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

Insider Research Bulletin

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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

- Abercrombie & Fitch Co. (NYSE: ANF)
- AutoDesk Inc. (NASDAQ: ADSK)
- Coach Inc. (NYSE: COH)
- PG&E Corp. (NYSE: PCG)

Discussion of 3DAdvisors Findings

<u>Abercrombie & Fitch Co. (NYSE: ANF)</u>

Abercrombie execs have benefited from good timing with their trades over the past five years. What has recently grabbed our attention, however, is the increasing aggressiveness of insider selling that began last year. With the issue trading in a tight range between $28 and $33 for a better part of 2003, insiders have recorded the heaviest annual sales (1.32 million shares) of those past five years. What's more, they did so at an average price of $29 compared to the 711,000 shares sold in 2001 and 2002 at an average price of $38. The behavior has not only persisted in 2004, but has actually intensified as insiders are on pace to transcend last year's record volume. Most recently, five execs sold 706,962 shares between March and June at increasing prices from $31 to $37.50. Total sales midway through the year has reached just under 900,000 shares.

Included in the activity are the sales by COO and Director **Seth Johnson**, who rather unexpectedly submitted his resignation last month. This is now the second high-ranking senior exec to leave the Company in the past year. Last July CFO **Wesly McDonald** abruptly left Abercrombie to assume the same position at Kohl's (NYSE: KSS). This seemingly premature exodus of two execs (Johnson is 50 years old, McDonald was 40 at the time) is interesting considering the subsequent proliferation of insider selling. In addition to Johnson's activity, Senior V.P. **Leslee O'Neill** cleared out a large portion of her exercisable options resulting in a significant reduction to her actionable position (vested options and common stock). We question O'Neill's future with the Company due to her curious behavior and recent trend of exiting execs, but the Company hasn't disclosed anything to confirm our suspicion.

- **Leslee O'Neill (43)** – Senior V.P., Planning and Allocation. Between March 3rd and June 3rd O'Neill exercised three series of non-expiring options with at least four years before expiration (expiration dates: 2/08, 6/08, 2/12). Not only did she immediately sell the underlying 126,998 shares, but also tapped into her common stock position to sell additional stock. In all, she ended up disposing of 149,402 shares at prices ranging from $32 to $37.32. Not only did O'Neill **wipe out 65% of her actionable position** (common stock plus exercisable options), but the sale had a detrimental effect on her option holdings. The Company reports that O'Neill had access to 281,575 vested options on May 25th, but this number includes 166,666 options with a $40.37 strike price, leaving them underwater. Through May she exercised nearly all of her in-the-money options. She then tapped into another series of options, which vested in full on June 8th, selling nearly half of what she had left in that series. Her aggressiveness is further evidenced by the fact that between 2000 and 2003 she disposed of 167,468 shares – just a few shares more than she sold in the past three months. O'Neill has been with the Company since 1994.

Grant Date	Shares	Price	Expiration Date	Remaining Options in Series	Unvested Options in Series	Remaining Vesting Dates
2//2/98	42,802	$15.87	2/02/08	28,702 [1]	0	---
6/08/98	100,000	$22.18	6/08/04	35,000 [1]	0	---
2/01/99	2,142	$37.68	2/01/09	2,142	0	---
2/01/99	200,000	$40.37	3/02/09	200,000 [2]	33,333	2/1/05
2/01/00	3,609	$20.81	2/01/10	903	0	
2/16/00	35,000	$15.25	2/16/10	8,750	8,750	2/16/05
2/01/00	3,503	$30.18	2/01/11	3,503	0	
2/05/01	65	$29.47	5/05/11	65	16	2/05/05
2/04/02	2,998	$25.00	2/04/12	2,998	1,499	2/04/05, 2/04/06
2/28/02	200,000	$26.64	2/28/12	100,000 [1]	100,000	2/28/05, 2/28/06
2/14/03	2,424	$26.98	2/14/03	2,424	1,818	2/14/05, 2/14/06, 2/14/07
				Total Vested In-The-Money Options:	**72,401**	

[1] Denotes position *after* O'Neill exercised options between March and June 2004.
[2] Options are underwater at current prices.

- **Seth Johnson (50)** – Executive V.P., COO, Director. Johnson had been Abercrombie's CFO between 1992 and 2000, the year he accepted the COO position. His tenure came to an unexpected end last month when he gave his resignation effective June 18th and then subsequently announced he'd be leaving the board in July. At the age of fifty his departure seems premature. But while most departing execs begin selling after the news is released, Johnson began exercising options and selling the shares a month earlier. When all was said and done, he had exercised nearly all his vested, in-the-money options between April 16th and June 8th and sold the underlying 202,498 shares from $33.55 to $37.50, **resulting in a 43% reduction to his holdings.** Though this selling was perhaps triggered by his resignation, we can't ignore the fact that Johnson has been a timely trader in the past. In May 2000 he purchased 10,000 shares at $9.75 and then sold six months later for at $15 profit – just ahead of a one-month, 30% slide to $17. He followed that transaction with March and May 2002 selling that totaled 73,865 shares at $31 and $45, ultimately preceding the stock's devaluation to $18 less than four months later. We should point out that by resigning now Johnson surrenders over $7 million in options, which were set to vest in February 2005.

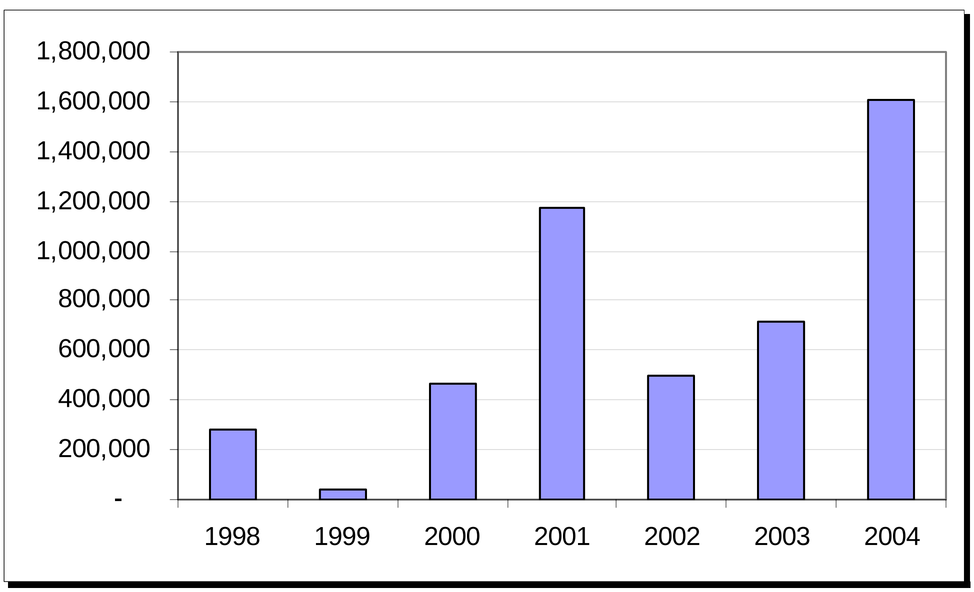
- **Michael Jeffries (59)** – Chairman, CEO. We have grown accustomed to seeing Jeffries selling heavily. But this hasn't always been the norm. Between 1999 and 2002 he had sold a total of 800,000 shares at an average price of $35. His selling volume escalated in 2003 when he sold 929,000 shares, only this time receiving lower prices (average $29 per share). And the sales have continued through 2004. After selling 100,000 shares in February, Jeffries sold a combined 300,000 shares between March 4th and June 3rd from $31 to $37.35. The sales are yet to have a major impact on Jeffries' holdings since the board has granted him 2.18 million options over the past two years. In addition to receiving annual option awards, under an Amended and Restated Employment Agreement, Jeffries was generously provided with a grant of one million shares of common stock in exchange for foregoing any future restricted share grants and a $12 million bonus for staying with the Company through 2008.

- **Diane Chang (48)** – Senior V.P., Planning. While Chang doesn't have anywhere near the size of Jeffries, her behavior is significant since she is a contributor to the round of selling and an additional exec reducing her holdings by a hefty percentage. In all, she sold 53,321 shares on April 15th and June 3rd between $33 and $36.20, resulting in a **39% reduction to her actionable position**. Like her peers, Chang's sales have picked up in recent months. Between 2001 and 2003 she had sold a total of 58,000 shares, which she nearly matched with her recent activity. But equally as revealing as her escalating volume is her past timing. Chang sold 26,862 shares in March and May 2001 before the stock lost 56% in just three months, and then sold again in April and May 2002 at roughly $31 – four months later the issue was trading below $18.

AutoDesk Inc. (NASDAQ: ADSK)

AutoDesk insiders have been on a torrid selling pace halfway through 2004. After selling a record number of shares in March (which we reported in the April 14th *Insider Research Bulletin*), many of the same sellers converged again in June. On June 8th and June 14th nine insiders sold a combined 467,906 shares between the prices of $37.86 and $39. Total sales for 2004 have now reached over 1.6 million shares, which might be attributed to the issue's climb to new five-year highs. But while the recent volume wasn't as heavy as it was a few months back, we're more intrigued by the effect the continued selling has had on the holdings of quite a few key insiders. Four executives and one director trimmed their actionable positions (common stock plus exercisable options) between 34% and 97%, which is excessive even at these prices. We would have to assume that the selling can't continue at this current pace since the size of many of these exec's annual options grants are down from previous years. For example, Sterling received 240,000 options in 2001, but only 70,000 in 2003. On a final note, we're impressed that the selling since March hasn't been dominated by one or two sellers with large holdings. From top to bottom, Company execs and directors have been cashing out. The continued selling by such a large group signals to us that there might be more to this story than just typical profit taking.

Figure 1. Total Shares Sold by ADSK Insiders 1998 - 2004. (2004 is through 6/17/04 only) Source: Vickers.



- **Joseph Astroth (48)** – Executive V.P., AutoDesk Location Services. We last reported Astroth, who's timed his trades accurately in the past, having sold 84,000 shares in March. The sale reduced his holdings by a significant amount, but didn't have nearly the effect that his 112,506-share sale on June 8th at $38 had. Since March, Astroth has now **sold off 83% of his actionable position** (common stock and exercisable options). The sheer volume of his sales halfway through 2004 has nearly outpaced his selling over the past five years. We're also interested in

Astroth's option activity, as he exercised six different series of non-expiring options (expiration dates: 3/18/08, 3/31/08, 9/09, 3/11, 3/12, 3/13).

- **Carl Bass (46)** – COO (formerly Senior V.P., Design Solutions Division). Since filing five years ago, Bass's only prior activity before selling in March was a 100,000-share sale in December 2003. After selling 50,000 shares on June 8th, he has now sold 173,749 shares over the past three months. The March and June activity has now **drained his holdings by 97%**, leaving him with just 6,183 shares of common stock. This activity is even more curious considering the sales came just days before he was promoted to the COO position.

- **Marcia Sterling (60)** – Senior V.P., General Counsel, Secretary. Sterling has exhibited similar behavior to her peers, having significantly picked up her selling volume this year. After having sold 292,000 shares between 1997 and 2002, she has now sold 356,752 shares since last June. Included in that total is the 90,000-share sale she executed on June 8th at $38.09, which **trimmed her position by 75%**. Sterling exercised three options series with expiration dates between 2008 and 2012.

- **Mark Bertelsen (60)** – Director. Bertelsen has never been known for heavy selling. He sells more frequently than many of his fellow board members, but the size of each transaction has been comparatively small. After having sold only 3,000 shares in March, Bertelsen wasn't going to pass up another opportunity to benefit from the gains most of his peers had taken already advantage of. On June 8th he made his largest sale in the past ten years, disposing of 40,000 shares at $38.95. Not only did he sell nearly as much in this one transaction as he had combined since 1997, but also **reduced his holdings by 34%**.

In addition to the above-mentioned, Directors **J. Hallam Dawson**, **Kris Halvorsen** and **Crawford Beveridge** sold 20,000 shares apiece, while Chairman, President and CEO **Carol Bartz** sold 60,000 shares under her 10b5-1 trading plan. All four sold in the earlier reported March round.

<u>Coach Inc. (NYSE: COH)</u>

We were initially inclined to dismiss recent selling by Coach insiders due to the fact that there has been persistent selling by certain executives during the issue's rise of the past year. We became very interested in the situation, however, upon further inspection. At first glance the volume appeared heavy, but we've encountered this type of behavior from this group in the past. What we weren't expecting was the number of insiders that converged to sell over the past few months. Between March 2nd and June 9th, *nine* insiders sold 1,127,244 shares between $39.87 and $45.01. This is the first time that more than five insiders came together to sell in any three month period dating back to late 2000 when the issue began trading. We also didn't anticipate that this selling would have serious effects on any of the insider's holdings. That presumption proved to be far from the truth as three trimmed their actionable positions by 50%, 55% and 72%. But trying to compute reductions for a few of these sellers proved to be very complicated. The Company admittedly had done a poor job of accurately disclosing insider transactions on the Form 4s. After speaking with the legal department, we determined that they have incorrectly reported the vesting schedules of numerous options series – footnotes disclose that certain series are "fully vested" years before the final vesting period. Another issue we have is that for the past few years Coach has been reporting stock sold to cover the cost of option exercises and related taxes not as sales, but under a different transaction code. This gives the appearance that they are disposing of considerably less amounts of stock than what they want us to believe. Finally, restoration stock transactions, which are detailed below, have a dramatic effect on beneficial ownership, yet haven't been clearly outlined in their filings with the SEC either.

Equally as confusing as Coach's Section 16 disclosure is its unusual treatment of stock options (and not in accounting terms). Take for example the $2 million loan provided by the Company to Executive Creative Director **Reed Krakoff** (a current seller) in July 2001. Krakoff collateralized the loan with 300,000 stock options, a practice we can't recall ever having seen; we're much more accustomed to seeing common shares pledged as loan collateral. The Company was very liberal to allow Krakoff to secure a loan with an asset he was yet to have in his possession. Then there's the issue of the Company's "Restoration Stock Option" program. Prior to this year Coach allowed certain executives to turn in common stock as payment towards the exercise of stock options. They were then granted new options, which had accelerated vesting schedules. Rather than having the typical four-year vesting period of Coach's annual grants, these options *vested fully in six months*. Coach says that restoration stock is intended to "encourage executives to own shares of Coach stock for purposes of exercising their stock options." We feel this contradicts ownership guidelines the Company has instituted (the specifications of the guidelines are not disclosed), which intend for executives to own stock to align their interests with those of the stockholders. After review, the Compensation Committee recently stopped the use of restoration options after it was determined that they had a detrimental impact on earnings per share. Investors should be concerned about the injudicious options practices sponsored by the Company – to us it suggests a proclivity towards self-serving behavior by Company executives.

- **Reed Krakoff (39)** – President, Executive Creative Director. From March 8th to April 22nd Krakoff exercised 375,492 options at a cost of $1.68 million. He turned around and sold 300,773 shares between $40.17 and $44.32, grossing $12.75 million. Some might conclude that the transaction was actually a net acquisition of shares, however, he did end making over $10 million on the deal before taxes. Krakoff has been a heavy seller since the issue began trading in 2000, but at this pace he will set new highs for annual sales volume. It is very difficult to compute Krakoff's reduction since he was one of the execs that took part in the Company's Restoration Stock Program.

- **Michael Tucci (42)** – President, Retail Division, North America. Tucci's activity is probably the most perplexing of the group. Since joining the Company in January 2003, his only prior transaction was a 30,000-share open-market purchase in December 2003 at $35, after the stock had nearly doubled on the year. The purchase would make sense if Tucci had one year to meet ownership guidelines, but from our experiences we doubt this to be the case. What's more, due to short-swing rules, Tucci was prohibited from selling any shares until June. When the restriction expired, he wasted little time cashing out as on June 4th and 8th he exercised all of his vested options and sold the 81,500 shares at roughly $44. The transaction

wiped out 72% of Tucci's actionable position, leaving him with only the shares he purchased in December.

- **Michael Devine III (44)** – Senior V.P., CFO. Devine has held the CFO position since joining Coach back in 2001. Since then, he had sold 184,975 shares in May and November 2003 at $22 and $36. The sales have pared his holdings since he holds very little in common stock and has been exercising his options and selling the shares immediately after they vest. This became more compelling when he sold a total of 99,709 shares between May 20th and June 8th, resulting in a **55% reduction to his holdings**. Devine has roughly 60,000 options set to vest in the upcoming year, making it doubtful that he will see his holdings replenished in the near to intermediate future.

- **Gary Loveman (43)** – Director. Loveman, a board member since January 2002, made his first transaction on June 3rd, selling 20,000 shares at $43.86. The transaction **trimmed his position by 50%**. Loveman has received two 20,000-share option grants during his tenure – one upon joining the board and the annual compensation granted in 2003 to all outside directors. Directors have not yet received their 2004 grants. We find it interesting that Loveman, who is the CEO of Harrah's (NYSE: HET), chose to sell such a sizeable percentage of his holdings rather than build his position considering he owns over $40 million in Harrah's stock.

- **Carole Sadler (44)** – Senior V.P., General Counsel, Secretary. On May 12th Sadler cleared out two non-expiring options series (expiration dates: 10/10, 8/12) to acquire 125,317 shares at a cost of $4.38 million. She then sold 115,609 shares at $40.68, grossing $4.7 million. The transaction is actually a net acquisition considering she sold just enough to cover any exercise costs and related taxes. But the reason we highlight Sadler's activity, other than the fact that she sold in unison with her peers, is the fact that the majority of non-expiring options she exercised had a strike price of $36.29, providing her with a $4 profit from the sale. We can't surmise any reason why with so much time remaining on the option she would exercise now unless she felt a risk existed that the options would slip underwater in the intermediate future.

  In addition to the above-mentioned, Chairman, CEO **Lew Frankfort** and President, COO **Keith Monda** sold 243,000 and 236,914 shares, respectively. Frankfort is a regular seller – under a 10b5-1 trading plan he's been selling a like number of shares each month dating back to January 2003.

<u>PG&E Corp. (NYSE: PCG)</u>

In a report dated June 2nd we highlighted the uncharacteristic activity by two PG&E executives who sold just fewer than 300,000 shares in early June. The sales were unusual because between 1997 through 2003 execs had cashed out of a mere 108,280 shares. Little did we foresee that the selling would continue, and in a very aggressive fashion. From June 1st through June 8th three additional execs sold a total of 1,163,519 between the prices of $28 and $28.52, driving the June total to 1.45 million shares. The sales, which surfaced just after the Company's first quarter earnings release, come at a time when the Street was just starting to warm up to the issue after years of turmoil. In fact, on June 1st the *Wall Street Journal* ran a story highlighting the Company's turnaround. Chairman, CEO, President **Robert Glynn** stated in the article that PG&E has a "strong, improving balance sheet." Yet, the very day the article went to print, Glynn sold $28.9 million in stock, a strange vote of confidence by any measure. This is a perfect example of behavior we are always on the lookout for – an executive attempting to boost investor confidence while sending conflicting signals with his trades. The sheer blatancy of these sales suggests that any negative surprises that may lurk are probably a quarter or two down the road. We say this because insiders typically do not sell aggressively just in front of negative news as they will tend to allow themselves some cushion so as not to appear they are trading on proprietary information.

- **Robert Glynn Jr. (61)** – Chairman, CEO, President. Despite having a substantial ownership stake in the Company, Glynn has been a very infrequent trader in the past. Between 1998 and November 2003 his only transaction was a 7,500-share sale in December 2001 at $18, just before the Company announced the bankruptcy of its PG&E utility. We have witnessed a dramatic turnaround this year from his passiveness of the past. Beginning on December 31st, 2003, Glynn exercised and sold 615,385 restricted stock units, grossing $17 million. The restricted stock was granted under the Senior Executive Retention Program enacted to retain executives through the bankruptcy proceedings and proposed reorganization. This he followed up with a 44,632-share sale on January 2nd at $27, which was reported as part of a 10b5-1 trading plan. But while we can expect a veteran exec with an actionable position of nearly two million shares to begin taking profit, we were completely unprepared for his June selling. On June 1st Glynn exercised nine series of non-expiring options (expiration dates: 1/05, 1/06, 1/07, 5/07, 1/10, 1/11, 8/11, 1/12, 1/13), five of which he cleared out entirely, and acquired 1,025,001 shares. He immediately sold the underlying stock at just over $28, grossing $28.9 million. The sale **wiped out 56% of his holdings**. But what we find intriguing is the fact that Glynn, who received a 2003 compensation package of $20 million, has now sold $47 million in restricted stock and stock acquired from vested options since December 31st. We note that the June sales were also reported as 10b5-1 selling. It is unclear whether or not this is the same plan that was established in January. If so, we question the legitimacy of a plan that allows you to sell less than 50,000 shares one month and over one million five months later. But then again, any plan initiated for the purpose of selling 56% of one's holdings should be considered suspect enough.

- **Gordon Smith (56)** – Senior V.P., President & CEO-Pacific Gas & Electric Co. Smith has made the most waves in the past with his activity, having sold more than just about any other PG&E exec. His trades can't go ignored considering he runs the utility division that has been the center of attention of the California energy crisis. To prove the point, just look at the prescient timing of his past sales. Smith sold 7,500 shares in August 2000 just months before the energy crisis began and then made his largest sale to date (33,500 shares at roughly $23) in March 2002 ahead of his division's announced bankruptcy. Like Glynn, his trades have become more aggressive in the past six months. He received $9.9 million from exercising restricted stock units in December 2003, and then followed that up by selling 158,036 shares in January and February, grossing an additional $4.3 million. But that wasn't enough for the 25-year company veteran. On June 3rd he sold 95,334 shares at roughly $28. While the selling has only put a small dent in his sizeable holdings, it provides further evidence that insiders are cashing out of the stock just as the Company is showing signs of stabilizing.

- **Daniel Richard (53)** – Senior V.P., Public Affairs. Since joining the Company in 1997, Richard's first transaction was the exercise of restricted stock in December 2003. He cashed in 128,205 units at $27, and then followed that up with a 36,011-share sale in early January. Richard joined in on the June selling with a 43,184-share disposition at $28.27. Unfortunately, Richard is not listed in the Proxy and the Company has done an inadequate job of disclosing his options holdings on his Form 4 filings. It is difficult to ascertain the sale's effect on his actionable position, but judging from the holdings of PCG senior vice presidents that have been with the Company for a similar period of time, we believe the reduction to be significant.

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