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Accounting: Quality of Earnings Issues
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Insider Research Bulletin

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Insider Research Bulletin is a summary of significant insider trading behavior that 3DA has identified at the following companies. None of the companies in this Bulletin have been previously covered, and because the insider trading behavior described here has been deemed significant, 3DA has initiated a review of accounting and governance behavior at these companies. These new companies may or may not become the subject of full 3DA Research Reports in the future.

Insider Research Bulletin is published periodically and exclusively for 3DA Research subscribers.

Companies in this Bulletin

- **Comverse Technology, Inc. (NASDAQ:CMVT)**
- **Fairchild Semiconductor International, Inc. (NYSE:FCS)**
- **Nordstrom Inc. (NYSE:JWN)**
- **Mandalay Resort Group (NYSE:MBG)**
- **Xilinx, Inc. (NASDAQ:XLNX)**

Discussion of 3DAdvisors Findings

Comverse Technology, Inc. (NASDAQ: CMVT)

Seeing insiders take profits on a rebound can be expected, but when the stock is still trading more than 80% off four-year highs and the insiders involved are selling considerably more than they did at higher levels in the past raises questions. Such is the case at Comverse Technology, where from January 8th through January 14th, five insiders sold 599,740 shares between \$18.07 and \$18.98. The recent round marks the second heaviest month of selling volume by insiders (insiders sold 1.09 million shares in October 2003) since insiders dumped over 830,000 shares in December 2000, a month before the stock began a steep descent from over \$100 to less than \$10 by late 2002. Even more troubling about the recent sales is the number of sell transactions insiders made – a sign of their urgency. A total of 49 sales were executed, which is the highest total seen since June 1999. Included in the recent activity - two senior executives cashed out of 30% and 35% of their positions, while two made their largest sales to date.

A few points of interest: the Company announced in 2001 that it was planning on re-pricing options for all of its executives. However, the Company was not allowing for every series of underwater options to be re-priced as a means to motivate employees. Also, employees were only to receive 0.85 shares for each option they exercised in order to control dilution. While shareholders do not typically welcome the re-pricing of options, the Company's plan seemed favorable to all parties. The Company announced the approved number of options that would be re-priced for the top four executives (all of which sold in January). However, these numbers turned out to be very misrepresentative of the actual amounts.

- Kobi Alexander – originally approved to re-price 1.23 million options, actually re-priced 2.27 million options.
- Zeev Bregman – originally approved to re-price 340,000 options, actually re-priced 670,000 options.
- Itsik Danziger – originally approved to re-price 330,000 options, actually re-priced 684,560 options.
- David Kreinberg – originally approved to re-price 164,000 options, actually re-priced 293,355 options.

Not only are we a little concerned with the increase in the options exchanged, but also with some of the terms of the re-pricing. It was originally reported that they would be re-pricing options that had strike prices between $46.50 and $85.00 (the stock was trading around $50 at the time). However, the stock continued to slide and the Company decided to re-price options granted as recently as 2001 and 2002 with strike prices of $14.75 and $16.05. These options were not underwater, and it seems as though the Company strayed from their earlier attempt at utilizing the re-pricing as a motivational tool. After doing a commendable job of disclosing the original terms of the re-pricing effort, the Company then abstained from disclosing any of the new terms. In all, Comverse ended up re-pricing four option series granted between 1996 and 2001 with strike prices of $14.75, $16.05, $46.50 and $85.00.

To make matters worse, each of the executives selling in the recent round didn't waste any time taking advantage of the re-pricing by exercising the newly granted options and selling the shares. These January sales came shortly after the first vesting period of the newly granted options.

- **Zeev Bregman (42)** – CEO Comverse Inc., Director. On January 14th, Bregman sold 100,000 shares at just under $19 per share. Since assuming his current role with the Company in January 2001, Bregman has shied away from making many transactions, having only sold once before in October 2003 (150,000 shares at $17.30), which can probably be attributed to the stock's slide from over $100 in early 2001 to roughly $10 in late 2002. Oddly enough, Bregman must feel the stock has appreciated enough to sell nearly 30% of his holdings.
- **Kobi Alexander (51)** – Founder, CEO, Director. Like Bregman, Alexander has been relatively quiet for a CEO with a sizeable position. He sold 720,000 shares combined into the stock's rebound at $10 on July 2003 and $17 in October 2003. More recently, he dumped 274,740 shares on January 13th and 14th at $18.43 to

$19.20. Most unusual about the recent activity is Alexander didn't sell any shares while the stock traded at higher levels in 1999 through mid-2001, yet has now dumped nearly 1 million shares as the stock rebounds from its lows.

- **Itsik Danziger (54)** – Director, former President. In 1999, 2000 and 2003, Danziger sold on average roughly 200,000 shares. Again, what concerns us most here is that this group of insiders is willing to unload equally as large or larger quantities than they have in the past at considerably higher prices. On January 13th, Danziger sold 150,000 shares at just over $18 per share. His selling has also picked up since 1999. After having sold 60,000 shares in 2001 and no shares in 2002, he has now sold 352,500 shares since October 2003.

- **David Kreinberg (38)** – Executive V.P., CFO. From 2000 to 2003, Kreinberg sold a total of 55,000 shares. Recently, he sold 55,000 shares on January 12th as the stock traded between $18.55 and $18.73. Not only was this his largest sale since filing in May 1999, but he also trimmed his position by 35%.

- **Sam Oolie (67)** – Director. While not by any dramatic margin, on January 8th Oolie made his largest sale dating back five years when he dumped 20,000 shares at roughly $18.30 per share. This actually happens to be his first sale since 2001.

Fairchild Semiconductor International, Inc. (NYSE: FCS)

There is no doubt that semiconductor stocks have had an impressive resurgence over the past year, as the Philadelphia Semiconductor Index has more than doubled. Fairchild Semiconductor has fared even better, climbing from $10 to $28 over the same period. We certainly expect to see insiders taking profits, and they deserve to, within reason. Yet, FCS execs recently held the largest round of profit taking excluding institutional ownership (10% beneficial owners) selling. From November 3rd through January 30th, thirteen insiders sold 1,653,482 shares between the prices of $22.70 and $28.07. As mentioned earlier in this week's report, we not only look at the total volume of shares sold, but the number of transactions insiders executed. This was the heaviest selling in both categories dating back to 1999. Also, this was the first time so many insiders came forth with sales, especially mid-level executives making their first sales since joining the Company. Insiders as a group have played this stock well, having made sizeable sales concurrently in May/June 2000 and February/March 2002, both into rallies and preceding considerable weakness.

A few points of interest: as we reported in the Comverse story, employees at Fairchild had their options re-priced back in 2002. Unlike CMVT though, this re-pricing was relatively straightforward. Options were re-granted at fair prices and the Company was very forthcoming with their disclosure. But this is definitely something to keep in mind. Also Senior V.P, Chief Information Officer John Watkins Jr., one of the selling execs, was loaned money by the Company in July 2000. On July 23, 2002, the loans were modified and extended. More interesting was the fact that the Company forgave one of the loans which was provided to fund federal and state income tax withholding obligations resulting from a grant of restricted stock given to Watkins. Not only did the Company forgive the loan, but also looked the other way on the accrued interest, while also agreeing to pay the taxes associated with the forgiveness.

- **Richard Cashin (49)** – Director. Since joining the board in 1997, Cashin, chairperson of the audit committee, has never surfaced with any open-market transactions. However, on February 22, 2002, he entered into a forward sale contract with an unaffiliated third party in which he promised to deliver 622,000 shares in exchange for a cash payment. While forward sales aren't that uncommon, Cashin's recent activity makes this situation very interesting. Pursuant to the contract, Cashin is expected to deliver 311,000 shares or the cash equivalent on or about February 22, 2004 and another 311,000 shares (or cash) on February 22, 2005. It is our opinion that if Cashin believed that the recent momentum of Fairchild's stock were to continue, he would prefer to give cash and hold his shares, or just turn over the 311,000 shares due this month. However, he took a drastically different approach. From November 12th through December 9th, he sold 797,187 shares at $23.75 to $24.67. The sale wiped out over 80% of his holdings. Cashin either bought out the contract entirely or else he's going to have to buy shares of the stock or come up with the cash come February 2005.

- **Kirk Pond (58)** – Chairman, President, CEO. Between 2001 and 2003 Pond sold 123,000 shares. Recently, he sold 275,000 shares on January 16th at $27.41.

- **Paul Schorr IV (35)** – Director. Schorr, a managing director at Citigroup Venture Capital Equity Partners, has been on the board since 1997. We have seen Schorr selling in the past, but those have been indirect sales of shares held by Citigroup, which owns a sizeable stake in Fairchild. Recently though, Schorr began selling his own shares, as from November 24th through January 22nd he sold 295,121 shares between $23.93 and $28. The sales have trimmed his personal holdings 40%.

- **Hans Wildenberg (age not disclosed)** – Executive V.P., COO. On November 3rd, Wildenberg sold a mere 2,400 shares at $22.75. Then, the stock popped in January and on the 16th he dumped an additional 50,800 shares from $27.56 to $27.70. Since joining the company in January 2001, Wildenberg had only sold 22,000 shares in March 2002 at slightly higher prices and 3,000 shares in September 2003. The sale trimmed his holdings by 75%.

- **David Henry (age not disclosed)** – VP, Worldwide Finance. On January 16th, Henry sold 15,681 shares at roughly $27.40 per share. Since filing in 1999, Henry had only sold a total of 20,315 shares, most of which were sold in 2000 at 35% higher prices. Henry has displayed a knack for selling ahead of significant weakness, selling shares in May 2000 at $46, before the stock dropped to $14 by yearend, and again in March 2002 at the year's high of $30, immediately preceding a six-month decline to $8.

- **Joseph Martin (55)** – Vice Chairman, Executive V.P., CFO. Martin has proven to be a pretty frequent seller over the past five years, selling anywhere between 61,632 shares (1999) to 305,000 shares (2001). However, he recently made his second largest sale since June 2000, when he sold 170,000 shares on January 28th and 30th at $24.52 and $25.92. Martin still has significant holdings after the recent activity.

Nordstrom Inc. (NYSE: JWN)

The holiday season and the abnormally cold weather that came with it were very good to retailers, especially those such as Nordstrom, which carry an upscale product mix. Yet, despite strong sales and a Moody's upgrade, from November 24th through January 15th, six insiders locked in gains on 4,466,456 shares between $32.06 and $37.45. The recent activity has been the heaviest selling (by a sizeable margin) at the Company in the past five years. Also interesting is that three mid-level execs cleared out between four and seven non-expiring option series, while making abnormally large sales compared to their historical selling.

A few points of interest: Director Stephanie Shern, who joined the board in 2002 and was a member of the audit and finance committee, abruptly resigned from Nordstrom's board in November. The Company declared that Shern resigned for personal reasons; however, she is also a board member at Scotts Co. (NYSE: SMG) and Gamestop Corp. (NYSE: GME) and didn't relinquish her position at either firm. Also unusual about the situation - it was just a few months back that Shern stated publicly that a few additional director opportunities were in the works. Also noteworthy, there are a high number of insiders' family members who were employed by the company during the 2002 fiscal year. More startling is the ample salaries they were given. Of the eight extended positions, six had annual salaries over $90,000. Four of the insiders who recently sold stock had family members employed, of note - Peter Nordstom's brother was hired at a salary and bonus of $609,000, while James O'Neal's wife was employed for $171,000.

- **John Nordstrom (66)** – Director, retired Co-Chairman. On November 26, 2003, the company issued a press release stating that the Elmer and Katherine Nordstrom Family Interests, LP would be selling up to 5.4 million shares of its 8.21 million-share stake in the company. John Nordstrom, one of two partners in the family trust that is an active member of Nordstrom's management team indirectly sold 4,385,503 shares from November 26th through January 15th at prices ranging from $32.06 to $37.45. The press release stated that the sales were solely for diversification purposes; nevertheless, this is a lot of shares to be unexpectedly sold by a controlling family of a closely held firm (Nordstrom family members own more than 25% of the Company).

- **James O'Neal (45)** – Executive V.P., President – Nordstrom Product Group. Between December 31st and January 7th, O'Neal sold 24,850 shares between the prices of $34.18 and $34.88. Of the total shares sold, 7,570 shares were sold indirectly for his wife, who was hired by the Company in 2003. This happens to have been O'Neal's first sale of substance in the past five years, as he had sold 944 shares (374 of which were for his wife) back in October 2003. After this sale, O'Neal still holds over 100,000 shares of common stock and exercisable options.

- **Peter Nordstrom (41)** – Executive V.P., President, Full-line Group. Peter Nordstrom sold 31,666 shares on December 12th at $34.04 per share. The sale might appear trivial for any member of the Nordstrom family considering their sizeable positions; however, this doesn't appear to be an average transaction. Nordstrom exercised six different option series (expiration dates: 5/04, 11/04, 5/05, 11/05, 11/06, 2/11), only one of which was set to expire in the near future. Not only was this the first time that he exercised this many options series and sold the underlying shares, but he also had only sold 13,586 shares combined since 1999.

- **Delena Sunday (43)** – Executive V.P., Human Resources and Diversity Affairs. O'Neal wasn't the only exec clearing out his options holdings, as Sunday exercised seven series herself (expiration dates: 5/04, 11/04, 11/05, 5/07, 11/06, 2/10, 2/11), only one of which was set to expire in the upcoming six months. Sunday, a filer since September 2000, sold the 12,932 shares she acquired on November 24th and December 10th at prices between $33.70 and $34.34 per share. Also like O'Neal, Sunday had not surfaced with any transactions until October, where she sold 4,880 shares at $28.25.

- **David Mackie (age not disclosed)** – V.P., Secretary. Mackie exercised four series of options (expiration dates: 5/04, 11/04, 5/05, 11/05) and sold 12,760 shares on December 12th at roughly $33 per share. Like his peers, Mackie has been an infrequent seller since filing in 2002. His only prior transaction was a 3,552-share sale in October 2003 at roughly $25.85.

<u>Mandalay Resort Group (NYSE: MBG)</u>

Over the past 52 weeks, shares of casino operator Mandalay Resort Group have appreciated over 90% thanks in large part to a surging Las Vegas travel market. The company was so pleased with their cash flow in the third quarter that they increased their dividend. Surprisingly, a few Company insiders don't appear to be willing to hang on to their stock long enough to reap the rewards. From December 10th through January 13th, four insiders sold 663,232 shares between $43.10 and $47.22. The selling at Mandalay has actually been more unexplainable than the norm. The Company's Chairman, CEO, COO as well as the Vice Chairman each wiped out their entire 7-million share positions since June, which the Company has declined to comment on. In addition, two other board members (one of which is the chairperson of the audit committee) wiped out substantial amounts of their holdings with atypical sales.

A few points of interest: During fiscal 2003, Chairman, CEO, COO Ensign was awarded a discretionary bonus in order to align his compensation to those at other gaming firms. This bonus, which was $750,000, would be a little easier to swallow if the Company had hired outside consultants to examine the conditions, however, the Company reported that it was based on a "subjective evaluation of his responsibilities and performance during fiscal 2003." Also troubling about Ensign's bonus was the board decided not to award stock options to any of its executives during fiscal 2003. They based this decision on the outstanding options the executive team already holds. However, Ensign is the only executive to consult the compensation committee regarding executive compensation, and also the only exec to receive a discretionary bonus.

- **Michael Ensign (65)** – Chairman, CEO and COO. Ensign, the Company's Chief Executive, sold nearly 1.5 million shares back in March 2002. Following that trade, he had been relatively quiet until resurfacing in June 2003, when he began selling at roughly $33, and to our surprise hasn't stopped. Most recently, Ensign sold 386,432 shares on January 12th and January 13th between $45.75 and $47.22. While this trade might not appear that remarkable, his overall sales since June definitely are. The Company reported Ensign to have had just over 7 million shares of stock and options (both exercisable and unexercisable) in May. His sales since then have wiped out his entire position, which amounted to an 11.5% stake in the Company. Ensign no longer has any common stock or exercisable options remaining. In published reports, the Company has denied that either Ensign or Richardson is planning to leave the firm.

- **William Richardson (56)** – Vice Chairman. As if seeing one exec cash out of his entire position wasn't enough, Richardson followed Ensign with a sell-off of his own. In an almost identical pattern to his peer, Richardson sold his entire position of 7,066,666 shares between June 2002 and January. Most recently, he sold his last 193,466 shares on January 12th and January 13th between the prices of $45.70 and $46.81. At first look, it might seem as if these two insiders indirectly hold the same shares jointly, however, they each held over 7 million shares apiece in May 2003.

- **Michael McKee (57)** – Director. McKee, a board member since 1996 and chairperson of the Audit Committee, sold 65,000 shares on January 12th at $46.85 to $47.08. The transaction marks his first sale in over two years, and to do so he exercised five series of non-expiring options (expiration dates: 6/07, 6/08, 2/09, 6/09, 6/10) and sold the underlying shares. The sale wiped out 75% of his actionable position (common stock plus exercisable options). This sale is a reversal of McKee's recent trading pattern. He also sits on the board of Realty Income Corp. (NYSE: O), where he last acquired 10,000 shares in October 2003 from an option exercise.

- **Rose McKinney-James (51)** – Director. On December 10th, McKinney-James, chairperson of the Compliance Review board, sold 18,334 shares at just over $43 per share. Like McKee, she cleared out her exercisable options by exercising three non-expiring series (expiration dates: 6/10, 6/11, 6/12). Not only did she cash out of her options, but wiped out her entire actionable position. Moreover, this was McKinney-James' first sale since joining the board in 1999.

<u>Xilinx, Inc. (NASDAQ: XLNX)</u>

Xilinx stock has rebounded nicely from the mid-teens lows in late-2002 all the way back to $40. And management apparently believes that the success should continue, as the CFO optimistically predicted revenue growth for the fiscal year to be between 26% and 32%. Yet, the same CFO and a handful of his peers displayed a different sentiment with their stock trades. In all, from November 3rd through February 5th five insiders sold 941,618 shares between the prices of $32.28 and $43.55. Not only was January the heaviest selling volume dating back to 1999, but November through January was the heaviest three-month period of selling going back as well. Even more important, insiders made the most sale transactions since mid-2000, which was exactly at the stock's peak before it began trending down. These insiders have displayed a knack for timing the stock, especially the CFO who acquired shares when the stock bottomed in July and August 2002. One exec that is reportedly not leaving the Company cleared out twelve non-expiring option series in the process of selling off 70% of his actionable position (common stock plus exercisable options).

- **Willem Roelandts (58)** – Chairman, President, CEO. Between November 7th and February 2nd, Roelandts sold 400,000 shares between $32.28 and $43.55. While he has proven to be a frequent seller over the years, his recent sales have picked up dramatically. From 1999 through 2002, he sold a total of 170,000 shares. Including the recent transactions, he sold over 1.4 million shares in 2003.

- **Sandeep Vij (age not disclosed)** – VP, Worldwide Marketing. A telling red flag is when a consistent seller makes a trade that stands out from his historical behavior. From 1999 through much of last year, Sandeep Vij sold just over 50,000 shares per year. From November 13th through January 22nd, he sold 104,000 shares from $34.75 to $37.75. This heavy selling is unusual considering he sold fewer shares at higher prices as recently as nine months ago.

- **Kris Chellam (age not disclosed)** – Senior V.P. Finance, CFO. As was the case with Vij, Chellam recently strayed from what appeared to be a rather consistent selling pattern since joining the Company in 1998. From 1999 through mid-2003, he had sold exactly 20,000 shares per year with the exception of 2002, where he didn't surface all year with any transactions. Recently though, Chellam sold 65,000 shares between November 13th and February 5th as the stock climbed from $35.06 to $40.35. Prior to his last sale in August 2002 (20,000 shares), he had acquired 10,000 shares from an option exercise in July and another 10,000 shares again in October as the stock bottomed out. His timing and recent reversal of sentiment is of importance.

- **Steven Haynes (age not disclosed)** – VP, Worldwide Sales. Between 1999 and 2001, Haynes' sales were quite heavy as the stock traded between $40 and $80. Since the stock's dramatic dip in 2002, he had been quiet, selling a mere 15,000 shares, followed by a total of 17,000 shares sold as the stock rallied throughout 2003. Now that the stock has climbed back, Haynes sold 368,618 shares from December 23rd through January 22nd at $38.49 to $43.46. Most curious about his sales is that he cleared out twelve non-expiring option series (6/05, 5/06, 5/07, 4/08, 11/08, 4/09, 4/11, 9/17/11, 9/28/11, 10/15/11, 10/31/11, 4/13). These sales wiped out over 70% of his actionable position.

- **John L. Doyle (71)** – Director. Doyle, chairman of the audit committee, surfaced for the first time since January 2001 when he sold 15,000 shares on November 21st at $35.90 and again on January 30th, selling 14,000 shares at $41.64. Doyle had sold an average of 55,000 shares per year between 1999 and 2001. Even though he is 71 years old, his shares shouldn't be discounted as he is up for reelection to serve another term on the board.