3D ADVISORS

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

Insider Research Bulletin

May 21, 2004

Contact: Bob Gabele (954) 728-9671 or bgabele@3DAdvisors.com

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

- Brunswick Corp. (NYSE: BC)
- Cendant Corp. (NYSE: CD)
- Motorola Inc. (NYSE: MOT)
- Owens-Illinois Inc. (NYSE: OI)

Discussion of 3DAdvisors Findings

Brunswick Corp. (NYSE: BC)

Ownership guidelines aren't a new fad created by Sarbanes-Oxley, but the corporate governance movement has definitely pushed more companies to use such initiatives to promote higher governance standards. Then there are companies such as Brunswick Corp. where insiders' attempts at meeting ownership guidelines set by the board seem to be a struggle. Not only did we find that BC insiders were flirting with non-compliance in terms of meeting the guidelines, a spate of recent selling has pushed their holdings well below target levels. From February 3rd through May 4th sixteen insiders sold 590,574 shares between $35.64 and $44. This is far from routine selling for this group. Over the past nine years insiders had sold a combined 535,498 shares – less than they sold over the past three months.

Now, we acknowledge that with the stock trading at five-year highs insiders are going to lock in some profits. However, when the sales put them below acceptable stock ownership levels set by the Company, it would seem that motives other than "profit taking" might have entered the picture. The guidelines state that the CEO must hold 175,000 shares of common stock, division presidents and the CFO must have 45,000 shares and senior vice presidents must own between 10,000 and 17,500 shares, depending on their position. Each executive has five years from the time they assume their title to meet the requirements. But the board didn't only establish guidelines for execs – there are guidelines in place for directors as well. The directors' plan, adopted in February 2003, imposes holdings requirements of 10,000 shares to be held by each board member by April 2006 and 20,000 shares by April 2008. Currently, only four of the ten directors are above target levels, while four of the directors don't hold any common stock that isn't deferred until their retirement. Making this situation more unique, five of the Company's top six employees listed in the proxy has yet to meet their target levels. In fact, two of those execs, CEO **George Buckley** and President-Brunswick Group **Dustan McCoy** are to have their holdings reviewed this year. Of the five execs that are below the requirements, four sold into the recent round. Included in the sellers, McCoy and President-Mercury Marine Group **Patrick Mackey**, both former Witco Corp. execs before Crompton and Knowles acquired the company in 1999, sold 79% and 40% of their holdings, respectively.

Despite the dramatic underperformance of BC shares since 2002 (the stock returned 55% less than its peer group), Brunswick execs have been compensated generously. CEO Buckley this past year was awarded $7.45 million in total compensation. Not only did he receive base salary, restricted stock award and long-term incentive payout increases in 2003, but he also receives a base salary above the mean of his peers. Considering the generosity of the board, one would think he would have no problem meeting his ownership requirements.

- **Dustan McCoy (54)** – V.P., President-Brunswick Boat Group. Since filing back in 1999 (he began his Brunswick career as the general counsel), McCoy had never sold a share. Like many of his peers, he entered into a 10b5-1 trading plan in early 2004 and wasted no time in making his first-ever sale. From March 12th through April 20th he dumped 121,250 shares between $41 and $44. We're curious as to why he would make such a sizeable sale immediately after establishing a trading plan, especially given the fact that, under the camouflage of the 10b5-1, **he has sold 79% of his actionable holdings**. Typically, a trading plan is designed to sell reasonable amounts of stock in the interest of diversification. Clearly, his actions seem at odds with the generally accepted purpose of these plans. Since he was hired in 1999, the Company should be reviewing his ownership this year. The fact that McCoy is out of compliance with the guidelines at this time strikes us as odd and makes his trading behavior all the more noteworthy.

- **Patrick Mackey (57)** – V.P., President-Mercury Marine Group. Mackey's story is very similar to McCoy's. He assumed his position in October 2000 and just recently made his first sale. Unlike McCoy though, he is yet to enter into a trading plan. On February 5th and February 6th he sold 50,000 shares at just under $36. His sale **wiped out 40% of his holdings**, which like McCoy, brings his holdings beneath the required levels dictated by the Company's ownership guidelines. Currently, he holds 23,145 of the required 45,000 shares he needs to possess by 2005. The activity by both execs tells us that they feel the need to lock in profits at these levels rather than be in a position to meet the Company's holdings expectations.

- **George Buckley (57)** – Chairman, CEO. Buckley was actually the first Brunswick exec to arrange a 10b5-1 trading plan (August 19, 2003). He made his first and only plan sale in October 2003, dumping 225,000 shares. The sale was his first since filing his Form 3 (Initial Statement of Beneficial Ownership of Securities) back in 1999. He recently sold again, disposing of 200,000 shares on March 8th and May 4th, grossing $8 million. But while Buckley still has an actionable position (common stock plus exercisable options) of 634,218 shares, his common stock holdings are only 101,718 shares. Under the Company's stock ownership guidelines the CEO is required to hold 175,000 shares of common stock within five years of employment.

- **Peter Leemputte (45)** – Senior V.P., CFO. After entering into a 10b5-1 trading plan on March 11th he immediately sold 25,310 shares on March 15th at just over $40. While he didn't reduce his holdings by a large percentage like his peers, the promptness of the sale after entering the plan suggests an urgency to sell. This was his first transaction since filing in January 2001.

Cendant Corp. (NYSE: CD)

It's been a while, but Cendant is once again hitting our radar for insider selling. This is the same company where insiders sold just months ahead of the 1998 accounting scandal and subsequent period where insiders reaped millions from re-pricing their options after the stock collapse. Now, this isn't the first time insiders have sold since then, but the volume is heavy for a round of sales that doesn't include **Henry Silverman's** selling, which boosted 2003 totals. In all, from April 6th through April 29th six insiders sold 1,017,998 shares between the prices of $24.17 and $24.90. What we find compelling about this recent activity is that some of the insiders involved have a history of prescient timing.

- **James Buckman (59)** – Vice Chairman, General Counsel. Considering he holds over 4 million shares, one would expect Buckman to sell frequently. But this hasn't been the case as his trades have been intermittent. Yet, one thing has been a constant: the timing of his trades have been extraordinary. Dating back to 1998, Buckman has displayed precision with both his buys and sales. In February 1998, shortly before the Company's devastating accounting scandal, he sold 300,000 shares at $36. Eight months later the issue was trading under $10 and he bought back 19,100 shares. The stock rebounded into the $20s by yearend. Then, two years later, as the Company was embroiled in class-action lawsuits, he sold 418,152 shares into weakness at $20. The stock continued its slide and closed out the year under $10 yet again. More recently, he purchased 7,000 shares in July 2003 at $17.99, which he recently reversed by selling 251,610 shares on April 23rd and April 28th at $24.24 and $24.75, grossing $6.1 million. In order to acquire the shares, he exercised both non-expiring options and restricted stock units.

- **Richard F. Smith (71) –** Director. As Chairman of the Audit Committee, Smith, despite his age, plays an active role on the board. With that said, he recently made his first sale since becoming a board member in 1997. On April 21st he sold 246,155 shares grossing $6.12 million, and **reduced his holdings by 41%** in the process. Not only have we taken note of the effect of the trade on his actionable position (common stock plus exercisable options), but also the fact that he sold 20% of the

Cendant stock he holds in his IRA, along with all the shares held in a family trust account. We last saw Smith buying 156,970 shares from 1998 through 2000.

- **Leonard Coleman Jr. (55)** – Director. Coleman, another board member since 1997, also recently made his first sale since his initial association with the Company. On April 21st he sold 50,000 shares at $24.87. A telling fact about Coleman's activity is that he sits on numerous other boards including Omnicom Group (NYSE: OMC), Heinz (NYSE: HNZ), Aramark (NYSE: RMK), Churchill Downs (NASDAQ: CHDN), and Electronic Arts (NASDAQ: ERTS), yet hasn't sold stock in any of the other companies. If he was selling for diversification purposes we would expect to see him taking some out of his other holdings.

- **Stephen Holmes (47)** – Vice Chairman, Chairman & CEO Hospitality Services Division. Like Buckman, Holmes was a seller in February 2000 ahead of the sell-off. Since then he has sold between 25,000 and 150,000 shares roughly every quarter starting in April 2003. He recently increased his volume as the stock continued to rally, selling 275,000 shares in April 22nd and grossing $6.85 million.

<u>Motorola Inc. (NYSE: MOT)</u>

Motorola's first quarter earnings came as a welcome surprise to investors. Few expected the Company to beat estimates by such a large margin, especially after last year's disappointment. Insiders though didn't wait long to cash out following the news. From April 22nd through May 6th five of them sold 496,853 shares between $19.10 and $20.80. Considering the large number of options insiders at Motorola are granted annually, insiders haven't sold as heavily as we'd expect them to during recent years (628,179 between 2001 and 2003), which should be attributed to the issue's devaluation. More noteworthy than the recent selling volume, however, were the holdings reductions by two key executives.

- **David Devonshire (58)** – Executive V.P., CFO. We are always intrigued by changes in trading behavior by company CFOs. That's why Devonshire's 170,000-share sale on April 23rd at $20.40 definitely caught our attention. The sale, his first since joining the Company in 2002, **trimmed his holdings by 57%**. Like many of his senior exec peers, he is granted a large number of options annually and even more so to get him to sign on with the Company. Yet, many of these options remain unvested and the restricted stock units are yet to have their restrictions lapse.

- **Gregory Brown (43)** – Executive V.P., President & CEO Commercial, Government and Industrial Solutions Sector. Typically, we would expect to see relatively new insiders like Brown (who began filing as an insider just last year) beginning to build their ownership position. This wasn't the case here as he sold 40,000 shares on April 23rd at $20.80. The transaction **dropped his holdings by 80%**. Brown was granted large quantities of options and restricted stock units as an incentive to join the Company. However, only 50,000 options vested in January 2004 and additional options and stock units don't vest until January 2005.

- **Thomas Lynch (49)** – Executive V.P., President & CEO Personal Communication Sector. Lynch runs the Company's fastest-growing division whose handset sales, in Q1, helped propel results. On April 23rd he sold 211,175 shares at $20.30. This was only his second sale since becoming a filing insider in 2001. He last sold 50,122 shares in October 2003 at $13.75. The more aggressive activity tells us that there could be more to this than just locking in gains on the stock's strength.

- **Peter Lawson (57)** – Executive V.P., General Counsel. Lawson, a Section 16 filing insider since 1996 sold recently for the first time since we last saw him sell 32,100 shares throughout 1999 at considerably higher prices ($70 to $113). Now, he sold 75,000 shares on May 6th at $19.10.

<u>Owens-Illinois Inc. (NYSE: OI)</u>

From 1998 through 1999, as shares of Owens-Illinois traded in the $40 to $50 range, insiders locked in relatively modest profits considering the stock's run, and even from 1998 through 2003, insiders had sold less than 200,000 shares combined. That's why we became very intrigued recently when insiders held their largest round of selling in the past ten years, as from March 2nd through May 5th fourteen execs and directors sold 435,280 shares between $12.15 and $14.92. Not only did we take note of the selling volume at these comparatively low levels, but two long-standing directors cashed out of large percentages of their holdings.

We view this convergence of insider selling, during the same window, to be quite significant given the fact that this group has not done so, en masse, in the past even in the presence of much higher stock prices.

- **Robert Dineen (74)** – Director. As we've mentioned in the past, an insider's age is an important criterion in determining the significance of their activity. Typically, insiders over age 70 are planning their retirement from the company. This doesn't seem to be the case with Dineen, who remains very active on the board. Not only is he nominated to serve for another three-year term, but also serves at the Chairman of the Nominating/Governance Committee. This is why we view his 18,182-share sale on April 26th at $14.59 as significant. Not only was this his first-ever transaction since joining the board ten years ago, but the sale also **wiped out 67% of his holdings**.

- **John McMackin Jr. (52)** – Director. Like Dineen, McMackin is one of the more experienced board members. And also like his peer, he recently surfaced with his first-ever transaction. On April 26th he sold 18,391 shares at $14.69 to $14.77, exercising all of his vested options in the process. The transaction **trimmed his actionable position (common stock plus exercisable options) by 66%.** Unlike Dineen, McMackin's term doesn't expire for another year. The reductions made by each director are surprising considering board members only receive annual compensation grants of 5,000 options.

- **Thomas Young (60)** – Executive V.P., CFO, Director. Young, second in command in the executive ranks, was actually the Co-CEO before Steven McCracken was hired earlier in the year. Like the rest of the group, he has made very subtle trades over the years. Young was a buyer (5,000 shares) back in February 2000 at $13.87 and then later purchased an additional 5,000 shares in November 2000 after the stock collapsed below $4. His first sale (4,000 shares) came in February 2002 at $12.50 – less than the price he paid just two years earlier. More recently he sold

29,705 shares on May 4th and 5th from \$14.05 to \$14.34. After the sale, Young still holds 275,000 shares of common stock and exercisable options.

- **Joseph Lemieux (73)** – Chairman. Though Lemieux has the largest ownership stake of all insiders (1.2 million shares), his recent behavior is abnormal based on his prior trading behavior. The last time we saw him sell was back in 1997 when he dumped 418,176 shares. He had numerous opportunities in the late 90's and throughout 2002 to lock in profits at levels higher than where he recently sold. Yet he now has chosen to sell 235,000 shares at prices in the \$14 to \$15 range.

We are interested in the composition of the OI board. Currently there are nine directors, seven of which the Company deems to be independent. However, upon review the question of independence certainly could be challenged. James Greene Jr. and Michael Michelson are both associates of Kohlberg Kravis Roberts & Co., L.P., which has a 23% ownership stake in Owens-Illinois. Not only do they have an ownership interest in the firm, but also KKR provides management, consulting and financial services to the Company which they are compensated handsomely for. In addition to these two, there are currently two executive directors (Thomas Young and Steven McCracken) and also Chairman Joseph Lemieux, who was a Company exec as recently as last year. This makes our assessment of independent directors four out of nine, not the majority required by NYSE rules. Chances are management will vote along with KKR associates due to its sizeable holdings, creating a voting block that defies the board's intended independence.