Resideo Technologies: Path to $0 and Why a Restructuring is the Best Outcome

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Executive Summary

- We laid out the facts for both a short sale investment and a potential activist long investment in Resideo Technologies (Ticker: REZI) in January 2020 here: www.porterstreetresearch.com. This report assumes some knowledge of topics covered there. Having turned negative, we believe the most likely outcome for Resideo Technologies, (will be referred to as Rezi in this report) is a restructuring and a $0 share price in the next 3-9 months.

- Before the Corona virus hit the US in February 2020, we felt Rezi's business was under pressure. The Corona virus accelerated Rezi's underlying issues, namely, a lack of cash generation, too much debt, and zero leadership. We believe that Rezi could run out of available cash and need to tap their revolver by Q1 2020. Rezi may not trip covenants right away given their ability to add back all kinds of one-time expenses to Adj. EBITDA. However, we believe the disruption from supply chains, lack of demand for new products and a pullback in available credit to support ADI's dealer customers will cause Rezi to burn through cash an accelerated rate in the first half of 2020. The cash burn should coincide with Rezi tripping their covenants at some point in 2020.

- The entire bull case for investing in Rezi today is that the ADI Distribution business could be worth more than the current enterprise value of Rezi and a spin-off or sale of ADI is coming as early as the second half of 2020. We believe this is misguided. ADI's business is nearing a cyclical peak. The pull back by lenders who finance security dealers combined with a downturn in demand from Corona will begin to hurt ADI's results. *(Our discussion of the ADI business begins on page 9)*

- There are also technical, accounting and legal aspects surrounding any potential spin-off of ADI or sale of assets that we think makes a spin-off or sale unlikely. We summarize below:

  1. For Resideo to maintain certain tax benefits from the Honeywell spin-off, the earliest a spin-off or sale of ADI could happen is October 29, 2020.

  2. Under the current credit agreement, any spin or sale of assets is limited to 15% of consolidated total assets in a fiscal year or 40% during the life of the credit facility.
  - ADI accounts for an estimated 37% of Rezi's consolidated assets. There would have to be a re-financing or change of terms in the current credit facility to spin-off or sell ADI

  3. If a spin-off is executed, the Honeywell liability payments don't go away. Each new entity would be jointly responsible for the Honeywell liability payment which is currently $140mn/year

  4. Each new entity would have to meet certain minimum ratings agency requirements.
  - As Rezi's ratings are on downgrade watch as it is, we think it is unlikely the combined entity and separate entities could receive requisite minimum ratings to support a spin

- We believe bulls are anchoring on the recent sale of Anxiter, a competitor in the security distribution space, that was purchased for 8X in EBITDA in the fall of 2019. ADI has higher margins than Anxiter and we have seen bull cases arguing ADI is worth as much as 10X Adj. EBITDA. Below we demonstrate a range of scenarios to estimate what ADI could be worth. Under our "Bull Case", we show a simple estimate of what the implied remaining value of the P&S division would be assuming ADI is sold at various multiples. At 10X Adj EBITDA, subtracting the proceeds from a sale implies the P&S division is available "for free". Anytime an investment thesis rest upon getting "XYZ division for free" it is often wrong" and we expand on why below.

	Multiple for ADI				
Bull Case	6	7	8	9	10
ADI Adj EBITDA	$ 187	$ 187	$ 187	$ 187	$ 187
ADI Sale Value	$ 1,122	$ 1,309	$ 1,496	$ 1,683	$ 1,870
Rezi EV Current	$ 1,856	$ 1,856	$ 1,856	$ 1,856	$ 1,856
Less ADI Remain EV	**$ 734**	**$ 547**	**$ 360**	**$ 173**	**$ (14)**
Product Adj EBITDA w. Full Hon.	$ 169	$ 169	$ 169	$ 169	$ 169
Implied EV/Adj EBITDA Products Only	4.3	3.2	2.1	1.0	(0.1)

To be conservative and realistically assess ADI's potential sale value we make the following adjustments:

- Apply a multiple that adjusts for where we are in the cycle at ADI (6-8X)
- Account for taxes on the transaction
- Apply a proportional (based on assets) share of the Honeywell liability payments

As shown below, after making adjustments, we see the P&S division trading at an implied EV/EBITDA multiple of 4-5X. Low, for sure, but for a business that may be in structural decline that can't generate cash flow, requires years of restructuring

PSR Conservative	Multiple for ADI				
	6	7	8	9	10
ADI Adj EBITDA w/ Share of Liability	$ 125	$ 125	$ 125	$ 125	$ 125
ADI Sale Value	$ 750	$ 875	$ 1,000	$ 1,125	$ 1,250
Tax (20%)	*$ (150)*	*$ (175)*	*$ (200)*	*$ (225)*	*$ (250)*
After Tax Value ADI	**$ 600**	**$ 700**	**$ 800**	**$ 900**	**$ 1,000**
Rezi EV Current	$ 1,856	$ 1,856	$ 1,856	$ 1,856	$ 1,856
Less ADI Remain EV	**$ 1,256**	**$ 1,156**	**$ 1,056**	**$ 956**	**$ 856**
Product Adj EBITDA w/ Pro Forma Liabililty	**$ 221**	**$ 221**	**$ 221**	**$ 221**	**$ 221**
Implied EV/Adj EBITDA Products Only	5.7	5.2	4.8	4.3	3.9

- Resideo and certain named executives including the former CEO and CFO are subject to 18 class action lawsuits alleging executives made knowing and mis-leading statements regarding Rezi's business. In at least one instance, Gabelli and Co. has also named Honeywell as a defendant in the lawsuit claiming the company knowingly spun off Rezi despite the challenges the business units faced. Rezi currently has no permanent CEO and the current interim CFO, Rob Ryder, is a consultant. Brian Kushner, an executive at FTI Consulting was brought onto the board in late 2019 and his experience is as a turnaround consultant helping bankrupt or near bankrupt companies. The Boston Consulting Group and at least one other consulting firm are engaged with Rezi on site to help with cost reductions, possible M&A and restructuring advice.

- Without a sale or spin-off of ADI, under the weight of the Honeywell liabilities, lawsuits and debt coming due in next 3 years, we don't see how Rezi generates enough cash to survive in its current form. We believe the best way forward for Rezi and its employees is to restructure the company via bankruptcy. The courts offer the best solution to attempt to have the Honeywell liabilities reduced or put back to Honeywell. As a reminder, the Honeywell liabilities have absolutely nothing to do with Rezi's core business and are purely financial in nature.

- The short interest for Rezi shares is 7.8% (up from 5.5% in early March) and with over $650mn of market capitalization, we believe Rezi is short sale candidate with a very high risk/reward over the next 3-9 months. We fully acknowledge that on any perceived good news: the hiring of a turnaround CEO or alternative financing structures, Rezi's stock could rip higher. However, any move up should prove temporary and may provide a better opportunity to initiate a short position.