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

Insider Research Bulletin

September 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

- Electronic Arts Inc. (NASDAQ: ERTS)
- MDU Resources Group Inc. (NYSE: MDU)
- Reynolds American Inc. (NYSE: RAI)

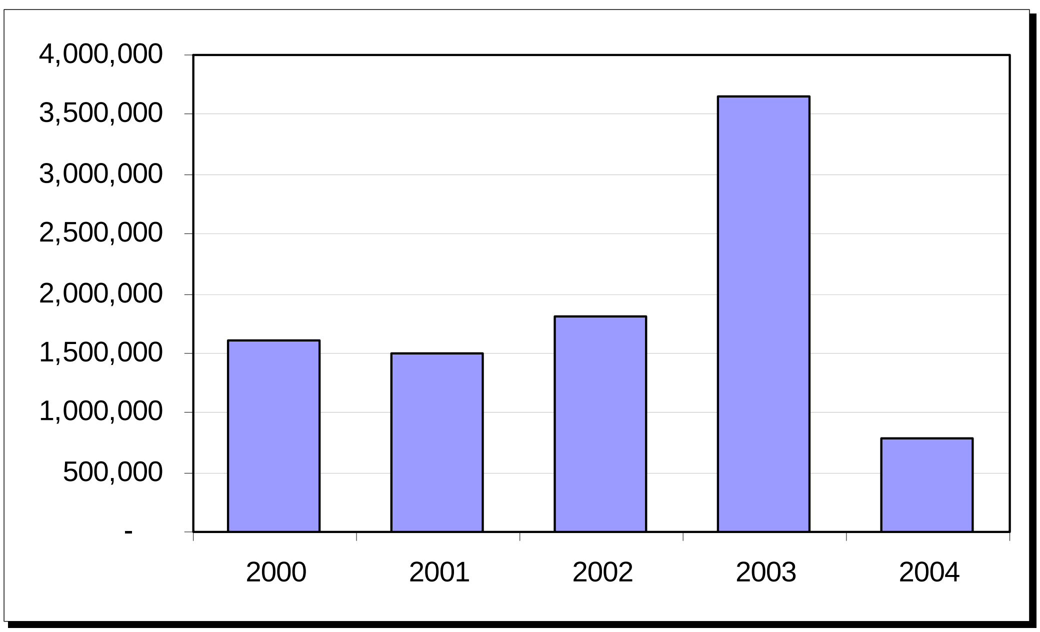
Discussion of 3DAdvisors Findings

Electronic Arts Inc. (NASDAQ: ERTS)

Persistent insider selling by Electronic Arts insiders has been on our monitors for nearly five years. The selling has always appeared to be routine, as annual sales have averaged 1.99 million shares per year dating back to 1995. By sheer volume, this year's activity seems to fall in line with historical selling levels, but there are a few interesting facets to these sales that haven't been present in the past and deserve to be highlighted. First and foremost are the heavy holdings reductions by four insiders, three of which were named in the 2003 Proxy. President, Worldwide Studios **Don Mattrick**, Executive V.P., Worldwide Studios **Bruce McMillan**, and Executive V.P. & GM, North American Publishing **Nancy Smith** sold off 70%, 35%, and 66% of their holdings, respectively, with sales throughout the year. This is the first time that we've ever encountered such large reductions by these Company veterans, not to mention that Director and co-founder **Timothy Motts** has shed 61% of his position since May. As you'll read below, Motts' dispositions were partly attributed to a divorce settlement, but his behavior following the divorce-related share transfer is very interesting. In addition to the reductions, there are a handful of executives and directors that may be falling short of meeting Company mandated ownership guidelines. Directors are required to hold common stock valued at three times the annual retainer of $35,000 within three years of joining the board. At the September 9th closing price of $47.97, directors should each have a very reasonable 2,188 shares. Currently, two of the seven non-executive board members fall short of meeting these guidelines. While we know the details for directors, the Company's disclosure of its guidelines for operating executive leaves something to be desired. All that's reported is that ownership requirements for all executives were implemented last year, the terms of which aren't revealed.

Finally, the continued heavy selling presents another foreseeable issue. Despite being rewarded with very generous option grants in fiscal 2003, 2004 grants were the smallest we've seen in over five years (FYE is March 31). Should this trend continue and the sales persist at this pace, the ownership levels of Electronic Arts' executives will continue to diminish.

Figure 1. Options Granted to Named Executives, Fiscal Years 2003 to 2004.
Source: ERTS SEC Filings.



A few points of interest: Electronic Arts has a history of interesting governance practices, such as providing loans to executives. In 2000 the Company provided full-recourse loans to six executives for the purchase of Class B stock, which the Company has now decided to eliminate by converting them Class A shares. Then in 2002, Executive V.P., CFO **Warren Jenson** was loaned $4 million (interest free) for undisclosed purposes, which was to be forgiven over four years as long as he continues his employment. We know the loan wasn't used to purchase ERTS stock. In addition to the loan, Jenson was given a $500,000 signing bonus, $100,000 for relocation and temporary housing expenses, and a grant of 1.2 million stock options. The Company explains that the large compensation package was due to a "competitive recruiting environment for highly regarded and talented chief financial officers".

- **Don Mattrick (40)** – President, Worldwide Studios. Mattrick, Electronic Arts' second in command, sold 100,000 shares on August 26th at $51.42. The sale itself isn't overly alarming compared to his past volume. However, he has now sold 425,000 shares through seven separate transactions since January, equal to **70% of his holdings**. The last time his activity was this aggressive was in August through November 2002 when he dumped 750,000 shares just weeks ahead of a sudden 26% slide by yearend. This year's frequent and heavy activity signals a sudden shift from what we witnessed last year when he sold 160,000 shares in just two transactions. What's more, Mattrick has been a Section 16 filing insider since 1996 and over that period has only amassed a common stock position of 2,472 shares.

- **Bruce McMillan (41)** – Executive V.P., Worldwide Studios. It could be just a coincidence that McMillan's past three rounds of sales coincided with sales executed by Mattrick, but considering McMillan reports directly to Mattrick and the two worked together at Distinctive Studios from 1982 until it was acquired by EA in 1991. It's hard to ignore the possible correlation. McMillan sold 40,000 shares on August 26th at $51.84, pushing his 2004 sales total to 190,646 shares, or **35% of his actionable position** (common stock plus exercisable options). Though he's been a filing insider since 1999, McMillan's first sales came in May 2003 and he's now executed seven transactions since.

- **Timothy Mott (55)** – Director, co-founder. Mott's selling history is pretty irregular compared to what we're more accustomed to seeing from a company's co-founder. Between 1996 and 2003 he sold a total of 315,600 shares, with long periods of inactivity between trades. His behavior over the past three months is a different story, however. After selling 50,000 shares in May, he transferred 131,968 shares from his common stock position to his former spouse pursuant to a divorce settlement. The transaction wasn't filed with the SEC, but was inconspicuously included in a footnote on a Form 4 filed for his July sales. Its likely that his ex-wife sold the shares, but she is not required to file her trades since she no longer resides in his house. Then, on July 30th, Mott exercised five series of non-expiring options (expiration dates: 8/05, 7/06, 7/07, 7/08, 7/09) and sold the underlying 77,520 shares at $50.02. Including the transferred shares, Mott has now **trimmed his holdings by 61%** since May. Chances are he had little control over the shares he had to relinquish in the divorce, but his willingness to part with another large block of shares shortly thereafter is quite telling. It should also be noted that Mott is the Chairman of a private IT outsourcing firm called *All Covered*. He sits on the board with Electronic Arts Executive V.P. **Russell Reuff**, who sold 35,000 shares of EA on August 20th.

- **Nancy Smith (51)** – Executive V.P. & General Manger, North American Publishing. Smith has been a Section 16 filing insider since 1995 and was a named executive in Proxy statements through 2003. She proved to be a heavier seller in her early years than we've seen of late, but that changed in the recent round. Between 1995 and 2000 Smith disposed of 1.33 million shares, far greater than the 314,000 shares she sold between 2001 and 2003, years when the issue experienced some of its strongest growth. Her selling has noticeably picked up this year. After selling a total of 100,000 shares in February and May at $46 and $51, Smith sold 250,000 shares between August 11th and August 31st, grossing $12.5 million. She acquired the shares from the exercise of three options series set to expire between August 2009 and October 2011 and the sales resulted in a **58% reduction of her ownership**

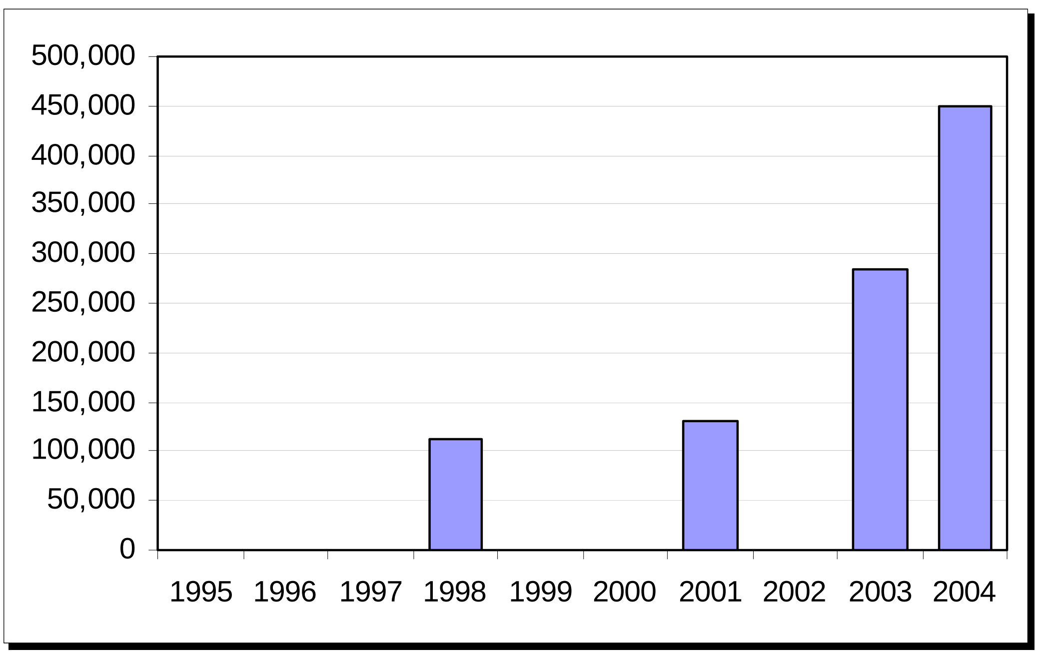
stake. This was her largest round of selling since she dumped 648,708 shares back in October 1996.

Also taking part in the round was Chairman, CEO **Lawrence Probst** who sold 86,300 shares between August 25th and August 27th. His 2004 selling to this point is below his 2002 and 2003 volume, but there is a May 2004 transaction that stands out. In addition to selling 50,000 shares, he contributed 100,000 shares held by a family limited partnership to an exchange fund. He effectively swapped 25% of the partnership's ERTS stock for an undisclosed number of shares in the fund.

MDU Resources Group Inc. (NYSE: MDU)

As was the case with other utility companies we've covered over the past few months, the MDU Resources story is one of uncharacteristically heavy insider selling. The issue has been trading in a tight range between \$20 and \$25 since May 2003 and insiders unloaded a large number of shares as the stock climbed to the upper levels of that range. From August 13th through August 27th five execs sold 352,340 shares between the prices of \$24.31 and \$24.85. Sales for 2004 have now nearly matched the total shares sold between 1995 and 2003.

Figure 2. Total Shares Sold Annually by MDU Resources Executives (1995 through August 2004). Source: MDU SEC Filings



The recent selling was sparked by the accelerated vesting of performance options granted in 2001 and set to vest in 2010, which was triggered by the Company hitting performance targets based on return on equity (25%), earnings per share (25%) and total relative shareholder return (50%). But what's less obvious is that a large percentage of MDU exec's holdings were comprised of these performance options and they jumped at the chance to sell them, leaving themselves with an inconsequential amount of options. In their defense, the Company stopped granting stock and performance options under the 1997 Executive Long-Term Incentive Plan late last year. But after the named executives received on average 113,000 stock options in 2002, 2003 performance grants paled in comparison, averaging less than 10,000 shares per person, which don't begin to vest until next year should they hit their targets.

Table 1. Stock Option Holdings of MDU Resources Named Executives (Exercisable / Unexercisable) Source: MDU SEC Filings

Named Executive	12/31/2002	12/31/2003	8/25/2004
Martin White	60,700 / 180,000	0 / 270,000	0 / 0
Ronald Tipton	49,125 / 72,000	0 / 108,000	0 / 58,860
Warren Robinson	37,950 / 62,400	0 / 93,600	42,120 / 51,480
Lester Loble	34,000 / 54,600	41,850 / 81,900	78,975 / 45,045
Vernon Raile	15,630 / 20,800	0 / 31,200	0 / 0

As mentioned, though most of the sellers didn't tap into their common stock holdings to execute these sales, the activity did diminish their actionable positions (common stock and exercisable options). Led by Chairman, President, CEO **Martin White**, four of the execs sold between 35% and 75% of their ownership positions. White sold nearly twice as many shares in one week than he had over the past ten years, leaving him with just enough common stock to meet ownership guidelines the board put in place in 1994. With the exception of Senior V.P., Governmental and Public Affairs **Robert Wood**, all other sellers are meeting the requirements (though some by a very small margin). Wood, who's been with the Company for over ten years, is still well below his target.

A few points of interest: Director **John Wilson**, a board member since 2003, is currently deemed by the Company to be independent. We find this evaluation to be rather curious considering Wilson is the President of Durham Resources, LLC that sold off Great Plains Energy and Great Plains Natural Gas to MDU Resources back in July 2000. Wilson served as Great Plains Energy's president and was an executive vice president at Great Plains Natural Gas. One element of director independence is that a director could not have been an employee of the company or any of its subsidiaries in the past three years. Of probably more significance to investors is the fact that Wilson is a member of the Audit Committee, which NYSE regulations state are to be comprised solely of independent directors. Though the three-year look back period has lapsed, he was appointed to the committee before it had done so.

- **Martin White** (62) – Chairman, President, CEO. Since assuming the position of President/CEO back in 1998 (he joined the Company in 1991), White had only surfaced with two prior sales. The first sale covered 68,042 shares at the all-time high in May 2001 and proceeded a nearly 40% four-month slide from \$26 to \$16. Then in August 2003 he sold 69,600 shares in August 2003 at \$21. His recent activity though stands alone. Between August 20th and August 27th White exercised all of his vested options and sold nearly the entire lot, 240,800 shares grossing \$5.9 million. The sale **wiped out 66% of his actionable position** and leaves him with less than 120,000 shares, including shares held by a trustee in his 401(k) plan. While no longer holds any options, vested or unvested.

- **Robert Wood** (61) – Senior V.P., Governmental and Public Relations. After having sold a total of 11,405 shares between 1995 and 2003 (all shares were sold in 2003), Wood surfaced on August 17th to sell 31,200 shares, which **dropped his holdings by 75%**. The shares he sold were acquired by exercising performance options, of which he sold the entire block of shares. Wood still holds 2,421 shares of common stock and 7,700 shares in a retirement plan, which leaves him short of meeting the Company's ownership requirements. Though he doesn't have any vested options, he does have an option for 9,000 shares, which will vest in 2007.

- **Vernon Raile** (59) – Senior V.P., Chief Accounting Officer. On August 19th Raile exercised the last of his vested options, one series of performance options with a February 2011 expiration, and sold the underlying 31,200 shares at roughly $24.80. Not only was this Raile's second sale in the past ten years, but it **reduced his holdings by 35%**. Following the sale Raile directly holds 32,189 shares of common stock and another 12,500 shares in a 401(k) plan and ESOP plan, which are held by a trustee.

- **Ronald Tipton** (57) – CEO, Montana-Dakota Utilities & Great Plains Natural Gas. As was the case with the other sellers, Tipton exercised the portion of options that vested in February 2004 ahead of their planned 2010 vesting date. He immediately sold the 49,140 shares at just over $24 and **trimmed his position by nearly 36%**. Tipton has 54,000 shares of common remaining and nearly 40,000 shares in his 401(k) plan, but doesn't have any vested options.

Reynolds American Inc. (NYSE: RAI)

Neither a Moody's downgrade, a pending RICO case, nor a report by the Centers for Disease Control and Prevention regarding declining tobacco use has been able to slow the momentum of Reynolds American shares. The issue has raced past most analysts' price targets in the wake of an impressive second quarter earnings report. Shortly after the earnings release Company execs began locking in profits. Typically, we discount insider activity at a firm that recently completed a merger due to the lack of SEC filings and uncertainty about the composition of senior management. But after reviewing both the activity and updated ownership positions of key Reynolds American executives, we feel confident that there's not only a story here, but we have enough information to shed some light on the behavior. From August 3rd through September 7th thirteen insiders sold 492,826 shares between $70.90 and $75.60.

We've grown accustomed to seeing outgoing or disgruntled execs selling after a new management team is announced, but this doesn't appear to be the case here. A majority of RAI's new management team came from RJR Reynolds and not only did they file Form 3s and subsequent Form 4s reporting their holdings, but we can use their RJR trading history to give us a good basis for their trading habits. One detail that instantly jumped out is the unusually heavy volume and resulting holdings reductions by key employees. In the past, we did not encounter high levels of sales by these execs, which is probably due to the comparatively small amounts of stock held by management. Prior to the merger, executives and directors held less than one million shares (this doesn't include shares granted under the 1999 LTIP which are subject to certain restrictions) or 1.1% of the total shares outstanding. Between 1999 and 2003 insiders sold a total of 484,375 shares – a large number of which were sold by seven execs in an uncharacteristically heavy round in September 2002, just days after the Company issued an earnings warning which sent the stock into an abrupt 30% slide. Through the first eight months of this year, the selling volume (most of which came in the recent round) has matched the volume over the prior four years.

Figure 3. RAI Daily Closing Prices, December 1, 2003 To September 10, 2004. Blue diamond is the date RJ Holdings shares were converted to Reynolds American shares; blue shaded area is where insiders sold 492,826 shares. Source: RAI SEC Filings.

What really caught our attention was that insiders wasted little time selling the newly granted RAI shares after their RJR shares were converted. Twelve of the thirteen sellers dumped between 25% and 94% of their holdings with the average reduction equal to 65%. Not only have we never before seen group selling of this magnitude, but these holdings reductions are unprecedented for the Company. What's more, on the same day that a handful of the sales were executed, Chairman, CEO **Andrew Schindler**, President and COO of Reynolds Tobacco Co. (a subsidiary of RAI) **Lynn Beasley**, and Executive V.P., General Counsel **Charles Blixt** each established a 10b5-1 stock trading plan. As our clients know, it is quite curious to see insiders, who have been selling aggressively, enter into 10b5-1's *ex post facto*. When this occurs, we can only assume that the individuals involved intend to continue selling. It was disclosed that Beasley and Blixt plan to "balance their personal investment portfolios," but considering they each own a total of 34,298 and 30,758 shares (and exercisable options), respectively, following their sales, it would seem that something other than diversification is on their minds.

Finally, on August 31st execs were granted an aggregate of 133,263 performance shares, which vest 33% per year beginning in August 2005. What we find interesting about this recent selling behavior is that these insiders don't hold any unvested stock options, have small ownership positions following the recent sales, and won't have any performance shares vest until 2005.

- **Andrew Schindler (59)** – Chairman. After a tumultuous 2003, Schindler composed the B&W merger and subsequently announced his retirement from his executive position. He will help coach his replacement **Susan Ivey** for the next six months and then will stay on as RAI's non-executive chairman. Following the announcement Schindler sold 103,485 shares on August 5th, which was only his second sale in the past five years (his only prior sale was for 2,567 shares in June 2003). He also entered into a pre-arranged trading plan to further "balance his personal finances for his upcoming retirement," but details of the plan weren't disclosed except for the fact that the sales will surface during the next five months. Then on September 7th he cleared out two series of options set to expire in 2010 and sold the underlying 107,512 shares, which combined with the August sale **dropped his holdings by 36%**. Though he established the trading plan in August, his September sales were not reported as 10b5-1 selling. Expect more sales to follow.

- **Dianne Neal (44)** – Executive V.P., CFO. Since RJR stock began trading in 1999, Neal had only executed two transactions – a 12,812-share disposition in November 2003 at $59 and a 393-share sale in February 2004 at the same price. On August 4th and August 5th she exercised her lone option and sold the underlying 24,000 shares. On top of the option-related sale she also sold an additional 4,363 shares out of her common holdings, which combined resulted in an **82% reduction of her holdings**. Following the activity Neal has only 6,250 shares of common remaining.

- **Charles Blixt (52)** – Executive V.P., General Counsel. Between 1999 and 2003 Blixt sold a total of 68,572 shares, which he's already surpassed with his combined selling of RJR and RAI shares this year. On August 4th and August 5th he sold 38,687 shares at roughly $73. Shortly after **selling 37% of his ownership position**, he then filed a 10b5-1 trading plan which stated his intent to sell an additional 16,450 shares. Should he sell those shares, Blixt will own a total of 22,000 shares, substantially below the 138,000 shares he owned in March 2003.

- **James Maguire (52)** – Executive V.P., Sales, RJ Reynolds Tobacco Co. Maguire has been one of the more aggressive sellers since 1999; having sold a total of 87,550 shares between the time the issue began trading and 2003 (though he only sold less than 9,000 shares last year). After the conversion of his RJR shares to RAI stock he cleared out both option series he was granted (both series vested immediately) and sold the underlying 43,279 shares, or **63% of his actionable position** (exercisable options and common stock). Maguire has 24,985 shares of common stock remaining, which amounts to his smallest ownership position in the past five years.

- **Lynn Beasley (46)** – President, COO, RJ Reynolds Tobacco Co. On August 4th and August 5th Beasley sold 47,560 shares at roughly $73 and effectively **trimmed her holdings by 58%**. Though this isn't her largest sale to date, it is only a few shares less than her prior largest disposition, which was executed in September 2002 just ten days after the Company issued an earnings warning which caused a one-month, 30% slide. But also of note is that she started a 10b5-1 trading plan the day she sold, which will further diminish her holdings. If she sells all the shares she intends to, she will own less than 25,000 shares, significantly less than the 105,000 shares she's held on average between 1999 and 2003.