

Special Situation Investing Newsletter

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April 21, 2008

“TWO REPORTS IN ONE”

This is the second report for April 2008 is slightly different than many other Special Situation calls we have made. As you can imagine, all reports evolve just like trading strategies and just like the sentiment of the market. But the major reason there are two events here is that the end result may actually be known (but not completed) and gone in either or both by the time we do release the next Special Situation letter for the first of two for the month on Monday, May 5, 2008. Today we have covered Wendy's International and CVR Energy, Inc. in separate reports.

“PART ONE: Wendy's International & Peltz the Activist”

WENDY'S INTERNATIONAL INC. (NYSE: WEN) \$25.30 (-\$0.08; -0.3%)

STOCK STRATEGY: Buy Stock, \$30.00+ Target, but must hedge at least part of transaction.
Hedging Strategy: Hedge stock with JUNE-2008 \$22.50 PUTS at \$0.60 for one-third of position and hedge two-thirds of the position with the JUNE-2008 \$20.00 PUTS at \$0.15.

OPTIONS STRATEGY: If you want to merely take risk-based capital here with a far smaller amount than our normal 10% per-position allocation for any traditional equity portfolio, then we'd suggest a synthetic trade by buying the JUNE-2008 \$25.00 CALLS at \$1.75 and selling the JUNE-2008 \$22.50 PUTS at \$0.60 with roughly one-fourth of the capital. *BUT...* if you are taking this route please readdress this on Friday morning AFTER Wendy's has reported earnings. There is no way to assure that this cannot tank much on a poor earnings number, so if you want an "options only" transaction then we'd expect you to address this right after the open Friday morning. That also means the options prices will look different, so you can contact us via email on Friday to ask us to review this "then-new options strategy." Once again, we do not advocate risky big bet options transactions. So if your total portfolio is \$100,000.00 and if you wanted to keep your downside on an organic pick to 15% then you would only use \$1,500.00 in the combined trade after buying the Calls and selling the puts. Because you have written a put at \$22.50 for one-fourth of the funds, there is technically more downside risk here.

Overview, Event, and Catalyst

As everyone except the Sudanese know who the former Dave Thomas was and what Wendy's is, we'll skip the background data here. In the past, Wendy's International Inc. (NYSE: WEN) was a decent play. But after it spun off Tim Horton's (THI) this one has been a pig and now the spin-off is worth more than the parent. The good news is that activist Nelson Peltz and friends may be making a more concerted effort to secure the company soon. While Wendy's has earnings this coming Friday, the company now has Nelson Peltz (and friends) breathing down management's neck much harder than in 2007. He wants to acquire the company or to make it worth more. The investor group (Trian, Sandell, and Triarc) has amassed a large enough stake to matter with nearly 10%. The group has demanded a special meeting and has said that it

intends to go garner support for its activist activities. Management is trying to not play ball.

This coming Friday is the Wendy's earnings date, and frankly it is hard to imagine any great numbers out of a fast food retailer that should otherwise be nearly immune from the spending pinch as it is in the fast food sector. While personal experience and personal preferences are often better than none at all, they are not relevant because the company has been mismanaged for so long. Last week, Nelson Peltz and friends sent a more harsh letter than before with more demands and something short of an ultimatum for the company not to act on its own before that earnings date.

The perceived buyout price from the group was around \$27.00, but that may be an arbitrary number in reality as Peltz's SPAC Trian I, Triarc, and others were said to offer some \$900 million and the balance in stock. Based upon where the stock has traded, and based upon where we think management cannot accept an offer under, **we think a buyout of \$30.00 must be the minimum that Peltz and friends will have to come up with.** And he should be able to. While management was able to hide, the last 35% to 40% drop in the stock price took away much of their ability to rebuff suitors when they wanted to enhance value in the first place.

Long History Together

This is one we've followed for months and months, and now it seems the stuff is finally starting to hit the fan. Now that the Triarc division is finished, Peltz can concentrate on this one.

NOVEMBER 13, 2007... AP noted that Peltz may have a bid with a secret bidding price, although at one point prior Peltz had noted a perceived value of \$37.00 to \$41.00 back when shares were under \$31.00. Right around this time, we had publicly noted the possibility of a "takeunder" being likely.

SEPTEMBER 27, 2007... WSJ noted that competitors may be emerging to challenge a Nelson Peltz acquisition back when shares were north of \$34.00. Once again, *"takeunder as most likely."*

Since Wendy's spun the rest of Tim Horton's off in late 2006, things just haven't been the same.

Brief Financial Ramifications

Wendy's financials are actually in good shape (or at least much better with less valuation leverage) as the company has stabilized assets and its debt has marginally contracted. When the company was first under pressure, frankly we thought investors should be happy with the valuations that the stock had.

The good news is that shares have slid a massive 30+% and so far 2008 appears to be the stabilizer as far as the chart is concerned. We vision \$30.00 as fair value to bring this one back in line with other peers, and there appears to be a perceived floor in the stock around \$23.00 (9% under current prices). If this was not there and if that was not our belief, this entire position and idea would be a non-starter.

Actually, compared to peers, the company's debt-to-equity looks lower than many peers; its forward P/E ratios are in-line with or even cheap to peers, its \$2.2 Billion market cap makes it within a range that activists can push around, and its price to book value and price to tangible book value are now looking cheap. None of this was the case in most of 2007.

Recent Analysts

As far as the analysts, Goldman Sachs just recently noted a SELL rating with a \$21 price target. We think that is too aggressive on the downside and think that the extra one-week time frame may have played a part as the market was still reeling from post-GE earnings pessimism. The average analyst target is now between \$24.00 and \$25.00, although that has slid through time from higher levels.

Conclusion

Nelson Peltz may be aggressive, but he is proving to be rather patient and resilient. We think Peltz can come up with \$30.00 in a deal that MAY appease management. There are many defensive plays that the company has, and the State of Ohio makes for one more defense. But it is doable. We also believe that the pullback from north of \$40.00 has to tip Wendy's hand further. If not, management is going to have an

outright revolt on their hands.

If you are just taking the options stab at the piñata here, then please wait until after earnings and you can evaluate it Friday morning. But if you are hedging the stock, then you will know your downside going in. The "event risk" is the activist here more than the earnings, but better safe than sorry. As noted, if you want an "options strategy update" on Friday after the even, send me an email and I will give you one as the post number option prices are ALWAYS temporarily more clear than the pre-event.

“PART TWO: CVR Energy Inc. & The Fertilizer Spin-Off”

CVR ENERGY, INC. (NYSE: CVD) \$24.07 (+0.39; +1.6%)

PLEASE NOTE STOCK STRATEGY: Because we prefer stocks that trade with options to limit event risk, economic risk, and the potentiality of management making odd and costly decisions, this one is the "bonus round" of the dual picks sent this Monday. There is essentially no way to hedge this transaction, hence the reason it is a "bonus" rather than our main call.

The Business Overview

CVR Energy, Inc. operates in two segments: first in the refining and marketing of transportation fuels, and second in the production and marketing of nitrogen fertilizer products. This second business is not what made the company super valuable, but it is the hidden asset. Most traders do not even know this parent company, let alone the asset spin-off. The company is based in Sugar Land, Texas, and the operations are as follows:

The Petroleum segment includes a coking medium sour crude refinery in Coffeyville, Kansas; a crude oil gathering system serving central Kansas, northern Oklahoma, and southwest Nebraska; storage and terminal facilities for asphalt and refined fuels in Phillipsburg, Kansas; and a rack marketing division supplying product through tanker trucks directly to customers located in close geographic proximity to Coffeyville and Phillipsburg, and at throughput terminals on Magellan's refined products distribution systems. This segment offers gasoline and diesel fuel, as well as coke and other refined products, such as NGC, slurry, reformer feeds, sulfur, gas oil, and produced fuel to other refiners, convenience store companies, railroads, and farm cooperatives.

The Nitrogen Fertilizer segment produces and markets ammonia and urea ammonia nitrate (called UAN) fertilizers. This segment markets its ammonia products to industrial and agricultural customers, and UAN products to retailers and distributors in Kansas, Missouri, Nebraska, Iowa, Illinois, Colorado, and Texas.

The Event & Catalyst

CVR Energy has decided that it may capitalize off of the agriculture and fertilizer craze. This will be done via a partial IPO spin-off of a limited partnership formed by CVR Energy, Inc. to own and operate a nitrogen fertilizer facility and develop a diversified portfolio of assets that are complementary to its business and CVR Energy's refining business.

CVR Partners, LP has filed to come public via an initial public offering at the end of February under the "CVE" NYSE ticker; the prospectus calls for a sale of 5.25 million units, and that is before a 787,500 unit overallocation. If this deal were to be hurried through, we think it would instantly get a premium to its prior indication. CVR partners is a limited partnership formed by CVR Energy, Inc. to own and operate a nitrogen fertilizer facility and develop a diversified portfolio of assets that are complementary to its business and CVR Energy's refining business. Its nitrogen fertilizer business produces ammonia and urea ammonia nitrate fertilizers. Interestingly enough, it claims to be the lowest cost producer of ammonia and urea ammonium nitrate in North America.

What is interesting is that after the offering, CVR Energy (parent) will indirectly own approximately 87% of the outstanding units. With the filing amount of up to \$120,750,000 that could be offered, this gives a

starting point of somewhere in the vicinity of \$1 Billion in market cap (on the surface).

Because of issues outlined above and below, we think a miniature version of the EMC-VMware spin-off could be replicated here on a smaller basis. The fact that Potash Corp. of Saskatchewan, Mosaic (NYSE: MOS), and others have rallied exponentially and have continued to garner massively upward pricing power, this one may add another 25% to as much as 35% or 40% more to the value of CVR ENERGY (CVI) by the time this is all said and done.

The Perceived Downside

First and foremost, "CVI" has not been public long at all. Insiders will sell more stock and create dilution, the company has an active shelf registration, management is "quiet and private," the company has no history of beating or missing earnings estimates that can be relied upon, and much is closely held.

Goldman Sachs owns more than 36% of the parent company, as does Kelso & Co. After that, notable shareholders to likes of S.A.C. Capital, Wellington, JPMorgan, Wellington, Fidelity and more are in there; but these alone control more than 80% of the company.

If the company decides to wait too long to come public, this "hidden value" in the company will likely disappear and never make it to market.

The Perceived Upside

The fact that 80% of this company is controlled by a few power players probably only lends more credibility to the company's desire to bring this fertilizer operation public.

Even if the company spin-off doesn't make it to market, the forward valuations from the analysts are at least justifiable at the current prices and at prices within 10% in either direction before the stock starts looking rich or cheap to growth peers in the oil refining sector.

Unique Issues To Decipher

While the refinery assets go back to 1906, Coffeerville Group Holdings, LLC, won the bankruptcy court auction for the operations of the petroleum business and nitrogen fertilizer in early 2004. Goldman Sachs and the Kelso Funds acquired the entity, and the new CVR Energy was formed in September 2006, the assets were then properly allocated, and the company came public via IPO in late October 26, 2007.

*One other key issue at hand is that **this IPO is "contemplated" rather than assured.*** With the incredible hype and performance around fertilizer and agriculture at the moment, this company could easily accomplish a spin-off if it chooses to. That is probably twice as easy if it is truly the lowest cost producer.

While the thought of "bankruptcy" in the same decade is present, the idea that either Goldman Sachs or the Kelso Funds would be in this to see it tube would seem almost absurd even from a skeptic.

The Intrepid Potash IPO was said to be pricing Monday night with a share price north of \$30.00, and that would be a two-time hike if that is completed at the terms going around at 6:00 PM or so on Monday night.

Reaching Out to Management

While we have not have tried to speak with every officer of the company, we have numerous calls into officers and representatives of the company that are entirely not responded to. We have spoken with Platt's, and a personal contact there noted that the company has denied interviews and visit requests. Management is not interested in talking to analysts nor does it want to speak with reporters.

Financial History of Proposed SPIN-CO

While the revenues seem a stretch to get to a \$1 Billion-ish valuation, the truth is that these earnings and the leverage ahead in the coming fertilizer climate should at least cover that level. CVR Partners generated the following in sales and income:

- net sales of \$173.5 million and operating income of \$71.0 million in 2005,
- net sales of \$170.0 million and operating income of \$43.0 million in 2006,
- and net sales of \$187.4 million and operating income of \$48.0 million in 2007.

The Parent & The Opportunity

When this came public, agriculture and fertilizer were popular sectors, as if energy was not; but the stock has not reflected this at all. The reason for that is the fairly recent IPO, the fact that insiders will start taking more money off the table in stock, and because the company may decide to tap the well again. Do NOT have any expectations of a buyout here, at least not from us.... while it is shareholder friendly, enough stock is in friendly hands that an outsider has zero chance of forcing this company into any action at the current time.

The company as a whole has a \$2.07 Billion market cap, yet the underlying value that could be extracted from today's prices on the books is rather small at roughly a perceived value to "income" of roughly 20% in the last 3-year period.

CVR Energy's shares have traded as high as \$30.94 since coming public, and levels under \$20.00 have been eclipsed only momentarily. The stock is in the middle part of its post-IPO trading range and is technically in a no-man's land at the moment. The refinery operations have kept a lid on this, and frankly it looks like everyone has forgotten about or just entirely discounted its fertilizer operations.

Key Outside Events

The "hotter than hot" INTREPID POTASH IPO makes this one front and center on the demand side. Potash companies are NOT the exact comparison here, but the agriculture plays tied to fertilizer make it in the same boat:

Potash Corp. (POT) is up over 200% in one year;
and The Mosaic Co. (MOS) is up well over 300% in a year.

Companies that are more appropriate in the group are as follows:

Terra Nitrogen Company, L.P. (TNH), up about 150% in a year;
and Terra Industries Inc. (TRA), up almost 150% in a year.

Conclusion

This is one of the more risky transactions out there, but it is also one that we'll be covering with our thousands of free website readers with regularity after this has been received by our paid subscribers. If you have trouble stomaching freshly public companies that are in hot sectors (energy & agriculture) and if you cannot accept stocks that do not trade with stock options yet, then just ignore this "bonus" pick here.

We'll be sending out our next Special Situation newsletter on Monday, May 5, 2008. Stay tuned, and thanks for subscribing.

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April 21, 2008

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