3D ADVISORS

Research Notes

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Contact: Bob Gabele (954) 779-3974 or bgabele@3DAdvisors.com

Research Notes are a brief description of the insider trading, accounting, or governance behaviors that we have been investigating for possible inclusion in standard 3DA reports, and may also include other information of general interest to 3DA subscribers. The ⬆ symbol indicates that we have observed management behavior that suggests a bullish sentiment.

Companies in this Research Note

- Capital One Financial Corp. (NYSE: COF) ⬆
- Martek Biosciences Corp. (NASDAQ:MATK)
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- Wendy's International Inc. (NYSE:WEN)

3DAdvisors Research Notes

Capital One Financial Corp. (NYSE: COF) ⬆

Insider Trading: Outside director turns to open market to purchase $20 million in stock

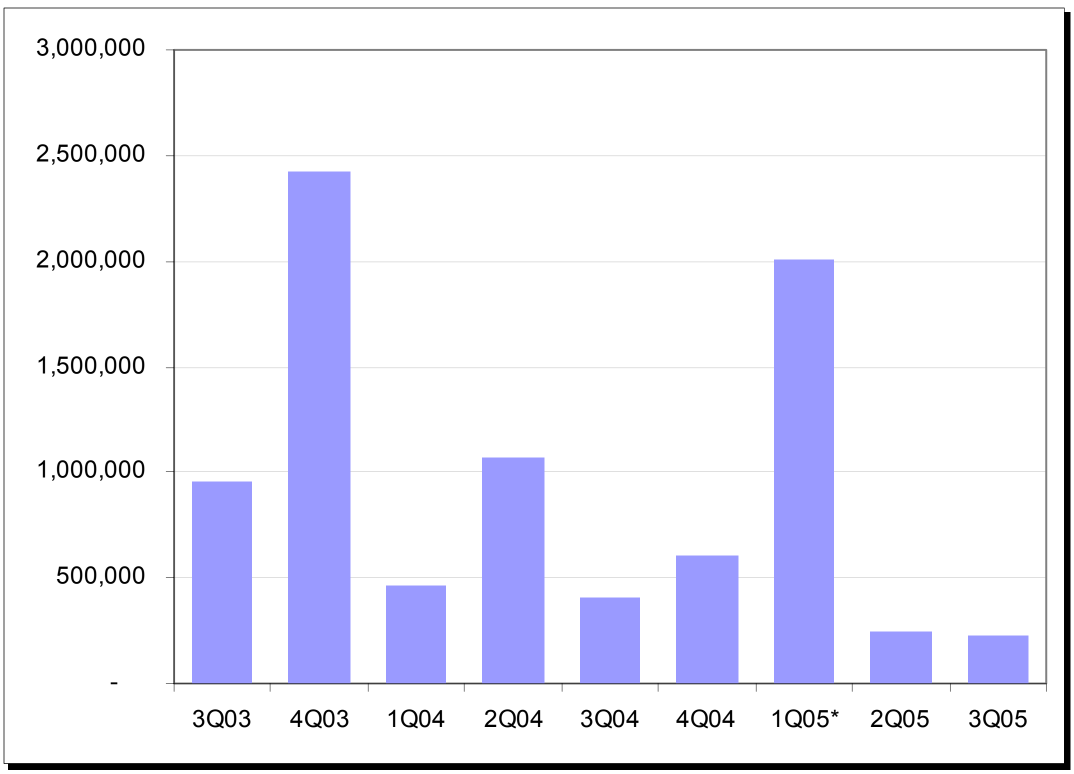
Insider Trading: Selling has decelerated since 2004 in possible sentiment reversal

Open-market buying is a rare event at Capital One Financial. The last time we saw any accumulation was July of 2002, when insiders bought following a 40% one-day slide on the news that the Company was forced to reclassify 40% of its loan portfolio as sub-prime. Since, selling has been the predominant activity from insiders. In fact, you might recall that we've covered convincing profit-taking by COF insiders in two past issues of *Insider Research Bulletins* (07/09/04 and 12/21/04), which preceded six months of volatility that shed 15% in the shares' value. The issue has since rebounded on strong second quarter earnings, and despite the uncertainty relating to the acquisition of New Orleans-based Hibernia (NYSE:HIB), one board member is placing a large bet.

Stanley Westreich (68), a board member since 1994, paid $20 million on August 11th and August 12th to acquire 240,595 shares on the open market. Not only did

Westreich reinvest nearly all of the money he's received from the sale of COF shares over the years, but increased his already sizeable ownership position by 34%. Taking into account his age and current holdings, this is an enormous investment for this outside director, and a clear sentiment reversal from the first quarter when he was a seller after having established a 10b5-1 trading plan in November 2004. This impressive move carries even more significance when one considers the fact that the average quarterly selling by Capital One insiders has progressively declined since late 2004, and the selling volume this quarter is currently at the lowest levels we've seen since early 2003.

Figure 1. Quarterly Selling Volume by Capital One Financial Insiders. Source: COF SEC Filings.



* CEO Richard Fairbank sold 1.98 million of the 2.01 million shares under a disclosed 10b5-1 trading plan

Martek Biosciences Corp. (NYSE:MATK)

Insider Trading: Three insiders, including a newly-appointed director, sell shares into lowered revenue guidance-related weakness

Accounting: Numerous concerns regarding product visibility and management's inability to provide 2006 earnings guidance

Inventory management and customer demand aren't the only issues that have plagued Martek Biosciences, the high-flying maker of food supplements and baby formula additives. For two consecutive quarters the Company has lowered its revenue guidance, leaving analysts with an abundance of concerns over earnings visibility and new market expansion that management seems presently incapable of alleviating. The frustrations certainly showed during the fiscal third quarter conference call:

<u>CEO Pete Linsert</u>

We do think that if we are fortunate, certain food products could be introduced in '06 and of course the ultimate test is how well or how much our customers are going to -- how many customers are going to buy these products?

So there are a lot of ifs and all we can say is we hope to sign up some more big players. We hope a lot of promotions going into this and that is a condition of our agreement. And that everybody is going to give this a tremendous effort.

<u>Analyst</u>

And that's why we think we're going to wait until 2007.

<u>CEO Pete Linsert</u>

Things could be, as they say, we could be fortunate and things could get [better] sooner. But at this stage I think for us to give you some suggestions, I think we want to be on the conservative side.

<u>Analyst</u>

After missing four quarters in a row I don't know when we are going to be fortunate here. You have missed four quarters in a row. If you can include the next quarter it sounds like it is going to be below the street's guidance, at least.

Immediately following the conference call, two investment firms downgraded the stock, and one even cut its recommendation two levels from “Buy” to "Underperform", slashing its target price from $60 to $33. Investors, who were already testy following the disappointing third quarter revenue guidance provided in April (the issue dropped 46% on the report date) reacted contemptuously to the news as well, trading the shares down to $38, well below the year-to-date high of $70. It is into this slide that three insiders sold 280,000 shares at an average price of $43.

Although the sales by directors **Sandra Panem** and **Richard Radmer** are notable, we are more interested in the activity of **Jerome Keller (62)**, the Company’s top sales and marketing executive who is (was) clearly in the limelight for Martek’s failure to establish new product markets. On September 6th, the day of the earnings release, it was simultaneously announced that Keller was retiring from the Company effective October 31st and was appointed to the board for a three year term. Just days later he exercised a majority of his vested options, none of which were set to expire until September 2007 at the earliest, and sold the underlying 230,000 shares, equal to 84% of his holdings, at roughly $44. As you can see from the chart below, Keller has displayed a penchant for well-timed sales, giving us the impression he doesn’t believe the issue has bottomed just yet.

Figure 2. MATK Daily Closing Price, January 4, 1999 through September 20, 2005. Black diamonds are the dates that Jerome Keller sold MATK shares. Source: Reuters and MATK SEC Filings.

MEMC Electronic Materials (NASDAQ:WFR)

Insider Trading: CEO adopts 10b5-1 trading plan and immediately begins diversification

Insider Trading: CEO's behavior contradicts the described intent of the trading plan

We are always on the lookout for insider activity that warrants preemptive disclosure from the Company. Many times, the related behavior is relatively straightforward and doesn't necessitate any 3DA commentary. However, instances such as the 10b5-1 trading plan adoption and subsequent selling by MEMC Electronic Materials' president and chief executive **Nabeel Gareeb** (40) certainly grab our attention.

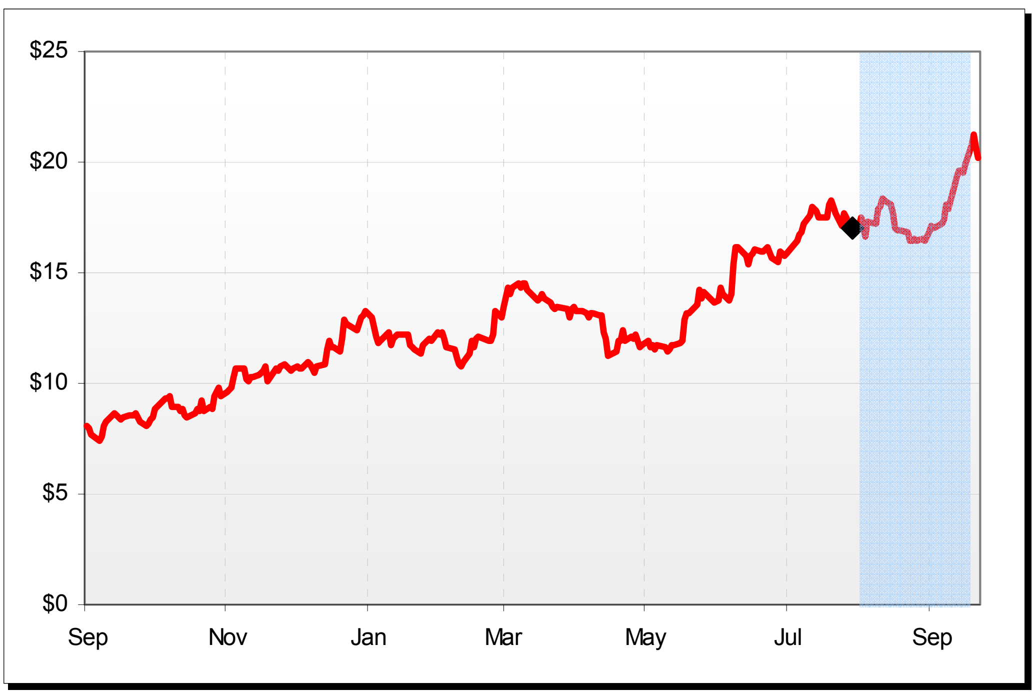
On July 29th, just two days after releasing its second quarter financials, the Company issued a press release announcing Gareeb had adopted a pre-arranged trading plan for estate planning purposes. The release fell short of disclosing how many shares Gareeb plans to sell, but it clearly implied that this diversification was designed to take place over an extended period.

> *…under his Rule 10b5-1 plan, Mr. Gareeb's options may be exercised from time to time and the underlying stock* ***sold over a five year period*** *at pre-determined price points.*

What we've seen from Mr. Gareeb so far flies in the face of all recommended practices for responsible 10b5-1 activity. First, Gareeb began selling just two business days following the adoption date. As we've highlighted in a *Special Report* (06/17/05) covering abusive trading plan behavior, it is advised insiders wait 30 to 60 days before commencing their plan sales to shield them from any suspicions they traded while in possession of material information. Gareeb's immediate sales also give the impression there is a sense of urgency to sell, which conflicts with the stated estate planning motive.

Even more significant is the fact that **Gareeb has sold 70% of his actionable holdings in the first two months of the plan's existence**. Between August 2nd and September 19th he exercised the majority of vested options from two March 2012 options series (one series is performance, one time-vested) and sold the underlying 893,100 shares at $17.50 and $20.55. His remaining holdings are comprised solely of vested options, as he has neglected to acquire any common stock during his three years with the Company.

Figure 3. WFR Daily Closing Price, September 1, 2004 through September 22, 2005. Black diamond is where Nabeel Gareeb entered in to his 10b5-1 trading plan; Blue shaded area is where he sold 893,100 shares. Source: Reuters and WFR SEC Filings.



We are not going so far as to say Gareeb shouldn't be selling at all. Since he joined the Company in April 2002 WFR's shares have climbed from $8 to $20 and he had never capitalized on the success. However, the manner in which he has done so is not only misleading to the investor community, but is in direct contrast to the intent of Rule 10b5-1.

Republic Services Inc. (NYSE: RSG)

Insider Trading: Vice Chairman sold 99% of his holdings

Insider Trading: Sales by General Counsel and President confirm VC's activity isn't an isolated event

When Republic Services reported second quarter earnings on July 28th the message was quite clear – the Company's cost control initiatives have mitigated rising fuel costs and the Company is on track to meet third quarter estimates. Management went so far as to raise its year-end earnings guidance to a range of $1.70 to $1.74 a share from a range of $1.67 to $1.72 a share. The Street didn't bite, as RSG shares have drifted lower from the highs since late July, and now we're seeing signs of management's own uncertainty.

Figure 4. RSG Daily Closing Price, February 1, 2004 through September 22, 2005. Black diamond is the date that Whit Hudson sold 795,000 shares. Source: Reuters and RSG SEC Filings.

On August 25th, Vice Chairman and Secretary **Harris "Whit" Hudson** (62) cleared out all four of his vested options series, none of which were nearing expiration (expiration dates: 2/09, 10/09, 1/12, 2/13) and monetized the 795,000 shares at $35.32, grossing $28 million. The sale, which was his first in the past ten years, **accounted for 99% of his actionable holdings** (common stock and exercisable options) and leaves him with fewer than 4,000 shares of common stock and no options that will vest downstream. Hudson, the brother-in-law of Company founder **Wayne Huizenga**, was given a sweetheart deal that extends through 2007, so we're not expecting an announcement that he's stepping down, and our contacts close to the source tell us this, more than likely, a need to raise cash is not what motivated Hudson to this move.

Additional sales by General Counsel **David Barclay** (42) and President **Michael Cordesman** help substantiate our suspicions. Barclay sold 30,000 shares on July 21st, his first sale under a 10b5-1 trading plan adopted in May 2005, and has now sold more shares under the plan (94,382) than he had sold cumulatively between 1998 and 2004, dropping 53% of his shares in the process. This activity has our attention and warrants our further research.

Sara Lee Corp. (NYSE:SLE)

Insider Trading: Insiders continue to sell at deteriorating prices while Company carries out reorganization plan

Governance: Ownership guidelines contain liberal requirements and include unvested restricted shares in related holdings calculations

With its share price regressing throughout the year, Sara Lee has undertaken a number of initiatives to increase shareholder value. It has already shed its Direct Sales division and is in the process of spinning off its Branded Apparel division in an attempt to focus on its core operations. The Company also disclosed that it has repurchased $562 million in stock since July 1st. So far, the reorganization costs have cut deeply into earnings, which are reflected in the waning share price. The issue now trades at prices nearly 30% off the year-to-date high and lags the DJ U.S. Food Products Index by 23%. Meanwhile, a few of the very managers responsible for executing the Transformation Plan have been distributing their personal shares at 12 month lows.

Since the Plan was announced in February, insiders, who were historically frequent sellers, ceased all activity until May/June. Considering the deteriorating share price and with the Street still in the process of absorbing the reorganization news, we were compelled to highlight the second quarter activity in an August 2nd issue of *Research Notes*. Since then there have been three sellers, including one that didn't participate in the earlier round, that have distributed an additional 152,159 shares at prices as low as $18.97. In all, five key executives have sold 366,813 shares since early May into fading prices from $22 to $18.97. Departing Chairman **Charles McMillan** led the group with a 90,000-share sale and has now sold 234,260 shares since June. More importantly, two division heads, **Lee Chaden** (62) and **Richard Noll** (47) dropped shares at the lowest prices we've seen.

Chaden, who heads the Brand Apparel division that will be spun off next year sold a total of 27,401 shares on August 5th and September 14th and has now distributed more shares subsequent to the Transformation announcement than he had cumulatively in the past four years he's been a registered filer. We also took note that each of his four sales since December 2004 have come at successively lower prices. Noll's first-ever sale of 61,455 shares occurred just days after the Plan was announced when the issue traded at $23.45. He then sold 34,758 shares on September 13th and September 14th at 19% lower prices ($19). The behavior of these highly-visible execs is hardly the endorsement we would expect under the circumstance.

Figure 5. SLE Daily Closing Price, September 1, 2004 through September 22, 2005. The first blue shaded area is where insider selling was covered in the *Research Notes* dated August 2nd; the second blue shaded area is where Chaden, Noll and McMillan have sold more recently. Source: Reuters and SLE SEC Filings.

On a final note, we should point out that Sara Lee goes to great lengths to promote employee stock ownership. The Compensation Committee has configured the compensation strategy to facilitate the attainment of shares to meet stock ownership guidelines that have been established for over 500 employees. What the Company fails to mention is they incorporate *unvested* restricted shares that carry two to five year vesting schedules in their holdings. Not only does this defy the intent of these guidelines, but does little to promote bona fide common stock accumulation, which is evident among this group of selling executives.

<u>Wendy's International Inc. (NYSE:WEN)</u>

Insider Trading: Insider running Tim Hortons dumps nearly entire position

Accounting: Questions about Hortons franchises when separated from Wendy's

We have become very intrigued with Wendy's much-publicized restructuring plan, forced upon current management by two large hedge fund shareholders. There can be little doubt that the unlocking of the value of Tim Hortons through an early-2006 IPO, followed by a spin-off down the road has provided the primary catalyst for sending Wendy's shares soaring on the news to a rich trailing twelve month PE ratio in excess of 100.

Call us sentimental, but the proposed deal, whereby Wendy's would be divesting itself of its fastest growing and most profitable division, leaving a tired business with declining margins and slowing same store sales, reminds us eerily of another deal from decades ago when now defunct Eastern Airlines sold off its profitable Eastern Shuttle in order to focus on its failing core business.

There can be little doubt that the key underlying variable responsible for Wendy's current trading premium is the value that is expected to be derived from the IPO and subsequent spin-off of Tim Hortons. Though estimates vary, it is quite clear that most of them are lofty and presume that a stand-alone Hortons will look as profitable as it does under the Wendy's umbrella. Should Hortons not deliver the expected value in the market place, all bets would be off.

To this, we find ourselves inexorably drawn in by the behavior of **Paul House (61)**, President of Tim Hortons and Wendy's director who has cleared out of 95% of his holdings in the rally following the restructuring announcement. House has been largely credited for the Tim Hortons successful growth picture and has been at the helm since the 1995 acquisition by Wendy's. Now, as Hortons is on the verge of becoming the key to unlocking shareholder value, House should be considered one who stands to benefit the most from the proposed deal. Yet, he has chosen to cash in instead.

Figure 6. WEN Daily Closing Price, September 1, 2004 through September 22, 2005. Black diamond is the date of the restructuring announcement that included the IPO of Hortons; Blue shaded area is where eleven insiders sold 1,181,493 shares. Source: Reuters and WEN SEC Filings.

There have been other aggressive sellers at Wendy's since the announcement as well (*Insider Research Bulletin* 08/29/05), all selling aggressively, including recently-resigned Wendy's president **Thomas Mueller** who, in addition to selling 95% of his holdings, also forfeited 41,375 restricted shares in doing so early. What gives?

As stated above, we are becoming increasingly curious that there may be something about the Wendy's/Hortons relationship that makes Hortons more profitable as a part of Wendy's than as a stand alone entity. If so, it would seem that House may have knowledge of these things and they may cause him concern. Clearly, certain Wendy's insiders know something, even at this early stage, about how the deal will be structured.

No doubt, the above is supposition on our part at this time and we have more digging to do. One thing we have noticed is that there is a difference between the average Tim Hortons franchisee and that of a Wendy's owner. Tim Hortons franchisees, for instance, find more "Mom and Pop" shops in their numbers. Many of these entities are not very well capitalized and, in certain cases, Hortons has entered into, according to the Company's most recent proxy:

> "flexible lease arrangements with certain franchisees who are not required to invest a significant amount of equity. Because the legal entity within which such a franchise operates is considered to not be adequately capitalized, that entity is considered a variable interest entity ("VIE"). Based on review of the financial statements it receives from these franchisees, the mathematical projections performed by the Company indicate the Company is the primary beneficiary, as that term is defined by FIN 46R, of these VIEs and, accordingly, the Company has consolidated approximately 80 franchised Hortons restaurants as of January 2, 2005".

Granted, the above relates to just 80 franchisees of Horton's 2,721 restaurants at the time. Although the numbers involved are not material, we find it interesting that there were no such FIN 46R consolidations on the Wendy's side of the business. This thought gains more traction when one considers that only 3.6% of Hortons stores are company operated (just 98) vs. 26% at Wendy's (1,328). To us, this provides an early clue that the franchisees on the Hortons side of the business may require more assistance and/or concessions from the Company than may be the case on the Wendy's side where franchisees are typically larger and presumably better capitalized.