3D ADVISORS

This 3DAdvisors Report Covers:

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

Tax Benefit From Unusual Option Plan Running Out CDW Computer Centers, Inc. (NASDAQ:CDWC) Update

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CDW Corporation, formerly CDW Computer Centers, Inc., is a direct marketer of multi-brand computers and related technology products and services. CDW's extensive offering of products, including hardware, software and accessories, combined with its service offerings, provide comprehensive solutions for its customers' technology needs.

Summary of 3DAdvisors Findings for CDWC

- **Accounting:** Benefit from unusual option plan running out
- **Governance:** Separation agreement leads to lucrative comp deals for executives

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Discussion of 3DAdvisors Findings

Accounting: Benefit from unusual option plan running out

Our January report concerning CDW highlighted the unusual stock option plan administered by Company founder, Michael Krasny. Named The MPK Stock Option Plan (MPK), the initiative was implemented for the benefit of three key executives. Michael Krasny, not the Company, contributed the shares for the options. In spite of the fact that the stock to be used, upon exercise of the options, has been contributed by Krasny, the Company has been reaping the tax benefits from the exercises. Whatever deal was struck between Krasny and CDW to implement this situation (read: allow the Company to get the tax break from shares contributed by the founder's holdings) has not been clearly disclosed. The deal occurred prior to CDW's IPO. What we do know is that the MPK program has been a big factor in providing significant tax shelter for CDW's earnings in recent years. For more detail on MPK, please refer to our January report.

Make no mistake about it, the low (about a penny per share) exercise price of MPK options has allowed huge tax benefits to inure to the Company. Overall option-related benefits have been so large that they boosted CDW's Cash from Operations by $70 million in 2002 (30% of Cash from Operations), $58 million in 2001 (19%) and $71 million in 2000 (50%). Now, of course, the MPK Stock Option Plan is not the only option plan of CDW's. It has been however, responsible for the lion's share of the tax benefits generated from all plans: Of the 2002 total benefit of $70 million, 54% was attributable to MPK. MPK represented 74% of the $58 million tax benefit in 2001.

This year however, the MPK goose stops laying. Of the original 16.6 million options for shares that constituted the plan, only 1.1 million remained unexercised as of F/Y end 2002 (12/31). The two remaining plan holders, **Gregory Zeman** (958,864 shares) and **Daniel Kass** (150,000 shares) have now exercised their once-a-year option to cause the Company to register the shares for sale. The sale will bring a tax-benefit of about $19 million vs. (MPK-related) totals of $38 million and $43 million in 2002 and 2001 respectively. After this, MPK-related benefits will no longer be available.

Governance: Unusual separation agreement leads to expensive comp plans

In our last CDW report we mentioned a more-than-revealing Separation Agreement between the Company and its V.P. Purchasing, **Paul Kozak**. Kozak had left the Company premises on September 28, 2001. The Separation Agreement was dated December 31, 2001. His employment officially ended on January 2, 2002. Upon reviewing the terms of this agreement, it would certainly seem that something quite contentious was going on and this individual very much seemed to have solid ground to stand on. Kozak received three months severance on his $187 thousand salary and a pro-rated portion of his bonus. The Non-Compete portion of the deal jumped right out at us as he received $722,000 in 13 monthly payments totaling $56,000 each. But there was more. On top of this, he was reimbursed $40,000 in payment of his legal fees in connection with securing the agreement; cashed out of his Country Club membership, received outplacement services for a year and continuing education expenses of up to $8,000.

To be sure, this did not seem to be a typical package for a person in charge of purchasing at a computer hardware retailer/distributor. The size of this package has made us wonder what knowledge he may have that the Company does not want divulged. According to the Company, he had “primary responsibility for our warehousing, distribution and technical service functions” (read: inventory).

His departure, and its resulting Separation Agreement seems to have shaken things up a bit as evidenced by the fact that, during F/Y 2002, an undetermined number of executive officers signed on to a newly created Compensation Protection Plan. The Plan provides for, upon termination without cause, two year’s base salary and 200% of their bonus (Termination Bonus) they would have been entitled to in the exit year, a prorated incentive bonus based on the value of the Termination Year Bonus, paid health insurance for two years and outplacement services up to $20,000. The consideration for all of this is the covenant to not compete.

That bonus feature is not insignificant. Bonuses at this Company have been running at around 300% of base salary. So the termination compensation picture (even before factoring in the "Annual Incentive Bonus") looks to shape up to be about eight years of base salary! Clearly, CDW puts a high value on keeping loose lips from affecting their ship, all at the expense of shareholders.