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 standard 3DA reports, and may also include other information of general interest to 3DA subscribers. The ⬆ symbol indicates that we have observed management behavior that suggests a bullish sentiment.

## Companies in this Research Notes

- Biogen Idec Inc. (NASDAQ: BIIB)
- BMC Software Inc. (NYSE: BMC)
- Celanese Corp. (NYSE: CE)
- Hologic Inc. (NASDAQ: HOLX)
- Oracle Corp. (NASDAQ: ORCL)
- Pharmaceutical Product Development Inc. (NASDAQ: PPDI)

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## 3DAdvisors Research Notes

Biogen Idec Inc. (NASDAQ: BIIB)

- Over the last 12 months at Biogen Idec, executives have profited from a series of aggressive behaviors to an extent we rarely see. There was billionaire financier Carl Icahn, who made a very public play on the Company and then backed away once his involvement increased the stock price and he was called upon to formalize his offer. There is also the executive team, who has used a variety of management-made announcements to consistently dump its ownership into the resulting rallies, all under the guise of pre-arranged 10b5-1 trading plans. We have covered the succession of events, including the egregious insider behavior, in a number of reports since early 2006, which were all tied together in a 3DA report titled "Trading Behavior and Fundamentals Say Deal Unlikely" dated 11/05/07. Not surprisingly, there have been a few additional events to update since we posted the report.

- We would be remiss to not begin with the Company's December 12th announcement that it ended its two-month search for a buyer without any formal bids being made. While many on Wall Street expected a deal was imminent, the asking price proved too rich and we suspect there were just too many loose ends regarding the rights to key drugs for a buyer to justify the asking price. The news caused a cataclysmic


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sell-off and by the time the dust settled, the shares bottomed at $53 after trading as high as $85 after management announced it was looking for a buyer. Many investors and sell-side analysts still deem the reaction overblown, as the issue did trade in the high $60's before the Company decided to shop itself around, but assessing the fair value of BIIB shares has always been tricky due to numerous fundamental questions. But this is why we place great emphasis on following managements' actions rather than acquiescing to their bullish endorsements.

- Less than one week after the fallout, it was quietly reported that Executive V.P. of Portfolio Strategy **Burt Adelman** (55), the second longest-tenured employee in the executive office, would leave at the end of the year having just reached the Company's retirement age that entitles him to full benefits. After serving the Company for sixteen years, mostly spent overseeing drug development operations before passing the torch to **Cecil Pickett** in September 2006, the news of his retirement received little more than a brief mention in an SEC Form 8-K, which of course, is required for a departing named officer. But we note that Biogen Idec has historically issued press releases for retiring and resigning insiders, including six that we found in recent years, among them former executives **Peter Kellogg** [1] and **William Rohn** [2]. So how come Adelman's departure was not deemed worthy of a press release?

- We suspect it is a combination of the timing, as they wanted to minimize the reaction to a key officer leaving immediately after the sale (or lack thereof) announcement, but they also seem to be downplaying his importance to Biogen's R&D efforts. It is well known that Biogen's pipeline is a concern, especially with the mounting competition in MS drugs, and is key to the Company's ability to meet the lofty long-term guidance they continue to publicize. With R&D head Pickett still relatively new to the Company and his tall task at hand, this development should be more of a concern and has yet to receive any media or analyst attention. Adelman's importance, and maybe even his intimacy of confidential information, is suggested by the consulting agreement he was provided, which pays $400,000 for "making himself available for consulting for a period of six months". This is nearly twice as much as he was receiving in base salary.

- Then there were two insiders who surfaced at the end of the year to sell despite the issue's trading in the high $50s. Executive V.P. of Human Resources, Public Affairs and Corporate Communications **Craig Schneier** (59) surfaced on December 31st to continue taking profits under a 10b5-1 plan entered into in February 2006. He monetized 36,250 options which vested that very day and had another seven years before expiration. Throughout 2007 he sold a total of 290,000 shares which accounted for 90% of his actionable ownership. Also selling was the head of corporate and business development, **Mark Wiggins** (51), who we have repeatedly highlighted for his abusive trading plan habits along with the narrow profits he has accepted on his options. The Company reported that he would sell 30,000 shares under a plan through May 2008, but more accurately he has unloaded 425,000 shares, equal to 99% of his ownership, including the 6,800 sold on December 31st at $57. He monetized the same option series as Schneier which became actionable

[1] "Biogen Idec Announces Management Change." BusinessWire-First Call. June 29, 2007.
[2] "Biogen Idec Chief Operating Officer William Rohn to Retire." BusinessWire-First Call. November 29, 2004.


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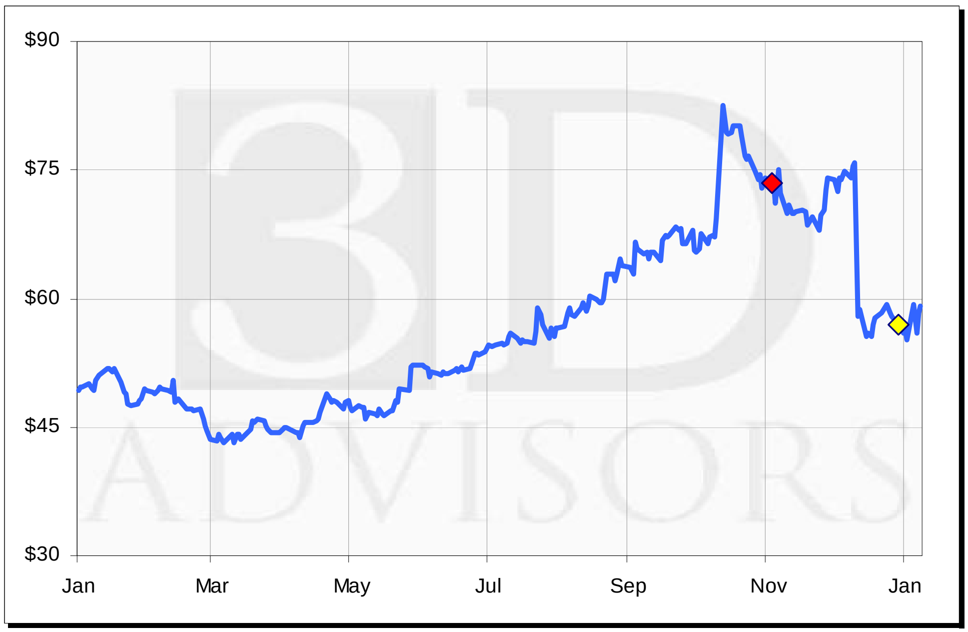
that day. The irony of their activity is that the sales under these trading plans are reportedly dependent on the attainment of pre-specified share price targets. We wonder just how low these price targets are if a 30% slide does not suspend the sales' execution.

**Figure 1.** BIIB Daily Closing Price, 01/03/07 through 01/10/08. Red diamond is the date of the 3DA full report (11/05/07); Yellow diamond is where 2 insiders sold additional shares (12/31/07). Source: Reuters and 3DAdvisors, LLC.




- Finally, as we have seen on numerous occasions when Biogen Idec shares were in need of resuscitation, the Company issued a press release on January 7th to update the investor community on its "long-range strategy and financial goals". This second release provided identical financial, product and patient guidance as the last one issued four months earlier. We should add these were the first occurrences of guidance being provided mid-quarter since the 2003 merger. As was the case back in September, the shares rallied 7% on the release, but Wall Street was not as convinced the second time around and the issue gave back the gains the following session. To our surprise, no insiders sold the brief rally, but we suspect they will be a little more mindful of their trading habits after the December setback following the "no sale" announcement. But then again, the behaviors we have observed since then suggest that for some insiders, it might very well be business as usual.

BMC Software Inc. (NYSE: BMC)

- Back in the third quarter we reported a very uncharacteristic round of sales at BMC Software, which occurred while the issue traded at a 2007 low (see Insider Research Bulletin dated 07/02/07 and non-trading findings in Research Notes on 07/20/07). At the time, Wall Street was disappointed with the Company's flat-lined revenues and the much ballyhooed reorganization plan that had yet to show any significant benefits. But a lot has changed since then as the Company has put up two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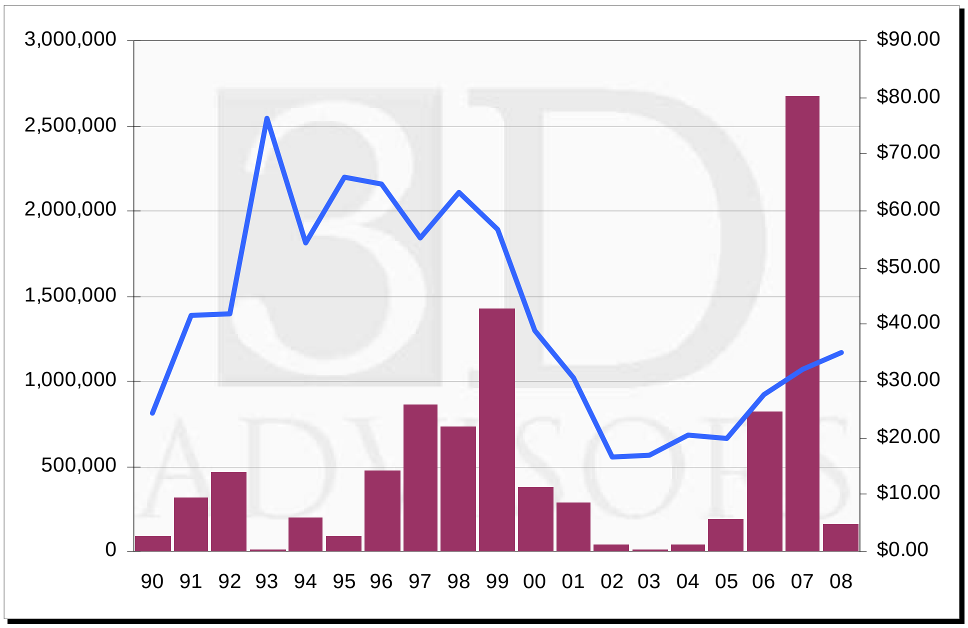
consecutive quarters of top and bottom line positive surprises and the sell-side is emphatically making its bull case. What has not changed, however, is the persistent selling of operating officers and board members, who closed out 2007 and have already entered 2008 with the most prolific three months of sales in the past 20 years.

**Figure 2.** BMC Annual Shares Sold by Insiders (Red Bars, Left Scale) and Average Selling Price (Blue Line, Right Scale). Source: BMC SEC Filings.




- BMC insiders have embraced Rule 10b5 as nearly all key officers adopted personal sales plans in late 2006 and capitalized on the liberties afforded by the Rule throughout 2007. But whereas the plan was intended to provide corporate insiders a 'safe harbor' within which to trade their shares in a *reasonable* and *systematic* manner, BMC execs have, in our opinion, stepped outside the realm of acceptable plan behavior. Take for example the Company's seven-year chief executive, **Robert Beauchamp** (47), who had sold only 175,000 shares between 1996 and mid 2006. Since commencing his first of three trading plans in November 2006, Beauchamp has sold 2 million shares, or 60% of his actionable position. This is a dramatic change in his trading approach and apparent ownership beliefs that cannot be overlooked, especially as it seems to be endemic throughout the executive office.

- BMC veteran, CFO **Steven Solcher** (46), was one of the first officers to adopt a trading plan (February 2006), but had sold only 20,000 shares in plan during 2006. Between January 2007 and January 3, 2008 he became more active, selling 130,000 shares equal to 60% of his accessible stock and options, including 70,000 which came out since the fourth quarter. With only 36,000 options scheduled to become actionable this year, his 10b5-1 plan is clearly set up to dispose of more shares than he will be able to replace through option vesting. While there is a handful of other top execs who have been sellers, we are also drawn to the atypical sales of a few board members, specifically Audit Committee members **Jon Barfield** (55) and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**George Raymond** (70). Barfield monetized every last option at his disposal (from six non-expiring series) on December 7th, selling 190,000 shares which accounted for 97% of his position. These were his first sales since joining the board in 2001 and are his only sales in the past two years at any of the four companies where he holds a board seat. Raymond, who chairs the Audit Committee, sold 50,000 on November 30th and finished the year having sold 50% of his ownership. These sales have our attention because of the Company's enduring internal control issues that are not expected to be resolved until late 2008.

- Despite what the Company portrays in the Proxy Statement, executive ownership of common stock, or what the Company calls 'shares owned', is nearly non-existent. These figures are inflated with restricted stock, nearly half of which is performance based and not guaranteed, and when they are stripped out the actual holdings totals are astonishingly low. Outside of CEO Beauchamp, who does hold 100,000 common, the remaining nine Section 16 officers collectively hold 200 shares. While certain officers to their credit do hold plenty of vested options, the non-existent direct common ownership demonstrates the Company's ineffectiveness at tying insider interests to those of the shareholders, despite their own claim this is accomplished. At the moment, the Company has stock ownership guidelines in place only for board members. But we anticipate they may adopt exec guidelines once the first round of restricted stock vests in 2009 and insiders are able to attain their targets at no personal cost.

<u>Celanese Corp. (NYSE: CE)</u>

- Few insider selling situations catch our attention faster than a 16(b) short-swing violation due to its rare occurrence and indisputable sentiment implication. This behavior takes on even greater significance when it occurs in chorus with profit-taking by a large group of insiders, which suggests a common motive for the violation and authenticates the team's consensus sentiment. Shortly after including chemical company Celanese in a December 28th Watch List, we note that Chief Financial Officer **Steve Sterin** (35) filed a Form 4 for a 25,000 share sale on January 2nd. This sale came less than five months after Sterin purchased 1,500 shares on the open market on August 13th, effectively putting him in violation of the six-month short swing period. While the potential penalty for this infraction, the disgorgement of profits to the Company or shareholders, is nominal, the subtext is quite noteworthy.

- The "short-swing rule" has been around a long time and is broadly understood on Wall Street, so it is highly doubtful this was an absentminded slip-up on his part. While he has been Celanese's CFO only since July, he is a seasoned finance officer with controller experience who "led the implementation" of the Company's Sarbanes-Oxley compliance procedures. The likelihood of this being an oversight that got by not only him, but Celanese's compliance department, head counsel, as well as his broker, Morgan Stanley, is quite low. Apparently, the $11,000 profit he would have to forfeit from the August purchase did not outweigh his desire to cash in at the current prices. His actions, viewed in conjunction with the 540,000 shares sold by five other top officers in the fourth quarter, make it clear insiders are intent to unwind their positions, and seemingly with an 'at any cost' urgency. In addition to Sterin, whose sale clipped 95% of his actionable holdings, **John Gallagher** (43), president of Celenese's largest division, Acetyl Intermediate, which reported declining sales


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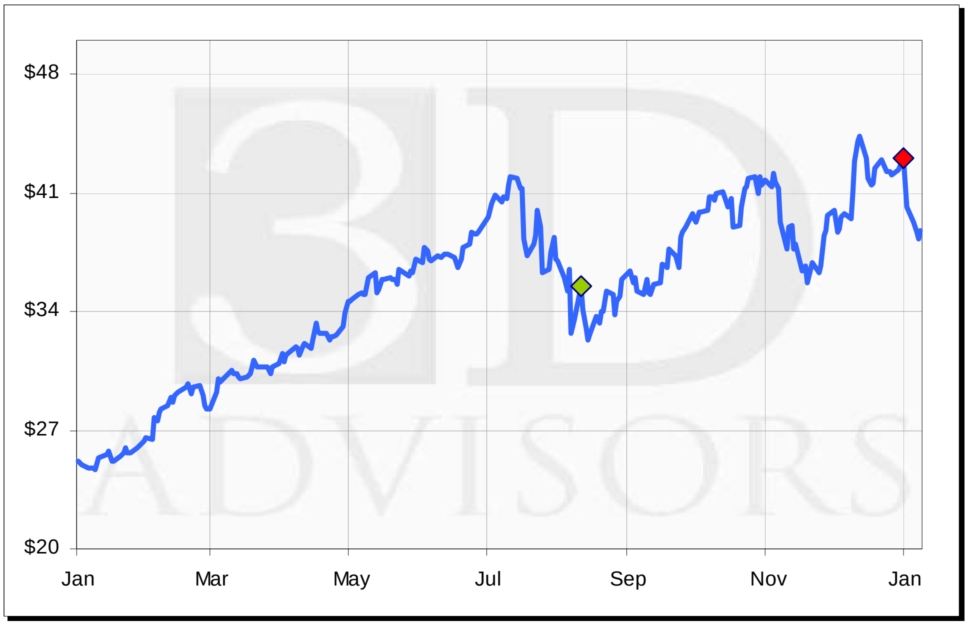
and margins in the third quarter, surfaced with his first sales on record. On December 12th Gallagher took full advantage of the previous day's guidance increase that boosted the issue 9%, cashing out 60% of his position (200,000 shares). This was reportedly done through a 10b5-1 trading plan adopted back in September, but the timing seems particularly fortuitous, especially in the context of the aggressive selling by his colleagues.

**Figure 3.** CE Daily Closing Price, 01/03/07 through 01/10/08. Green diamond is where CFO Steven Sterin bought shares; Red diamond is where he sold shares. Source: CE SEC Filings.




- **Doug Madden**, president of the Acetate division, was also a profit taker during this timeframe, but through a sales plan of his own, commenced selling on the very day guidance was raised and over a two-day period, sold 102,000 shares. Taking into account the 50,000 sold in September, he has depleted his ownership by nearly 70%. Other sellers of note in the fourth quarter were: General Counsel **Curtis Shaw** (75% reduction), Senior V.P. of Business Strategy and Development **Jay Townsend** (85% reduction) and Senior V.P. of Operations and Technical **James Alder** (65% reduction).

- To be fair, insiders had been sidelined from taking profits for quite some time. Blackstone, which took the Company public back in 2005, had been steadily scaling back its original 100 million share position between the IPO date and May 2007, when it sold its last 20 million shares. After a six month lock-up period associated with the IPO, four subsequent lock-ups related to Blackstone secondary offerings, and later an "Employee Stockholder's Agreement", insiders were effectively prohibited from selling stock until July 2007. While this does help us to better understand the group move in Q4, it does not exonerate them from the lofty percentage reductions, and certainly is no defense for CFO Sterin's insider trading violation. It will be very interesting to see if the Company can deliver on the two guidance increases issued since October.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Hologic Inc. (NASDAQ: HOLX)

- We addressed the abundance of shares being sold by insiders at women's healthcare firm Hologic in an Insider Research Bulletin dated 12/20/07. Since the October 22nd acquisition of Cytyc Corp., executives and directors from both sides aggressively monetized their positions to a degree we can only recall having seen in a few prior merger situations. Not only did Cytyc insiders, both those leaving and others who made the transition, clear out their CYTC shares leading up to the merger date, but they also have been very active since and a few Hologic insiders have followed suit. Since our report, there have been a few new insider developments and we also have begun analyzing and monitoring the Company's fundamentals and earnings quality. Thus far, our efforts have not revealed enough for us to issue a full report, however, the persistence of insider selling behavior plus other interesting issues that we have found will cause us to continue to monitor the name closely.

- For starters, we want to update information we reported on Director **Daniel Levangie**, formerly a Cytyc board member, head of its Surgical Products division, as well as the second largest inside shareholder. Levangie cleared out all 1.1 million of his actionable Cytyc shares and options before the merger, and then sold his entire new position (converted and accelerated unvested CYTC options) in Hologic immediately after the deal closed. At the time, we were uncertain of his status due to his behavior as well as the fact he was not issued a grant covering 50,000 options that was awarded to all Hologic board members. As was the case with his earlier HOLX sales, the Form 4 disclosing the October 22nd option grant was filed late (January 10th), but does prove his status as not only a board member, but one who prefers to hold cash rather than HOLX shares.

- While there was a handful of sellers to surface since our last report, we discount the trades of Hologic directors **Laurie Fajardo** and **Arthur Lerner**, who collectively sold 46,000 shares in January but had resigned from the board in October when the merger closed. More important are the sales of new Hologic board members, **Wayne Wilson** and **Sally Crawford**, both formerly Cytyc board members. Crawford continues to sell under a pre-arranged trading plan entered into in August, having now sold 66,960 shares since October. These shares accounted for more than 60% of her new Hologic position, but the director option award, which vested on January 1st, replenished part of her holdings. Director Wilson cleared out 97% of his Cytyc actionable stock and options before the deal but since surfaced for the first time on December 20th and January 4th to sell 12,302 shares at roughly $70. These shares accounted for only 15% of his new holdings, but we fully expect to see more selling as he has his own 10b5-1 plan in place. Below are a few 'red flags' that our initial analysis uncovered in the fundamentals and we urge any clients with an interest in the name to contact us with any questions.

- **Selenia growth hinges on digital mamography market penetration:** Selenia, Hologic's primary revenue growth driver, is depending on the transition to more expensive digital machines to fuel future growth. Selenia unit sales are up year-over-year but the Q2 earnings conference call revealed that 80 to 85% of Selenia orders are coming from current HOLX customers with only 15% to 20% from new customers. The Company's 2007 SEC Form 10-K (FYE 09/30/07) indicates that Selenia had a 60% market share in "direct-to-digital full field mammography", up from



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55% in Q2. It clearly seems that what is driving Selenia's growth is the upgrade to digital. At a 60% market share, however, and new customers accounting for just 15% to 20% of orders, one wonders whether there is enough momentum to continue to achieve substantial revenue growth and subsequently support the $2.35 billion in debt taken on for the Cytyc acquisition. In addition, a new disclosure in the Risk Section of Hologic's recently filed 2007 SEC Form 10-K is interesting:

> *"The current levels of growth in the markets for our direct-to-digital full-field mammography products…may not continue to develop as expected or be indicative of future growth…Demand for newly introduced technologies or treatments can initially be exaggerated as supply increases to meet pre-existing demand. However, once the pre-existing demand is met, growth in the market may abruptly stop or significantly slow."*

- **CMS Medicare reimbursements a concern for digital mamography:** Estimates are that currently only 10% of the image centers nationwide have digital mammography. Though this clearly indicates a large market opportunity for Selenia, the primary obstacle facing Hologic is the fact that reimbursement rates are falling, making it much more difficult for buyers to justify the more expensive Selenia systems which run from three to five times more than traditional film setups. One competitor, Fuji, has introduced a system (approved by the FDA in 2006) that allows a film mammography system to be converted to digital at one-third the cost of a total replacement system.

- **Holix Osteoporosis segment (8.7% of revenue) continues to lag:** This segment has been suffering revenue declines throughout fiscal 2007, falling by 19.5% since fiscal 2006. Operating margins within Osteoporosis have fallen by half since 2005, prompting analysts to ask whether the Company would consider selling the division. Though Hologic denies it plans to sell, instead pointing to "the tremendous amount [they have done] in wringing cost out of the product" (Q3 conference call) and that they expect to see related benefits from the effort in 2008, one wonders whether the rapid fall is more a market phenomenon than a need for cost optimization: The Company's Q3 SEC Form 10-Q indicates that decreasing prices and reimbursement reductions for osteoporosis exams may be the real culprit. HOLX may very well be stuck with the business having not found a buyer given the unfavorable reimbursement trends.

<u>Oracle Corp. (NASDAQ: ORCL)</u>

- As evidenced by its fiscal second quarter surprise reported on December 19th, Oracle continues to elude the credit crunch which has hampered other large tech firms facing declines in customer tech spending. But the earnings and revenue growth have done little more than keep the issue, which ended the year at the same price as it opened the calendar fourth quarter, ahead of the volatile NASDAQ index. Despite the lack of price gains, Company insiders, whose aggressive behavior we highlighted in a 10/11/07 Insider Research Bulletin, compounded the near-record 2007 trading volume with further distributions just before year-end. Bear in mind, the activity we spotlight excludes the 1 million shares sold by CEO **Larry Ellison** nearly each session under a 10b5-1 trading plan adopted in July.


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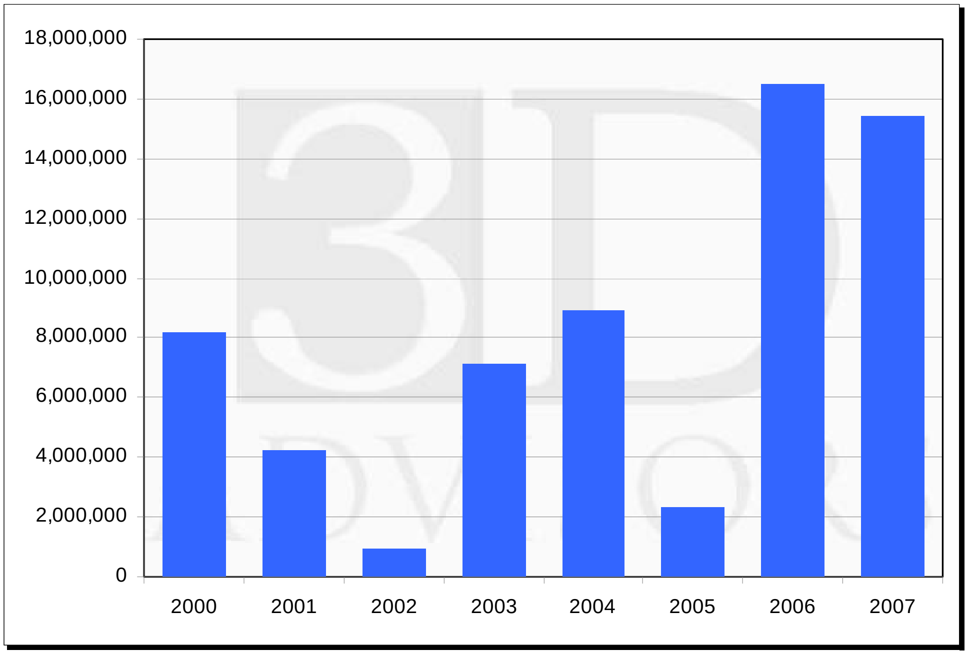
**Figure 4.** ORCL Annual Shares Sold by Insiders. Source: ORCL SEC Filings.




- Shortly after our last report, which detailed the sales of key officers such as Co-President **Charles Phillips** and the head of Oracle Asia and Japan, **Derek Williams**, each who cleared out his entire position, another named officer, **Keith Block**, head of North America operations, surfaced to sell 1.3 million shares on October 22nd and October 23rd. Combined with his sales earlier in the year, this translates to a 60% reduction in Block's holdings during the course of 2007. Moving ahead, there have already been three insiders to surface since the FY2Q earnings release. After issuing press releases to disclose the adoption of Co-President and Chief Financial Officer **Safra Catz's** first two trading plans in 2004 and 2006, we have yet to see any disclosure from the Company for her current plan, adopted in April 2007, under which she has already distributed 1.5 million shares. After each of the last three earnings releases Catz monetized 500,000 options scheduled to expire in July 2012 and ended the year having sold off 25% of her position.

- **Juergen Rottler**, head of Customer Services, joined Oracle in 2004 after a lengthy career with Hewlett-Packard. He had been one of the more reserved traders until 2007, having sold just 400,000 shares over his first three years. That all changed when he shed 90% of his actionable holdings in 2007, trading in and out of two separate 10b5-1 plans, including the 150,000 sold on December 27th at $23. The Form 4 did not designate the trade as part of his July plan, but we suspect this was a filing error. He will not have any new derivative equity vest until June. Rounding out the group of recent sellers was Chairman **Jeff Henley**, who kicked off a personal sales plan adopted in September. Henley sold 500,000 shares during the final week of the year, but more importantly, looks to be extending an aggressive two year stretch of sales which had shed 65% of his holdings. We fully expect that the flurry of late 2007 sales will carry forward into the New Year.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- On a final note we turn back to the 10b5-1 activity of Oracle's colorful chief executive, which we gave little attention to in our last report. At the time, Ellison was in the early stages of a new plan under which he intends to sell 100 million shares over a one-year period (through September 2008). We have now seen that he is well ahead of the reported pace, having already sold 78 million shares, and should sell the full allotment eight months ahead of schedule. While the 100 million shares accounts for just a small percentage of his 1 billion plus position, we remind our clients that nearly half of his remaining holdings (525 million shares) are pledged as collateral for various lines of credit. For more information on the risks associated with insider pledged shares, please see the 3DA Special Report of the same name posted on 09/14/07 (search by ticker symbol SRPT).

Pharmaceutical Product Development Inc. (NASDAQ:PPDI)

- After the close on Tuesday, January 8th, PPDI released its updated guidance for Q407 and first time guidance for 2008 and held a conference call to discuss its outlook the following morning. The guidance for 2008 comes about a month later than what the Company has done in prior years "in order to have a better handle on certain potential events." In the release, the Company "narrowed" guidance for Q407 to the lower end of its previous guidance for the quarter. But the market reacted to the 2008 guidance; the Company forecasted full-year revenue of $1.563 billion and EPS of $1.88 (both figures are the mid-points of given ranges). The revenue guidance was slightly higher than the consensus ($1.513), but the EPS guidance was substantially stronger (by about 10%) than the $1.71 consensus number. On January 9th, reacting to the stronger than expected guidance numbers for 2008, the shares rallied over 10% on heavy volume, closing at $46.86, a new 52-week high.

- Despite the initial market reaction to the new guidance, we thought that many of the questions asked by analysts during the conference call – and management's answers – focused on many of the same items that we have covered in our most recent coverage of the Company (see 3DA reports on 07/09/07 and 10/10/07) that are indicative of an increasingly competitive market for the Company's core Development segment in addition to our observations concerning insider trading and accounting behaviors. Questions were asked about lengthening contract terms, smaller upfront payments, DSOs, bad debt write-offs, contract wins and cancellation rates and other areas that point toward a more competitive environment. In fact, the very first question asked by an analyst on the call was about business "wins" (i.e. new contracts) and RFP activity in Q407, an area that received most of the attention in the wake of the Company's disappointing Q207 results. CEO **Fredric Eshelman** declined to make any comments at all on Q4, saying it would have to wait until early February when they release Q4 and full-year results.

- What stood out to us in terms of the 2008 guidance is how back-loaded it is in Q3 and Q4, and how dramatic the growth rates are over the actual/expected numbers for 2007. A big driver of the Q408 numbers is an expected $25 million milestone payment from Takeda Pharmaceutical, with some analysts expressing some concern over whether or not the Company will receive the payment when expected as the timing of such payments is notoriously difficult to predict.


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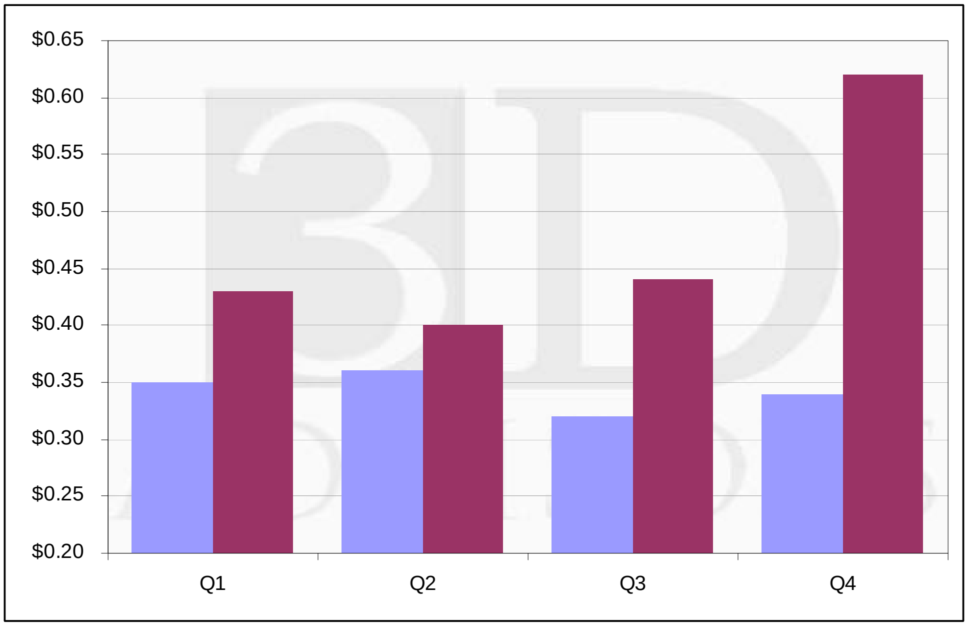
**Figure 5.** PPDI 2007 (Blue Bars) and 2008 (Red Bars) Diluted EPS. 2007Q1-Q3 are actuals; 2007 Q4 and 2008 numbers are the mid-point of Company guidance. Source: PPDI.




- Eric Coldwell, from Robert W. Baird, was blunt in asking Eshelman about how the Company now has the confidence to put up a very aggressive forecast after several disappointing quarters where they missed guidance. Note that in his response, Eshelman does not really answer the question. Coldwell downgraded PPDI from "Outperform" to "Neutral" the following day:

  **Eric Coldwell, Robert W. Baird:** I guess my first question gets to the revenue guidance in [the] development [segment]. Looking back for posterity for the last I believe five quarters, PPD's revenue has missed street targets. You've cut the fourth quarter revenue target and yet you've delivered pretty strong guidance for 2008 in development and if I heard you correctly, it sounded like you are putting in a larger burn rate out of backlog and also baking in some of the central lab contracts that you've recently won with the anticipation that they start on time. Recent experience has not proved to be the case though. Cancellations have been running above norms.

  Where do you get the confidence that after a year-and-a-half, revenue guidance is now more projectable, you can be more comfortable with an acceleration in 2008?

  **Fredric Eshelman:** Well, I think several factors. As you point out, we have a little bit more coming out of backlog than we've had in the past. We have to look at the market as reflected on the dollar volume of RFPs that we've seen over the last year and our expectations for how those would continue and the expectation that our hit rate would remain at least as good as it is, if not go up.

  We are expecting some improvement in GCL, as you point out, and we've maintained all along that although we did have a soft spot in '07 that we thought that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was recoverable and a 15% to 20% top line growth rate was still within the realm of what we thought we could produce based on the market. So as always, we're doing our best.

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