3D ADVISORS

Research Notes

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Research Notes are a brief description of the insider trading, accounting, or governance behaviors that we have been investigating for possible inclusion in a standard 3DA report, and may also include other information of general interest to 3DA subscribers.

Companies in this Research Note

- Avon Products, Inc. (NYSE :AVP)
- Education Management Corp. (NASDAQ: EDMC)
- Family Dollar Stores Inc. (NYSE: FDO)
- NCR Corp. (NYSE: NCR)
- Sara Lee Corp. (NYSE: SLE)
- WCI Communities Inc. (NYSE: WCI)
- Wesco International Inc. (NYSE: WCC)

3DAdvisors Research Notes

Avon Products, Inc.

Other: Shareholder class-action lawsuits filed
Other: Company discloses reversal in "channel stuffing" lawsuit

Two law firms announced shareholder class-action lawsuits against Avon in the last couple of days. Schatz & Noble P.C. announced but has not filed its lawsuit, while Lerach Coughlin Stoia Geller Rudman & Robbins LLP has apparently filed its suit. Both firms allege essentially the same misconduct on the part of the management and board of Avon: that management provided overly optimistic guidance that it knew was incorrect, particularly with regard to Eastern Europe, Russia and China, and then when they lowered guidance following last quarter's results, shareholders suffered the consequence of a $5.30, 14% decline in the stock.

Neither of the press releases announcing the suits mentions any of the accounting or trading behaviors we have observed, even the more recent items that we covered in our update on 02/15/05 that focused on the issue of how management seemingly dodged questions in the conference call regarding overseas markets, and the insider selling that took place immediately thereafter, most notably by CFO **Robert Corti**, who dropped 50% of his actionable position.

Jeffrey Huron, the lead attorney in the class action brought by former reps that we have been following so closely because of its link to the channel stuffing behavior we have observed, was somewhat surprised by how quickly these suits were filed. We will be following the new legal actions closely, as well as the original "channel stuffing" suit.

Speaking of that original suit, the Company did finally disclose in its recently filed 10-Q the fact that the California Court of Appeal had overturned the trial judge's decision to throw out 3 of the 4 "causes of action" in the suit filed by Huron, essentially three months after the court ruled. The Company continues to maintain that it is nothing more than a dispute over how returns are credited, and not worthy of class action status. We also note that the Company filed its 10-Q about 10 days after the earnings announcement, whereas in the recent past it has filed its 10-Q, if not on the same day as the release, then within one or two days, suggesting the Company is being more careful about what it discloses and does not disclose.

Education Management Corp. (NASDAQ:EDMC)

Insider Trading: EDMC insiders begin selling despite regulatory eye on industry

Insider Trading: Ex-director collars 80,000 shares, files Form 4 two months late

Insider Trading: Two insiders adopt trading plans covering large % of their holdings

Insiders at Education Management have resumed their selling, despite intense regulatory scrutiny on the for-profit education sector. The most notable transaction was executed by former director **James Burke** (52), who chaired the Audit Committee in 2004. Although Burke didn't stand for re-election at the end of 2004, he hedged his remaining holdings by entering into an 80,000 share collar on May 4th (Section 16 filers have to report their trades for up to six months following their departure from a company). The Form 4 filing was submitted late on July 25th, which gives us a feeling that the Company may be concerned its activity is being monitored.

This assumption is further supported by the 10b5-1 trading plan adoptions of Chairman **Robert Knutson** in November 2004 and Executive V.P., CFO **Robert McDowell** on June 30th. Knutson's plan called for the distribution of 720,000 shares, or roughly half his holdings, through November 2005. He began selling one day after adopting the plan and has already sold 566,107 shares through July. McDowell announced he'll be selling 120,000 shares equal to 25% of his holdings through June 2006, but he is yet to make his first plan sales. He did sell just prior to the plan's adoption, dumping 40,000 shares in June, including 20,000 shares held in his retirement account. Finally, Director **James Pasman** (74) announced that he will not be standing for re-election at the end of the year. He exercised all of his options on May 25th and sold the 80,000 shares, nearly 90% of his holdings, at \$30.61. With six months before his term ends, his behavior seems impulsive.

Family Dollar Stores Inc. (NYSE: FDO)

Insider Trading: Four insiders sold shares with issue trading at three-year lows

Insider Trading: In addition to options-related activity, two sellers cashed out common shares

Four insiders sold shares between July 11th and July 15th with the issue at three year lows. Senior V.P., Merchandising and Advertising **John Scanlon** cleared out his entire series (20,000 options) granted in September 2000 that has an expiration of September 2005, but then also sold an additional 15,930 shares out of his common holdings. Oddly enough, Scanlon last acquired 20,000 shares from an option exercise in September 2004 and held the shares as they traded from $28 at the time of acquisition to $35, but then sold the shares at $25. Lending further proof to our assumption that this round of sales wasn't only related to the expiring option series, Senior V.P., Finance **Martin Sowers** sold 20,000 shares out of his common position at $25, the lowest price he's accepted for his shares since January 2001. He had sold the same number of common shares in January 2005 at 25% higher prices. We haven't seen this many shares being sold (152,930 shares) by a group of FDO insiders since the first quarter 2002 when the issue traded at $33.

NCR Corp. (NYSE: NCR)

Governance: Interim CEO provided a generous incentive award despite transitory tenure

Governance: Stock options issued with an accelerated vesting period

Governance: NCR hires Symbol Technologies' Bill Nuti as CEO

When **Mark Hurd** abruptly left NCR to take over Hewlett-Packard on March 29th, Director **James Ringler**, the former vice chairman at Illinois Tool Works, took over as NCR's interim chief executive, even though he had the shortest tenure of all current board members. The Company is reportedly "actively engaged in a search for a new CEO", leaving us to believe that Ringler's time at the helm will be brief. Despite already having been awarded over 20,000 options and shares in the past two years, the board granted him 52,610 options on July 11th with an accelerated vesting schedule, as two-thirds vested on the date of grant and the remainder will vest monthly over the ensuing three months. Though we agree his responsibilities increased significantly on short notice, this award, and more specifically its vesting schedule, seems awfully generous for an employee of the Company who was already being adequately compensated.

Bill Nuti's entrance as NCR's new CEO is quite interesting. Nuti played the Gerald Ford role in heading up Symbol Technologies in the wake of the "impeachment" of its entire management team and ensuing SEC battles. Of late, however, his undoing at Symbol has been his inability to transition Symbol from crisis to growth mode, as the Company has repeatedly missed its numbers.

Given his track record at growth management, we are left to suspect that he is not being brought into NCR for skills other than what he has been known for: crisis management, restructuring and optimization strategies. Sounds like an extension of the Hurd legacy to us. We're not surprised to see that NCR shares dropped almost 4% on the news of his arrival.

<u>Sara Lee Corp. (NYSE: SLE)</u>

Insider Trading: Executives sold shares with issue trading at 52-week lows

Insider Trading: Executive V.P. Chaden liquidated his entire common stock holdings into weakness

It isn't often that we see activity at Sara Lee, and we certainly wouldn't expect to see any selling with the issue trading near two-year lows. Yet, just before announcing that they would be taking a $472 million restructuring charge in the fourth quarter, four execs, including Chairman **Charles McMillan** sold a total of 214,654 shares between May 6th and June 17th at an average price of $20. At these prices, our first guess was that they were cashing in expiring options, but this wasn't the case. In fact, these insiders didn't even exercise any options. All of the shares were sold out of each individual's common stock holdings, including the 14,094 shares sold by Executive V.P., Global Marketing and Sales **Lee Chaden** who liquidated his entire common stock position since March at incrementally lower prices. Also selling was General Counsel **Roderick Palmore** who sold at 20% lower prices than where he sold at last November.

<u>WCI Communities Inc. (NYSE: WCI)</u>

Insider Trading: Stealthy derivative activity persists at WCI

Insider Trading: Directors Don Ackerman and Alfred Hoffman currently have 53% and 60% of their ownership position pledged to securities brokers

Other: Loan environment shifting for WCI

Since March, we have issued two *3D Reports* (March 24th and June 22nd) on WCI Communities, highlighting amongst a number of issues, certain insiders' use of stealthy forward sale contracts to monetize significant percentages of their holdings. The last activity we covered involved Director **Alfred Hoffman**, who entered into a forward sale of 1 million shares on June 15th, by far his largest derivative activity to date. Following the transaction, he now has 60% of his holdings pledged. Since that last report, another director has surfaced with his own derivative activity.

On July 20th **Don Ackerman** (71), a board member since 1995 and former chairman through February 2005, entered into a "Variable Prepaid Forward Agreement" with Credit Suisse First Boston covering 500,000 shares to be delivered by July 2008. No where did the word "sale" show up in the Form 4, and in fact, he presented the transaction as an "acquisition" on Table II of the filing. He did not provide any details as to how much cash he received up-front for the shares.

No attempts have been made by Ackerman or the Company to conceal these transactions. In November 2003 it was disclosed that Ackerman entered into a 10b5-1 plan to monetize up to 500,000 WCI shares. He would later amend the Plan, increasing the share allotment to 850,000 shares. This wasn't his first derivative activity under the Trading Plan, as he had already opened two contracts in the first quarter of 2004 covering a total of 334,000 shares, not to mention the 1 million shares pledged prior to the Plan's adoption. In all, Ackerman currently has 1,834,000 shares monetized, **equal to 53% of his holdings**. Although they've adequately disclosed the activity, it doesn't emasculate the fact that WCI's two largest inside shareholders have monetized over 50% of their holdings.

Our Fort Lauderdale sources are revealing some interesting shifts in the loan environment, with regards to commercial lenders and the tower condominium market. For the past two quarters, these lenders have been increasingly concerned about the practice of downstream condominium purchasers "flipping" units prior to closing on the property. This has been a common practice in the S. Florida market which has greatly exacerbated the speculative froth that continues to exist in the area.

Generally, construction loans are not approved until a substantial number of units are under non-cancelable contracts and the developer has collected deposits from the purchasers which, in WCI's case, range from 10% to 30%. Up until recently, our sources tell us that WCI, through its large circle of "friends and family", has been able raise capital quickly for its projects because it aids purchasers in the flipping game by permitting assignment of pre-construction contracts prior to actual closing.

Our legal contacts, involved in the S. Florida commercial market, inform us that lenders, concerned about these pre-closing "flippers" selling into the same market as the developer, have increasingly been adding restrictions in their loan agreements with developers that disallow the practice of pre-closing assignments by downstream buyers. These restrictions have quietly become commonplace, at the commercial loan level the size of which is required by WCI in order to commence construction on one of its Tower Buildings. Whether this affects WCI in every loan situation, however, is not certain at this time.

Whether such restrictions are commonplace at many of the smaller developer projects is unclear. We say this because our conversations with the owner of the largest ReMax franchise in the state reveals that, at the retail level, such pre-closing assignments are still being included in their standard sales agreements with buyers. Keep in mind, ReMax does not see WCI deals, which are sold exclusively through Prudential Real Estates Affiliates. We found it very interesting, however, that the largest Remax franchise in the state is not aware, at least not openly, of the trend for local commercial banks' adding restrictions to the assignment of pre-construction contracts prior to closing. In fact, we found a comment by our ReMax contact to be significant as he indicated that such restrictions would have a material affect on his condo business.

Wesco International Inc. (NYSE: WCC)

Insider Trading: Three directors sold between 80% and 100% of their holdings as the issue rebounded off the lows

Insider Trading: Wesco's largest institutional shareholder unloaded 56% of its holdings

Shares of electrical supplies and equipment distributor Wesco International have had an impressive run since 2003, climbing from lows of $4 to $36 as recently as March. Insiders, who hadn't sold since May 2000, cashed out a record number of shares into the 2004 momentum, distributing a total of 2.54 million shares. Absent from the activity were a couple of Company directors and its largest institutional shareholder, who surfaced late in the second quarter of 2005. While we certainly expect them to take advantage of the issue's gains, the timing of their sales seems curious to us. The issue lost 33% of its value between March and May, only to regain most of the losses. However, before the issue fully recovered, Directors **George Miles**, **Robert Tarr**, and **Kenneth Way** sold between 80% and 100% of their holdings. Miles and Tarr's sales were their first since joining the board in 2000 and 1998, while Way began his sell-off in June 2004. Then there's the selling by The Cypress Group, which just last April held over 45% of Wesco's outstanding shares. Cypress, which has two of its partners on Wesco's board, executed its first sales in December, dumping 6.46 million shares at $25 and then sold 4 million shares on June 15th in a secondary (held solely for the shareholder at $28.75). The selling over the past eight months has trimmed its holdings by 56% and leaves it with a 17% ownership stake. We are monitoring this situation to see if any executives enter the picture.