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Posted 7/31/2002

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Company Focus

Tech insiders are buying; should you follow?

By some measures, insider trading patterns at technology companies are more bullish than they've been in decades. Here's a look at the opportunities -- and pitfalls.

By Michael Brush

Like Pennsylvania coal miners stuck deep in a hole in the ground, some investors who still own beaten-up technology shares are noticing the distant rumble of help on the way.

It's the sound of the sector's high-level insiders turning bullish.

As their stocks were pummeled during the past several weeks, senior managers at technology companies stopped selling -- and many began plowing their own money into shares of their companies. The reversal has moved some insider sentiment measures off the charts.

"At no time in our history of monitoring insider activity for 32 years have we seen a more bullish attitude projected from insiders in the technology sector," says Michael Painchaud, who tracks insiders for money managers at his Seattle firm, Market Profile Theorems.

With their front-row seats, insiders often do a great job of getting in and out of their stocks at the right time, even if they can be a little early. In the Nasdaq bubble era of 1998-2000, for example, insiders were unloading shares like crazy. "During that time, investors were buying expensive stock from insiders," says Painchaud. "But today, on average, investors are selling stock to insiders."

Insider winners and losers

Insider buying has been the strongest among pummeled wireless companies, such as **Nextel Communications** (NXTL, news, msgs), **Western Wireless** (WWCA, news, msgs) and **AirGate PCS** (PCSA, news, msgs). It has also been strong among the beaten-up software companies, such as **MatrixOne** (MONE, news, msgs), **Legato Systems** (LGTO, news, msgs) and **Stellent** (STEL, news, msgs).

However, heavy insider selling still paints a bleak outlook for many of the former high fliers with a popular following. Among those ranking poorly: **QLogic** (QLGC, news, msgs), **Emulex** (ELX, news, msgs), **Apple Computer** (AAPL, news, msgs), **PeopleSoft** (PSFT, news, msgs), **Network Associates** (NET, news, msgs) and **Foundry Networks** (FDRY, news, msgs). The same goes for the semiconductor group. Insiders have been actively dumping shares at names such as **Cypress Semiconductor** (CY, news, msgs),

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Atmel (ATML, news, msgs) and **Richardson Electronics** (RELL, news, msgs), for example.

It could be a head fake

Indeed, there's no shortage of reasons to be negative about technology companies. Valuations look rich. And there are still too many tech companies, points out Merrill Lynch strategist Rich Bernstein. He'll continue to tell clients to underweight the group until more consolidation helps survivors become more profitable. And even though tech mutual funds lost $2.6 billion in the second quarter, there's probably more selling ahead. "Although it was beginning to feel like panic, we aren't convinced we've seen the bottom yet," he says.

Still, it's hard to ignore that signal coming from the insiders. "The last time we had anything close to this was late in 2001, just before we saw the huge rally in technology shares of 30% to 40%," says Painchaud. Insider analysts at Argus Research have noticed the same thing. Their trailing eight-week buy/sell ratio the Nasdaq recently moved into bullish territory. "I think we are at or near a bottom, and we are reloading our portfolios," says David Coleman, editor of Argus' Vickers Weekly Insider Report.

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Beaten-up wireless and telecom shares

Given the ongoing price wars for new cell-phone customers as growth slows (not to mention the high debt levels and overcapacity in the group), it's hard to imagine why anyone would buy shares in wireless companies right now. But that's exactly what many insiders have been doing.

Take Nextel, for example, the fifth-largest wireless company. Its handsets are popular among businesses in part because of a "direct connect" feature that allows users to press a button and talk without dialing. Throughout the year, insider buying at the company kept going up as the stock price drifted down. "You have to be impressed with that," says Coleman. Indeed, Nextel shares recently jumped when the company turned in another good quarter.

But Robert Rock, who analyzes telecom sector debt at John Hancock Advisors, warns that there are a lot of risks for anyone who piles into Nextel shares along with the insiders. "They have been buying back bonds, but they still have too much debt," says Rock. While the company has enough cash to last for two years, one way it's preserving it is by cutting back on capital spending. "Even though they have a niche product, there are questions about how big that market is. And if they don't get enough new customers, or capital spending goes through the roof, they could have problems. It is a high-wire act."

Insiders have also been actively buying at AirGate PCS, an affiliate of **Sprint PCS Group** (PCS, news, msgs) serving the Carolinas and some Midwestern states. “We feel very positive about our short-term prospects and our long-term business model,” says Chief Financial Officer Alan Catherall, who has been buying the company’s shares recently. One catalyst lies just around the corner, says the CFO. Later this summer Sprint will introduce wireless phones with faster connections. Subscribers will be able to attach the handsets to computers so they act as wireless modems in airports and hotels. “Sprint will launch the service with a lot of advertising and promotion, so it will stimulate new says Catherall.

Other telecom companies whose insiders have been buying include Western Wireless, which offers cell-phone service in rural areas in the West, and **Crown Castle International** (CCI, news, msgs), which owns transmission towers used by wireless companies. Analysts at Vickers Insider Weekly Report also recently turned positive on **Broadwing** (BRW, news, msgs), which offers phone service in the Cincinnati area, as well as business-to-business high-speed data services.

Again, though, investors need to tread cautiously if they buy shares in any of these companies. “It’s always nice to see that management believes in the company,” says Alex Peters, who manages the **Franklin Global Communications fund** (FRGUX). “But most of the debt here is trading at distressed levels, and the issue is whether their balance sheets are strong enough for them to survive. If not, the stock is going to get wiped out.”

Western Wireless is facing challenges from bigger cell-phone companies who are avoiding the company’s high fees by setting up their own networks in its territory, says Rock, the telecom debt analyst at John Hancock. Upcoming consolidation in the wireless group, meanwhile, could hurt Crown Castle. “I don’t care what anyone says, there is going to be less need for towers,” says Rock. “You are already seeing a lot of network sharing as a prelude to mergers. The question is whether Crown Castle can cut capital spending quick enough.” And like many observers, Rock is not convinced that faster wireless connections will really draw that many new customers to wireless service.

Battered software companies

Many software companies also trade down at levels where insiders think they are good values. One example is Legato Systems, a storage-software company. “Even though the tech sector is taking a time out, we are in a fairly dynamic space,” says Chief Executive Officer David Wright, who recently took a small position in his company’s stock. He expects demand to pick up partly because companies will want to have better backup records following high-profile document destruction scandals. CFO Andy Brown, another recent buyer, thinks his company’s new strategy of working with partners such as **EMC Corp.** (EMC, news, msgs), **IBM** (IBM, news, msgs) and **Hewlett-**

Packard (HPQ, news, msgs) will pay off. “We are working with the gorillas now, instead of against them.” At least Legato’s books are less likely to hold bad surprises. It already had its accounting scandal a few years ago.

MatrixOne is another software company where insider buying looks interesting, says George Muzea of Muzea Insider Consulting. Donald Hunt, a MatrixOne vice president in charge of worldwide sales, recently plunked down almost $300,000 to buy shares of his company at $5.87. “That’s probably a lot of money for him, so you have to be impressed with that,” says Muzea. “He is in a good position to know what’s going on because he is in sales.” MatrixOne offers software that helps companies and business units share information. Sell-side analysts believe several contracts are in the pipeline at aerospace and defense companies. They also think partnerships with IBM and Accenture are paying off.

Other software companies with decent insider buying include **MSC.Software** (MNS, news, msgs), which makes simulation software for product design, and e-business software companies such as **Akamai Technologies** (AKAM, news, msgs) and Stellent.

Software companies with significant insider selling recently include PeopleSoft, **Paychex** (PAYX, news, msgs), **Internet Security Systems** (ISSX, news, msgs), **webMethods** (WEBM, news, msgs), Networks Associates, **Tibco Software** (TIBX, news, msgs) and **Inktomi** (INKT, news, msgs).

Some Pitfalls

Watch out for “false positives” if you try to interpret insider data on your own. Recent multi-million dollar insider buys at **Juniper Networks** (JNPR, news, msgs) and **NetScreen Technologies** (NSCN, news, msgs), for example, look interesting until you dig into the details. The purchases were really made by investment funds that reported them as insider buys because the funds have representatives on the boards of Juniper and NetScreen.

Professional insider analysts also take away points for things like first-time purchases, or those made by directors. And they look at the insider’s track record. Muzea, for example, doesn’t think much of recent insider purchases at Western Wireless by CEO John Stanton and director Jonathan Nelson. “If you want to go broke, follow those guys. They’ll take you right over a cliff. They are not good buyers.”

Muzea also questions the enthusiasm for tech among other insider analysts. “I don’t see what they are seeing,” he says. “It is true the selling has dried up. But they aren’t buying much, either. So it doesn’t mean the stocks can turn around and run off. We are waiting for more buying as a sign that there is value. We have a neutral on tech right now."

Richard Cuneo of Vickers agrees that Muzea may have a point. "Stocks might just have gotten so low that the desire to sell former $125 stocks at $2 just isn't there." Market Profile Theorems' Painchaud holds his ground with his bullish view of insider activity in tech. "There is as much information content in selling less as there is in buying more. If you try to short that sector right now the odds are against you."

As of the date of publication, Michael Brush owned shares in Matrix One.

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