



This 3DAdvisors Report Covers:

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

Insider Selling Picks Up as Share Price Languishes The Clorox Company (NYSE:CLX) Update

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The Clorox Company is engaged in the production and marketing of non-durable household consumer products. Principal products include bleach, household cleaners and salad dressings and other food flavorings.

Summary of 3DAdvisors Findings for CLX

- ▶ **Insider Trading:** Selling picks up as share price languishes
- ▶ **Accounting:** No pension adjustment and share repurchases pump up earnings

Discussion of 3DAdvisors Findings

Insider Trading: Selling picks up as share prices languishes

We have become more-than-interested in the acceleration of insider activity at Clorox in recent months. Coming at a time when general insider selling activity has virtually exploded, the Clorox trades are easy to miss. The fact is however, that while so many other company insiders have profit-taking to use as an excuse, Clorox sellers find their activity exposed to our radar: The stock has declined since March, yet insider sales have increased.

One of the highpoints of the recent insider distribution picture at Clorox is the fact that selling has spread from the sales by CEO **Craig Sullivan** (which had dominated the picture during the second half of '02) to a growing number of other operating executives. We find it very curious that, with the shares drifting lower (and in a good market) so many insiders are surfacing to lighten their positions at the same time:

Karen Rose (53) – CFO. Rose's May sales of 19,520 shares, at \$44 each, are her largest since the shares peaked back in 1999. Last year, she had been selling, at about 2,000 to 2,500 shares per trade, between June and December. The selling at that time had materialized after the shares had been recovering from their 33% drop from the \$48 range to \$32. We had become interested in her subtle selling into the recovery.

Her recent, much larger, sale of 19,520 shares provides an extra exclamation point on her activity, especially since it finds itself accompanied by others behaving similarly.

Richard Conti (47) – Group Vice President. Conti has been with Clorox since 1981. He had not sold shares in the past five years, having passed on the chance to reduce his position even during the 1999 peak period when the shares traded for as high as \$66 each. On June 4th, he sold 27,388 shares for \$45 each.

Gerald Johnston (55) – President and COO. Johnston sold 27,656 shares on May 28th for \$43 each. Johnston was last seen selling near the 1999 peak, getting prices between \$51 and \$54 each at the time.

Lawrence Pieros (47) – Group Vice President. Pieros has never been an active seller. Prior to this recent activity, his only sales for the past five years had totaled just 616 shares and occurred back in September of 1998. His profile changed rather dramatically this year. He followed up a 22,000 April sale (at \$48 each) with one of 18,884 shares in June, this time at the lower price of \$45. The sales resulted in a 16% reduction in actionable holdings, about twice that of the reductions registered by the other sellers.

Glen Savage (46) – V.P. and General Manager, Laundry and Home Care. Savage dropped 15,576 shares on June 2nd at \$44.50 each. This was his largest sale in the past five years as he declined to take advantage of the 1999 peaking share prices. Last year, he sold a smaller amount of shares (11,760 shares) at higher prices (\$46 range).

Mary Springer (37) – V.P. and General Manager, Glad Products. Ms. Springer sold 2,313 shares at \$42.75 each in late May. She is a recently elected officer and therefore is a newly filing insider. Consequently, we have little historical data concerning her. It is interesting however, that her sales fall into the same window as this expanding list of Clorox insiders who are lightening up.

Accounting: No pension adjustment and share repurchases add \$0.055 to earnings through Q3 of F/Y 2003

At the time of our initial report (11/26/02), Clorox had indicated that the under funded condition of its Pension Fund had caused the Company to charge Shareholders' Equity \$65 million as a Minimum Pension Liability adjustment. At that time, the Company had stated that it would likely be funding the Pension in F/Y 2004. The funding amount was not indicated at the time. This funding exercise has begun, and sooner than originally expected. Clorox contributed \$54 million to its Pension Fund in Q3 (ended 3/31/03) and has indicated that an additional \$37 million contribution will be required in Q1 of 2004.

The Company's Pension Fund continues to cling to unrealistically high-assumed rates for both Expected Rate of Return on Plan Assets (9.5%) and Discount Rate for calculating present value of the Benefit Obligation (7.25%). Both rates are helping to juice the EPS calculation. Unlike most other companies that have already bitten the bullet on this issue, Clorox does not plan to adjust its high Expected Return Rate on Plan

Assets until F/Y 2004. At that time, it has indicated that it will move the rate to 8.5%. The Company does not mention however, what it planned to do with its high discount rate assumption.

In this environment, most companies are adjusting both Expected Rate of Return and Discount Rate assumptions downward. In most cases, it has not been unusual to see a reduction to 8.5% in Expected Return rate coupled with a Discount Rate reduction to the 6.75% range. Although Clorox does provide a disclosure of an estimated effect of the change in Expected Rate for 2004 (about \$0.015 per share), the Company fails to disclose any effect from a reduction in the discount rate. It is interesting to note however, that the whole story is, very likely, not being disclosed as the Company has failed to discuss the potential effects of a corresponding reduction in the assumed discount rate. Should Clorox reduce its discount rate to a range consistent with reality (6.75%) there will be a greater impact pressuring earnings lower and pension liability higher than is being disclosed as of the latest Q.

Even in the light of a large Pension contribution, Clorox continues to use cash for share repurchases. Through Q3, the Company has used \$348 million in cash to buy 8.2 million shares (vs. \$296 million through Q3 of F/Y 2002). The move contributed \$0.04 per share to earnings through Q3. So, between holding Pension rates unrealistically high (for F/Y '03) and share repurchases, Clorox has been able to squeeze \$0.055 into its EPS calculation through Q3 of 2003.

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