



This 3DAdvisors Report Covers:

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

Insider Research Bulletin

July 20, 2004

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

- ▶ Monsanto Co. (NYSE: MON)
- ▶ The Pepsi Bottling Group Inc. (NYSE: PBG)
- ▶ YUM! Brands Inc. (NYSE: YUM)

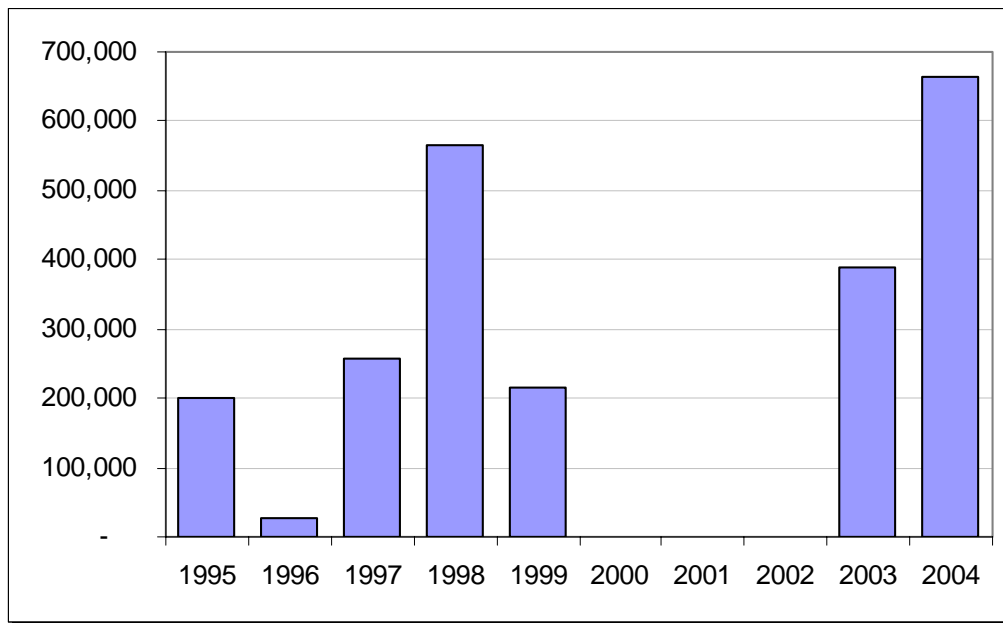
Discussion of 3DAdvisors Findings

Monsanto Co. (NYSE: MON)

Monsanto insiders wasted little time selling after the release of its solid third-quarter earnings report. Despite forecasting continued growth and reaffirming 2004 guidance, seven insiders sold 469,160 shares at prices ranging from \$36.20 to \$37. But the selling was anything but ordinary for this group. After having sold a total of 387,598 shares between 2000 and 2003, insiders have already sold more in the month of July than they had in any prior *full year* dating back to 1995.

There are two key components to the recent behavior that caught our attention. Firstly, five of the sellers reduced their actionable positions (exercisable options and common stock) significantly, dropping between 28% and 79% of their holdings. We've never seen such aggressive selling from MON execs and directors in the past, which can be attributed to the issue reaching prices last seen in 2001. However, insiders sat on the stock three years ago and didn't surface with any dispositions until 2003. While profit taking can be expected, the Company has ownership guidelines in place that

Figure 1. Shares Sold by MON Section 16 Insiders, 1995 to 2004. (Sales for 2004 are through July 16 only) Source: Vickers.



mandate execs to hold a certain amount of common stock based on a multiple of their base salary – each director is required to hold 12,000 shares. With such guidelines in place, we would only expect to see selling of this magnitude if execs were already in compliance with the guidelines. This isn't the case. Four of the six selling executives are far from owning the requisite amount, while six of the eight board members are yet to hold the obligatory 12,000 shares. There is a twist though to Monsanto's guidelines. While most companies outline a timeframe for meeting the ownership targets, Monsanto's guidelines are perpetual. However, as long as the insider is short of compliance, a small percentage of each option they exercise has to be held. We believe this is a good way to ensure insiders will build their ownership position, but unfortunately does little to guarantee that it will be done in a timely manner.

Finally, the Company issued a press release on July 14th announcing that Chairman, President, CEO **Hugh Grant** established a 10b5-1 trading plan. Grant reportedly will exercise options and hold some of the acquired shares in order to build up his common position and meet ownership targets (five times his base salary or approximately 150,000 shares). But we don't interpret this to be an encouraging sign. Not only does this indicate that he intends to sell shares ahead of meeting ownership targets, but also hints that he won't be turning to the open market to accumulate shares.

- **Frank AtLee (62)** – Director. AtLee has been a director since 2000 and was called upon to be the interim president and CEO from May 2002 through Grant's appointment in May 2003. For his added responsibilities he was granted an options for 150,000 shares in 2003, which fully vested in February 2004. On July 9th and 14th AtLee exercised all of his vested options to acquire 160,000 shares and monetized 140,000 shares, grossing \$5.1 million and **reducing his holdings by 73%**. These were his first sales since joining the Company four years ago – his only prior transaction was a 4,000-share open-market purchase in August 2002 at \$16.

Though the transaction significantly reduced his holdings, he still holds enough common stock to meet his ownership requirements.

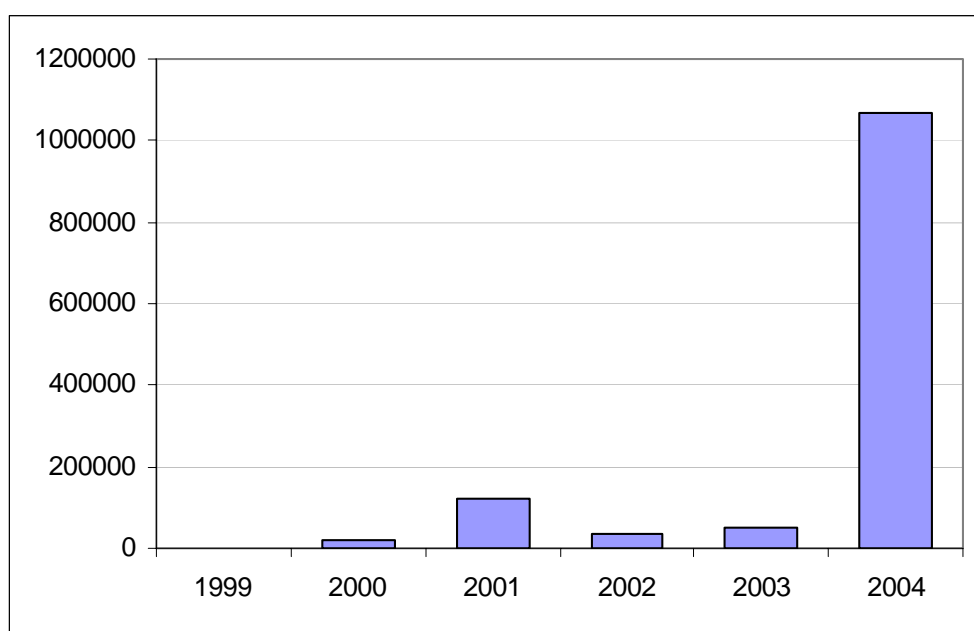
- **Brett Begemann (age not disclosed)** – Executive V.P., International Commercial. Begemann is a relatively new Section 16 filer, having registered in June 2003. On July 6th he made his first transaction, selling 43,290 shares at roughly \$37. Not only did the sale **wipe out 60% of his actionable position** (common stock plus exercisable options), but also left him with 12,900 shares of common stock, far below the level he is expected to have as mandated by the Company's ownership guidelines.
- **Janet Holloway (48)** – Chief Information Officer. On July 7th Holloway exercised *all* of her vested options and sold 126,000 shares at roughly \$36.60. Since filing in October 2000, her only prior transaction was a 5,000-share open-market purchase in August 2002 at \$16. What's more, the recent sale **trimmed her holdings by 79%**, which is significant considering she only has 48,790 unexercisable options which vest between April 2005 and March 2007.
- **Cheryl Morley (48)** – Senior V.P. On July 14th Morley executed her first transaction since filing in October 2000 – a 58,300-share sale at roughly \$36.30. In order to acquire the shares, she exercised two options series (more than half of her vested options), which weren't set to expire until October 2010 and April 2013 to acquire 70,000 shares. Though she held on to 11,700 shares to facilitate closing in on her ownership requirements, the sale still **reduced her holdings by 45%**.
- **Mark Leidy (47)** – Executive V.P., Manufacturing. Leidy is another exec that recently surfaced with a first-ever sale. On July 6th he **sold 28% of his position** with a 35,570-share sale at \$37. Since Leidy only held 4,000 shares of common stock prior to this sale, he was required to hold a percentage of the 44,370 shares acquired from exercising a \$20 option series. He now holds 12,800 shares of common, which is still well short of his required ownership level.

The Pepsi Bottling Group Inc. (NYSE: PBG)

Despite posting respectable second-quarter earnings on July 8th, analysts have been concerned with weakening soft drink sales. Higher prices drove Pepsi Bottling's earnings in the quarter, which helped offset uninspiring 2% global case volume growth. But the question is whether or not earnings growth sustained by pricing power alone can continue to meet expectations or even if prices will continue to increase at all. Company Chairman, CEO **John Cahill** apparently doesn't see pricing as an issue, commenting, "The pricing environment in the U.S. was favorable -- a trend we expect will continue." But his actions tell another story. Cahill recently executed his first sale since joining PBG in 1999 and led the largest round of selling in Company history. Between April 15th and July 12th five insiders sold 1,058,610 shares between the prices of \$29 and \$30.50. The chart below shows the magnitude of the selling, as insiders have now sold more since April than they had combined since 1999 – this with the issue trading below its two-year highs. One possible explanation for the sudden spike in selling is the accumulating options Pepsi insiders are sitting on. From 2000 to 2003 executives were granted over 30 million options, nearly half of which are now vested. Option grants increased an average of 45% from 2002 to 2003 for the five named executives in the

Proxy. Coincidentally, those same execs were given 2003 bonuses, which are based solely on EPS growth, that were on average nearly 25% lower than the prior year. It's rather curious that their compensation derived from Company performance targets decreased, while long-term incentives, which are based on vague metrics, increased significantly.

Figure 2. Shares Sold by PBG Section 16 Insiders, 1995 to 2004. (Shares sold for 2004 are through July 16 only.) Source: Vickers.



- **John Cahill (46)** – Chairman, CEO. Cahill has had varying positions with PepsiCo since 1989, but was appointed to PBG's board in 1999 and has held executive positions since 2000. After joining the Company he began accumulating shares on the open market, purchasing 50,000 shares between \$8.24 and \$13.75. He has since built up an actionable position of common stock and exercisable options in excess of 1.7 million shares. His sentiment suddenly changed July 2004 when he entered into a 10b5-1 trading plan (terms of the plan were not disclosed) and immediately executed his first-ever sale. On July 12th he sold 225,000 shares at just over \$30, grossing \$6.8 million. Since the Company didn't report any information on the plan, we don't know how many shares Cahill will be selling. Based on our experience, however, the first sale is a good indicator of future transactions, which tells us that Cahill may end up diversifying a significant portion of his holdings.
- **Eric Foss (45)** – President, PBG North America. Foss is another veteran PepsiCo exec that recently surfaced with his first sale. Since registering as a Section 16 filing insider with Pepsi Bottling in October 2001, his only prior transaction was an 8,950-share open-market purchase in March 2002 at roughly \$25.76. On May 13th and July 1st he reversed his sentiment, selling 200,000 shares at \$29 and \$30.50. This reversal, after the issue appreciated 15% following his purchase, leaves us to question how much upside Foss believes is left in the stock. On a side note, Foss joined the board of United Dominion Realty Trust (NYSE: UDR) last year but hasn't bought or sold any UDR shares since.

- **Margaret Moore (56)** – Director. On May 5th Moore exercised four series of non-expiring options (expiration dates: 3/09, 3/11, 3/12, 3/13), three of which she cleared out, and monetized all 91,656 shares, grossing \$2.7 million. Not only is this her first sale of PBG stock since filing as a Section 16 insider back in January 2001, but is a considerably larger transaction than when she sold PepsiCo shares back in February valued at \$769,123. Moore was a buyer of PBG stock in August and December 1999, purchasing 23,000 shares at \$10.09 and \$7.88.
- **Barry Beracha (62)** – Director. Beracha, who serves at the Chairman of the Audit Committee, has been a board member since 1999. Over the years we had only seen Beracha buy 4,000 shares back in April 1999, which changed when he **sold nearly 30% of his position** on April 23rd and July 12th at just over \$30. This activity could be written off as diversification, but Beracha also sits on the boards of McCormick (NYSE: MKC) and Sara Lee (NYSE: SLE) and hasn't sold shares of either company in the past two years.

In addition to the above-mentioned insiders, Senior V.P., General Counsel **Pamela McGuire** sold 90,000 shares between March 1st and July 1st, marking her first-ever selling and former director **Craig Weatherup** sold 455,714 shares on April 15th. Weatherup, who held the Chairman position from 1999 through January 2003, didn't stand for re-election at the May 2004 shareholders' meeting.

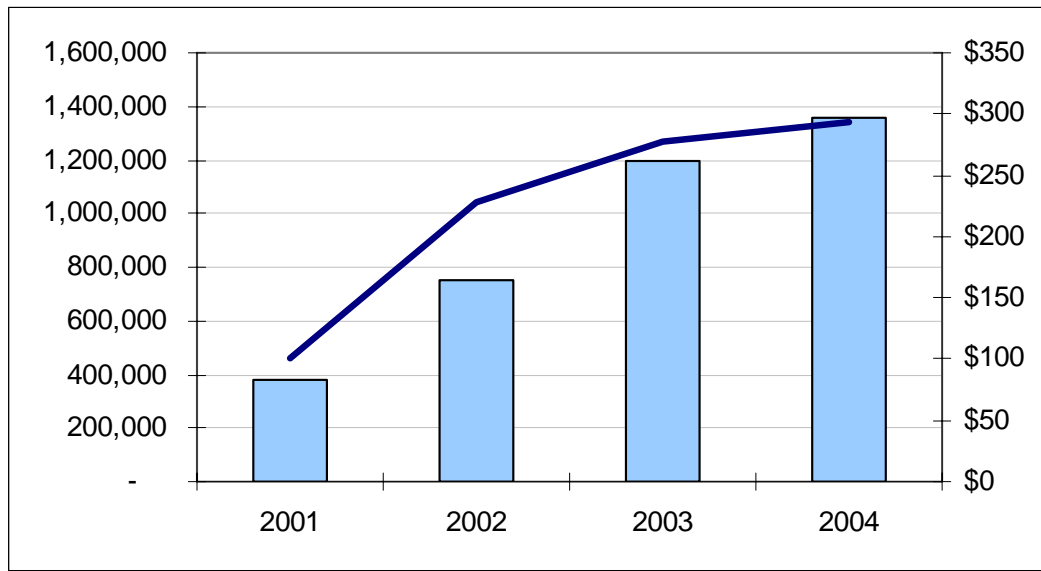
YUM! Brands Inc. (NYSE: YUM)

We've been closely monitoring the insider activity at YUM since last year with a noticeable change in executive trading behavior. The selling commenced after a handful of key executives entered into 10b5-1 trading plans after years of relative quiet. But the rather steady sales of last year have intensified as of late despite the issue trading in a tight range over the past five months. From October 2003 through March of this year, insiders sold a total of 920,000 shares as the issue climbed from \$30 to \$37. Since then, from April 1st through July 1st, at prices ranging from \$36.50 to \$39, ten insiders sold another 819,855 shares. Year-to-date selling has already surpassed the total number of shares sold between 1997 and 2003, this after two consecutive quarters of strong earnings. This is another unmistakable example of insiders using pre-arranged trading plans to quietly increase their levels of selling. For example, Chairman, Yum! Restaurants International **Peter Bassi** entered into his first trading plan back in October 2003 and sold 40,000 shares through February. He then entered into a new plan in March and has since sold over 100,000 shares. Three additional high-ranking executives who have been with the Company for at least four years had never sold before recently establishing 10b5-1 plans and are now selling frequently.

Insiders exercised a total of 343,734 options in 2001. Halfway through 2004, however, that number had jumped to 1.39 million. At the same time, the Company has substantially picked up the pace of its repurchase activity and has already invested more cash in repurchases through two quarters than they had in any prior full year. In fact, the Company has spent \$294 million year-to-date to buy back stock – equal to 75% of its cash flow from operations. CFO **David Deno** downplayed the escalating buybacks, commenting, "The Board's action reflects its belief that the Company's shares are undervalued and represent an outstanding long-term investment opportunity given the

performance of the Company's business portfolio." We can't remember the last time a Company spokesperson stated that their stock, which is trading at all-time highs, is considered to be undervalued, especially when he himself has sold 160,000 shares since February after having sold a mere 496 shares over the prior five years.

Figure 3. YUM! Insider Sales and Share Repurchases, 2001 to 2004. (Insider sales are blue bars and left scale in number of shares; Repurchases are the dark blue line and right scale in millions of dollars. 2004 through July 16 only). Sources: Vickers and YUM SEC Filings.



On a final note, there have been a few changes to the board that are notable. Two members of the Audit Committee have stepped down in the past year while a third left the Committee but remained on the board. **Jamie Dimon**, a prominent board member since 1997, resigned this month. The Company didn't provide any specifics, but hinted that it was due to the Bank One/JP Morgan merger completion. In addition to Dimon's departure, **Sidney Kohl**, a board member since 1997 and Chairman of the Audit Committee from 1997 through 2002, didn't stand for re-election this year due to age restrictions, and **Jackie Trujillo** had to step down from the Audit Committee in March because as the Chairman of the Harman Management Committee, one of YUM's largest franchisees, she was deemed to be a dependent board member. While these resignations probably didn't have ominous motivations, such high turnover on the board's most pivotal committee should be monitored.

- **David Novak (51)** – Chairman, CEO. Novak began selling under a 10b5-1 trading plan back in July 2003. From the time he initiated his plan until yearend, he had sold a total of 246,000 shares. Not only has the 10b5-1 selling persisted in 2004, but we've watched him become more aggressive. Since January, Novak has disposed of 359,916 shares, including 220,916 shares that were sold between April 1st and July 1st at prices ranging from \$36.50 to \$38.20. Though we recognize that the issue appreciated 27% since September 2003, it has been trading in a tight range since March, precisely when Novak's selling picked up. Prior to the 2003 sales, his only

transactions were open-market purchases between 1997 and 2001. Novak was a board member of both Bank One (NYSE: ONE) and J.P. Morgan Chase (NYSE: JPM) before they merged, but over the past two years we've only seen him purchase shares of Bank One.

- **David Deno (46)** – CFO. Since registering as a Section 16 filer back in November 1999, Deno's trading history had been relatively nonexistent – he had only sold 496 shares in May 2003 at \$24. In February 2004 he established a pre-arranged trading plan and has been aggressively selling since. In all, he's sold 160,000 shares year-to-date, or **25% of his holdings**, 96,000 of which were disposed of between April 1st and June 1st from \$36.50 to \$38.40.
- **Christian Campbell (53)** – Senior V.P., General Counsel; Secretary; Chief Franchise Policy Officer. Prior to this year, Campbell's only transaction since filing back in 1997 was a 3,000-share open-market purchase in December 1997 at \$30. Like Deno, he entered into a pre-arranged 10b5-1 trading plan in the first quarter and has since sold 110,646 shares. Of that total, Campbell sold 73,764 shares between April 1st and June 1st.
- **Peter Bassi (54)** – Chairman, YUM! Restaurants International. Bassi has only been a seller since February 2003, after having bought shares between 1997 and 2002. He entered into his first 10b5-1 trading plan in October 2003 and sold 68,712 shares under that plan through March. Despite the issue trading sideways since that plan ended, his selling has picked up under the new plan initiated in April. From April 1st through July 1st, Bassi has already sold 72,992 shares between \$36.80 and \$37.76. Bassi is a director of Pep Boys-Manny Moe & Jack (NYSE: PBY), and purchased 2,000 shares of PBY in May.
- **Aylwin Lewis (49)** – President, Chief Multibranding and Operating Officer. Between March 2002 and July 2003 Lewis sold 51,380 shares, which he has nearly eclipsed since entering into a trading plan in April. Since then, he has sold 46,736 between April 1st and July 1st. In order to acquire the shares to sell, Lewis had to exercise options since he doesn't own any common stock. His remaining actionable position of 559,516 shares is tied up in vested options and 23 shares he holds in his 401(k) Plan. Lewis sits on the board of Halliburton (NYSE: HAL) and Disney (NYSE: DIS), but hasn't made any transactions at either company in the past two years.

Also selling was Founding Chairman **Andrall Pearson**, Chief People Officer **Anne Byerlein**, and President, Chief Concept Officer, Taco Bell **Emil Brolnick**, who made his first sales since filing in 2000 and **reduced his holdings by 33%**.

Copyright © 2004 by 3DAdvisors, LLC. **ALL RIGHTS RESERVED.** Your possession and use of this report is subject to the terms and conditions of the 3DA Product License Agreement, and any unauthorized use or access constitutes theft and 3DA will prosecute violators to the full extent of applicable State and Federal Law. This research report may not be reproduced, stored in a retrieval system, or transmitted, in whole or in part, in any form or by any means, without the prior written consent of 3DAdvisors, LLC. The information in this report was based on sources believed to be reliable and accurate, but no warranty regarding its accuracy or suitability for any purpose is expressed or implied. Nothing contained in this report is or should be construed to be a recommendation to sell, hold or purchase any security.