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

New 10b5-1 Plans Suggest No Slow Down to Selling Symantec Corporation (NASDAQ:SYMC) Update

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Symantec Corporation provides content and network security software and appliance solutions to enterprises, individuals and service providers. The Company provides client, gateway and server security solutions for virus protection, firewall and virtual private network (VPN), security management, intrusion detection, Internet content and e-mail filtering, remote management technologies and security services to enterprises and service providers worldwide. Symantec has offices in 36 countries worldwide. The Company views its business in five operating segments: enterprise security, enterprise administration, consumer products, services and other activities.

Summary of 3DAdvisors Findings for SYMC

- **Insider Trading:** New 10b5-1 plans suggest no slow down to selling
- **Accounting:** Symantec dodges restatement with an August 9 “Mea Culpa”
- **Accounting:** Virus scares continue to hold margins unexpectedly high

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Discussion of 3DAdvisors Findings

We have been noting aggressive selling by Symantec insiders since our initial September 4, 2003 report, and then again in each of three subsequent updates (12/11/03, 1/11/04 and 6/28/04). In every report we had taken note of how insider holdings had deteriorated after each round of distribution. The heavy insider selling has no doubt been encouraged by windfall gains from successive virus attacks that have served to bolster the consumer segment of Symantec’s business, keeping sales from higher margin retail products brisk, which in turn has provided continuing lift to Symantec shares. Even a recent $20 million “adjustment” to revenue due to an error in calculating deferred revenue seemed to draw little reaction from investors (see below) and the stock has continued to trade near its highs.

Insiders, however, have not only continued their active selling pace but also are giving signals that their selling is far from over and may even accelerate. With substantially reduced new option grants, combined with the fact that key insiders have depleted their holdings (including options) noticeably, it is a fair assumption that executives see risk in holding large amounts of Symantec shares for the longer term.

Insider Trading: New 10b5-1 trading plans suggest no slow down to selling

Since the selling at Symantec has been going on for some time, it is easy to become lulled into a sense of complacency about the activity especially since the insiders involved are beginning to use the cover of 10b5-1 trading plans to explain their motivation for selling. This camouflage has been evident in recent Company responses to press inquiries about insider selling as Symantec spokesperson, **Genevieve Haldeman**, has cited “automatic-sales plans” in her statements that certain Symantec executives were selling for “portfolio diversification”.

Increasing numbers of Symantec insiders are filing these 10b5-1 trading plans, causing raised eyebrows from our camp, as it is quite apparent that something other than simple portfolio diversification is on their minds. What’s more, the very fact that so many, who had already been selling aggressively, have stepped up to file these plans recently is evidence that their selling is not likely to slow any time soon. Some of the new plans have been filed by insiders who had already significantly depleted their holdings in the past year, such as Executive V.P. and General Manager – Global Services and Support, **Gail Hamilton** who, after reducing her holdings by almost 60% in the past year, and having been granted no new options in 2003, filed her first 10b5-1 in early August (2004). We find it intriguing that this plan, which implies intent to diversify her holdings, would have been filed *ex post facto*. Clearly, the filing of her 10b5-1 plan suggests that Hamilton plans to continue her selling, which already has exceeded levels one would normally associate with simple diversification of holdings.

But Hamilton is not alone in exhibiting this behavior. In the month of August, two additional Symantec insiders, director **Daniel H. Schulman** and Chief Marketing Officer **Janice Chaffin** have also filed trading plans. In total, since December of 2003, seven insiders have filed 10b5-1’s indicating their intent to sell shares under a trading plan, and most of them had been active sellers prior to the filing of the plans. This is quite unusual behavior. Section 16 legal experts advise that, when filing such plans, insiders wait a period of time before beginning to sell. This to mitigate any suspicion that the plans may have been filed with knowledge in hand that something may be changing within the company. With so many Symantec insiders filing both before and immediately after their 10b5-1 filings, this prudent advice has clearly been ignored. It seems apparent to us that, with so many insiders having reduced their positions prior to filing their 10b5-1 trading plans, contrary to the intended implications of such plans, monetization (not diversification) of positions is what is on the minds of many Symantec insiders.

There is no doubt, in our minds, that in spite of the systematic look to the insider sales at Symantec, the true significance of the activity is in the position reductions registered by those involved. What’s more, some execs and directors either haven’t met the Company’s mandated ownership guidelines or have shown they are satisfied owning just the minimum quantity required (20,000 shares of common stock for execs, 10,000 shares for directors). Two of the current sellers hold less than 20,000 shares, while four of the seven board members are yet to comply with the guidelines.

Second only to the December/January round, insiders sold more in July and August than in any two-month period dating back to 1997. In all, 795,240 shares were sold by eleven executives between July 6th and August 11th at prices ranging from $41.84 to $46.73.

Figure 1. SYMC Daily Closing Prices, August 1, 2003 through August 20, 2004. Shaded blue area is period where insiders sold 795,240 shares. Source: Reuters and SYMC SEC Filings.

- **Greg Myers (54)** – Senior V.P., Finance, CFO. Myers' selling has noticeably picked up over the past two years. After having sold a total of 229,188 shares between the times he registered as a Section 16 filing insider in 1999 and 2002, his volume has now exceeded 485,000 shares over the past 20 months. Included in that total is the 98,440-share sale he executed on July 27th that **reduced his holdings by 40%**. The options he exercised were not set to expire until 2010/2011. Since June of 2003, Myers has sold off 60% of his position. What's more, he exercised options to acquire 70,000 shares and sold the remaining shares out of his common position, leaving him with exactly 20,000 shares, the precise minimum number of shares required to meet his ownership target.

Table 1. Annual Shares Sold by Greg Meyers, CFO. Source: SYMC SEC Filings

1999	2000	2001	2002	2003	2004
4,652	81,540	82,996	60,000	**277,268**	**208,440**

- **John Schwarz (53)** – President, COO. After having sold 100,000 shares in March and May, Schwarz entered into a 10b5-1 trading plan under which he made his first pre-arranged sale in June for 43,000 shares. Including the 43,000 shares (the options he exercised to do so were not expiring until 1012) he sold on August 2nd at $45.87, Schwarz has now **sold 25% of his holdings** this year, equal to 186,504 shares. The sales this year have been his first since joining the Company in 2002. One interesting point – Schwarz has now exercised and sold one-third of his total vested options. This might not seem that significant, but Schwarz was generously awarded an option grant for one million shares when he signed with Symantec in 2002.

- **Gail Hamilton (54)** – Executive V.P., General Manager, Global Services and Support. After having sold a record number of shares in 2003 (674,000 shares), Hamilton surfaced on July 26th to make her first sale of the year, exercising options not set to expire until 2010 and disposing of the underlying 40,000 shares at $42.50. Though this is small compared to her past activity, she subsequently filed a 10b5-1 with the SEC informing us that more sales are to follow. Since June of 2003, Hamilton has **sold over 56% of her holdings**.

- **Dieter Giesbrecht (60)** – Senior V.P., General Manager, Enterprise Administration Business Unit. On July 30th Giesbrecht exercised 105,000 options (not expiring until 2010/2011), sold those shares, and like Myers, tapped into his common holdings to sell an additional 20,000 shares, all between the prices of $46.15 and $46.52. Giesbrecht's 2004 sales have nearly matched the aggregate number of shares he sold between 1996 and 2003, and have **reduced his holdings by 25%**.

- **John Thompson (55)** – Chairman, CEO. Since 2000, Thompson has been awarded a total of 14.1 million options. Due to these sizeable grants, the 2.1 million shares he's sold since 2002 have gone relatively unnoticed and even though he wasn't granted any options in 2003, still has a large reserve of vested and unvested options. However, that doesn't mean we can completely discount the 852,000 shares he's sold year-to-date, including 327,000 shares sold on July 26th and 30th, grossing $13.9 million. His activity adds to the assembly of Symantec executives heading to the doors with record selling.

In addition to the above-mentioned executives, Senior V.P., General Counsel **Arthur Courville**, Senior V.P., Communication and Brand Management **Donald Frischmann**, and Senior V.P., Human Resources **Rebecca Ranninger's** sales have now driven their **year-to-date reductions to 41%, 40% and 32%**, respectively. Frischmann is yet to meet his ownership requirement even though the five-year period he was given to do so has lapsed.

<u>Accounting: Symantec dodges restatement with an August 9 "Mea Culpa"</u>

A Company statement, greeted with yawns by Wall Street, that Symantec "had discovered an error in its calculation of deferred revenue" which resulted in an accumulated $20 million adjustment to revenue, intrigued us. The Company went on to explain that a "manual error" was made and as a result, deferred revenue was understated and recognized revenue overstated by the corrected amount (above), resulting in an erasure of $0.04 per share from GAAP earnings. This interesting admission that the Company was reversing some of its revenue timing seemed to go unnoticed by investors.

What catches our attention here though is the fact that "the revisions to revenue and earnings are an accumulation of the effect of the error over multiple quarters." The Company goes on to explain, "the error was not material to any relevant prior periods." To us, it is quite evident that Symantec, in claiming immateriality, has avoided restatement of the prior periods involved. But the SEC is on record (SEC Staff Accounting Bulletin #99) stressing that any decision to not restate cannot be based solely on immateriality. Certain interpretations (to the bulletin) imply that "outs" are available however and it would seem that Symantec has determined that restatement is not necessary in this case.

It is quite interesting that Symantec's auditors did not do more checking on the balance in the deferred revenue account, and charges and credits to that account. Since deferred revenue plays such a fundamental role in the Company's timing of revenue recognition, one would think that it would get quite a bit of scrutiny. We cannot be at least somewhat suspicious as to whether Symantec knew certain things were being done incorrectly and that a certain amount of subtle revenue management had been going on. Consequently, it would not surprise us if the auditors discovered the error later in the game and all parties agreed to put a happy face on it so they could call it a simple, internally discovered error. It will be interesting to see whether the SEC agrees with the Company's decision not to restate previous periods.

Accounting: Virus scares continue to hold margins unexpectedly high

Symantec began subtly guiding margins conditionally lower back in July of 2003 with the following statement: "Although our gross margin remained flat, we anticipate that our net revenues from our Services segment may grow and comprise a higher percentage of our total net revenues in future periods, in which case our gross margin would likely decrease, as our services typically have higher cost of revenues than our software products." This statement, first appearing in the Q for the period ending 7/31/2003, has been included in each Q and K since. Staving of the expected margin constriction, however, are the windfall gains experienced by the Company in the wake of the numerous virus threats that have served to significantly bolster the consumer segment of Symantec's business.

It would seem, however, that eventually Symantec expects to see more competition from larger companies who are already established in the service business and that Symantec will have to be much more price competitive, this in addition to the direct implication that the eventual abatement of windfall profits from virus fears will result in margin constriction.