

HC2 Holdings, Inc. (HCHC – \$2.73*)
Buy; \$8.50 PT; \$127.1M Market Cap

Breaking News
Tuesday, July 14, 2020

Announces Pursuit of Strategic Alternatives for HCHC's Wholesale Telecom Segment

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Summary and Recommendation

On 7/14, before the market open, Buy-rated HCHC (Buy, \$8.50 PT) announced the pursuit of strategic alternatives for PTGi. As a reminder, HCHC's PTGi business is an international wholesale telecom service company that provides voice and data call termination. This segment operates in a highly competitive market, with declining usage rates, and pricing pressures. We note: this segment generated sales/EBITDA of \$794M/\$5M in FY18 vs. \$696M/\$3M in FY19. While segment sales are a material driver to HCHC's consolidated P&L, given the low margin nature of this business segment, the profit contribution is minimal. As a result, we value HCHC's wholesale telecom asset at ~\$5M, based on 3x our FY21 EBITDA estimate, in our SOTP valuation analysis.

Even though we are encouraged by the announcement of a strategic review, the potential sale of PTGi might not make a material contribution in de-leveraging HCHC's current balance sheet, in our view. Rather, we believe this announcement supports our thesis that the refreshed board and management team is taking a thoughtful approach in evaluating which of the company's operating segments will be deemed "core" vs. "non-core" going forward. Recall, HCHC is also reviewing alternatives for both the company's insurance and construction segments.

We reiterate our Buy rating, as we continue to see multiple catalysts on the horizon at HCHC that could unlock shareholder value, including monetizing "larger" non-core assets to materially de-lever the balance sheet. We further anticipate the continued reduction of corporate overhead to be a component of management's value creation plan.

Analyst certification and important disclosures can be found on pages 4 - 7 of this report.

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Valuation

Our price target of \$8.50 is based on a sum-of-the-parts analysis.

Business Unit	Financial Statistic Description	Statistic		Est.
		(Ms)	Multiple	Valuation
DBM Global	FY21E EBITDA - 92.5% ownership	\$65	7.0	\$455
HMN JV 30% stake sale	30% interest sold to Hengtong Optic-Electric	\$285	30%	\$86
HMN JV 19% stake put-option	19% interest under 2-year put-option (\$285M or FMV)	\$285	19%	\$54
ICS Group Holdings	FY21E EBITDA - 100% ownership	\$2	3.0	\$5
Pansend Life Sciences	Cost basis of total investments below (per HCHC filings):			
MediBeacon	42% ownership	\$300	42%	\$125
R2 Technologies	56% ownership	\$80	56%	\$45
BeneVir Biopharm Inc.	Potential payments to HC2 from milestone achievements	\$512	10%	\$51
Genovel Orthopedics	75% ownership	\$4	0.0	\$0
Triple Ring Technologies	27% ownership	\$3	0.0	\$0
Continental Insurance Group	Total adjusted capital of \$347M	\$347	0.7	\$226
American Natural Gas	69% ownership; valuing at investment cost	\$92	1.0	\$92
HC2 Broadcasting Holdings	Cost basis of total investments (per HCHC filings)	\$179	1.0	\$179
Total Sum of the Parts				\$1,316
Minus:				
Corporate expenses	FY21E Corporate Expenses	\$25.0	5	\$125
Total debt (1Q 2020)				\$712
Less: cash, cash equivalents, restricted cash, and ~\$122M insurance co. cash				\$65
Net debt (cash)				\$647
Less: \$55M conv. notes	Assume conversion into ~12.6M shares of HCHC stock			(\$55)
Preferred stock (\$10M)	Assume conversion into ~2.2M shares of HCHC stock			\$0
Noncontrolling interest				\$76
Total HCHC equity value				\$522
Est. diluted shares	Includes ~14.8M shares of HCHC stock assumed from conversions above			61.2
Est. HCHC Net Asset Value				\$8.53

\$ in millions.

Risks

Acquisition/Integration. The company actively evaluates potential acquisitions as part of its growth strategy. Acquisitions pursued by the company could be dilutive to financial results and result in a difficult, dilutive, or expensive integration.

Acquisition/Integration. The company recently completed acquisition(s). If the company fails to successfully integrate the acquisition, the deal may lead to disappointing returns.

Growth plan. There are many factors that may impact the company's ability to achieve its stated growth objectives.

Insider ownership. Directors and executive officers collectively own a significant percentage of the company. While this may align interest with other shareholders, investors might view a future sale by any director or officer negatively.

Liquidity and solvency. The company has a significant debt load and interest expense, which may hamper its ability to invest in the business. Also, the company may need to raise additional capital in the future, and access to such capital is difficult to predict.

General industry. The company could miss our estimates and/or its financial guidance.

Competition. The company operates in a highly competitive environment for acquisition opportunities, including from public companies with similar business strategies, investment partnerships, blank-check companies, private equity firms, among others.

Economy. A decline in economic growth or economic disruptions could have a negative impact on the company's operating units and financial results.

Foreign currency risk. The company has operations outside of the U.S., primarily in the U.K., exposing the company to foreign currency exchange rate fluctuations, which could adversely impact the company's operations and/or financial condition.

Holding company. The company is a publicly traded holding company, and its equity interests in operating subsidiaries and other investments comprise primarily all of its assets. As a result, the company's principal revenue and cash flow is distributions from subsidiaries, which may be limited by law or by contract in making certain distributions to the holding entity. Further, the holding company's ability to service debt and/or to finance future acquisitions are dependent on the ability of subsidiaries to make upstream cash distributions.

Insurance operations. The company's insurance operations are subject to legal restrictions and regulatory requirements, including the amount of statutory capital that must be held to maintain financial strength. Further, financial results from the insurance operations could be negatively affected if actual performance differs from management's assumptions and estimates.

International operations. The company operates in international markets and could in the future pursue additional investments in foreign entities. Exposure to international laws, regulations, politics, taxes, and currency poses risk to the company's operations.

Minority investments. The company owns a minority interest in a number of entities, over which the company does not exercise control and/or has little to limited influence. As a result, the company may be unable to direct or manage those operations to drive value.

Loss of key personnel. The current management team will be instrumental in executing the company's growth strategy. The resignation or loss of a key member of management would have a negative impact on the company.

Significant stockholder security sales. Future sales of substantial amounts of common stock by holders of preferred stock, or by other significant stockholders, could adversely impact the market price of the company's common shares.

Pandemic. The global spread of the novel coronavirus (labeled COVID-19) has created significant uncertainty and economic disruption (both in the near term and, potentially, long term). The extent to which a pandemic could affect the company's operations, financial condition, and supply chain is difficult to predict and depends on evolving factors, including: duration, scope, government actions, and other social responses. The company could, therefore, experience material/adverse impacts to its business and financial results.

*Closing price of last trading day immediately prior to the date of this publication unless otherwise indicated.

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Rating	B. Riley FBR Research Distribution ¹	B. Riley FBR Banking Services in the past 12 months ¹
BUY [Buy]	71.29%	32.55%
HOLD [Neutral]	28.23%	26.27%
SELL [Sell]	0.48%	0.00%

(1) As of midnight on the business day immediately prior to the date of this publication.

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