



#### This 3DAdvisors Report Covers:

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

## Insider Research Bulletin

March 18, 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

- ▶ Baker Hughes Inc. (NYSE: BHI)
- ▶ Cal Dive International Inc. (NASDAQ:CDIS)
- ▶ Lam Research Corp. (NASDAQ: LRCX)

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## Discussion of 3DAdvisors Findings

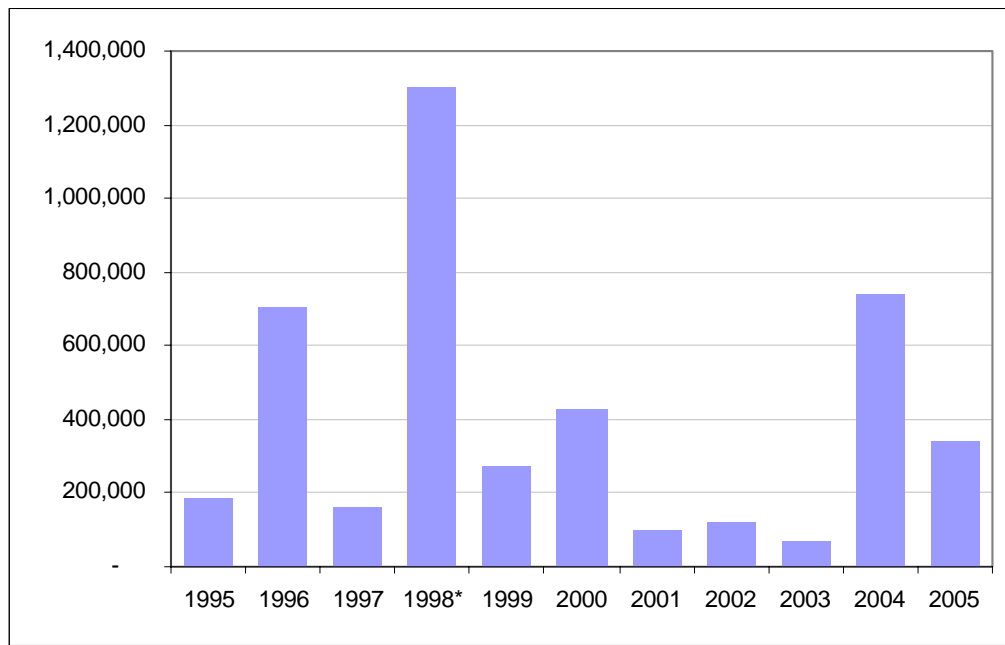
It has been our experience that the trading activity by insiders at oil service companies tends to be more predictive than that of their counterparts at oil exploration and production companies. Activity within this group (oil service) has been intensifying in concert with both rising oil and share prices. Though insider sales have accompanied this rise, we are now noting a number of companies where executives have monetized a large percentage of their holdings and, in many cases, have moved to clear out a significant number of their options to lock in gains. The first company to pique our interest was Smith International (NYSE: SII), which we covered in a March 9<sup>th</sup> *Insider Research Bulletin*. Since then, we have analyzed the selling by insiders at two new companies, Baker Hughes and Cal Dive International, which are discussed below. We also highlight in this report seven additional companies in the industry where we are seeing increasing selling volume, which we are monitoring closely (see Appendix A).

## Baker Hughes Inc. (NYSE: BHI)

Though insiders at Baker Hughes have been somewhat steady sellers over the years, we note that only on two prior occasions in the past have we seen BHI insiders converge over a short period of time to sell in unison. One such instance was in mid 1997 when a group comprised primarily of mid-level execs sold just ahead of a 40% drop in oil prices, which translated into a 60% reduction in the value of BHI shares. With oil prices clearly at all-time highs, it appears as if Company insiders might once again be getting itchy, as five of them sold 343,758 shares from March 2<sup>nd</sup> through March 8<sup>th</sup> between the prices of \$45 and \$47, roughly the same prices they sold at back in 1997.

As interested as we are at this convergence, we're even more intrigued by the fact that each of the sellers monetized between 44% and 92% of their actionable positions (exercisable options and common stock) in the process. To do so, each cleared out most or all of their vested options, as they exercised between four and six series of non-expiring series, which is the most aggressive option activity we've ever seen by Baker Hughes executives. The two heaviest sellers (by number of shares sold) in the group were CFO **G. Stephen Finley** and General Counsel **Alan Crain**, each of whom executed their largest sales on record. Crain's sale was 1500% larger than his next largest sale.

**Figure 1.** Shares Sold by BHI Insiders. Source: BHI SEC Filings.



\* One million shares were sold by a former director on November 6, 1998

This liquidation of holdings becomes even more noteworthy when you take into consideration the Company's recent introduction of ownership requirements for its executives. Baker Hughes hasn't disclosed exactly when the guidelines were put in place, but the first mention we can find shows up in the 2004 Proxy issued on March 1<sup>st</sup>. The disclosure is quite limited, stating only that executives are to hold between two and

five times their base salary in Company common stock. How long they have to meet the requirements is not disclosed. Given, however, the pace at which this group of executives is exercising options and selling all the underlying shares, it appears as if they are currently more concerned with locking in gains than they are in meeting their ownership targets.

With the strong performance of the stock this year, some degree of profit taking is certainly to be expected. The fact that these insiders are exercising multiple non-expiring options series and significantly decreasing their actionable positions, coupled with the general acceleration of insider selling at oil service companies, gives us reason to increase our monitoring of the entire group at this time (see Appendix A).

- **Alan Crain (53)** – V.P., General Counsel. Since joining the Company in 2000, Crain's activity had been rather modest, executing just four sales, in total, covering a total of 14,798 shares. His behavior changed, to say the least, on March 3<sup>rd</sup> when he sold 126,617 shares, equal to **92% of his actionable position** (common stock plus exercisable options). Crain cleared out all of his vested options, which included six different options with expiration dates between October 2007 and January 2014. It also included one series with a \$41 strike price that wasn't set to expire until 2011, which he sold at \$46; hardly an impressive gain after taxes. Crain will have a total of 15,666 new options vest in July 2005.
- **G. Stephen Finley (54)** – Senior V.P., Finance and Administration, CFO. Finley, a Company exec since 1987, executed his largest-ever sale on March 4<sup>th</sup>, distributing 114,812 shares at \$46.47. The sold shares, which accounted for **44% of his ownership position**, were acquired when he exercised five series of options with expiration dates between October 2006 and January 2013. Though Finley's been disposing shares since December 2003, this was his first open-market sale since August 2000. Until now, Finley has been exercising options and turning in enough shares to cover the option price and associated taxes. Now, in a display of new behavior, he is selling, in the open market, **all** the shares exercised for.
- **Ray Ballantyne (55)** – V.P., President, INTEQ. On March 4<sup>th</sup> Ballantyne exercised five series of non-expiring options (expiration dates: 1/12, 7/12, 1/13, 7/13, 1/14) and sold all the newly-acquired 28,513 shares at \$47.50. Following the sale, which **trimmed his holdings by 76%**, Ballantyne owns 9,031 shares of common stock and no longer holds vested options. Though this isn't his largest sale on record (he sold 75,428 shares in March 2004), this is the first time we've ever seen him clear out so many options. Ballantyne will have a total of 8,466 options vest through the remainder of 2005.
- **Alan Keifer (50)** – V.P., Controller. Add Keifer to the list of Baker Hughes execs that have monetized all of their vested options. On March 2<sup>nd</sup> and March 3<sup>rd</sup> he cleared out four series with expiration dates between January 2011 and January 2014, including the same \$41 option exercised by Crain. He then sold the 17,137 shares at roughly \$46, **dropping his holdings by 85%**. Keifer now holds 249 vested options, 2,877 shares of common, and will have 5,433 new options vesting in July.
- **Greg Nakaniahi (53)** – V.P., Human Resources. After joining the Company in 2000, Nakaniahi sold a total of 914 shares through 2003. In July 2004 he exercised one option and sold the underlying 3,939 shares, which was a transaction of little note.

His more recent behavior, however, is much more interesting: Between March 4<sup>th</sup> and March 9<sup>th</sup> he exercised five series of non-expiring options (expiration dates: 11/07, 1/11, 1/12, 7/12, 1/13) and sold the newly-acquired 57,679 shares at \$47. The dispositions **shed 65% from his actionable position.**

#### Cal Dive International Inc. (NASDAQ:CDIS)

Shares of Cal Dive International are clearly in uncharted territory. The issue has reached \$50, after never having broken above \$30 in the past eight years. Certainly some selling by CDIS insiders is expected, especially since they have routinely taken profits in the past. But what we look for is any distinctiveness in the recent selling behavior that sets it apart from prior sales into momentum. It appears we found what we were looking for.

From March 2<sup>nd</sup> through March 9<sup>th</sup> six insiders sold 595,540 shares, including 500,000 shares sold by Chairman, CEO **Owen Kratz** pursuant to a forward sale contract. On March 4<sup>th</sup>, Kratz entered into a forward sale agreement with Citibank covering two equal blocks of 250,000 shares, each with settlement dates in March 2008. Though the Company did issue a press release about the transaction, there are still some interesting points that shouldn't be overlooked. First, Kratz set the terms for the derivative transaction on a Thursday; just two days after the Company issued its fourth quarter earnings report. The Company, however, didn't issue a press release for the forward sale for five days, until the following Tuesday, March 8<sup>th</sup>. A one business-day delay is understandable, but withholding material information for more than two days definitely gives us the impression they were concerned how the market would absorb the news.

What's more, this isn't Kratz's first derivative activity. In March 2002 he entered into a transaction similar to a forward-sale called a Maximum Monetization and Asset Protection Agreement in which he pledged 500,000 shares in exchange for an upfront cash payment and later pledged another 250,000 shares to a different investment house in November 2002. Both of these contracts are yet to be settled.

Though we have encountered a handful of corporate insiders that have utilized multiple derivative transactions to gain access to cash without resorting to open market selling, something seems different here. First, the Company had reported Kratz's previous forward sale obligations in both the 2002 and 2003 Proxy statements, but failed to report them in the 2004 Proxy. It seems rather material to us that nearly 43% of Kratz's ownership position, which is equal to 7.5% of the Company's outstanding shares, is actually pledged to three different third-party investors. We don't expect to see any mention of this in the 2005 Proxy. And though Kratz reports that he has every intention of settling these contracts with cash as opposed to the shares, he reported taking out the earlier contracts due to personal cash needs, leaving us to question if he'll be in the position to come up with that much cash at settlement.

But as we mentioned, Kratz isn't the only Cal Dive insider to monetize their shares on the heels of the fourth quarter earnings release, as five other executives sold on March 2<sup>nd</sup> and March 3<sup>rd</sup>. It doesn't appear a coincidence that these execs and directors, most of which had never before converged to sell in a one or two-day period, chose to sell in the time frame between when Kratz reported setting the terms of the

forward sale and its attendant (and delayed) press release. A release, we might add, that prompted some short-term volatility in CDIS shares.

- **Owen Kratz (49)** – Kratz’s above activities have resulted in his having **pledged 43% of his holdings** to third-party investors. Since joining the Company in 1990, Kratz had only sold twice, in August 1999 and March 2000 covering a total of 387,900 shares. It will not be known until March 2007, when the first contract is to be settled, whether or not he follows through with his promise to deliver cash instead of the shares.
- **Martin Ferron (47)** – President, COO, Director. Ferron had been buying CDIS calls since August 2003 and has profited nicely each time he has done so. Most recently he bought calls in August 2004 with a December 2004 expiration. He exercised the calls in December, and then held the shares. This positive behavior now seems past-tense: Between March 2<sup>nd</sup> and March 4<sup>th</sup> he cleared out all of his vested options, comprised of one expiring series, and also the shares acquired from the call, selling a total of 37,000 shares. The sale was his largest since joining the Company back in 1998, and **reduced his holdings by 42%**, the largest percentage reduction of any prior sale except when he cleared out his holdings in 1999 shortly after joining the Company. We would typically discount the selling of expiring options, but since his current activity represents a reversal of his previous call-buying behavior, we view his recent selling to be significant.
- **James Connor (46)** – Senior V.P., General Counsel, Secretary. Connor also cleared out all of his vested options on March 2<sup>nd</sup> and March 3<sup>rd</sup>, exercising two series (expiration dates: 04/05, 2/14) and sold the underlying 8,340 shares at \$50. The sale **trimmed his actionable position by 87%** and leaves him with just 1,564 shares of common stock.
- **Lloyd Hajdik (38)** – V.P., Chief Accounting Officer, Controller. Hajdik originally filed as a Section 16 insider back in February 2004 and wasted no time cashing in on his first vesting of stock options, which occurred last December (2004). On March 2<sup>nd</sup> and March 3<sup>rd</sup> he exercised his only available options which weren’t set to expire until December 2008, and sold the shares **equal to 77% of his ownership position**. All that Hajdik now holds is 607 shares of common stock and will have 2,000 options vest in December 2005.

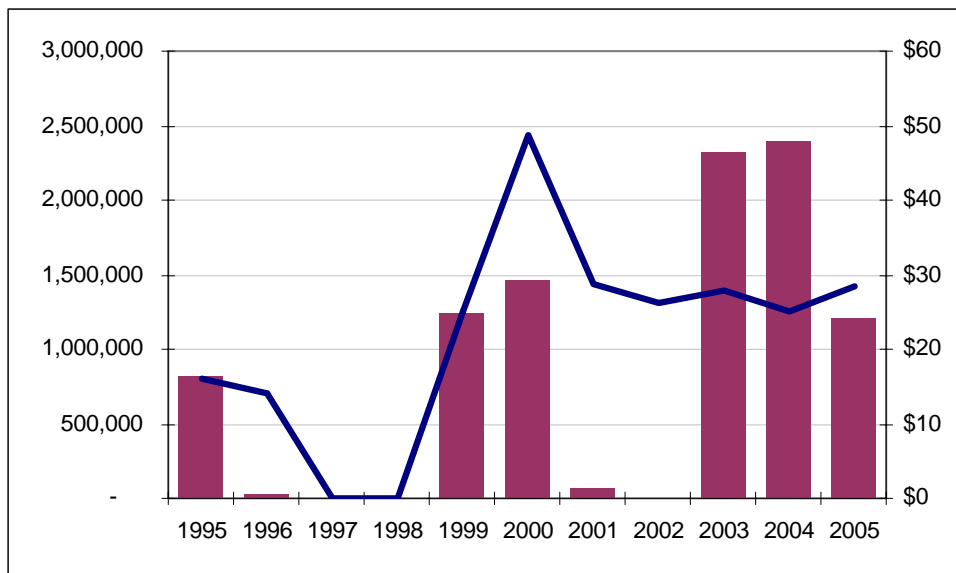
Additionally, two directors, **William Transier (49)** and **Anthony Tripodo (51)**, have sold for the first time ever: Transier, who is the chairman of the audit and compensation committees, exercised all of his vested options (one series set to expire in November 2010) and sold for the first time since joining the board back in 2000. His sale nearly wiped out all of his holdings, leaving him with just 2,000 shares of common stock. He also sits on the boards of Endeavor International (AMEX: END) and Reliant Energy (NYSE: RRI) but has only acquired shares of each over the past two years. Tripodo’s sale, his first since joining Cal Dive’s board in February 2003, dropped his holdings by 58%. He currently holds 1,500 shares of common stock, 6,600 vested options, and will have 8,800 options vest in February 2006.

## Lam Research Corp. (NASDAQ: LRCX)

Though shares of Lam Research and the DJ Semiconductor Index rallied into the end of 2004, we have seen both slow through the first quarter of 2005. But what hasn't slowed is the unusually high volume of LRCX insider sales which we initially covered in our December 10<sup>th</sup> *Insider Research Bulletin*. Despite meager gains since, insiders have continued dumping shares, paring back their holdings to levels not seen in years. The selling coincides with industry uncertainty, as inventory levels throughout the semiconductor and semi equipment industries have raced to exceedingly high levels, giving concern that capital spending on equipment will continue to stall. Lam's \$129 million in inventory during the quarter was the highest level seen since the second quarter 2002. It was disclosed in its fiscal second quarter earnings report that "backlog fell by 10% and we should expect to see orders fall another 15% to 20%", while Applied Materials and KLA-Tencor have recently provided similar outlooks.

The selling has been led by Chairman, CEO **James Bagley (65)**, who announced that the long-anticipated transition to turn the Company over to President, COO **Stephen Newberry** would finally commence in July 2005. But we never discount the selling in cases like this, as Bagley has been at the LRCX helm since 1997 and has stated that he has no plans to leave the Company's board. After years of accumulating a sizable ownership position, it is quite interesting to now see him swiftly monetize the majority of his stake as Bagley has now sold 2.67 million shares over the past year. Yet, he isn't the lone seller, as those execs closest to him have also been distributing their shares at an uncharacteristic pace. As you can see from Figure 2 below, the total volume of selling by LRCX insiders has picked up over the past few years and even more so over the past two months, despite the share price showing very little appreciation.

**Figure 2.** Selling Volume by Lam Research Insiders (red bars and left scale) and Average Price of Shares Sold (blue line and right scale). Source: LAMR SEC Filings.



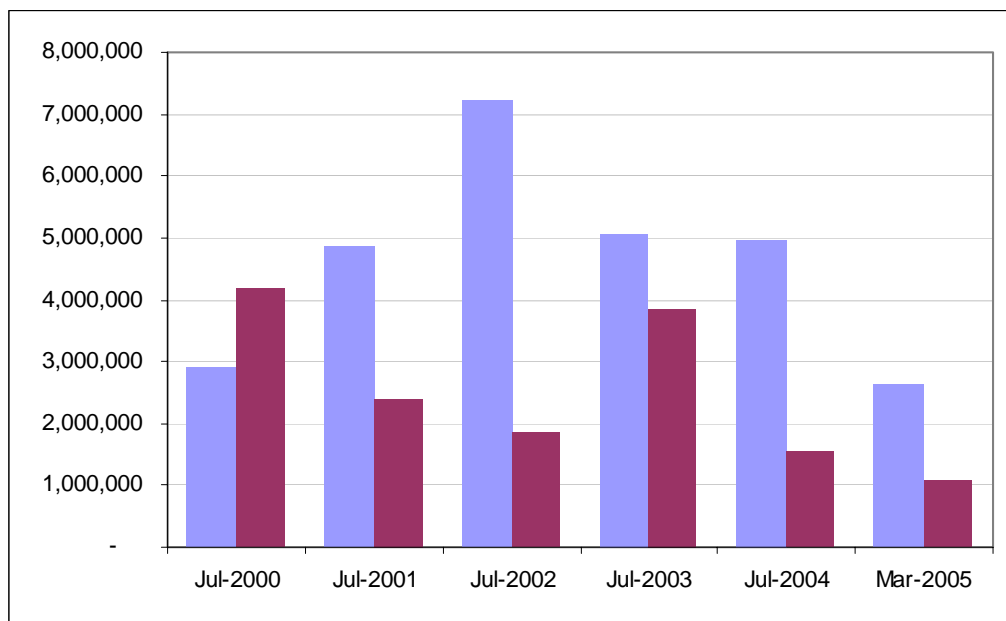
These insiders have been quick to monetize their options holdings despite the fact that they didn't receive any type of equity compensation in 2004 and are yet to receive anything this year. The Company has not disclosed why it has abstained from providing stock-based incentives last year. Whatever the reason, it is safe to say that any continued selling will only push their ownership positions down to levels that will only take longer to replenish. As you can see from Table 1 below, each of the named executives' holdings are at their lowest levels in a number of years. And as Figure 3 illustrates, both the cumulative number of exercisable and un-exercisable options held by the Company's five most senior execs are now at five-year lows.

**Table 1.** Holdings Reductions by LRCX Named Executives. Source: LAMR SEC Filings.

Named Executives	Position	Shares Held As Of:				Chg Since	
		09/13/02	09/12/03	12/01/04*	03/10/05	Chg Since 2003	Dec. 2004 3DA Report
J. Bagley	CB, CEO	4,654,000	3,473,000	2,262,514	1,401,000	-59.7%	-38.1%
S. Newbury	P, COO	1,115,250	1,485,247	1,238,347	1,054,812	-29.0%	-14.8%
N. Bright	SVP	261,021	458,921	373,101	323,101	-29.6%	-13.4%
E. Maddock	GVP	--	104,308	24,536	21,774	-79.1%	-11.3%
S. Lindsay	GVP	--	--	138,063	53,058	N/A	-61.6%

\* Date of last 3DA Report

**Figure 3.** Options Holdings of LRCX Named Executives. Exercisable Options (blue bars) and Unexercisable (red bars). Source: LAMR SEC Filings.



A few points of interest: Lam Research might have some of the worst options disclosure practices we've seen. First, the Company typically grants multiple series of

options every year, each with different vesting schedule. What makes this confusing is that they only periodically report the vesting schedules of their options annually in the Proxy statements, leaving some options series nearly impossible to track. The more common practice, however, is that most companies disclose an option's vesting schedule on the Form 4 at either the time of grant or time of exercise, which LRCX hasn't done either. What's more, good disclosure dictates that insiders reveal the holdings of each individual option series being exercised on a Form 4. Lam doesn't provide this information, only a cumulative total of all their vested and unvested options. We don't think this behavior is an accident.

- **James Bagley (65)** – Chairman, CEO. Bagley continues to sell under a 10b5-1 trading plan he entered into back in March 2004. After selling 1.48 million shares between 1998 and 2003, he has now sold 2.6 million shares, equal to **60% of his ownership position**, during the past year, including 800,000 shares sold since our last report issued in December 2004. What's more, Bagley has been selling at prices below the average price he accepted for his shares in 2003.
- **Stephen Newberry (50)** – President, COO. After selling a total of 605,900 shares between 1998 and 2003, Newberry adopted a 10b5-1 trading plan in November 2004 and has since sold 421,035 shares, including 221,035 shares that he distributed between February 8<sup>th</sup> and March 1<sup>st</sup> at an average price of \$31. Though the selling hasn't reduced his position to the same degree as many of his peers, it is clear that his selling pace has picked up considerably, as theirs has.
- **Nicolas Bright (48)** – Senior V.P. and GM, Global Products. As we mentioned in the earlier report, it took Bright six years before he executed his first sale at the Company, and the selling since has been steady. Bright sold 100,120 shares in November and December 2004, and then sold another 50,000 shares between February 8<sup>th</sup> and February 28<sup>th</sup> at roughly \$31. Since late 2003, Bright has now **trimmed his holdings, nearly all of which is tied up in vested options, by 30%**.
- **Stephen Lindsay (65)** – Group V.P., Global Sales and Corporate Marketing. Lindsay continues to shed his holdings under the cover of a 10b5-1 trading plan, as he exercised options set to expire in August 2009 and sold the underlying 75,000 shares on February 8<sup>th</sup> and February 15<sup>th</sup>. After having an actionable position of 273,000 shares just six months ago, Lindsay has **reduced this by 80%** and now holds just 50,000 vested options and 3,058 shares of common stock.

Though there has rarely been a time when selling within the Semiconductor Industry has been non-existent, it is periods like we're experiencing now, with the DJ Semiconductor Industry Index slightly down over the past three months, that signals from industry insiders tend to be the most revealing. We highlight in Appendix B semiconductor firms that have managed either a negative or slightly positive three-month return, yet insiders have shown no pause in their share distribution. In many cases, these companies are trading well off their 52-week highs.

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## Appendix A

Additional Notable Selling Within the Oil Services Industry

Company	Ticker	Number of Sellers	Shares Sold Since Dec. '04	% of total sales in last year	Key Holdings Reductions	P/E (Avg:37.18)	P/Book (Avg:3.95)
Ensco	ESV	11	476,142	52.8%	SVP: 83%; Director: 90%	55.33	2.64
FMC Technologies	FTI	7	432,210	29.3%	SVP: 38%	19.90	3.49
Global Santa Fe	GSF	11	289,185	43.1%		279.54	1.94
Helmerich & Payne	HP	6	230,963	57.7%	GC: 40%	N/A	2.03
Paterson-UTI Energy	PTEN	3	1,830,000	27.4%	SVP: 34%; CEO: 30%	39.13	4.18
Transocean	RIG	6	286,852	73.7%	CEO: 41%; COO: 34%	103.48	2.09
Weatherford Intl.	WFT	7	527,504	44.9%	Director: 36%; Director: 32%	24.69	2.39

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## Appendix B

Additional Notable Selling Within the Semiconductor Industry

Company	Ticker	Number of Sellers	Shares Sold Since Dec. '04	Share Price Chg Since 12/04	P/E (Avg:24.89)	P/Book (Avg:3.60)
Broadcom	BRCM	9	900,804	-4.4%	48.45	4.19
Analog Devices <sup>1</sup>	ADI	7	194,134	-3.3%	25.16	3.58
Flextronics <sup>2</sup>	FLEX	3	3,551,100	-13.9%	25.43	1.32
Jabil Circuit <sup>3</sup>	JBL	3	1,615,000	4.4%	29.79	2.72
Linear Technology	LLTC	5	256,667	0.9%	31.19	6.12
Marvell Technology	MRVL	7	4,463,832	3.5%	76.28	3.95
PMC-Sierra	PMCS	3	278,776	-15.7%	33.15	5.32
Rambus <sup>4</sup>	RMBS	6	496,779	-38.5%	43.83	4.15
Silicon Laboratories	SLAB	6	606,179	-11.6%	21.85	4.05
Xilinx <sup>5</sup>	XLNX	3	570,062	0.8%	28.49	3.97

<sup>1</sup> We issued reports on Analog Devices on January 8, 2003 and February 25, 2003

<sup>2</sup> Flextronics was highlighted in a Special Report dated February 9, 2005

<sup>3</sup> We issued a report on Jabil Circuit on July 24, 2003

<sup>4</sup> We issued reports on Rambus on March 3, 2004 and August 27, 2004

<sup>5</sup> We issued a report on Xilinx on February 12, 2004