

## Nortek Sell-Off May Face Lawsuits

Written by Bob Snyder  
07. 07. 2016

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**Nortek**, the diversified industrial company that holds 9 of our industry's brands in its *Audio, Video & Control* group, will sell the entire company to a British turn-around specialist for \$2.6 billion...or maybe not...

Nortek's *Audio, Video & Control* brands include **ELAN, Furman, Gefen, Niles, Panamax, Xantech, Speakercraft, Proficient** and **Sunfire**.



Another division, *Ergonomic & Productivity Solutions*, also includes brands in our channels, **Ergotron, Anthro** and **OmniMount**.

. (Which always raises the question for AV: "What, we aren't ergonomic or productive enough for those brands to join us in AV Control?")

These brands-- and all of Nortek-- are signed away in \$2.8 billion deal with **Melrose Plc** in the UK.

Don't fall for the headlines about "a merger" because the merger is only the temporary financial vehicle that maximizes the British investment and probably reduces US federal corporate tax (Thank you, Nevada tax laws). In this deal, **Nortek would end up as a wholly-owned subsidiary of Melrose PLC, a public company enjoying the publicity of one of the first post-Brexit acquisitions.**

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Oddly enough, the British press (and British branches of *Bloomberg* and *Reuters*) are hailing the Nortek deal as Melrose's acquisition of a "fan maker" and "ventillation products" company. This is based on the fact that three Nortek divisions (  
*Air Quality & Home Solutions*  
,  
*Residential & Commercial HVAC*  
and  
*Custom & Commercial Air Solutions*) account for 64.9% of Noretek's total sales-- adding up to \$1.653 billion in turnover.

[Melrose Buys Fan Maker in First Major U.K. Purchase Since Brexit](#)  
*Bloomberg* - 17 hours ago

[Melrose to buy US ventilation products maker Nortek](#)  
*Reuters* - 5 hours ago

Another division, *Security Control Solutions* accounts for 17.1% and \$436 million in sales. (Hey, we know these brands from  
**Nortek Security & Control**  
**GTO** : 2GIG, Go and  
**Linear**  
. But this division also has  
**AV & Control**--  
, the makers of gate and garage door openers.)

Apparently even *Ergonomic & Productivity Solutions* outperforms us with \$294 million turnover and 11.6% out of all sales.  
**Solutions**--  
**with all its 9 brands-- does only \$163m and represents a mere 6.4% of all Nortek sales.**  
(To give you an idea, it's like being Apple Watch and iPad in middle of Apple's iPhone business.)

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And if you take the position that those three groups should be together (*Ergonomic & Productivity Solutions*,  
*Security Control Solutions*,  
, and  
*Audio, Video & Control*  
) in one, and it still would add up to only 35.1% of Nortek.

These numbers making pushing air around a lot more attractive than pushing audio and video.

Add up all Nortek's six groups (with their respective companies) and the Melrose deal puts \$85 a share into the pocket of shareholders. Not bad for a company that declared Chapter 11 in 2009 and then fought their way out of it.

### **But some shareholders are in revolt.**

Melrose says the purchase price represents a premium of approximately 38% to Nortek's closing price on July 5, 2016, and a premium of approximately 80.4% to "the volume weighted average price over the prior six month period."

Certain stockholders of Nortek, affiliated with Ares Management LLC, Anchorage Advisor Management LLC and Gates Capital Management, Inc., owning 68.7% of the outstanding shares of Nortek common stock entered into tender and support agreements with Melrose.

That leaves just less than one-third of shareholders on a train ride they might not vote to take when the shareholder's meeting comes to ratify the Melrose deal-- even though Melrose is offering them the same share price.

**Several shareholder rights attorneys now chase the other shareholders**, arguing the premium is significantly below the average one-day premium of nearly 85.87% for comparable transactions within the past three years. Further, the \$86 merger is "significantly below the target price of \$95.00 set by an analyst at Imperial Capital LLC on August 5, 2015."

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In the last three years, Nortek traded as high as \$92.96 on August 20, 2015, and most recently traded above the merger consideration – at \$91.62 – on August 24, 2015.

These attorneys think shareholders can further argue: On May 12, 2016, Nortek reported strong earnings results for its Q1 2016: net sales of \$613.9 million for the three months ending April 2, 2016, a 7.2% increase from the same period of the prior year. Nortek also reported GAAP operating earnings of \$28.9 million for the three months, a 275% increase from the same period of the prior year.

In commenting on these results, Nortek President and Chief Executive Officer Michael J. Clarke remarked, "Over the past few years, we have made significant investments to improve our operations and reposition the business for long-term, sustainable growth. The benefits from these investments are showing up and we're feeling really good about our start to the year and momentum across the business."

In light of [these facts](#), attorneys such as **Robbins Arroyo LLP** (and others) want to examine Nortek's board of directors' decision to sell the company now rather than allow shareholders to continue to participate in the company's continued success and future growth prospects.

Or maybe these lawyers just want to stick their noses into the Big Deal trough and get some cash by coming in-between Buyer and Seller. In any case, these legal firms are already actively advertising their services to shareholders.

**Our conclusion: this is NOT a done deal. The deal is in play and stands a chance of falling through.**

Another buyer can emerge and steal the deal. Nortek has insisted upon "a window shop period" through August 6, 2016, during which (subject to certain procedures outlined in the Merger Agreement), Nortek may enter into discussions and negotiations with third parties that submit an unsolicited proposal to acquire the Company.

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But it will cost them: if Nortek agrees to accept a superior proposal prior to 11:59 p.m. (Eastern time) on August 6, 2016, **Nortek would be required to pay to Melrose a termination fee equal to \$50 million.**

We're not sure if United Technologies falls into the unsolicited category as they were in talks to buy Nortek last year. Nortek has dropped 16% in value since then-- and some Wall Street pundits think United Technologies could jump into the deal. The \$50 million break-up fee handcuffed to the Melrose deal means they would need to offer \$89.11 a share at minimum.

Even at \$100 a share, United Technologies would be paying just over 1X Nortek's projected revenue for 2016, a discount if you consider the major industrial purchases of recent years. United Technologies is refocusing its energies on commercial building technologies, even dumping its helicopter business (Sikorsky), to make that focus work.

At \$16.8 billion annually, Climate, Controls, and Security is already the biggest business in UTC's \$65.1 billion annual empire. It operates at 16.5% operating profit margin versus about a 4.8% operating profit margin (2015) for Nortek.

It is important to stress here: these acquisitions usually imply the company being sold is being poorly run-- and needs a Big Brother with more know-how. But it is not always the case. Bigger companies often just have more cash, better buying terms, more resources, and a better tax structure. In the case of Nortek, it is clear that management worked some miracles to get the company out of Chapter 11 and onto the table for a Big Deal.

The Melrose press release contains the usual corporate back-slapping that comes with that Big Deal. You can read their press release at the link below this article. But for us it is more important to understand what this Melrose deal means to Nortek and its AV brands if the sale is completed.

### First, the back-slapping...

"We have watched and admired Nortek's progress and we are convinced we can steer this fine business to achieve its full potential," said Melrose's Chairman Christopher Miller. "We see a company full of hard-working, dedicated people who are really good at what they do. We can

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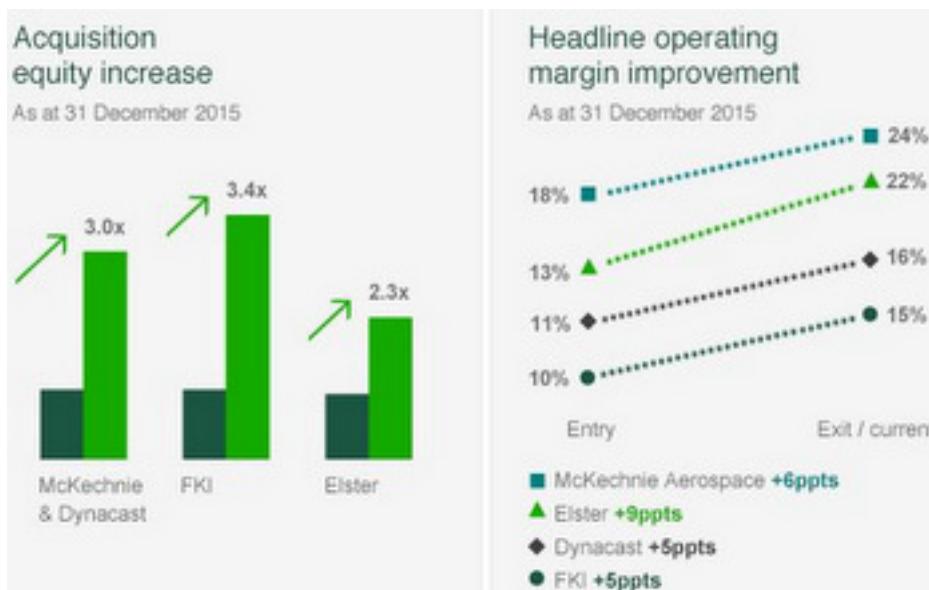
harness those strengths by meaningful long term investment and a vision based on our own experience in similar and relevant markets down the years. Melrose has been a highly successful custodian and builder of US businesses and we are confident that we can bring that expertise to build Nortek for the long term."

### And now the back-stabbing (of sorts)...

Melrose PLC is clear about their intention. They only buy underperforming industrial manufacturing businesses whose performance can benefit from their expertise-- upgrading Nortek's supply chain and IT systems, reducing its interest expenses, lowering high administrative costs, improving the corporate tax position, and putting money up for profit-realizing product extensions.

They buy these companies to "flip" them for profit. Much in the same way you see those TV shows where people buy a deteriorating house, bring in the architects and carpenters, fix it quickly and offer it to a new owner at a good profit.

The Melrose strategy is based on "supporting and incentivizing management teams to transform and grow their businesses without the burden of quarterly reporting or restrictive financing covenants, achieving above market profit growth and increased operating margins."



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If you look at Melrose, their top executives all come from accounting backgrounds. They will proudly cut overheads and try to grow the gross margin by raising prices wherever they can.

Melrose has been able to increase headline operating margins by 5 to 9 percentage points in all their historical investments.

*(See the chart.)*

Nortek can expect an extreme business course in how Brits tightened up the ship and batten down the hatches.

I can personally speak to this as I have been on the Board of a public British company after it acquired our US company. You're talking about a country where people, to survive and thrive, must watch the pennies. In America, to save a few dollars, it isn't worth going to three different shops. In UK, it is. People worry about how long a shower takes and if a light is left on... the things that Americans worry about for the sake of ecology, the Brits worry about because of higher costs.

Put simply, the British will run a tighter ship.

Nortek can expect the new owners to be open to new investments that clearly show return. On average, Melrose says it invests "a further third of the original purchase price in its businesses post-acquisition."

But there is a rub: companies like Melrose might unshackle its acquisitions from thinking about quarterly returns.

**Yet there is a ticking clock. Fix-and-repair companies like Melrose work on returning**

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**investment to their shareholders in 3-5 years-- maximum.** While ideas on investments will be welcomed, there will be tight timelines and managers who don't deliver on time will be terminated. There's no time in this type of timetable for second chances.

Melrose will be looking to get Nortek firing on all cylinders as quickly as possible.

I promised you some back-stabbing (of sorts) in the story...but not by me. It's more of an internal thing, like another *Et tu, Brutus*. Let's call it: the threat within.

To get maximum payout, companies like Melrose often tear apart their acquisitions like Nortek and sell it piece-by-piece. (Take a look at their **FKI plc** deal on their web site if you don't believe me.)

If Nortek is more valuable when sold company-by-company (or division-by-division), it is in the nature of a company like Melrose to exploit that value in the name of its shareholders.

The chances are also likely, particularly in our AV group, the British will evaluate whether Nortek really needs to support nine brands. You may see brands sold off or collapsed into others.

Chances are likely Nortek will thrive under this new British regimen, but it is very likely that 3-5 years from now, Nortek will be sold again--in pieces.

Go [\*\*Nortek and Melrose PLC Press Release\*\*](#)

Go [\*\*Melrose PLC\*\*](#)