company's former general counsel. But we can understand her urgency to sell as the issue dropped 50% over the next six months. One final note. Blackwell is required to hold three times her base salary in Common Stock, which at the close on 3/4/2004 ($61.33) should be worth $1.25 million. After the recent sale, she only holds $1.16 million in Common Stock.

- **Theodore Solso (57)** – Chairman, CEO. Over the past seven years, the only time we've seen Solso cross our screens was when he bought shares (19,687) between October 1997 and September 2001. In fact, over the past few years, Solso, who has a seat on the boards of Irwin Financial (NYSE: IFC), Ball Corp. (NYSE: BLL) and Ashland Inc. (NYSE: ASH), had only *purchased* 6,000 shares ($323,000 investment) of Ball in March 2003. It wasn't until March 18th and April 6th that he finally decided to sell Cummins stock, dumping 62,050 shares and grossing $3.9 million. Solso exercised six series of non-expiring option series (expiration dates: 9/04, 12/04, 12/05, 7/06, 9/08, 2/10) to acquire the shares to sell. After the sale, he still holds just over 400,000 shares.

- **Thomas Linebarger (41)** – V.P., President, Power Generations Business. Like Solso, Linebarger hadn't sold since becoming a Section 16 filing insider back in 1998. However, he also entered into a 10b5-1 trading plan in the past couple months. He recently sold 500 shares as part of the trading plan on March 17th, and then as the stock climbed $9 to $65 by April 6th, he dumped an additional 33,700 shares. In order to acquire the shares to sell, he cleared out six series of non-expiring option series (expiration dates: 12/05, 7/06, 2/10/07, 2/11/07, 9/08, 1/11), and then **sold 40% of his actionable position** (common stock and exercisable options). Before the recent sales, Linebarger's only prior transactions were a 1,153-share open market purchase in June 2001 at $43 and an 8,529-share open market buy in September 2001 at $29.

- **Rick Mills (55)** – V.P., Group President, Filtration. Since filing in 1996, Mills' only prior sale before he established a 10b5-1 plan in early 2004 was a 6,730-share disposition in August 1999 at prices higher than current levels. That sale preceded a three-month, 40% slide. Since setting up the trading plan, he sold 2,600 shares in January 2004 and then recently increased his aggressiveness when he dumped 51,300 shares between March 19th and April 6th, grossing $2.9 million. The sale **reduced his holdings by 54%**. And like his peers, he exercised a large amount of options series, five in all, with expiration dates between 7/06 and 1/11.

- **Steven Chapman (49)** – V.P., International, and President, International Distributor Business. Chapman displayed the most aggressive option activity of the group. He cleared out **twelve series** of non-expiring options with expiration dates between 12/05 and 9/11. A majority of the options he cleared out had at least three years left before expiration. Equally as troubling, he exercised one option series at $60.84 and sold the underlying shares at $65, accepting a mere 6% profit on the sale. Since filing as an insider back in February 2002 his only prior transaction was a 10,235-share sale in May 2002 as the stock was under pressure and continued to slide to 10-year lows.

MGM Mirage Inc. (NYSE: MGG)

Over the past few months we've been keeping a close eye on the insider behavior at MGM Mirage. This isn't the first company in the hot Vegas space to show insider selling recently. We've already highlighted insider selling at Mandalay Bay Group (NYSE: MBG) (see *Insider Research Bulletin* of 2/13/04), which at the time was the more aggressive of the two. But with the ranks of MGG sellers expanding and with three high-ranking MGM insiders having dropped significant percentages of their holdings we feel the activity has become something to keep an eye on. In addition, further inspection reveals some interesting governance issues with regards to board composition.

Beginning with the insider activity, from January 30th through April 26th, seventeen insiders sold 1,216,575 shares between $40.16 and $46.35, grossing $51.5 million. The sales, which began just after the Company announced 4Q03 earnings, have persisted continuously, which goes against past behavior where insiders had typically converged to sell in much tighter windows, typically one month or less. There is no question that there has been much appreciation in this stock and insiders are, no doubt, punching in gains; however the recent persistence of selling represents a change in the insider trading patterns that we have been accustomed to here in the past. Also notable, CEO Terrence Lanni, President, CEO-MGM Resorts, Director John Redmond, and Vice Chairman Daniel Wade have sold 32%, 52%, and 91% of their holdings, respectively, so far this year. Finally, insiders sold about half as many shares though the first four months of 2004 as they had between 2001 and 2003 combined.

Outside of the insider picture, the interesting thing is the composition of the board. Currently, there are seventeen board members. The board is officially approved to be composed of eighteen members, but one director passed away last year and the vacancy has yet to be filled. The board is definitely on the large side. The American Bar Association's Corporate Director's Handbook states that the ideal board size is nine. Certainly we don't necessarily believe that a company should conform to an average size. Indeed, board sizes of industry peers however, are nowhere near as large: Mandalay Resorts (NYSE: MBG), Harrah's (NYSE: HET), and Caesars Entertainment (NYSE: CZR) each have eleven board members. Although we acknowledge that with its majority stake (56.8% as of 3/15), we would expect the representation of Kerkorkian's interest on MGG's board to be significant, governance watchdogs say that boards of eighteen or more should draw investor concerns. In addition, Terrence Lanni serves as both the CEO and Chairman. This wouldn't be such an issue if the board elected one non-executive member to serve as a lead director, a policy that over 32% of mid and large-cap companies have adopted. Also, four of the directors are over the age of 72 – an age that many companies use as a mandatory retirement age. Two of those directors are over 80 years old.

Finally, and most importantly, NYSE rules state that a board be composed of more than 50% independent directors. This seems hardly the case here. Five of the directors are current MGM executives, while one (Vice Chairman Wade) was an executive as recently as 2001, which the NYSE deems to be "dependent". Not only did Kerkorian open three of MGM's properties, but he also engineered MGM Grand's takeover of Mirage Resorts. We'd be hard-pressed to find anyone who feels he's independent. Two additional directors have very close ties to Kerkorian. Alex Yemenidjian is the Chairman and CEO of MGM Inc., a subsidiary of Kerkorian's Tracinda Corp, while James Aljian is an executive of Tracinda, and also a board member of Metro-Goldwyn-Mayer studios, which is 74% owned by Tracinda. Aljian is also the Chairman of the Compensation Committee, which NYSE rules state is supposed to be headed by an independent director. Even though Kerkorian and his crew might be lawfully deemed independent, he has the power to swing any vote that gets put in front of the board. Here are the most interesting of the sellers:

- **Terrence Lanni (61)** – Chairman, CEO. Though he had sold nearly two million shares between 1995 (when he assumed his chairman role) and 2003, Lanni's activity has been relatively sporadic. During that time period he held four rounds of selling – in late July to early August 1999 (989,608 shares), February 2000 (400,000 shares), then in February through April 2002 (238,108 shares) and finally in July 2003 (350,000 shares). Lanni surfaced more recently when he sold 400,000 shares from February 4th through February 19th, grossing $16.8 million. The sale **reduced his holdings by 32%.** What concerns us with the size of this sale is that Lanni, at $3.9 million in salary and bonus in 2003, is already quite highly compensated by the Company. In addition, he had 300,000 options re-priced in 2001 and was awarded restricted stock grants valued at $5.2 million in 2002.

- **John Redmond (45)** – President, CEO-MGM Resorts, Director. Redmond sold 395,000 shares so far this year, between January 30th and April 27th from $40.07 to $46.35. Since assuming his role in 1999, Redmond had sold nearly 700,000 shares through 2003. He sold 221,662 shares between February and April 2002, and then surfaced again to sell 475,000 shares between July and October 2003. His sales just this year however, have **reduced his holdings by 65%**.

- **Daniel Wade (51)** – Vice Chairman. Wade has held just about every executive position imaginable since joining the Company in 1990. And he has been well compensated over the years. Yet, while many of his peers have built up handsome ownership stakes, Wade's has consistently averaged fewer than 200,000 shares. This could have something to do with the 945,000 shares he's sold over the past five years. More recently, Wade sold 67,500 shares on February 4th at $40.25. Yet, different from past years, this sale nearly left him dry. The sale **reduced his holdings by 91%** and left him with a mere 6,350 shares (2,600 shares of which are common stock). Non-executive directors are only granted 5,000 options per year, so his holdings will not be restocked any time soon.

- **Gary Jacobs (58)** – Executive V.P., General Counsel, Secretary, Director. Since becoming a Section 16 filing insider back in June 2000, Jacobs' only prior transaction was a 3,000-share open-market purchase in November 2000 at $26. That changed on February 27th when he sold 60,000 shares, grossing $2.6 million. It's interesting that he's now stepping up to sell shares after sitting on the sidelines for the past few years watching his peers sell

- **James Murren (42)** – President, CFO, Treasurer, Director. Murren joined the Company in 1998 and had sold twice since, dumping 200,000 shares in February 2002 and later 78,400 shares in December 2003. His third sale was executed on February 23rd, when he sold 100,000 shares, grossing $4.2 million. Like Jacobs, the sale didn't make any significant dents in his holdings, but becomes more interesting in that it occurred during the same time frame as the others.