



#### This 3DAdvisors Report Covers:

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

## Insider Research Bulletin

August 10, 2005

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*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

- ▶ Carpenter Technology Corp. (NYSE:CRS)
- ▶ Lone Star Technologies Inc. (NYSE:LSS)

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## Discussion of 3DAdvisors Findings

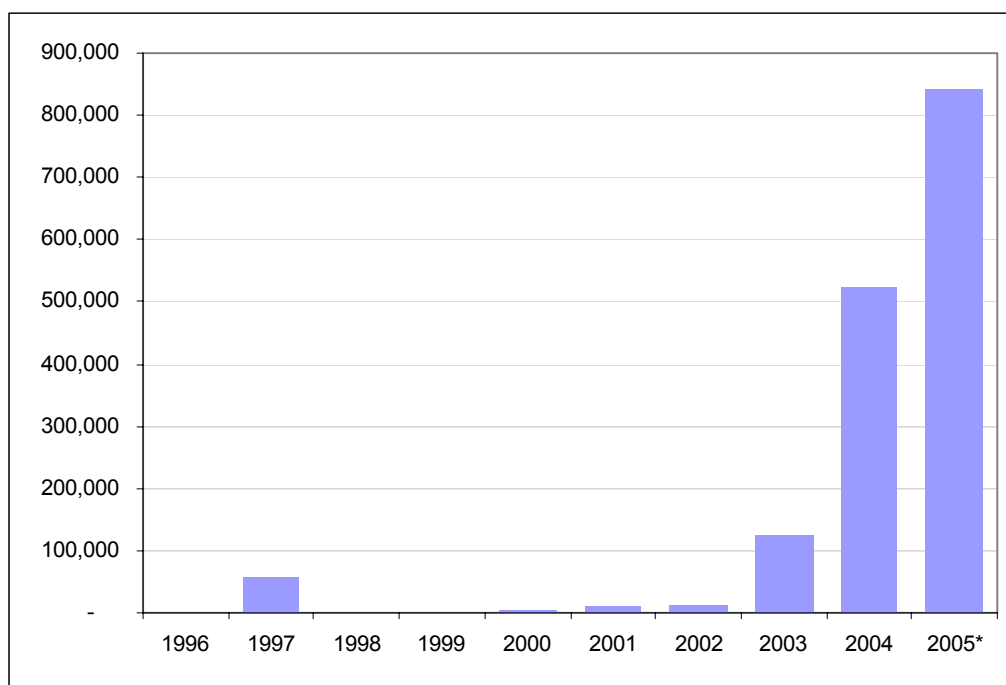
### Carpenter Technology Corp. (NYSE:CRS)

Carpenter Technology presents one of the more interesting examples we've encountered of a key management group liquidating its holdings. Even though we just covered the Company in a July 14<sup>th</sup> *Insider Research Bulletin*, there has been subsequent activity that our clients should be aware of. After insiders sold 737,000 shares from April to June, establishing new highs for annual selling volume, eight of the insiders that participated in the earlier activity dumped an additional 109,406 shares over the past two weeks (July 27<sup>th</sup> through August 8<sup>th</sup>). Whereas the first sales were executed into share price softness at an average price of \$55, the more recent distributions came on the heels of the fourth quarter earnings report, which featured doubling profits that motivated investors to trade the stock above \$60.

Carpenter's shareholders have certainly been rewarded with gains over the past two years as anti-dumping restrictions and related trade actions against offending countries have taken hold. Given the sharp gains in the shares, clearly some profit taking from insiders should be expected. But having said that, we must point out that the

magnitude of selling displayed by key management goes far beyond what we would expect to see in a typical round of profit taking. Rarely, for instance, do we come across situations where a company's chief executive, who is not retiring or leaving the company, monetizes the majority of his holdings such as Carpenter CEO **Robert Torcolini** has done, slashing his holdings by 68% since May.

**Figure 1.** Selling Volume by CRS Insiders. Source: CRS SEC Filings.



\* Sales reported through August 9, 2005

Following Torcolini's lead, other key subordinates have followed suit. Even the newest member of the executive team, **Dennis Oates**, Senior V.P. of Specialty Alloys, has sold off his position, an action contrary to what we would expect from a new executive who would normally be building a position after coming on board. The aggressiveness of recent insider selling may suggest that rumors that anti-dumping restrictions may be eased following the current round of sunset reviews may have substance, and insiders are seizing profits now.

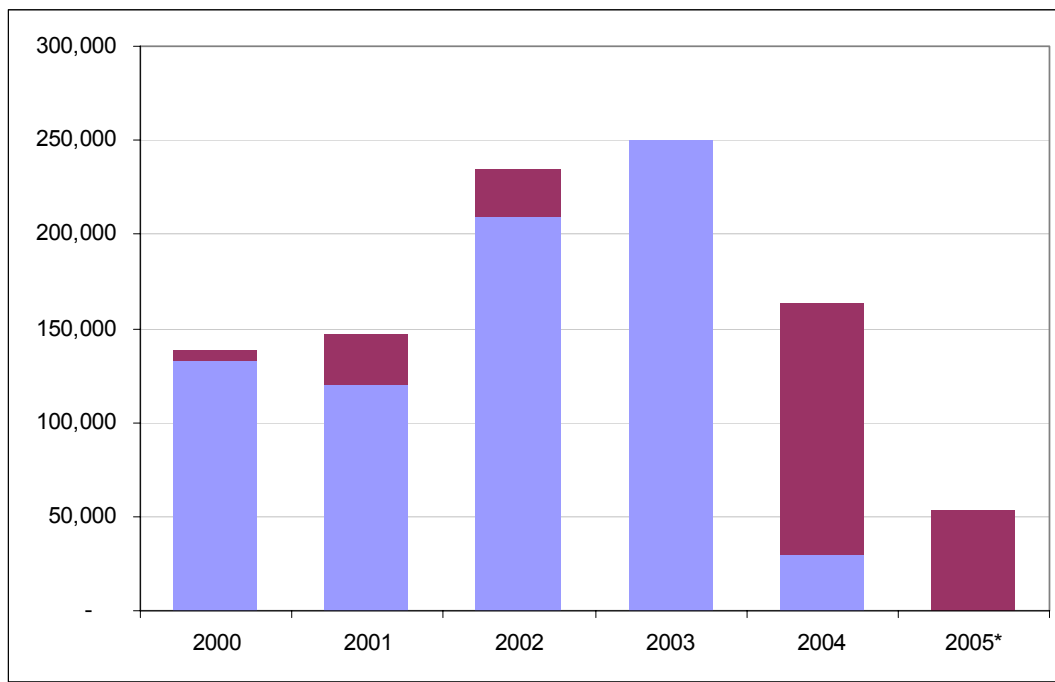
**Table 1.** Holdings Reductions for CRS Named Executives. Source: CRS SEC Filings.

Insider	8/30/2002	8/29/2003	8/27/2004	8/1/2005	YTD Reduction
R. Torcolini	136,821	173,320	233,616	74,340	68%
M. Shor	87,322	127,219	128,166	28,047	78%
T. Geremski	47,933	77,947	74,728	17,244	79%
D. Oates <sup>1</sup>	--	--	15,012	1,020	91%

<sup>1</sup> Dennis Oates joined the Company in September 2003.

Any re-building of insider holdings here clearly will not be accomplished through the vesting of stock options in the foreseeable future. The Company hasn't issued any substantial option awards to its employees since fiscal 2003 and shows no signs of resuming the practice. There are currently only 440,628 options available for issue under the 1993 Stock-Based Incentive Compensation Plan, which wouldn't be enough to cover a full distribution to its employees (based on award levels seen in the past). Furthermore, there was no attempt made to submit a plan amendment to shareholders requesting a supplement to the option reserves at the last annual meeting. Over the past two years Carpenter has awarded both time-vested and performance-based restricted shares, which prolongs the time they will have to wait before new shares become accessible. For example, CFO **Terrence Geremski**, who has sold 64,000 shares since June, received a total of 80,000 restricted shares over the past year, but the earliest of those, totaling 13,000 shares, will not vest until June of 2006.

**Figure 2.** Restricted Stock (Red Bars) and Options (Blue Bars) Granted to CRS Named Executives. Source: CRS SEC Filings.



\* Updated to reflect restricted stock grants issued on July 22, 2005

- **Robert Torcolini (53)** – Chairman, President, CEO. Torcolini continues to liquidate his holdings, as he exercised one of his two remaining options series between June 28<sup>th</sup> and August 2<sup>nd</sup> and sold the underlying 34,000 shares at an average price of \$63. Since May, Torcolini has sold a total of 157,900 shares **accounting for 68% of his actionable holdings** (common stock plus exercisable options). The activity far outpaces the 38,000 shares he had sold cumulatively over the past eight years since becoming a Carpenter exec. Torcolini will not see meaningful holdings replenishment until June of 2006 when he will have a combination of 71,000 options and restricted stock vest in that month (see Appendix A).

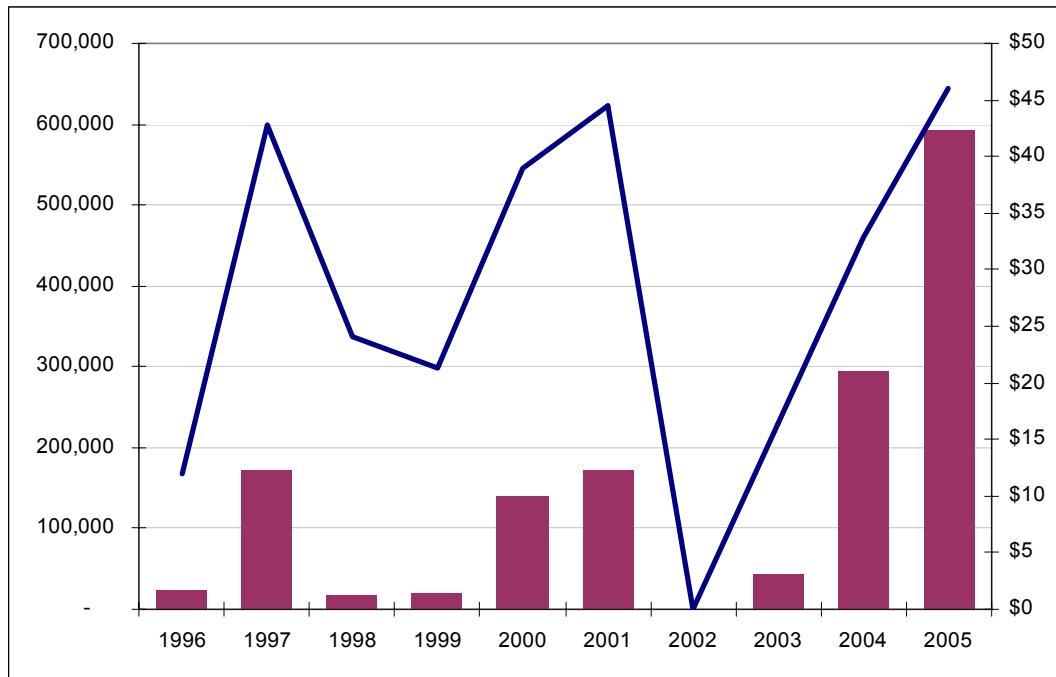
- **Terrence Geremski (57)** – Senior V.P., Finance, CFO. After exercising a majority of his vested options in June en route to selling 39,667 shares, Geremski tapped into his last remaining vested options on July 28<sup>th</sup>. With just one series of options at his disposal, which vested in June 2005, Geremski monetized the 16,666 shares at \$62. On the year he has now **sold 79% of his holdings** and only has 17,244 shares of common stock remaining. As in Torcolini's case above, Geremski will not see new vestings until June of 2006 when he will have a combination of 29,677 options and restricted shares vest in the same month (see Appendix A).
- **Michael Shor (45)** – Senior V.P., Engineered Products Operations. Even though his incentive compensation has slowed dramatically, Shor continues to monetize his holdings, which following his 16,667-share sale on July 27<sup>th</sup>, are **78% lighter** than they were before he began the sell-off in April. Shor had sold a total of 45,093 shares since initially filing as a Section 16 insider back in 2000, considerably less than the 97,317 shares he has now sold year-to-date. Following the activity he has 8,000 vested options and 19,647 shares of common stock at his disposal (see Appendix A).
- **Dennis Oates (51)** – Senior V.P. of Specialty Alloy Operations. Although Oates was a seller in the second quarter, we chose not to highlight his sales in our first report. Following his subsequent sale, his activity warrants mentioning. Oates is the newest member of Carpenter's executive team, having joined the Company in late 2003. Upon his hiring, he was awarded a stock option for 30,000 shares which have only partially vested. Between April 27<sup>th</sup> and July 27<sup>th</sup> he exercised and sold all 10,000 vested options at prices ranging from \$56 to \$61. With only 1,020 shares of common stock comprising his remaining actionable holdings, the sales **trimmed 91% of his position**. However, since his award came in late 2003, his options are on a different vesting schedule as those of his peers and he will have 10,000 more vest in September and an additional 10,000 vest in September 2006 (see Appendix A).

#### Lone Star Technologies Inc. (NYSE:LSS)

There are times when a company, such as Lone Star Technologies, seems in such a sweet spot that any insider selling should just be ignored. Lone Star's niche of welded oil country tubular goods (OCTG) and steel tubular products, used by oil service companies and producers, puts it squarely in the middle of such a sweet spot. Supported by record high oil prices and aided by anti-dumping restrictions on imports, LSS shares have been bid up to all-time high ground. However, we've seen Lone Star shares in this rarefied \$60 range on three other occasions in the past ten years, only to see them fall each time, Icarus-like, back to earth in short order.

Perhaps such memories of the past linger in the minds of Lone Star insiders who recently have been bailing out of their holdings at a record pace. From July 6<sup>th</sup> through August 1<sup>st</sup> four insiders sold 239,221 shares between the prices of \$48.57 and \$51.58. More importantly, the magnitude of their holdings reductions compels us to alert clients to the activity in spite of the apparent positive future prospects in place for the industry.

**Figure 3.** Shares Sold by LSS Insiders (Red Bars and Left Scale) and Weighted Average Price of Shares Sold (Blue Line and Right Scale). Source: LSS SEC Filings.



Year-to-date insider distributions have nearly caught up to the aggregate shares sold between 2000 and 2004 which is not an insignificant statistic when one considers that Lone Star shares spent plenty of time trading at levels close to today's during that period: The shares traded into the \$50 to \$60 range in 1997, 2000, and 2001 but insider selling in those years paled in comparison to what we've seen in just the past four weeks. What's more, the stock's momentum in those earlier years was never sustained after insiders surfaced to take profits.

Be advised, timing by certain Lone Star executives in the past has proven prescient on a number of occasions. CFO **Charles Keszler**, for instance, has shown proficiency with his activity dating back to 1996, having bought and sold ahead of precipitous momentum swings. Now, we are not attempting to presume any perceived pull-back in oil prices as presenting the cause for such caution from insiders. What is causing the current insider movement is difficult to assess at this time. One area we're investigating involves certain anti-dumping restrictions and the possibility of their being eased given the renewed profitability for the industry.

Although some profit taking can be rationalized by the issue's momentum, what can't be as easily justified are the abnormally large holdings reductions by a number of key insiders, especially when you take into account the downstream vesting of incentive awards. As you can see from Table 2 below, three of the Company's top four lieutenants sold between 63% and 100%, which is even more interesting since both CFO Keszler and General Counsel **Robert Spears** sold under the guise of routine 10b5-1 activity, but this action was far from routine. In fact, both execs, in clear contradiction to the intention of Rule 10b5-1, have amended their plans numerous times this year to

ensure their selling flexibility. The holdings liquidation of board member **Jerry Ryan** is equally as compelling – Ryan was a former consultant to the Company and even ran one of its subsidiaries, Fintube Technologies. Due to his close relationship, he is currently deemed an “interested” director and was re-elected to the board this year for another three-year term.

**Table 2.** Holdings Reductions by LSS Named Executives. Source: LSS SEC Filings.

Insider	Position	2/28/2003	2/29/2004	8/5/2005	YTD Reduction
R. Best	CB, CEO	473,823	590,545	446,773	<b>19%</b>
J. Alvarado <sup>1</sup>	P, COO	--	--	25,000	<b>N/A</b>
W. Dunn	CEO-Steel	150,828	199,378	0	<b>100%</b>
C. Keszler	VP, CFO	98,250	130,250	45,844	<b>63%</b>
R. Spears	VP, GC	87,500	119,500	2,299	<b>98%</b>
J. Ryan	Director	83,750	65,625	0	<b>100%</b>

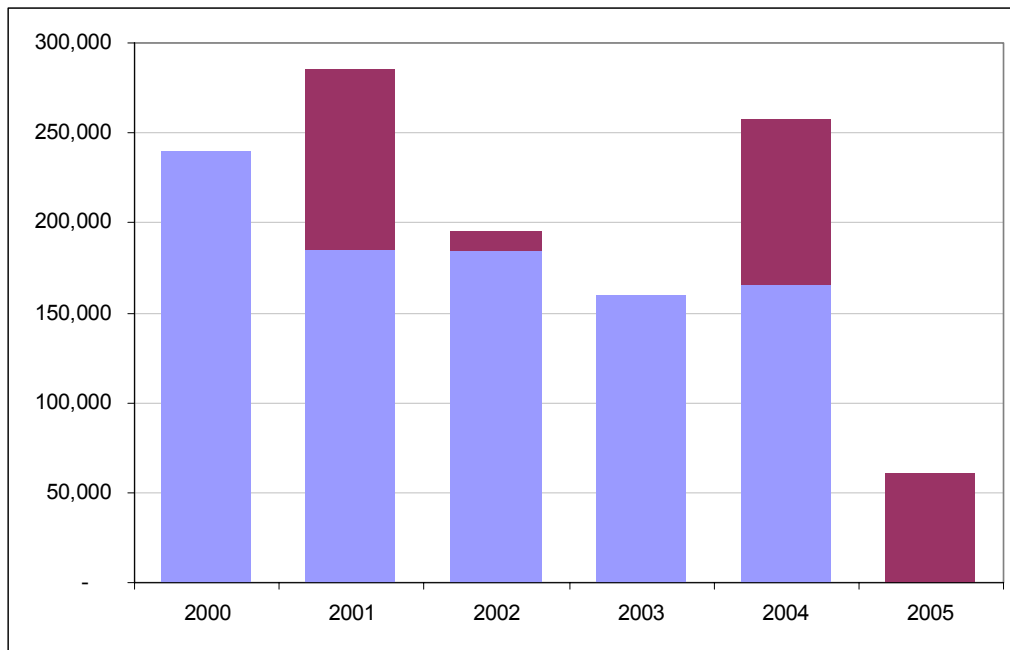
<sup>1</sup> Joseph Alvarado joined the Company in June 2004.

As we mentioned earlier, this uncharacteristic holdings deterioration comes during a period when the Company appears to have amended its compensation philosophy. Although we have not seen a formally disclosed new policy, the Company has yet to grant stock option awards for 2005, making this the first time options haven't been utilized in the compensation plan since 1994. Restricted stock grants have been low this year in comparison. Should there be any prolonged period where stock options are not issued and the Company continues to utilize a restricted stock based compensation strategy in the current award size range, we might not see these insiders' holdings recover to their 2004 levels for quite some time.

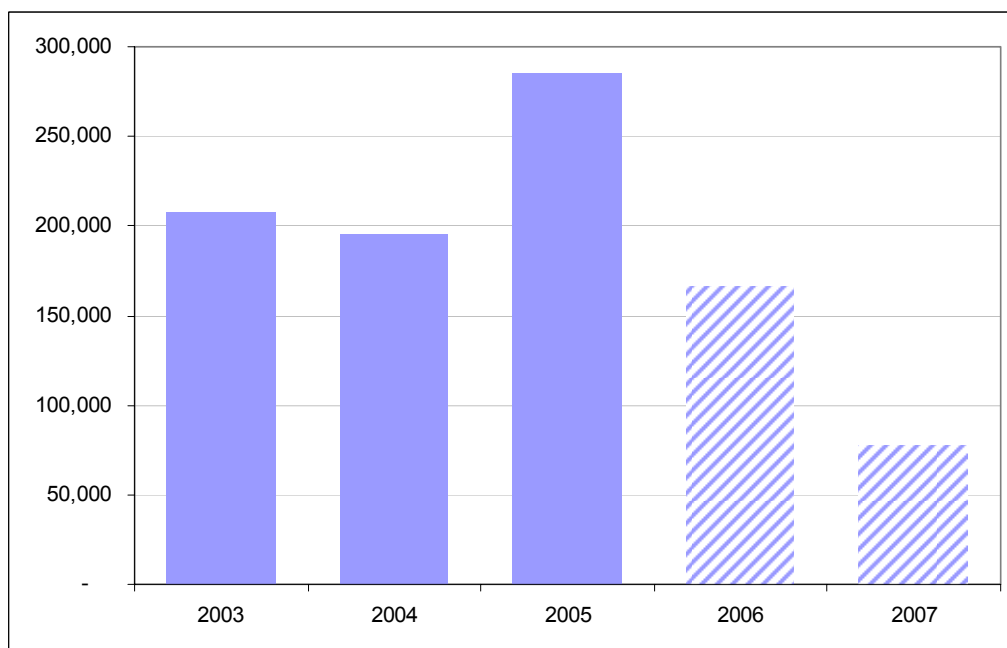
As you can see from Figures 4 and 5 below, not only were incentive awards down in 2005, but the downstream vesting of options in 2006 and 2007 will come in at record lows. Stock option grants issued in February 2004 vested in full one year from the grant date, so there is currently only one outstanding unvested options series, which will bestow no more than 10,000 shares to any individual down the road. It is in situations like this that aggressive selling of this nature, and the consequent holdings reductions, are most revealing in terms of the overall insider sentiment.

Finally, we should address the issue of the recent intensification of rank and file option exercises, which we've discussed in a number of other Insider Research Bulletin stories over the past month. Lone Star's senior managers aren't the only ones that have been aggressively distributing shares on the year, as we're seeing a dramatic pickup in employee stock option exercises, which more often than not signifies employee selling. The volume through the first two quarters of 2005 tops all option exercises, collectively, that occurred between 1998 and 2004, and we expect to see this pattern continue into the third quarter (see Figure 6). There seems to be more of a sense of urgency to hold cash here than when the issue was trading at equivalent prices in earlier years.

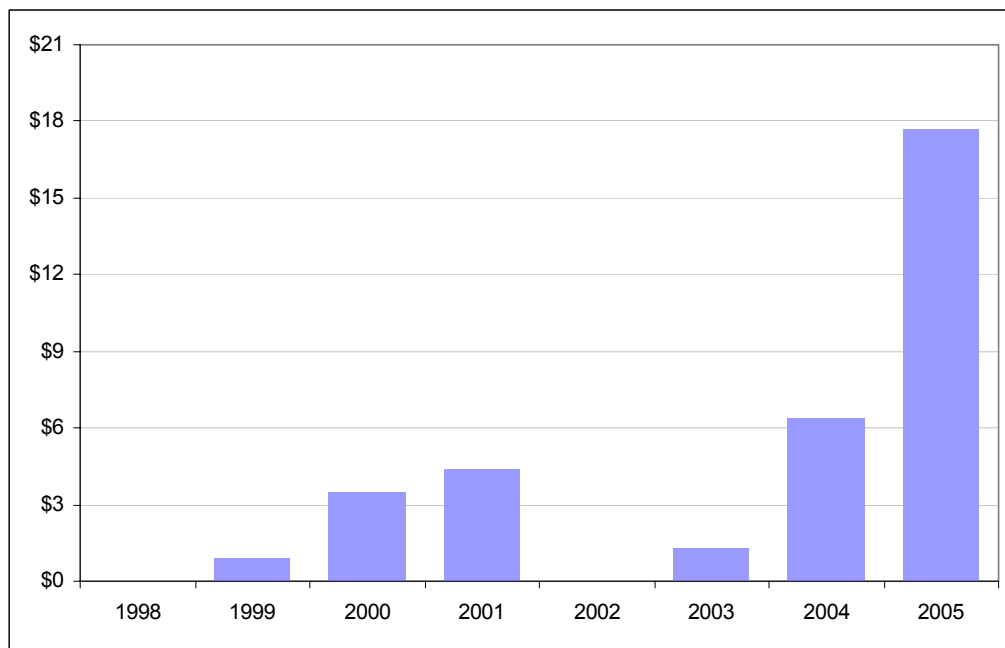
**Figure 4.** Restricted Stock (Red Bars) and Option Grants (Blue Bars) to LSS Named Executives. Source: LSS SEC Filings.



**Figure 5.** Annual Option Vesting Totals for LSS Named Executives (Diagonal bars are what will vest in those years from options issued through August 2005). Source: LSS SEC Filings.



**Figure 6.** Cash Flows from the Exercise of Stock Options (Millions of Dollars). Source: LSS SEC Filings.



- **W. Byron Dunn (51)** – President, CEO, Steel Division. Dunn has been running Lone Star's largest subsidiary, Steel, since 1997. It seems rather odd that the head of the division that has been driving the Company's growth has moved to cash out of his shares. After selling less than 100,000 shares between 1997 and 2004, Dunn started off the year by exercising four options series and selling the 75,000 shares on January 28<sup>th</sup> at \$39. Apparently, the issue's new highs were too alluring, as Dunn monetized his remaining holdings. Between July 21<sup>st</sup> and July 27<sup>th</sup> he exercised all of his vested options series (expiration dates: 2/09, 2/10, 2/11, 2/12, 2/13) and sold his last 3,263 shares of common stock for a total distribution of 124,513 shares. Dunn, who had an ownership position of 200,000 shares last year, now **holds no actionable shares** (common stock and exercisable options). What makes his activity even more compelling is that he will not see new options vest throughout the remainder of the year, and far less (20,000 shares) vest next year than he has recently sold (see Appendix B).
- **Charles Keszler (42)** – V.P., CFO. Keszler, an LSS Finance exec since 1996, has sent some very informative signals over the course of his tenure. In his earlier years, he was buying shares from \$14 all the way up to \$31 before the stock headed to \$59 by late 1997. He then reversed course in October 2000, selling 10,000 shares at \$43 ahead of a 35% drop, and then again in April 2001 at \$52 just prior to the issue's five-month slide to \$11. He didn't resurface until September 2004 when he sold 37,500 shares under his second 10b5-1 trading plan. In January 2005 he once again amended his trading plan and quickly distributed 30,000 shares in February at \$45. Two months later he modified his plan yet again, which instantly interested us as we're constantly monitoring situations where insiders are repeatedly making plan adjustments. His first sale under the new plan came into the recent strength, as he



exercised his February 2010 and February 2012 option series on July 19<sup>th</sup> and sold the 47,500 shares at \$49.88. Not only was this his largest sale to date, but the activity **led to a 63% year-to-date holdings reduction**, by far his biggest percentage move to date. Of all the current sellers, Keszler has the most shares at his disposal, including 16,166 new shares that will vest in 2006 (see Appendix B), but these will hardly replace what he has sold this year. We are always interested when a chief financial officer disposes of shares in such an aggressive manner.

- **Robert Spears (61)** – V.P., General Counsel, Secretary. Spears' behavior this year is clearly a departure from anything he has displayed in the past. After selling a total of 16,250 shares between 1996, the time he joined the Company, and 2004, he entered into his first trading plan last November. Under the first plan he sold 18,750 shares in January (2005), quickly modified the plan on February 3<sup>rd</sup> and immediately resumed selling, unloading nearly 80,000 shares by the end of the month. Apparently that wasn't enough, and three months later he altered the terms of the plan once again. Between July 6<sup>th</sup> and August 1<sup>st</sup> he exercised five series of options with expiration dates ranging from May 2009 through February 2013 and sold the underlying 42,500 shares at roughly \$50. Under the cover of his 10b5-1 plan, he has exercised all of his long-held and newly-vested options series in 2005 and sold all of the shares. **His 120,000-share position in 2004 now consists of only 2,299 shares of common stock.** With very few actionable shares remaining and only 16,166 new shares vesting throughout all of 2006 (see Appendix B) it seems to us that cash is more of a compelling concept, in his thinking, than potential LSS share appreciation.
- **Jerry Ryan (62)** – Director. Although Ryan's holdings deterioration wasn't as sudden as some of the selling execs, the results are quite similar. After holding as many as 83,000 shares in 2003, his progressive sell-off since, including the 23,458 shares he sold between July 22<sup>nd</sup> and July 27<sup>th</sup>, has **left him without actionable holdings.** Don't look for these shares to be replaced anytime soon as he will have less than 5,000 new incentive awards vest throughout next year. Ryan, who was just elected to serve another three-year term, has now sold more shares through the first seven months of the year than he had in any of his prior four years on the board. We should point out that he is classified as a "dependent" director due to his former consulting relationship with Fintube Technologies, a subsidiary of the Company. Finally, Ryan also sits on the boards of Aeon (NASDAQ: Aeon) and Global Power Equipment (NYSE: GEG) but hasn't sold shares of either company in the past two years.

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## Appendix A

Option and Restricted Stock Vesting Schedules for Selected Carpenter Technology Corp. Insiders

Grant Date	Equity Type	Options/Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
<b>Robert Torcolini, Chairman, President, CEO. Common stock holdings: 47,040 shares</b>								
01/01/98	Options	11,300	\$49.75	06/26/99	06/25/08	11,300	0	Fully Vested
06/26/03	Options	150,000	\$16.12	06/26/04	06/26/13	66,000	50,000	06/26/06
06/23/04	R. Stock	10,000	N/A	06/23/09	06/23/09	10,000	10,000	06/23/09
07/22/04	R. Stock	42,000	N/A	06/30/05	06/30/06	21,000	21,000	06/30/06
06/30/05	R. Stock	10,500	N/A	06/30/10	06/30/10	10,500	10,500	06/30/10
07/22/05	R. Stock	12,000	N/A	07/22/06	07/22/07	12,000	12,000	7/22/06, 7/22/07
<b>Michael Shor, Senior V.P., Engineered Products Operation. Common stock holdings: 19,647 shares</b>								
01/01/98	Options	4,400	\$49.75	06/26/99	06/25/08	4,400	0	Fully Vested
06/21/01	Options	20,000	\$30.05	06/21/02	06/21/11	4,000	0	Fully Vested
06/26/03	Options	50,000	\$16.12	06/26/04	06/26/13	16,666	16,666	06/26/06
06/23/04	R. Stock	4,000	N/A	06/23/09	06/23/09	4,000	4,000	06/23/09
07/22/04	R. Stock	26,000	N/A	06/30/05	06/30/06	13,000	13,000	06/30/06
06/30/05	R. Stock	4,500	N/A	06/30/05	06/30/10	4,500	4,500	06/30/10
07/22/05	R. Stock	5,000	N/A	07/22/06	07/22/07	5,000	5,000	7/22/06, 7/22/07
<b>Terrence Geremski, Senior V.P.-Finance, CFO. Common stock holdings: 17,244 shares</b>								
06/26/03	Options	50,000	\$16.12	06/26/04	06/26/13	16,666	16,667	06/26/06
06/23/04	R. Stock	4,000	N/A	06/23/09	06/23/09	4,000	4,000	06/23/09
07/22/04	R. Stock	26,000	N/A	06/30/05	06/30/06	26,000	13,000	06/30/06
06/30/05	R. Stock	4,500	N/A	06/30/10	06/30/10	45,000	4,500	06/30/10
07/22/05	R. Stock	5,000	N/A	07/22/06	07/22/07	5,000	5,000	7/22/06, 7/22/07
<b>Dennis Oates, Senior V.P. of Specialty Alloy Operations. Common Stock Holdings: 1,020 shares</b>								
09/30/03	Options	30,000	\$21.44	09/30/04	09/30/13	20,000	20,000	9/30/05, 9/30/06
09/30/03	R. Stock	5,000	N/A	09/30/08	09/30/08	5,000	5,000	09/30/08
06/23/04	R. Stock	4,000	N/A	06/23/09	06/23/09	4,000	4,000	06/23/09
07/22/04	R. Stock	26,000	N/A	06/30/05	06/30/06	13,000	13,000	06/30/06
06/30/05	R. Stock	4,500	N/A	06/30/10	06/30/10	4,500	4,500	06/30/10
07/22/05	R. Stock	5,000	N/A	07/22/06	07/22/07	5,000	5,000	7/22/06, 7/22/07



## Appendix B

Option and Restricted Stock Vesting Schedules for Selected Lone Star Technologies Inc. Insiders

Grant Date	Equity Type	Options/Shares	Strike Price (Options)	First Vesting Date	Expiration Date (Options)	Remaining Options/Shares in Series	Unvested Options/Shares in Series	Vesting Dates of Remaining Restricted Shares/Options
<b>W. Byron Dunn, President, CEO of Steel. Common stock holdings: 0 shares</b>								
02/19/02	Options	35,000	\$15.07	02/19/03	02/19/02	8,750	8,750	02/19/06
02/19/02	R. Stock	3,500	N/A	02/19/04	02/19/07	1,750	1,750	2/19/06, 2/19/07
02/18/03	Options	30,000	\$16.51	02/18/04	02/18/13	15,000	15,000	2/18/06, 2/18/07
02/26/04	R. Stock	10,000	N/A	02/26/05	02/26/08	7,500	7,500	2/26/06, 2/26/07, 2/26/08, 2/26/09, 2/26/10
03/02/05	R. Stock	9,000	N/A	03/02/11	03/02/11	9,000	9,000	03/02/11
<b>Charles Keszler, V.P., CFO. Common stock holdings: 4,594 shares</b>								
02/20/01	Options	25,000	\$39.27	02/20/02	02/20/11	25,000	0	Fully Vested
02/19/02	Options	25,000	\$15.07	02/19/03	02/19/02	6,250	6,250	02/19/06
02/19/02	R. Stock	2,500	N/A	02/19/04	02/19/07	1,250	1,250	2/19/06, 2/19/07
02/18/03	Options	20,000	\$16.51	02/18/04	02/18/13	20,000	10,000	2/18/06, 2/18/07
05/14/03	Options	12,500	\$23.39	05/14/04	05/14/13	12,500	6,250	5/14/06, 5/14/07
02/26/04	R. Stock	7,000	N/A	02/26/05	02/26/08	5,250	5,250	2/26/06, 2/26/07, 2/26/08, 2/26/09, 2/26/10
03/02/05	R. Stock	4,750	N/A	03/02/11	03/02/11	4,750	4,750	03/02/11
<b>Robert Spears, V.P., General Counsel, Secretary. Common stock holdings: 2,299 shares</b>								
02/19/02	Options	25,000	\$15.07	02/19/03	02/19/02	6,250	6,250	02/19/06
02/19/02	R. Stock	2,500	N/A	02/19/04	02/19/07	1,250	1,250	2/19/06, 2/19/07
02/18/03	Options	20,000	\$16.51	02/18/04	02/18/13	10,000	10,000	2/18/06, 2/18/07
02/26/04	R. Stock	7,000	N/A	02/26/05	02/26/08	5,250	5,250	2/26/06, 2/26/07, 2/26/08, 2/26/09, 2/26/10
03/02/05	R. Stock	4,750	N/A	03/02/11	03/02/11	4,750	4,750	03/02/11