



August 27, 2003

State Auditor Janice Mueller
Legislative Audit Bureau
131 West Wilson St.
Madison, WI 53703

Dear Ms. Mueller:

This is a follow-up to our letter of March 10, 2003, in which we raised concerns regarding the State of Wisconsin Investment Board's holdings in the SureBeam Corp.

In our earlier letter, we referenced the fact that SWIB is by far the largest stockholder in SureBeam, owning 11 million shares – one-sixth of the company's total common stock. We stated that SureBeam had lost \$113 million over the previous six years, with \$52 million in losses coming since SWIB began purchasing stock in the company in Oct. 2001.

The company's financial condition has since worsened significantly.

During the past week:

- SureBeam was put on notice by Nasdaq that it could be delisted on Sept. 2 because the company failed to meet the deadline to file its quarterly report for the second quarter.
- A.G. Edwards & Sons recommended that investors sell shares of SureBeam, and stated that the failure to meet the quarterly report deadline "compounds credibility issues for management."
- SureBeam fired Deloitte & Touche after the firm questioned the company's basic method of recognizing revenue, and questioned the accounting related to two of SureBeam's most significant transactions. This was second time SureBeam fired an accounting firm in the past three months.
- Merrill Lynch stated it was suspending coverage of the company because the firm "can no longer appropriately analyze the stock from the financial perspective."

At close of business yesterday, SureBeam's stock price was \$1.54 – less than one-sixth of the company's IPO price in March 2001.

SWIB's holdings in SureBeam are now worth approximately \$17 million – 45 percent lower than the \$31 million that SWIB paid for the shares.

Due to SureBeam's consistent pattern of multi-million-dollar losses and Wall Street's pessimism regarding the company, we would like to re-emphasize our concerns that SWIB may not be acting in the best interests of government employees and Wisconsin residents in general.

In addition, we would like to bring to your attention apparent irregularities in the manner in which SWIB has purchased SureBeam stock.

Oct. 11, 2001, SWIB made its first purchase of SureBeam stock – 140,000 shares. SWIB made this purchase despite several negative assessments of SureBeam released several days earlier. These assessments, which we obtained via a public records request, were contained in SWIB's internal files:

- On Oct. 1, Gerard Klauer Mattison & Co. stated: "We are reducing [revenue] estimates for 2002 due to lack of new customer announcements and potential customer Tyson's merger with IBP... [H]aving heard fewer meaningful customer announcements and positive signals from management than in past quarters, we feel the pace of progress in signing up new customers and gaining traction with existing customers, notably Cargill, may be slightly slower than our previous expectations."
- On Oct. 2, Merrill Lynch stated: "The events of the past two weeks have caused some concerns in our minds over SureBeam's business plan." The firm cited the lack of government approval for importing irradiated fruits and vegetables, and for irradiation of processed foods.
- On Oct. 3, Credit Suisse First Boston stated: "[We are] downgrading to 'hold' from 'buy,' owing to the slow rate of adoption by the meat industry of SureBeam's technology... We are now cutting our penetration estimates in terms of total in-line processing volumes for fiscal 2002... We see near-term cash flows constrained."
- On Oct. 4, A.G. Edwards & Sons stated: "[We] lower our rating... Regulatory delays [are] having a negative impact on the potential 2002 service revenue assumptions... There has been a lack of public progress on the domestic processing side of SureBeam's business plan... [L]ong-term price objectives need to be significantly discounted until management details a predictable business plan and shows meaningful progress in developing a domestic service business."

SureBeam's stock price fell immediately following these assessments, from \$7.18 on Oct. 1 to \$4.80 on Oct. 8. Yet, SWIB made its initial stock purchase three days later, on Oct. 11.

Curiously, six days after SWIB's stock purchase, on Oct. 17, SureBeam announced plans to spin-off from its parent company, Titan Corp., and become an independent company. Under the plan, SureBeam received \$8 million in cash from Titan, a credit line of \$50 million from Titan, and the exchange of \$75 million in debt with Titan for SureBeam stock. SureBeam's stock price rose from \$8.81 to \$11.25 that day, and reached \$15.41 within a week.

These events beg the question: Did SWIB officials have advance notice of this highly favorable arrangement – and, if so, how? The spin-off was so favorable, in fact, that SureBeam's stock price quickly rebounded following its Oct. 17 announcement that it lost \$7.7 million during the previous quarter.

If SWIB's internal files contain documents that may shed light on this situation, they were not provided to us.

Similar events the following February raise similar questions.

On Feb 11, 2002, SureBeam announced losses of \$16.9 million for the previous quarter, and total losses of \$74.4 million for 2001. Over the next four days, SureBeam's stock price fell from \$9.82 to \$5.70.

Despite this unfavorable news, SWIB on Feb. 14-15 made its first SureBeam stock purchase in four months, purchasing 1,220,000 shares.

Curiously, four days after SWIB's stock purchase, on Feb 19, SureBeam announced that its \$75 million debt with Titan had been exchanged for SureBeam stock. SureBeam's stock price rose from \$5.59 on Feb. 19 to \$6.95 on Feb. 25.

Again, these events beg the question: Did SWIB officials have advance notice of this highly favorable arrangement – and, if so, how? The debt exchange was so favorable, in fact, that SureBeam's stock price remained relatively stable for the next three months.

Again, if SWIB's internal files contain documents that may shed light on this situation, they were not provided to us.

In a sudden turn of events that internal SWIB files do not explain, SWIB significantly increased its holdings of SureBeam stock over the following year as the SureBeam's performance worsened.

On April 25, 2002, SureBeam announced losses of \$9.0 million for the previous quarter. On July 29, SureBeam announced losses of \$5.1 million for the previous quarter. Nevertheless, SWIB went on to purchase approximately 3.7 million shares from Aug. 6-30; approximately 2.3 million shares from Sept. 4-30; and approximately 2.6 million shares from Oct. 2-18.

On Oct. 31, SureBeam announced losses of \$11.0 million for the previous quarter. Nevertheless, SWIB went on to purchase an additional 160,000 shares from Oct. 2002 – Feb. 2003, bringing its holdings to the current total of 11,032,554 shares.

In addition to SureBeam's consistent pattern of multi-million-dollar losses, the company has been cited for questionable accounting practices. Last year, the Center for Financial Research Analysis (CFRA) stated:

“100% of SURE's accounts are unbilled receivables... [U]nbilled receivables are clearly an inherent part of SURE's business. We also note, however, that unbilled receivables are the result of recording revenue in advance of invoicing... SURE booked 'negative revenue' during the December 2001 quarter to reverse revenue which was recorded in previous periods... [This] may lack the quality of other revenue because it is based on corporate estimates... CFRA is concerned with the Texas A&M transactions due to their two-way nature... CFRA notes that

because SURE advanced money to an entity from which it would later receive revenue, we question the quality of revenue resulting from Hawaii Pride due to the two-way nature of the transactions.”

The CFRA document, which is contained in SWIB’s files, is dated Feb. 15, 2002 – the same day that SWIB purchased 900,000 shares of SureBeam.

On Feb. 20, 2003, SureBeam announced losses of \$10.0 million for the previous quarter, and losses of \$35.1 million for 2002. On May 7, SureBeam announced losses of \$6.7 million for previous quarter.

Despite mounting unfavorable reports regarding SureBeam, SWIB has sold only a few shares as of the date of this letter.

Based on the questionable nature of SWIB’s early stock purchases, and SureBeam’s consistent pattern of multi-million-dollar losses, we urge the Legislative Audit Bureau to conduct an inquiry into SWIB’s investments in this company.

Sincerely,



Wenonah Hauter
Director, Critical Mass Energy and Environment Program

cc: Gov. Jim Doyle
Sen. Alberta Darling
Sen. Jon Erpenbach
Sen. Alan Lasee
Sen. Mary Panzer
Sen. Carol Roessler
Rep. Steven Foti
Rep. John Gard
Rep. Suzanne Jeskewitz
Rep. Dean Kaufert
Rep. James Kreuser
Patricia Lipton, Executive Director, State of Wisconsin Investment Board
Capital Times
Milwaukee Journal Sentinel
Wisconsin State Journal