THE WALL STREET JOURNAL.

http://www.wsj.com/articles/SB10001424052702303376904579135782687348574

MARKETS

Executives Hit Sweet Spot on Stock Sales

Corporate Executives Give Favorable Stock Guidance, Sell Shares, Then Disclose Bad News

By **SUSAN PULLIAM** and **ROB BARRY**

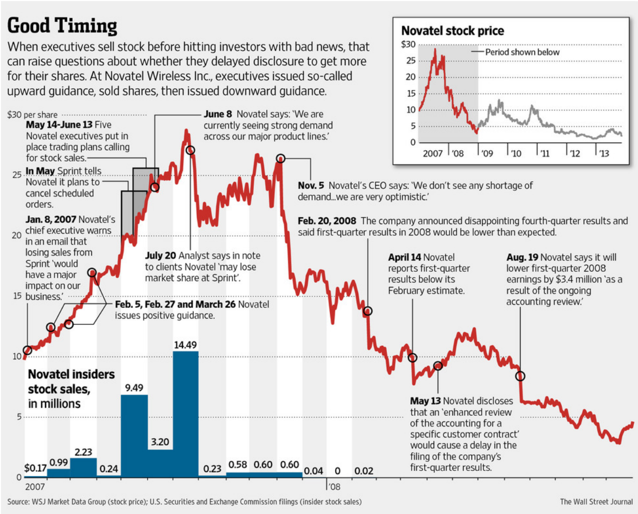
Nov. 13, 2013 11:00 p.m. ET

When George Weinert, then chief executive of Novatel Wireless Inc., found out one of the company's largest customers planned to cancel scheduled orders, he warned managers in an email that losing the sales "would have a major impact on our business."

His email, written in January 2007, has surfaced in a lawsuit because of what happened next. Novatel didn't inform shareholders about the bad news. In a news release that May, the San Diego-based maker of telecommunications equipment said its quarterly earnings would exceed expectations, citing "strong sales" across the board. That June and July, Mr. Weinert sold $3.3 million of company stock.

When an analyst later disclosed the problem with the big customer, Sprint Corp., the stock slumped. Months after that, Novatel disclosed that waning customer demand would hurt sales.

Ordinary investors often are dismayed when senior executives sell their own stock before hitting the market with bad news. The situation can be even stickier when corporate insiders declare their company's outlook bright, sell shares, then disclose bad



Source: WSJ Market Data Group (stock price); U.S. Securities and Exchange Commission filings (insider stock sales)

news. Such one-two punches sometimes give rise to accusations that executives boosted the stock price—and withheld unfavorable news—to increase personal profits.

A Wall Street Journal examination of earnings-guidance data compiled by research firm Earnings Whispers identified 1,468 cases since 2005 in which public companies issued so-called upward guidance—saying results looked better than expected—then followed with downward guidance within 120 days. Securities and Exchange Commission filings show that in 755 of those cases, corporate insiders sold in the window between the up and down, an advantageous time to sell.

There is no way to tell from the data whether sellers knew about impending bad news before selling, and it is perfectly permissible for insiders to sell stock after upward guidance. In the 1,468 guidance-change cases, about 9% more insiders sold in the favorable window than in the year-earlier period. Executives often buy and sell stock around the same time each year.

Among the 2,389 corporate officers who sold between swings in guidance, about 74% would have collected less money had they waited to sell until after guidance was lowered, according to the Journal analysis. The stocks declined in value by an average of 10.8% between the sales and the day after the guidance was lowered.

Novatel shareholders claim the executive selling there was fraudulent. Their lawsuit, slated for trial early next year in federal court in San Diego, alleges that Mr. Weinert and other top executives withheld bad news from shareholders, allowing them to sell their

EARLIER: DARK MARKETS

The Journal is investigating a new age of murkiness in the financial markets and the challenges that creates for investors.

- Directors Take Shelter in Trading Plans (/articles/SB1000142412788732369640457830007304695908 6)
- Big Lots Chief Probed by SEC (/articles/SB10001424127887323401904578159672827941536)
- Executives' Good Luck in Trading Own Stock (/articles/SB10000872396390444100404577641463717344178)
- For Superfast Stock Traders, a Way to Jump Ahead in Line (/articles/SB10000872396390443989204577599243693561670)
- Investor Hazard: Zombie Funds (/articles/SB10001424052702304444604577339843949806370)
- Traders Navigate a Murky New World (/articles/SB10001424052970203889904577199114267593518)
- Source's Cover Blown By SEC (/articles/SB10001424052702303459004577363683833934726)

shares at higher prices. Novatel has responded in court documents that any lost Sprint business was immaterial and didn't trigger the stock sales. A Novatel spokeswoman says Mr. Weinert and the other executives had preset trading plans that "met all legal requirements."

Some market experts say any trading by senior executives around the time of good or bad news is potentially problematic. "There is the timing and the content of disclosures by companies, and those two can be played with because you know you have a sale coming," says Stanley Veliotis, a professor of accounting at Fordham University, who has studied trading by insiders after positive earnings developments.

On Jan. 14, Ixia, a Calabasas, Calif., company that makes Internet testing equipment, said revenue for last year's fourth quarter would exceed earlier guidance. It cited better-than-expected performance at two recently purchased companies.

As the stock rose, insiders began selling. Over the next two months, eight senior executives, including then CEO Victor Alston and the chairman and general counsel, sold a total of more than $18.4 million of stock at an average price of $20.96 a share. The sales exceeded what the firm's executives had sold during the previous seven years.

Then came a surprise. On April 11, Ixia lowered guidance for the first quarter, citing revenue-recognition problems. Revenues for 2010, 2011 and the first three quarters of 2012 were restated. On April 30, the firm said earnings for the second quarter would likely miss analyst expectations. By May 1, its stock had fallen to $14.51. If the insiders had sold at that point rather than when they did earlier in the year, they would have collected $5.7 million less, a Journal analysis determined.

It isn't clear when senior executives learned about the problems. An Ixia spokesperson and the insiders declined to comment on the trading.

On Oct. 24, Ixia said in a news release that Mr. Alston had resigned after the company determined he had misstated his age, academic credentials and employment history. Its chairman and founder, Errol Ginsberg, has taken over that position.

Federal regulators last year accused the top executive of another company of hiding bad news from shareholders while he unloaded stock. In a civil suit filed in a California federal court in July 2012, the Securities and Exchange Commission accused the founder and former chairman of STEC Inc., a Santa Ana, Calif., maker of computer storage devices, of providing false or misleading information to shareholders.

STEC shares shot up about 800% between January and August of 2009 after the company disclosed good news: a new agreement to supply equipment to EMC Corp. The lawsuit alleges that founder, chairman and CEO Manouchehr Moshayedi learned that July that EMC was planning to order less the following quarter than STEC had hoped.

According to the SEC, he complained to fellow executives in a July 26 email that STEC was "now going to miss the top line and EPS [earnings per share] estimate numbers for Q-3." The following day, an EMC manager wrote to his boss that Mr. Moshayedi "wants us to make a deal in advance of their earnings call next week so he can guide appropriately," the lawsuit said.

The SEC alleges that Mr. Moshayedi persuaded EMC to place an order it didn't need, in exchange for a deep discount. The suit said that in a July 28 email, Mr. Moshayedi wrote to an EMC official: "Just tell me what you need, I knew asking you guys for a favor would go nowhere so I am now back at paying for favors. What is your price for keeping inventory for a week or two?"

The next day, Mr. Moshayedi and an EMC official "agreed to a secret deal to have EMC commit to purchase $55 million of STEC product in the third quarter, even though it only projected needing about $33-34 million," according to the complaint.

Days later, on Aug. 3, STEC kept its third-quarter earnings guidance unchanged. Mr. Moshayedi sold a chunk of his STEC shares through a secondary stock offering that same day, for $88 million, according to his lawyer.

Three months later, in a Nov. 3 conference call with analysts, Mr. Moshayedi disclosed that the EMC contract had been a "one-off" deal. STEC's stock dropped 38.9% by the end of the next day.

The lawsuit accuses Mr. Moshayedi, who stepped down as chairman and CEO in September 2012, of insider trading and fraud.

A lawyer for Mr. Moshayedi called the SEC's claims baseless and said the secondary offering was planned "long before" the SEC says Mr. Moshayedi learned the bad news. The lawyer said Mr. Moshayedi, based on past experience with EMC, had expected the company to boost its order.

The SEC declined to comment, as did EMC, which wasn't accused of wrongdoing. STEC has been acquired by Western Digital Corp.

At Aruba Networks Inc., a Sunnyvale, Calif., wireless-networking company, executives early this year tried to calm investors concerned about a competitive threat. Aruba-made equipment was for sale at an auction in 2011. *BLOOMBERG NEWS*

At Aruba Networks Inc., a Sunnyvale, Calif., wireless-networking company, executives early this year tried to calm investors concerned about a competitive threat. In a Feb. 21 conference call, investors pressed management on whether competition from rival Cisco Systems Inc. would hurt Aruba's results. Chief Executive Officer Dominic Orr responded: "It seems like they seem to have lost the interest to compete with us head on."

Less than three months later, on May 7, Aruba lowered its revenue guidance, saying competition from Cisco was partly responsible for a deteriorating outlook for the quarter that would end in June. The stock dropped 23% that day.

Top executives at Aruba sold $8 million of stock during the three months before lowering guidance. On May 1, six days before the guidance adjustment, Mr. Orr, the CEO, sold $168,000 of stock. If he had waited until right after the announcement, he would have collected $39,000 less, the Journal calculated.

To avoid accusations of insider trading, executives can create preset trading plans that call for automatic sales of stock, as long as the plans don't use inside information as a basis for the trades. An Aruba spokesman said Mr. Orr's sales were made under preset plans, and that the sale in May was consistent with his historical pattern of sales. He declined to elaborate.

Securities filings show that Mr. Orr sold more shares during the first four months of this year than he did all of last year. The spokesman said Mr. Orr continued to sell even after the stock fell in May, and that the other executive also sold under present plans.

Wall Street analysts were skeptical about the timing of Aruba's guidance shift. In a May 16 conference call, Ehud Gelblum, then a Morgan Stanley analyst, asked whether the heightened competition "really happened in the last four, five weeks?" according to a transcript.

Mr. Orr responded that the "uniformity and ubiquity" of the competition from Cisco was "rather dramatic." Mr. Orr didn't respond to requests for comment, and Mr. Gelblum declined to comment.

In May, shareholders filed suit in a California federal court, alleging that Aruba "purposefully downplayed the intense competition it was experiencing from Cisco." Aruba denies wrongdoing.

In the case of Novatel, the telecom-equipment maker that lost business from Sprint, the first sign of trouble came in January 2007 when Sprint notified the company it would cancel some planned orders for Novatel's big-selling product, a computer modem, according to court documents. Novatel had told investors that product was "a primary growth driver," according to the documents.

That May, when Sprint followed through on its warning, Mr. Weinert, then the acting CEO, sent an email to senior managers who now are defendants in the lawsuit, including current CEO Peter Leparulo. "We cannot loose [sic] all of our SPRINT business," his email said. "I made this clear in January didn't I??????"

The following month, on June 8, Mr. Weinert said in a news release: "We are currently seeing strong demand across our major product lines."

Between that May 14 and June 13, Messrs. Weinert and four other executives put in place new or amended preset trading plans calling for automatic sales. Under his plan, Mr. Weinert sold $3 million of his stock.

In court documents, Novatel and the other defendants have argued that the information about any lost Sprint business wasn't material, that insiders didn't believe it would affect the company's financial performance, and that sales by insiders weren't spurred by the Sprint development.

A Novatel spokeswoman says Sprint never canceled any current orders and that its customer "transitioned" from one product to another in the fall of 2007. Mr. Weinert didn't return calls for comment.

That July 20, analyst Anthony J. Stoss of Minneapolis's Craig-Hallum Capital Group published a note to clients, noting that a "rumor" was circulating that Novatel "may lose market share at Sprint," which he said accounted for 38% of Novatel's business at the time. Novatel stock closed down 5% that day. Mr. Stoss declined to comment.

Novatel raised its earnings guidance two more times in 2007 and said its outlook was bright. No mention was made of the change in Sprint orders. On an earnings call that Aug. 6, Mr. Weinert said: "We had an exceptionally strong first half of the year with Sprint."

That Nov. 5, Mr. Weinert said on an earnings conference call: "We don't see any shortage of demand...we are very optimistic."

Bad news arrived for investors about three months later, on Feb. 20, 2008, when the company announced disappointing fourth-quarter results and said first-quarter results in 2008 would be lower than expected, citing a shift in the market.

The next trading day, Novatel's stock declined by 22.9%.

Less than two months after that, on April 14, Novatel reported results that were $19 million lower than forecast, attributing the downturn to even weaker demand. The stock was hit hard, leaving it more than $6 below the $14-a-share level in early February.

That May 13, the company disclosed to investors that an "enhanced review of the accounting for a specific customer contract" would cause a delay in filing first-quarter results.

That August, the company said an internal accounting review would result in the lowering of first-quarter 2008 results by $3.4 million. It later said it had failed to provide "adequate training" regarding its "revenue recognition cutoff policies and procedures to ensure that revenues...were recognized in the proper period."

Jury selection in the case, which the judge has certified as a class action, is expected in January, according to lawyers who are involved.

Novatel's shares dropped to around $3.50 by November 2008 and haven't risen above $11 since 2011. Novatel stock closed at $2.14 in Nasdaq trading Wednesday.

Corrections & Amplifications
Craig-Hallum Capital Group analyst Anthony J. Stoss, in a July 20, 2007 note to clients, noted that a "rumor" was circulating that Novatel Wireless Inc. "may lose market share at Sprint," but he concluded that there would be no loss. An earlier version of this article incorrectly said Mr. Stoss believed Novatel might lose market share at Sprint.

Write to Susan Pulliam at susan.pulliam@wsj.com and Rob Barry at rob.barry@wsj.com