



This 3DAdvisors Report Covers:

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

Insider Research Bulletin

August 13, 2004

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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

- ▶ Aeropostale Inc. (NYSE: ARO)
- ▶ BJ Services Co. (NYSE: BJS)
- ▶ Nu Skin Enterprises, Inc. (NYSE: NUS)

Discussion of 3DAdvisors Findings

Aeropostale Inc. (NYSE: ARO)

Although retail issues across the board have been unsteady as of late, teen apparel retailers have broken away from the pack with compelling June and July comparisons. Insiders at a handful of shops selling to the generation Y market have been locking in profits, one of which, Abercrombie & Fitch (NYSE: ANF), we covered in a June 21st *Insider Research Bulletin*. Our attention now turns to new kid on the block Aeropostale, where the selling is not only aggressive, but insiders are showing little desire to hold onto their amassed positions. Most recently a group of twelve insiders and directors sold 1,652,661 shares between May 24th and July 27th at prices ranging from \$25.61 to \$30.08. Since the issue has only been trading for two years, we don't have an extensive trading history to compare the recent activity to, but in this case we don't feel it's a prerequisite for our analysis. Since November 2002, when the lockup expired from the issue's IPO, insiders have sold a total of 4.4 million shares, or roughly 8% of the total outstanding shares. We are accustomed to seeing heavy selling after lockup expiration, but the selling here has persisted and will have an irreversible effect

on the holdings of key insiders. The top five named executives have reduced their holdings by an extremely aggressive average of 73% since early 2003.

Table 1. Holdings Reductions of Key ARO Insiders. Source: ARO SEC Filings

| Named Executive | 2/1/2003 | 2/1/2004 | 8/1/2004 | Reduction since 2003 Proxy |
|-----------------|-----------|-----------|----------|----------------------------|
| J. Geiger | 2,986,299 | 1,300,824 | 408,026 | 86% |
| J. Mills | 3,465,681 | 2,200,107 | 870,621 | 75% |
| C. Finazzo | 705,615 | 502,365 | 272,543 | 61% |
| T. Johnson | 321,760 | 172,449 | 123,699 | 62% |
| M. Cunningham | 465,706 | 282,707 | 95,207 | 80% |

We can't think of another case where we uncovered such large reductions by *all* top company executives over such a short period of time. But there's more to these reductions than meets the eye. Execs have been cashing in a substantial portion of their vested options over the past year, which is significant considering they hold relatively small positions in vested options. Over the next four years, the five named execs have an average of 54,000 options set to vest, which is considerably less than the 1.03 million average of unvested options held by the top five exes at Abercrombie and American Eagle Outfitters (NASDAQ: AEOS). Finally, in addition to his heavy open-market selling, Chairman, CEO **Julian Geiger** entered into a forward purchase contract in March, which probably was unseen by the average investor. Geiger pledged a significant portion of his actionable position (common stock plus exercisable options) in exchange for upfront cash. This behavior lends further evidence to the overall negative sentiment exhibited by Aeropostale insiders.

Table 2. Vested and Unvested options held by Aeropostale Executives as of 8/10/04. Source: ARO SEC Filings

| Named Executive | Exercisable | Unexercisable |
|---------------------|-------------|---------------|
| Julian Geiger | 407,876 | 108,000 |
| John Mills | 0 | 0 |
| Christopher Finazzo | 307,043 | 57,750 |
| Thomas Johnson | 9,514 | 51,750 |
| Michael Cunningham | 58,808 | 51,750 |

- **Julian Geiger (58)** – Chairman, CEO. Though the 400,000 shares Geiger sold between June 21st and June 23rd is the second heaviest activity of the group, it is a less-visible transaction that has us interested in his behavior. On March 24th, with the issue trading just above \$34, Geiger entered into a forward purchase contract with Deutsche Bank that required him to **pledge all of his common stock** of 492,798 shares in exchange for upfront cash of \$30.87 a share. If the closing price on March 26, 2007 is less than \$33.84, Geiger will be required to turn over all shares to Deutsche Bank. Though these types of transactions aren't rare, it is very uncommon to see a high-ranking exec pledge all of his or her shares. The eye-opening transactions between March and June were his first since the company went public. Including the pledged shares, Geiger has **trimmed his actionable position by 86%** since the 2003 proxy.

- **Michael Cunningham (46)** – Executive V.P., CFO. Cunningham's activity appears to be rather straight-forward pre-arranged selling under a 10b5-1 trading plan (terms undisclosed) which began in late 2003. Since then he has sold 37,500 shares routinely each month, with 75,000 shares being sold on June 9th and July 14th at \$28.77 and \$30.01. But the selling has dramatically lowered his holdings: since the 2003 Proxy Cunningham has **sold 80% of his holdings**. At this pace, he will burn through all of his vested options in the next month and will drain his entire position by October. Unless he modifies the terms of his trading plan, this implausible act will become a reality.

- **John Mills (55)** – former President, Director. Mills was the Company's President and COO until he announced his retirement effective July 2004. Though he is no longer an exec, he still remains active on the board and is the largest inside shareholder, which is why his resignation does not mask the significance of his recent sales. Between June 8th and July 27th Mills sold 650,454 shares, grossing \$15.6 million and adding to his year-to-date sales of 1.81 million shares. Over the course of the year Mills exercised *all* of his vested options under a 10b5-1 trading plan, which is alarming considering he doesn't have any unvested options and hasn't been granted any during the past three years. Between January and April Mills had been selling 56,586 shares per month, but increased his volume under the plan in June and continued his pace in July after he either terminated the plan or it expired. Since February, Mills has **sold 60% of his ownership stake**.

- **Laura Moran (54)** – Senior V.P., Director of Human Resources. Moran's recent selling was small compared to her peers, but her trading history is definitely noteworthy. Since taking on her current role in 1998, Moran began selling in November 2003 and sold 395,709 by February 2004. But what's unusual about the trades is the fact that she didn't touch any of her vested options, instead selling all shares out of her common holdings. Her last sale of that period drained her common holdings, leaving her with only 150 shares. With the exception of unvested restricted shares, Moran's remaining holdings were tied up in a total of 187,479 vested and unvested options. On July 13th she exercised an option series set to expire in 2007 and sold the underlying 56,450 shares at \$30. Since the Company hasn't provided vesting schedules for her options it is nearly impossible to compute a reduction.

In addition to the above-mentioned executives, two directors, **Bodil Anderson** and **Mary Burton**, made their first-ever sales and reduced their holdings by 60% and

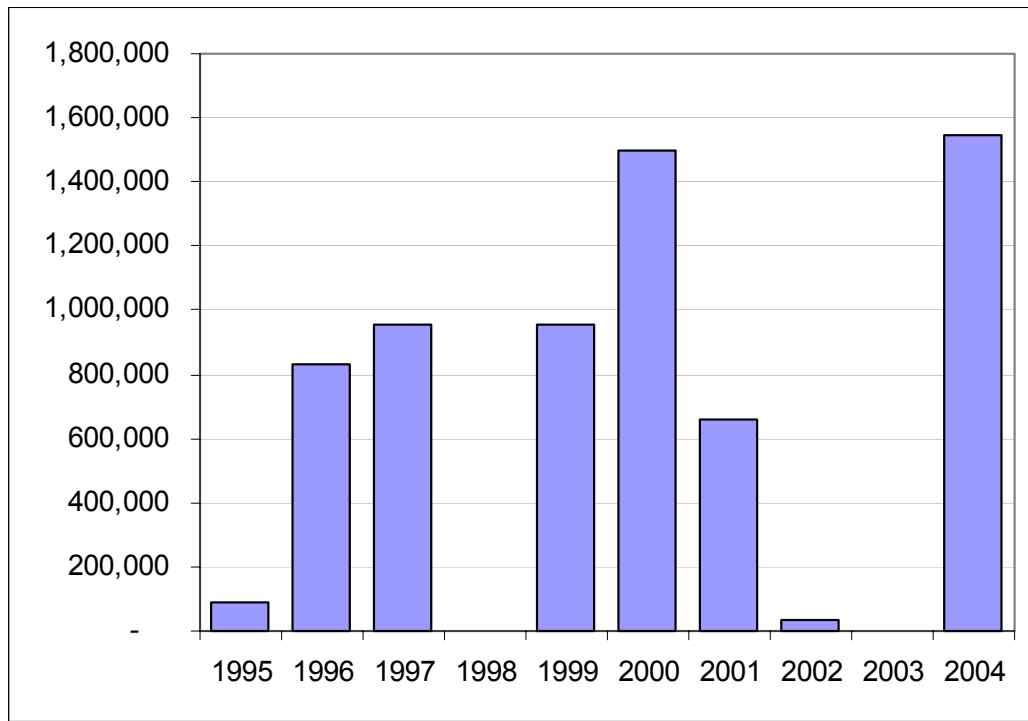
100%, while Director **John Howard** sold 200,000 shares on June 9th and 10th, resulting in a 51% reduction since February.

BJ Services Co. (NYSE: BJS)

Insiders at BJ Services have continued on their torrid selling pace that began in March and was highlighted in an April 16th *Insider Research Bulletin*. The recent selling was led by a few new execs and directors and in a similar pattern to the March activity, resulted in significant holdings reductions for the participants. From April 27th through July 30th eight insiders sold 588,789 shares at prices ranging between \$40.30 and \$50. The total volume wasn't as heavy as what we witnessed earlier, but then a majority of the shares were sold by Chairman, CEO **James Stewart**, while the current activity was more balanced.

Two directors, **John Huff** and **Michael Patrick** sold 97% and 95% of their holdings respectively, which can be attributed to director severance packages that pay one year's annual retainer for each year of their service to the Company. Such a plan leaves little reason for any board member to hold shares during their term since compensation will be provided at the backend of their service. Note that in the March round Directors **James Payne** and **Don Jordan** sold significant portions of their holdings – four of the six outside directors have now sold a majority of their stock in the past six months. And considering 2003 compensation awards amounted to a mere 2,658 options which vest over three years, it is going to be difficult for any director to restock their holdings without turning to the open market.

Figure 1. Total Annual Shares Sold by BJS Insiders 1995 through August 10, 2004



Excluding six months of weakness in 2001, the issue traded in a range from \$30 to \$40 between 2000 and 2003. This year the issue climbed to new all-time highs as the Company has benefited from US and Mexico drilling growth which nearly doubled second quarter revenues. But the question remains whether surging demand and geopolitical uncertainty will continue to push oil prices. The selling by BJS insiders, which has now mounted to the second highest annual total in the past ten years, could be telling us what these individuals think the future holds. Profit taking is surely one motive, but the fact that eight insiders have lightened their holdings this year between 26% and 97% leaves us to suspect these insiders see a top. If you don't think the stock has gotten ahead of itself, just ask CEO Stewart who when asked during the second quarter conference call how the Company would utilize its free cash flow responded that buybacks were the lowest priority due to the "current stock price situation."

- **Kenneth Williams (53)** – V.P., President, U.S. Division. Williams entered into a 10b5-1 trading plan in March and immediately sold 88,496 shares at \$43. As is the case with most trading plans, we expected to see some form of steady selling thereafter. But this wasn't the case. On April 27th he sold 40,000 shares at \$46, which was then followed by a 131,862-share sale on July 21st at \$49. Since March, his sales have **reduced his actionable position by 52%**.
- **Taylor Whichard (45)** – V.P. Finance, CFO. On July 30th and August 3rd Whichard exercised two series of options set to expire in 2007 and 2008 to acquire 44,408 shares. He immediately sold those shares and then tapped into his common stock holdings to sell an additional 38,816 shares, resulting in a **33% reduction of his holdings**. This is the first time in the past ten years that Whichard sold more shares than he exercised, which is unusual considering after this transaction he still has nearly 125,000 vested options he could have tapped into before selling the common.
- **John Huff (57)** – Director. Prior to this year, Huff had only executed two sales since joining the board in 1992 – he sold 36,000 shares in April 1999 at \$13 and 32,000 shares in March 2000 at \$32. As we mentioned above, BJS directors have made some pretty aggressive sales since March and Huff's recent activity is no different. On June 18th he exercised all of his vested options (he tapped into five series of options set to expire between October 2007 and October 2010) and sold the underlying 74,000 shares at roughly \$45. The sale **wiped out 97% of his ownership stake** and leaves him with just 2,000 shares of common stock. Huff's board term doesn't expire until 2006. We should also point out that Huff is the chairman and CEO of Oceaneering International (NYSE: OII) but hasn't sold any of his OII shares in the past year.
- **Michael Patrick (59)** – Director. Patrick, also a director at Cooper Cameron (NYSE: CAM), apparently has less reservation parting with his BJS shares than his CAM shares. After selling 2,700 shares of CAM in March 2004 for \$125,000, he dumped 38,000 BJ Services shares on July 26th, grossing \$1.8 million. Like Huff, Patrick exercised all of his vested options (expiration dates: 10/08 and 10/10) to sell and now holds a mere 1,600 shares of common stock. The sale, which **reduced his holdings by 95%**, matched the total shares he had sold over the past ten years. He last sold 7,200 shares in June 2000 at \$35.

- **David Dunlap (42)** – V.P., President, International Division. Since filing as a Section 16 insider back in 1995, Dunlap has been an infrequent seller, only having executed three sales between 1999 and 2001. His last sale of 71,924 shares in January 2001 preceded a six-month slide from \$39 to \$21. On April 27th he made his largest-ever disposition, selling 100,157 shares at \$46. Following the sale Dunlap still holds over 380,000 shares of common stock and vested options.

Nu Skin Enterprises, Inc. (NYSE: NUS)

Nu Skin has had its growing pains over the years but has managed to rebound to prices last reached in 1999. Through the good times and bad, managers have sold off sizeable amounts of their stock and a recent round has caused us to take a closer look. From July 30th through August 5th eleven insiders disposed of 2,943,625 shares between the prices of \$22.62 and \$26.95. The sales were led by Chairman and co-founder **Blake Roney**, who throughout the past year has now dumped over 7 million shares equal to 45% of his holdings. Joining Roney was Senior V.P. and co-founder **Sandra Tillotson**, who has also been selling heavily since last September. On July 27th the Company filed an 8-K and subsequent press release announcing that it would be purchasing 3.1 million shares from its original stockholder group (Roney and Tillotson included) and that a few in the group would be selling an additional 1.5 million shares to third-party investors. This comes nine months after Nu Skin purchased 10.2 million shares from the same insiders and approved the sale of 6.2 million shares to certain undisclosed investors. In order to finance the buyback, Nu Skin had to spend \$45 million in cash, and leverage itself by tapping into its revolving credit facility and a new shelf facility that was quickly established to buy back the shares. As a provision of the share buyback, the selling stockholders agreed to restrictions preventing them from selling any of their remaining shares on the open market for two years. This is hardly a generous concession on behalf of the insiders. Why would they need to sell shares on the open market when the Company continues to take enormous amounts of shares off their hands? But what the press release failed to disclose was that in addition to the sales by the founders, six executive officers sold on average 67% of their actionable positions (common stock and exercisable options), many of which exercised a curiously high number of their vested options in order to sell. In addition to Tillotson's late-2003 sales she sold an unnamed investor a call option to purchase 2 million shares and the right to buy an additional 3.5 million shares. Further information on this transaction is provided below.

Table 3. Ownership Positions of NUS Executives. Source: NUS SEC Filings

| Named Executive | 3/15/2003 | 3/15/2004 | 8/10/2004 | Reduction since 2003 Proxy |
|------------------|------------|------------|------------|----------------------------|
| Blake Roney | 16,712,890 | 10,617,368 | 8,817,368 | 47% |
| M. Truman Hunt | 353,325 | 347,112 | 312,112 | 12% |
| Corey Lindley | 374,250 | 313,625 | 223,625 | 40% |
| Brooke Roney | 1,526,985 | 1,000,001 | 850,001 | 44% |
| Sandra Tillotson | 8,981,144 | 4,231,144 | 3,641,114* | 59% |

* does not include 3.5 million shares an undisclosed investor has the right to purchase

Though the repurchases from select insiders was approved by the board, we feel the Company's founders have exploited the board's generosity and it doesn't end with just the stock sales. There are a handful of related-party transactions and material relationships between Nu Skin and certain founding shareholders and directors, not to mention four Roney family members are employed by the firm. Some of the more compelling are: a group of founders owns Scrub Oak Ltd. and Aspen Country LLC which lease the corporate office and distribution center to Nu Skin – 2003 fees totaled \$3.4 million, founders and a handful of their family members are product distributors and "receive substantial commissions" from the Company, Blake Roney owns Keystone Aviation LLC, which charts airplanes to Nu Skin, and finally Directors **Andrew Lipman** and **Jose Ferreira** each work for companies that provide legal or consulting services to the Company.

- **Blake Roney (46)** – Chairman. Roney has led all sellers over the past year, having sold 7.2 million shares or roughly 45% of his holdings. In October 2003 he converted all of his Class B Common Stock to Class A shares and sold 1.96 million shares to undisclosed third-party investors in addition to 3.43 million shares the Company purchased from him. More recently, on July 30th the Company repurchased an additional 1,212,288 shares for \$27.4 million while he sold 587,512 shares to private investors for \$13.6 million. Following the sales he still holds over 8 million shares through a family limited liability company. While we don't argue that this is a substantial position, it is far less than the 20.5 million shares he held just two years ago.
- **Sandra Tillotson (47)** – Senior V.P. Though by title she's only a senior vice president, Tillotson co-founded the Company with Blake Roney and is the second largest inside shareholder. Along with Roney she's been aggressively selling over the past year and her behavior is quite revealing. Just before converting all of her Class B shares last October, she sold 750,000 shares to a third-party investor with the issue trading at \$11.82 and picking up momentum. But there's more to this transaction than just her sale. Tillotson also granted the investor the option to purchase up to 2 million shares at \$13.70, with the right to purchase up to 3.5 million additional shares. Her bet couldn't have been less astute, as she's lost out on nearly \$12 a share in upside. Unfortunately, there was little provided on the call option's details, which makes this fruitless transaction even more inexplicable. More recently though, Tillotson sold a total of 590,000 shares to both the Company and private investors, grossing \$13.4 million. This drives her total sales since last October to over 3.34 million shares (not including shares covered by the call option), or **roughly 37% of her holdings**. If you include the 5.5 million shares she can be required to deliver under the terms of the call contract, then she will have sold nearly her entire position.
- **Ritch Wood (38)** – CFO. Wood surfaced on August 2nd and 3rd to execute his first transaction since registering as a Section 16 filing insider back in 2002. Though on the surface his 35,625-share sale at \$26.50 appears less alarming than the dispositions by some of his peers, a closer look reveals equally as concerning behavior. In order to acquire the shares to sell, Wood tapped into all nine options series he holds that are fully or partially vested with expiration dates between August 2008 and May 2013. He exercised nearly all of his vested options in order to **sell 87% of his actionable position** (common stock plus exercisable options).

Following the sale Wood has 1,420 shares of common stock, 4,000 vested options, and less than 5,000 options that will vest in the upcoming six months, combining to make a rather insignificant ownership stake for a key financial officer.

- **Robert Conlee (37)** – President, North Asia Region. Conlee, a fourteen year company exec only recently made his first-ever sale, dumping 127,875 shares on July 30th at roughly \$26. Like Wood, Conlee aggressively exercised his vested options, exercising ten different series (expiration dates: between 10/07 and 3/13) and clearing out three series. The sale **wiped out 77% of his holdings**, leaving him with 3,060 shares of common stock and 34,500 vested options. Prior to this sale, Conlee had purchased 35 shares during 2001 at roughly \$8. There is no word from the Company that Conlee is departing; in fact he received a promotion in January.

In addition to the above sellers, there are a handful of additional noteworthy transactions by Nu Skin execs. Executive V.P, President-Greater China **Corey Lindley**, and Regional V.P.s **Michael Smith** and **Mark Wolfert** sold **39%, 81% and 97%** of their holdings, while Senior V.P. (and an original shareholder) Brooke Roney sold 150,000 shares back to the Company.

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