May 11, 2018

# HC2 Holdings, Inc. (HCHC: $6.36)

*Recent Sale of a Life Sciences Asset Paves the Way for a De-levering Transaction to Reduce the Cost of Debt, Which Will Be Materially Accretive to the Common Equity*

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**Company Description**

HC2 Holdings, Inc. is a holding company run by Philip Falcone with a broad mandate to invest in businesses and assets through controlling or minority interests.

HC2's principal investments, at this time, are controlling interests in **1)** DBM Global (fka Schuff Steel; 92.5% interest), a leader in the North American steel fabrication and erection industry; and **2)** Global Marine (73.8% interest), a global leader in the subsea cable industry. In addition to DBM and Global Marine, HC2 has investments in smaller telecommunications, broadcasting, life sciences, technology, and utility companies.

**Figure 1. HC2 Holdings, Inc.—Select Securities, Prices as of Market Close on 5/10/18**

| Security | Coupon | Amt. Outst. | Priority | Maturity | Price | YTM | Current Yield | Moody's/ S&P | Next Call Date | Next Call Price |
|---|---|---|---|---|---|---|---|---|---|---|
| Secured Bonds | 11.00% | $510.0 | Holdco Sec. | 12/01/2019 | 102.750 | 9.0% | 10.7% | Caa1/B- | 12/01/18 | 100 |

**Common Equity**

| Security | Ticker | IC Rating | Price Target | Shares [1] | Price | Market Cap. [1] | 52 Week High | 52 Week Low | 52 Week % of High | 52 Week % of Low |
|---|---|---|---|---|---|---|---|---|---|---|
| Common Equity | HCHC | NR | None | 50.5 | $6.36 | $321.0 | $7.79 | $4.30 | 81.6% | 147.9% |

**Preferred Equity**

| Security | IC Rating | Price Target | Coupon | Amt. Outst. | Redempt'n Date | Conv. Price | Converted Shares |
|---|---|---|---|---|---|---|---|
| Series A Convertible Preferred | NR | None | 7.50% | $12.5 | 5/29/2021 | $4.25 | 2.9 |
| Series A-2 Convertible Preferred | NR | None | 7.50% | $14.0 | 5/29/2021 | $7.80 | 1.8 |

**Financial Data**

| LTM Ended 3/31/18 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue [2] | EBITDA [2] | Cash [4] | CapEx | Int. Exp. [3] | FCF | Total Debt | Net Debt [4] | Total Leverage | Net Leverage | TEV [1] | TEV/ EBITDA |
| $1,516.3 | $57.0 | $117.4 | $6.4 | $66.5 | ($15.9) | $697.0 | $579.6 | 12.2x | 10.2x | $979.0 | 17.2x |

(1) Shown assuming conversion of preferred to common equity.
(2) Reflects Core operating results excluding Insurance (after corporate overhead); see Historical Financial Summary.
(3) Reflects run-rate figure.
(4) Includes only cash held at the holding company level; pro forma for $85mn to be received from sale of BeneVir.
Sources: Bloomberg, company filings, and Imperial Capital, LLC.

## Recent Earnings Highlights

HC2 Holdings, Inc. (HCHC) released its 1Q18 (3/31/18) earnings after market close on 5/10/18. We believe the situation remains a sum-of-the-parts valuation story, and we provide highlights from its recent earnings release below:

- **DBM Global (fka Schuff):** DBM finished 1Q18 with a near-record backlog of $718mn, up from $498mn in 1Q17. Including contracts awarded but not signed, backlog metric is $759mn. Management estimates another $300mn of incremental opportunities that could be awarded over the near term. Management reaffirmed full-year EBITDA guidance for the segment of $60-65mn.
- **Global Marine (GM):** GM finished the quarter with backlog at a near-record of $430mn, up from $332mn in 1Q17. The segment showed soft results in the quarter driven by timing of projects. Underscoring the characteristic quarterly variability of the segment, management reaffirmed its full-year EBITDA guidance for the segment of $45-50mn.
- **Pansend/BeneVir:** As disclosed previously on 5/2/18, HC2 announced the agreement to sell its BeneVir segment to a subsidiary of Johnson & Johnson for $140mn upfront ($75mn to HC2 + $10mn in escrow) and potential for another $900mn of value pursuant to certain milestone realizations ($500mn to HC2). Additionally, management remains in discussions for monetization of additional Pansend (Life Sciences) assets. BeneVir had an $8mn cost basis.
- **Continental Insurance:** Still on track to close the $2.3bn acquisition of Humana LTC insurance business in 3Q18 (no consideration, Humana agreed to contribute $203mn and benefitted from a $500mn tax gain) – will be immediately accretive to risk-based capital (RBC) and statutory capital metrics – pro forma Continental will have $3.5bn of cash and assets.
- **HC2 Broadcasting:** Through a string of recent acquisitions, the company now has 150 operational stations in more than 130 U.S. markets and reaches roughly 60% of the population. It also has permits/licenses for an additional 501 stations.

Characteristic variability in project timing impacted quarterly results, but near-record backlog metrics at both core opportunity segments give us comfort to take a longer-term view on this situation. We believe the most important take-away from HC2's earnings is the monetization of its BeneVir asset at 10x initial investment cost.

We believe the value realization from this asset validates HC2's investment thesis. Further, in our view, the improved cash position of the business sets the stage nicely for a refinancing of the 11% secured bonds, and we believe a reduction in the cost of debt will be a significant value catalyst for the common equity. CEO Philip Falcone highlighted this as a top near-term priority. Please see our previous report dated 3/15/18.

# Capitalization

**Figure 2. HC2 Holdings, Inc.—Capitalization as of 3/31/18, Prices as of Market Close on 5/10/18**

| | | | Debt Face | | Net Debt Face | | Price / YTM Analysis | | | Interest Exp. Analysis | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **Core Operating Revenue (Ex. Insurance)** | **(3/31/18)** | **1,516.3** | | | | | | | | | |
| **Core LTM Adj EBITDA [1]** | **(3/31/18)** | **57.0** | | | | | | | | | |
| **Core LTM EBITDA %** | **(3/31/18)** | **3.8%** | | | | | | | | | |
| **LTM Capex** | | **6.4** | | | | | | | | | |
| **Settlement Date** | | **5/15/18** | **Cum.** | **LTM EBITDA** | **Net Cum.** | **LTM EBITDA** | | | | | |
| | **Rating** | **Balance** | **Debt** | **57.0** | **Debt** | **57.0** | | | | **Rate/** | **Est.** |
| | Moody's/S&P | | **Face** | **Mult.** | **Face** | **Mult.** | **Price** | **YTM** | **Mat.** | **Coup.** | **Int. Exp.** |
| **PF Consolidated Cash Balance (ex. Insurance) [2]** | | **154.1** | | | | | | | | | |
| **PF Corporate Level Cash Balance [2]** | | **117.4** | | | | | | | | | |
| **Secured / Subsidiary Debt** | | | | | | | | | | | |
| DBM Revolver ($50mn) | **DBM** | 40.7 | | | | | | | 4/30/19 | L+2.00% | 1.8 |
| Schuff Secured Notes Payable | **46.8** | 6.1 | | | | | | | 2018/2019 | L+2.50% | 0.3 |
| ANG Notes | | 12.2 | | | | | | | 2022 | 4.500% | 0.5 |
| ANG Seller Note | | 1.8 | | | | | | | 2022 | 4.250% | 0.1 |
| ANG Term Loan | **ANG** | 13.3 | | | | | | | 2022 | 5.040% | 0.7 |
| ANG Other | **28.8** | 1.5 | | | | | | | | 3.000% | 0.0 |
| GMSL/Cwind Notes Payable + RCF | | 23.7 | | | | | | | 2018-2024 | 7.500% | 1.8 |
| GMSL Shawbrook Bank Loan | | 10.0 | | | | | | | 4/3/19 | 7.490% | 0.7 |
| GMSL Capital Lease Obligations + Other | **GMSL** | 47.2 | | | | | | | 2023/2025 | 4.000% | 1.9 |
| GMSL underfunded pension | **99.6** | 18.6 | | | | | | | | | N/A |
| Other | | 11.8 | | | | | | | | | 0.6 |
| **Total Secured / Subsidiary Debt** | | **187.0** | **187.0** | **3.3x** | **150.3** | **2.6x** | | | | **Snr Int** | **8.4** |
| **HoldCo Debt** | | | | | | | | | | | |
| HoldCo Secured Notes [3] | Caa1 / B- | 510.0 | | | | | **102.750** | 9.05% | 12/1/19 | 11.000% | 56.1 |
| **Total HoldCo Debt** | | **510.0** | **697.0** | **12.2x** | **579.6** | **10.2x** | | | | | |
| **Equity Value** | | | | | | | | | | | |
| Noncontrolling Interest | | 115.1 | | | | | | | | | |
| HC2 Pfd shares (@ $4.25/$7.80) [4] | | 30.2 | | | | | **$ 6.36** | **4.75** | **Shs** | 7.500% | 2.0 |
| PF Common Stock (fully diluted) | | 290.9 | | | | | **$ 6.36** | **45.74** | **Shs** | **Int + Div** | **66.5** |
| **Total Equity Value** | | **436.2** | **1,133.2** | **19.9x** | **979.1** | **17.2x** | | | | | |

(1) Includes corporate overhead, but not Life Sciences or Other; see Historical Financial Summary.
(2) Pro forma for $85mn of cash to be received from the sale of Benevir subsequent to quarter-end.
(3) Pro forma for $110mn tack-on subsequent to quarter-end to take-out $102mn financing at its Broadcasting subsidiary.
(4) Preferred shares pay 7.5% cash coupon and PIK at 0–4% based on financial metrics, shown as converted ($26.5mn current face).
Sources: Bloomberg, company filings, and Imperial Capital, LLC.

# Overview

**We continue to believe the equity is undervalued.** In our view, HC2 is supported by significant asset value and led by a seasoned investor with a long track record of value creation (Phil Falcone). We believe HC2's core businesses are stable and unrealized portfolio value is substantial, providing coverage for HC2's bonds and considerable upside for the equity securities. We do not have investment ratings on the debt or equity securities of HC2 Holdings.

# Rationale

**Significant net asset value (NAV).** We believe the core operating assets alone cover HC2's debt. At the midpoint of our valuation, we believe the share price is worth around 50% more than current market pricing and almost 2.0x in our high case.

**Strong trends from core assets.** Near-record backlogs at DBM Global and Global Marine provide observable support of the trajectory of future business performance.

**Significant levers for outsized growth.** Identifiable near-term growth opportunities across multiple portfolio companies.

**Impressive management talent across entities.** Along with billionaire investor, Philip Falcone, the management teams of each portfolio investment have been highly curated.

**Attractive credit attributes.** The bonds contain financial maintenance covenants including: **1)** a minimum liquidity covenant and **2)** a collateral coverage covenant.

# Valuation

**We believe the core operating assets alone cover HC2's debt – DBM Global and Global Marine.** At the midpoint of our valuation of these two assets, we arrive at a value of $651.3mn, which implies approximately 1.3x coverage over HC2's corporate-level indebtedness.

**Based on our sum-of-the-parts analysis of the consolidated entity, we arrive at an equity value range of $442.1mn to $640.8mn (midpoint of $524.7), or $8.40 to $11.71 per share (midpoint of $9.77) vs. a recent share price of $6.36 (implying the potential for value on the upside to our mid-point valuation of as much as 1.5x the recent share price).** At recent levels, the equity represents a highly asymmetric return opportunity for investors, in our view.

We believe a catalyst for value realization could come in the form of a reduction in its cost of debt, which management has noted is a top priority.

**Figure 3. HC2 Holdings, Inc.—Sum-of-the-Parts Valuation, Prices as of 5/10/18**

| | | | Parameters | | | | TEV Contribution | | | HC2 | HC2's Share | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Position | | Metric | Low | High | Low | High | Low | Mid | High | % | Low | Mid | High |
| DBM (fka Schuff) [1] | Equity (consolidated) | FY18P EBITDA | 60.0 | 65.0 | 7.6x | 7.9x | $453.2 | $484.5 | $515.7 | 92.5% | $419.1 | $448.0 | $476.9 |
| Global Marine [1] | Equity (consolidated) | FY18P EBITDA | 45.0 | 50.0 | 5.0x | 6.0x | 225.4 | 262.9 | 300.4 | 73.8% | 166.4 | 194.0 | 221.7 |
| Continental Insurance | Equity (consolidated) | Statutory Capital | 68.9 | 68.9 | 0.7x | 0.9x | 48.2 | 55.1 | 62.0 | 100.0% | 48.2 | 55.1 | 62.0 |
| PTGi | Equity (consolidated) | Mid-cycle EBITDA | 6.4 | 10.0 | 4.0x | 5.0x | 25.4 | 37.7 | 50.0 | 100.0% | 25.4 | 37.7 | 50.0 |
| American Natural Gas [1] | Equity (consolidated) | Mid-cycle EBITDA | 2.4 | 12.5 | 5.0x | 9.0x | 12.1 | 62.3 | 112.5 | 67.7% | - | 22.7 | 56.7 |
| Broadcasting Investments [2] | Equity (consolidated) | Est. cost | | | | | | | | | 105.7 | 105.7 | 105.7 |
| Inseego (fka Novatel) | Equity (equity method) | Share Price | $2.04 | $2.04 | -25.0% | 25.0% | 90.0 | 120.0 | 150.0 | 22.0% | 19.8 | 26.4 | 33.0 |
| **Other Non-Control Investments (at Cost or Book Value) [2]** | | | | | | | | | | | 9.0 | 12.1 | 12.1 |
| **Life Sciences Portfolio [2]** | | | | | | | | | | | 50.0 | 49.5 | 74.2 |
| Corporate Expense [3] | | Normalized | (25.0) | (25.0) | 3.0x | 5.0x | (75.0) | (100.0) | (125.0) | 100.0% | (75.0) | (100.0) | (125.0) |
| Pro Forma HoldCo Cash [4] | | Book Value | | | | | | | | | 117.4 | 117.4 | 117.4 |
| **Gross Value** | | | | | | | | | | | **$886.0** | **$968.6** | **$1,084.6** |
| **HoldCo Indebtedness** | | | | | | | | | | | | **510.0** | |
| **Bond Coverage** | | | | | | | | | | | **1.7x** | **1.9x** | **2.1x** |
| Noncontrolling Interest [2] | | | | | | | | | | | | 18.9 | |
| **Value for Equity** | | | | | | | | | | | **$357.1** | **$439.7** | **$555.8** |
| Diluted Shares [5] | | | | | | | | | | | 50.98 | 52.57 | 54.01 |
| **Value per Share** | | | | | | | | | | | **$7.01** | **$8.36** | **$10.29** |
| HCHC Current Sh Px | | | | | | | | | | | | $6.36 | |
| Cash-on-Cash | | | | | | | | | | | 1.1x | 1.3x | 1.6x |

Note: See our report dated 3/15/18 for more detail on valuation rationale
(1) HC2 share is after segment-level indebtedness.
(2) Estimated as of most recently available disclosures.
(3) Management intends to realize steady-state corporate overhead closer to $25mn – recent levels are nearer to $30mn.
(4) Pro forma for $85mn of cash to be received from the sale of Benevir subsequent to quarter-end.
(5) Assumes share count dilution from RSUs and preferred equity, but excludes out-of-the-money warrants/options; treasury stock method utilized for option dilution.
Sources: Bloomberg, company filings, and Imperial Capital, LLC.

# Financial Summary

**Figure 4. HC2 Holdings, Inc.—Historical Financial Summary, FY15–LTM 3/31/18**

| ***Revenues*** | Quarter-ended | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Mar-17** | **Jun-17** | **Sep-17** | **Dec-17** | **Mar-18** | **FY15** | **FY16** | **FY17** | **LTM** |
| Telecommunications | 191.7 | 160.6 | 167.9 | 181.7 | 202.3 | 460.4 | 735.0 | 701.9 | 712.5 |
| Construction (DBM/Schuff) | 112.7 | 138.9 | 151.7 | 175.7 | 158.9 | 513.8 | 502.7 | 579.0 | 625.2 |
| Marine Services | 44.2 | 36.4 | 42.8 | 46.1 | 36.7 | 134.9 | 161.9 | 169.5 | 162.0 |
| Energy (ANG fka Utilities) | 4.3 | 4.1 | 3.9 | 4.1 | 4.5 | 6.8 | 6.4 | 16.4 | 16.6 |
| Insurance | 36.0 | 38.3 | 37.7 | 39.5 | 40.2 | 2.9 | 142.5 | 151.6 | 155.8 |
| Broadcasting | - | - | - | - | 10.7 | - | - | - | 10.7 |
| Other | 1.6 | 0.4 | 2.4 | 11.4 | 0.4 | 2.1 | 9.7 | 15.8 | 14.6 |
| **Total Net Revenue** | **390.6** | **378.7** | **406.4** | **458.5** | **453.7** | **1,120.8** | **1,558.1** | **1,634.1** | **1,697.2** |

| ***EBITDA*** | Quarter-ended | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Mar-17** | **Jun-17** | **Sep-17** | **Dec-17** | **Mar-18** | **FY15** | **FY16** | **FY17** | **LTM** |
| Telecommunications | 1.7 | 2.2 | 1.5 | 1.6 | 1.1 | 2.0 | 5.6 | 6.9 | 6.4 |
| Construction (DBM/Schuff) | 8.6 | 11.1 | 16.8 | 15.1 | 10.0 | 52.0 | 59.9 | 51.6 | 53.0 |
| Marine Services | 16.3 | 3.6 | 8.8 | 15.3 | (2.4) | 42.1 | 41.2 | 44.0 | 25.2 |
| Energy (ANG fka Utilities) | 1.2 | 1.0 | 0.3 | 0.4 | 0.7 | 0.9 | 2.5 | 2.9 | 2.4 |
| **Total Core Operating** | **27.8** | **17.9** | **27.3** | **32.4** | **9.3** | **97.1** | **109.1** | **105.5** | **87.0** |
| Corporate | (5.9) | (6.3) | (8.3) | (8.7) | (6.7) | (19.5) | (25.7) | (29.2) | (29.9) |
| **Total Core Less Corporate** | **21.9** | **11.6** | **19.1** | **23.7** | **2.7** | **77.5** | **83.4** | **76.3** | **57.0** |
| Life Sciences | (4.1) | (4.9) | (8.2) | (5.2) | (4.4) | (7.2) | (12.0) | (22.4) | (22.6) |
| Broadcasting | - | - | - | - | (5.1) | - | - | - | (5.1) |
| Other | (1.2) | (2.2) | (1.1) | 1.3 | (0.2) | (18.3) | (11.2) | (3.1) | (2.1) |
| Total Life Sciences & Other | (5.2) | (7.1) | (9.3) | (3.9) | (9.6) | (25.5) | (23.3) | (25.5) | (29.8) |
| **Total EBITDA (Ex. Insurance)** | **16.7** | **4.6** | **9.8** | **19.7** | **(6.9)** | **52.1** | **60.2** | **50.8** | **27.2** |

Source: Company filings.

## *Risk Factors*

- Inability to realize value of investment portfolio
- Certain investments are subject to significant cyclicality
- The company may not be able to access capital markets to complete further material acquisitions

## *Price Chart and Ratings History*

***Not Rated***

# Important Disclosures, Certifications and Other Information

## Ratings Distribution and Definitions

| Equity Ratings Definitions (as of 7/1/09) | | |
|---|---|---|
| Outperform | 63.06% | **Outperform**: TRR expected to exceed basket by at least 10% |
| In-Line | 34.23% | **In-Line**: TRR expected to be in-line with basket |
| Underperform | 2.70% | **Underperform**: TRR expected to underperform basket by at least 10% |

This Equity Ratings Distribution reflects the percentage distribution for rated equity securities for the twelve month period 4/1/17 through 3/31/18. Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Within the twelve month period ended 3/31/18, IC has provided investment banking services to 12.86% of companies with equity rated an Outperform, 0.00% of companies with equity rated an Underperform, and 5.26% of companies with equity rated an In-Line. As of 3/31/18.

**Fixed Income Ratings Definitions and Equity Ratings Definitions (prior to 7/1/09)**

**Buy**: TRR expected to exceed basket by at least 10%
**Hold**: TRR expected to be in-line with basket
**Sell**: TRR expected to underperform basket by at least 10%

Rating definitions are expressed as the total rate of return (TRR) relative to the expected performance of a basket of like securities over a 12-month period. Please refer to our publication dated 7/1/09 for details associated with the transition of our Equity Ratings to the current definitions.

***For a discussion of the valuation methods used to determine our price target, if any, please see page 3. See page 5 for the risks that may impede achievement of such price target, and page 5 for our ratings history and price chart.***

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| COMPANY | DISCLOSURE |
|---|---|
| HC2 Holdings, Inc. | None |

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