3D ADVISORS

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

Deal Disclosure and Insider Sales Add To Concerns Marriott International, Inc. (NYSE:MAR) Update

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Marriott International Inc. is an operator and franchisor of hotels and related lodging facilities worldwide. The Company operates or franchises 2,557 lodging properties worldwide, with 463,429 rooms as of January 3, 2003. It provides 4,316 furnished corporate housing units. Its operations are grouped into five business segments: full-service lodging (Marriott Hotels, Resorts and Suites; The Ritz-Carlton Hotels; Renaissance Hotels, Resorts and Suites, and Ramada International); select-service lodging (Courtyard, Fairfield Inn and SpringHill Suites); extended-stay lodging (Residence Inn, TownePlace Suites, Marriott ExecuStay and Marriott Executive Apartments); timeshare (Marriott Vacation Club International, The Ritz-Carlton Club, Horizons and Marriott Grand Residence Club brands), and synthetic fuel (the operation of its coal-based synthetic fuel production facilities).

Summary of 3DAdvisors Findings for MAR

- **Accounting:** Company fails to fully disclose details of property sale
- **Insider Trading:** Insider sales continue to rise

Discussion of 3DAdvisors Findings

Accounting: Company fails to fully disclose details of property sale

Our last MAR report covered a curious purchase, by Marriott, of 14 senior care properties, on December 30, 2002. Outside of its limited disclosure (no 8k and no associated press releases) the deal caught our attention because it occurred simultaneously with the sale of Marriott's entire Senior Living Services business to Sunrise Assisted Living. In the original purchase, of the 14 properties, Marriott paid $15 million in cash and assumed $227 million in debt. Upon the purchase, the Company disclosed that it would resell the properties in 2003. To us, this looked as if these properties had been "Put-Back" to Marriott as part of a separate arrangement. At the time, we had been curious about the balance sheet impact of the deal.

On September 2, 2003, Marriott announced that it had sold the 14 senior care properties to CNL Retirement Properties in a $184 million deal. This deal involved $92 million in cash and the provision of a $92 million acquisition loan (from Marriott).

Our related conversations with Marriott revealed that, prior to the December 30th purchase, the 14 properties had been held in a non-consolidated Joint Venture when Marriott sold its Senior Living Services business to Sunrise. At that time, their Joint Venture partner “was uncomfortable” with the sale, preferring instead to have Marriott remain involved with the 14 properties. According to the company spokesperson, in order to let the Sunrise deal go through, Marriott had to buy the 14 properties outright from the J/V partner, consolidating them on its balance sheet. Marriott then immediately wrote the properties down in Q4, which was not disclosed in the Q4 financials.

This write down surprised us. Since these properties had been listed as “Held for Sale”, a write down would technically not have been required until their ultimate sale. The early write-down could have come at the insistence of independent auditors who may have wanted to see the newly purchased properties (for which Marriott quite evidently overpaid) carried at net realizable value. Marriott falls short of revealing the actual amount of the write-down. Our conversations with the company revealed that it was included in the $131 pre-tax Q4 charge related to the sale of the Senior Living Services business.

The Company representative offered that the 14 properties were carried on Marriott’s books for $184 million and their subsequent sale, for the same amount, resulted in neither a loss nor a gain. This indicates to us that the deal, to take the properties off Marriott’s hands at net realizable value, was already agreed to at the time of the initial write down of their value upon purchase. Though the Company would like to make the matter seem immaterial, the sale price represents quite a difference from the $242 million involved in the initial acquisition, which included the assumption, by Marriott, of $227 million in debt. Based on our conversations, it is a safe assumption that the amount of the write off approximates the difference between the $242 million paid (assumed debt plus $15 million cash) and the $184 the properties were sold to CNL for in September, or $58 million.

Detail as to the disposition of the $227 million in assumed debt was left unclear however. There was no mention of it in any of the disclosures related to the sale of the properties to CNL. All the Company would reveal, initially, is that the debt had been “restructured” and the loan “paid”. A second, follow-up conversation, initiated by the Company representative, did much to not only clarify the question but also reverse the initial implication that the restructuring took the loan off Marriott’s books. It turns out that the loan “became part of Marriott’s general corporate obligations” and that, after “some payment”, most of it (about 75%, according to the spokesperson) still remains on the books.

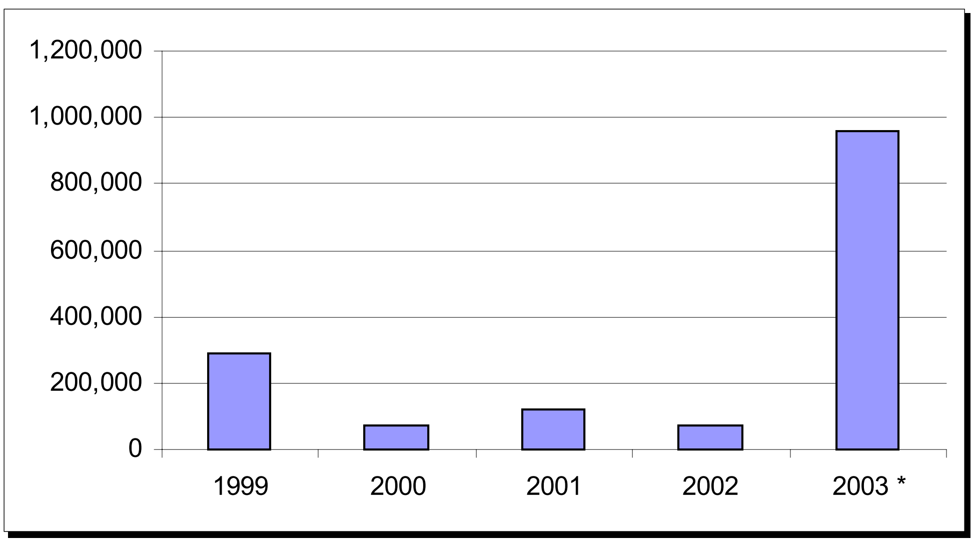
For all intents and purposes, Marriott overpaid about $58 million for the properties. After writing them down to realizable value, Marriott then sells them for no loss in a transaction where it has essentially financed the $92 million down payment, for half of the $184 million purchase price, and the related note makes up the balance of the deal. At the end of the day, Marriott is left with related long-term debt, approximating $170 million, on the books. In the end, it seems that Marriott’s exit from its Senior Living

Services business has resulted, behind the curtain, in the addition of about $170 to the Company's long-term debt, a development not apparent from company disclosures thus far. As is always the case with this sort of thing, we are as interested in the behavior as we are in the numbers.

Insider Trading: Insider selling continues to rise

Marriott is not a company where, over the years, we have been accustomed to seeing much selling from insiders, especially those outside of the Marriott family circle. The sands have begun to shift on this front however. Trusts, administered by Marriott CEO J.W. Marriott and/or his brother Richard Marriott, have been selling at unprecedented levels in recent months. Between the two entities, over 958,000 shares have been sold since early June at prices between $39 and $41. The largest sale in this cluster was one of 750,000 shares on August 26th at $40.71 each.

Figure 1. Stock Sales by Marriott Family Trusts
Source: SEC Filings



*Sales Through September 3, 2003

With practically four months to go, trustees J.W and Richard Marriott have sold far more shares this year than the prior four years combined. But there's more. Adding to the story here is the fact that other key insiders, who have not surfaced in a long time, have just recently sold their highest-ever amounts of shares:

- **Simon Cooper (57)** – President and COO, The Ritz-Carlton Hotel Company, LLC. Cooper joined Marriott in 1998, but has just sold his highest-ever amount of shares. On Sept. 3rd, he exercised options across four separate options series and sold the underlying 13,655 shares. All of the options had been vested for at least a year and were not set to expire until 2011 at the earliest. Perhaps the most telling detail to the transactions is the fact that most of the options were exercisable at prices in the $32 to $33 range. The underlying shares were sold at $41. It is rare to see an insider exercise, and sell, for relatively small profit when there is much time left on the options. In this case, with options from four series being exercised (the fourth were exercised at $28), one gets the impression that Cooper may have been concerned that the shares may head lower, sending his options underwater. Consequently, he may have moved now to lock in what profit he had in them. Prior to this, Cooper's only sales have been for fewer shares at higher prices: 2,919 shares in mid 2002 for $43.25 each and 1,500 in May 2001 for $48 each. His decision to act now, at lower prices than before, is significant, in our view.

- **Robert McCarthy (49)** – Executive V.P., North American Lodging Operations. McCarthy acted in a similar fashion as Cooper, exercising options across four separate series and selling the underlying 23,119 shares. Now, McCarthy's option strikes, which were between $16.75 and $25.10, were not as close to market price as Coopers. They all, however, have been fully exercisable since at least 2000. In addition, none of them were set to expire until 2011. Prior to this, we have no record of McCarthy having sold any Marriott shares.

Add the above sales to those by President and COO **William Shaw** (243,281 shares in June) and General Counsel **Joseph Ryan** (6,600 shares in May) and it is clear, to us, that insider sales at the company are running at unprecedented levels, and this with the shares coming off of multi-year lows, not all time highs.