QQ2 2020 HC2 Holdings Inc Earnings Call

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TEXT version of Transcript

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Corporate Participants

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* Michael J. Sena

HC2 Holdings, Inc. - CFO

* Wayne Barr

HC2 Holdings, Inc. - Interim CEO & Director

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Conference Call Participants

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* Craig N. Carlozzi

Longfellow Investment Management Co. LLC - Portfolio Manager

* Sarkis Sherbetchyan

B. Riley FBR, Inc., Research Division - Associate Analyst

* Garrett Edson

ICR, LLC - SVP

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Presentation

Operator [1]

Greetings. Welcome to HC2 Holdings, Inc. Second Quarter 2020 Earnings Call. (Operator Instructions) Please note, this conference is being recorded.

I will now turn the conference over to your host, Garrett Edson of ICR. Thank you. You may begin.

Garrett Edson, ICR, LLC - SVP [2]

Thank you, and good afternoon. We'd like to thank you for joining us to review HC2's Second Quarter 2020 Earnings Results. With me today are Wayne Barr, Interim CEO of HC2; and Mike Sena, HC2's Chief Financial Officer. This afternoon's call is being webcast on our website at HC2.com in the Investor Relations section.

We also invite you to follow along with our webcast presentation, which can be accessed on HC2's website, again, in the IR section. A replay of this call will be available approximately 1 hour after the call. The dial-in for the replay is 1 (844) 512-2921 with the confirmation code of 13707250.

Before I turn the call over to Wayne, I'd like to remind everyone that certain statements and assumptions in this earnings call, which are not historical facts, will be forward-looking and are being made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, including, among others, statements related to the expected or potential impact of the novel coronavirus, COVID-19 pandemic and the related responses of the government and HC2 on our business, financial condition and results of operations and any such forward-looking statements, whether concerning the COVID-19, pandemic or otherwise, involve risks, assumptions and uncertainties. These forward-looking statements are subject to certain assumptions and risk factors that could cause HC2's actual results to differ materially from these forward-looking statements.

The risk factors that could cause these differences are more fully discussed in our filings with the SEC. In addition, the forward-looking statements included in this conference call are only made as of the date of this call and are as stated in our SEC reports. HC2 disclaims any intent or obligation to update or revise these forward-looking statements except as expressly required by law. During the call, management will provide certain information that will constitute non-GAAP financial measures under the SEC rules, such as but not limited to, adjusted EBITDA, insurance, adjusted operating income and insurance pretax adjusted operating income. Certain information required to be disclosed about these non-GAAP measures, including reconciliations with the most comparable GAAP measures is available in the most recent earnings press release, which is also available on our website.

And finally, as a reminder, this call cannot be taped or otherwise duplicated without the company's prior consent.

Now I'd like to turn the call over to HC2's Interim CEO, Wayne Barr. Wayne?

Wayne Barr, HC2 Holdings, Inc. - Interim CEO & Director [3]

Thanks, Garrett, and good afternoon, everyone. Thank you for joining us, and we hope you and your families continue to remain safe and healthy. I also want to give special thanks to all of our employees at HC2 and our subsidiaries who continue to work tirelessly during these very challenging times to serve all of our customers across our portfolio of businesses. Your efforts are greatly appreciated.

Let me quickly introduce myself. I've been a director on HC2's Board since the inception of the company. Since taking on the additional role of interim CEO, I've had the opportunity to catch up with our entire corporate management team as well as all of our subsidiaries. We have a business that has great potential to unlock significant value, and I look forward to working with the team in this role and continuing to contribute to HC2's long-term success.

On today's call, I'll walk through some second quarter highlights, discuss the continued impact of COVID and our strategies regarding our business, and address our efforts for completing a successful refinancing, which is key to setting us up for long-term success. Our CFO, Mike Sena, will then provide more details on our second quarter performance, and then we'll take some questions. Our second quarter was clearly impacted as the country was by the ongoing COVID-19 pandemic. That said, there were a number of bright spots for HC2 in the quarter, which are helping set the stage to execute further on our priorities of debt and overhead reduction.

Starting with our Energy segment, the recently renamed (inaudible) , which was formerly known as American Natural Energy, continues to perform very well, more than tripling its adjusted EBITDA, compared to the prior year period, aided by the Alternative Fuels Tax Credit and the additional 20 fueling stations in the Southeast U.S., we acquired last year. We have been very pleased with (inaudible) recent performance. And the fueling station acquisitions, the renewal of the AFTC and macroeconomic conditions favoring (inaudible) business model have significantly strengthened its positioning in the marketplace.

Second, our construction segment generated adjusted EBITDA in the quarter of over $19 million, more than doubling our first quarter 2020 performance and providing further evidence of the resilient business we have built-in construction over the past few years.

In addition, at our Life Sciences segment in April, our 2 technologies received an additional $10 million equity investment from Huadong at a post-money valuation of $90 million to further fund the company's efforts as it gets closer to commercialization. As a reminder, under an exclusive distribution agreement, Huadong will distribute R2 skin lightning devices and products in Greater China and other Asia Pacific countries.

We also completed the sale of our 30% ownership in HMN, while still retaining a 19% put option that is exercisable in 2 years and utilize the net proceeds to further reduce the amount of principal outstanding on our 11.5% notes by $51 million. Since the beginning of 2020, we've now reduced the principal on these notes by approximately 27% to $342 million, allowing us to realize approximately $15 million in annual interest savings moving forward. With respect to the impact COVID-19 has had on HC2, we have adapted to the current circumstances as best as possible and continue to work closely with the management teams of our subsidiaries to ensure we are aiding them in every possible way.

As we enter the 6-month of the pandemic, we want to provide a more detailed update on those businesses that continued to be most affected by COVID.

At construction, the evolving COVID situation and lower oil and gas prices continue to cause some level of disruption to active project work and delays in new project awards. Most impacted has been DBM's Industrial Services business, GrayWolf, which has seen certain customers opt to defer routine maintenance and repair work or to either delay or cancel new capital projects. And while DBM received approximately $97 million in net new awards in the second quarter and continues to maintain a substantial adjusted backlog of $714 million, we have yet to see the pace of new project awards return to pre-COVID levels. As we noted on our last call, we expect a decline in construction's adjusted EBITDA for 2020, as compared to last year. Rustin and team have done an exceptional job navigating DBM through this challenging period and prioritizing the health and safety of their employees.

The company has been very effective in adapting processes and maintaining operational efficiencies while ensuring compliance with applicable safety guidelines and also avoiding potential delays on active projects. If these pandemic-related actions have resulted in increased costs, putting pressure on both active and out-for-bid project margins. To mitigate the effects of these additional costs and the potential impact of further slips in new awards, the company is undertaking all necessary steps to protect the business, including certain targeted cost reductions.

Despite the challenges posed by COVID and disruptions to the commercial and industrial construction markets, we remain confident in the long-term potential of DBM and believe it is positioned to rebound nicely once the effects of the pandemic subside. There also continues to be minimal impact to accounts receivable collections, which remains a credit to the high-quality of DBM's customers. At broadcasting, the deferral of the advertising spending continues industry-wide, and that may have some impact on the segment's top line in the near term.

We also continue to believe the expected benefits from our recent larger revenue share agreements will also be deferred to 2021. That said, we continue to believe our broadcast distribution platform remains a significant growth opportunity for HC2, given the broad geographic reach of our station group and the ongoing acceleration of cable cord cutting across the country. Meanwhile, at our Life Sciences division, COVID thus far has had minimal impact on the timing of R2's expected commercial launch and MediBeacon's progress toward regulatory approval. In fact, barring any COVID-related issues are 2 plans to commence its preorder process later in the third quarter, in advance of the fourth quarter or early 2021 launch. As a reminder, both R2 and MediBeacon are fully funded for ongoing activities and as a result, we currently do not anticipate the need for further capital investment from HC2. As we look at the back half of 2020, there will be some additional impact to our results due to COVID. However, our near-term strategic priorities are clear, significantly improve our capital structure and reduced Holdco cost.

To that end, over the past couple of months, our management team and the Board have been comprehensively evaluating our portfolio of businesses to determine the best way to unlock value and position the company for long-term success. We are keenly aware that the first major near-term goal is to execute on the successful refinancing of our 11.5% notes. This will set the stage to create long-term value. We have made strong progress thus far in 2020 by reducing the principle of these notes by nearly $130 million, thanks to the completion of the Global Marine and HMN sales, a great outcome for HC2 and given the regulatory concerns, a testament to our ability to complete a challenging transaction at an appropriate valuation. With the Marine sale behind us, our immediate focus is now on best positioning HC2 for when we go-to-market to refinance. This requires laying some additional groundwork over the next couple of months to properly prepare us for what lies ahead. First, we continue to evaluate all of our businesses and strategic alternatives to determine if there are one or more opportunities that we can pursue to ensure the successful improvement of our capital structure and improve our balance sheet.

As previously communicated, we announced that we have stepped away from the exclusive discussions with the potential acquirer of Continental Insurance. We are again actively reviewing our options with respect to Continental, including how best to reorganize this business for the benefit of all of our stakeholders. We also continue to explore all options available to us through DBM to further optimize our capital structure, but are unable to comment any further on either process at this time.

Last month, we announced that we were seeking strategic alternatives for PTGI carrier services, our telecom subsidiary, which would help further simplify our overall business in advance of the refinancing. The amount of net proceeds we would expect from a potential sale would likely not meet the conditions to qualify as an asset sale under our 11.5% notes indenture. As a result, should we execute on a transaction there, we would expect to utilize net proceeds for working capital purposes.

Finally, at broadcasting, we are working diligently to refinance the indebtedness at the segment's Holdco level, which is due in October. We have a strong relationship with our lenders and are currently in close discussions with them on extending the maturity and expect to be able to make an announcement to that end in the coming weeks. As part of the refinancing, we will look to sell several noncore stations to reduce the principle on these notes. However, the vast majority of our broadcasting platform will remain intact and with our network of over 230 stations, it remains well positioned to take advantage of opportunities out there as cord cutting further accelerates.

In addition, we continue to evaluate our options with respect to our retained interest in HMN as well as our other holdings to determine if there is additional value that can be unlocked to benefit HC2's efforts to refinance its indebtedness. With the addition of our 4 new Board members in mid-May and the reconstitution of our Board at our annual meeting last week, it has been all hands on deck to achieve this goal, allow us to move forward as a company and position HC2 for long-term sustained success.

The continued evaluation of opportunities presented by our operating segments is coupled with ongoing efforts to reduce our corporate level cost structure and we are trying to leave no stone unturned there. We are undertaking a comprehensive review of corporate expenses and continued to identify other costs that can be rationalized.

The results of these efforts will improve our liquidity and make HC2 more attractive when we embark upon our refinancing. While we are still working through the logistics of consolidating the space with the broadcasting business, we have already made progress on rationalizing and downsizing at our current headquarters in New York City from 3 floors of office space to a single floor. Once completed, we expect our lease expense will be substantially reduced from its current level. At this point, we currently expect to realize annualized savings of 35% to 40% of corporate real estate cost savings from the $2 million in 2019.

We've recently revised our executive compensation plan for 2020, moving away from the historic NAV-based structure and replacing it with a more traditional plan that will significantly reduce our cash needs. While I am the interim CEO, I was put in place to get things accomplished, and it's all hands on deck here. We are laser-focused and already taking the steps necessary for a successful refinancing. We've consolidated all of our employees onto one floor. We have terminated the management services agreement with HCP. We are in the final stages of extending the indebtedness at broadcasting, all while looking at a variety of ways to extract the greatest value from the portfolio.

We have been able to act quickly and effectively, thanks to our great team. Our team and I have known each other for years, and that has enabled us to quickly come together and hit the ground running. As we look ahead, while we continue to navigate through the pandemic, we are pleased that the refreshed and strengthened Board and management team are firmly aligned with respect to what we need to achieve in the near future and beyond.

We are laser-focused on reducing corporate expenses and getting the refinancing at the Holdco level done as soon as possible to generate a successful outcome and position HC2 for a long-term value creation. We will continue to pursue multiple paths to recognize value while ensuring that we do not see the upside opportunity. By executing in the near term, we will be best positioned for the long-term to strengthen our balance sheet and maximize the full potential and value of our businesses. With that, I'll turn the call over to our CFO, Mike Sena, who will discuss some of the financial highlights.

Michael J. Sena, HC2 Holdings, Inc. - CFO [4]

Thank you, Wayne. Let's review our second quarter performance. Consolidated total net revenue for the second quarter 2020 was $377 million, compared to $479.2 million in the prior year period as revenue -- as lower revenues from the Telecommunications, Construction and Broadcasting segments as well as the Insurance segment, net of eliminations, were partially offset by an increase in revenue from Energy.

In particular, Telecommunications revenue was down primarily due to normal variability and industry pressures. Net income attributable to common and participating preferred stockholders for the second quarter of 2020 was $12.7 million or $0.26 per share compared to net income of $9 million or $0.12 per share in the prior year period. Second quarter 2019 net income attributable to continuing operations was

$0.24 per share. At the company's core operating subsidiaries, which comprises of HC2's Construction, Energy and Telecom segments, adjusted EBITDA for the second quarter of 2020 was $23.5 million compared to $25.2 million in the prior year period as improvements in Energy were more than offset by reduced contributions from Construction and Telecom. Total adjusted EBITDA, which excludes our Insurance segment, was $15.2 million in the second quarter of 2020 compared to adjusted EBITDA of $25.5 million in the prior year period. The difference in the adjusted EBITDA compared to the prior year period was driven by lower income at our other segment, which now includes equity income from the 19% piece of the HMN joint venture.

The decline in the Other segment from the prior year period was due to lower profits at the HMN joint venture due timing of turnkey project work. Also contributing to the lower adjusted EBITDA was an increase in losses from our Life Sciences segment due primarily to R2, which increased spending from the comparable period to ramp up efforts to achieve commercialization of its products.

Let's just take a couple of minutes to go into a bit more detail in a few of our segments. At Construction, we recorded adjusted EBITDA for the second quarter of 2020 of $19.1 million compared to $23.1 million in the prior year period. Second quarter 2020 results were impacted by the timing of commercial project work under execution and lower contribution from industrial maintenance and repair project work, primarily due to COVID, combined with depressed oil and gas prices. As Wayne mentioned, DBM has taken a series of pandemic-related actions that have resulted in $8.4 million of incremental costs attributable to cleaning, additional steps taken by employees in maintaining appropriate social distance and other measures to comply with safety guidelines.

We have excluded these costs to arrive at adjusted EBITDA as they specific -- as they are specifically related to COVID-19, however, these are cash costs. As of June 30, 2020, reported backlog was $410 million, adjusted backlog, which takes into consideration awarded but not yet signed contracts was $714 million, mainly consistent of smaller to medium-sized projects and which provide construction with significant visibility. While we still saw a significant amount of unawarded projects in the quarter, we are also beginning to see some release, as evidenced by the $97 million in net new awards signed into reported backlog by DBM in the quarter.

That said, we expect the pandemic to continue to have an impact on timing of projects for the foreseeable future. And as a result, we continue to believe adjusted EBITDA for Construction for the full year 2020 will be below full year 2019.

At Energy, we recorded adjusted EBITDA in the second quarter of $4.2 million compared to adjusted EBITDA of $1.3 million in the prior year period. This segment continued to benefit in the quarter from the renewal of the Alternative Fuels Tax Credit, or AFTC, which had not yet been approved in the second quarter of 2019 as well as AMG's acquisition of 20 CNG stations at the end of the second quarter of 2019.

The AFTC is in effect through December 31, 2020. As a reminder, it is typical that the AFTC is only renewed for the current year and 1-year forward, rather than for multiple years in advance, but we remain optimistic that compressed natural gas continues to receive support on Capital Hill. The gross tax credit, which equals -- which equates to $0.50 per gasoline gallon equivalent is shared with our customers as an incentive for them to continue the conversion of our fleet to CNG, and over time, larger CNG fleets would mean greater volumes for our stations.

Meanwhile, at Insurance, we generated pretax adjusted operating income for the second quarter of $14.6 million compared to $33 million in the prior year period. The reduced pretax AOI was primarily driven by nonrecurring favorable claims activity, specifically related to the impacts on the reserves resulting from approved premium rate increases recognized in the prior year period, and additional unfavorable claims activity and reserve developments in the current quarter.

Claims activity for purposes of reserves is forecast on a linear basis, while actual claims activity is not. And as such, periods of favorable and nonfavorable claims activity is normal. Insurance also incurred larger expenses due to increases in headcount to support the segment's growth. As of June 30, 2020, insurance had cash and invested assets of $4.5 billion, total GAAP assets of $5.7 billion, and an estimated $360 million of total adjusted capital. At the end of the quarter, HC2 had consolidated cash, cash equivalents and investments of $4.6 billion, which includes cash and investments associated with HC2's Insurance segment. Excluding Insurance, consolidated cash was $64.3 million. Corporate expenses for the second quarter of 2020 were $3.6 million, a $800,000 decrease from the prior year period as lower bonus expense resulted from changes during the quarter in the bonus plans and was largely offset by some onetime expenses in the quarter related to the CEO transition.

As Wayne noted in his remarks, we continue to focus on significantly and responsibly reducing overhead at the Holdco level, particularly in the face of the pandemic. During the second quarter, we completed another partial redemption of our 11.5% notes, reducing our note principal by another $51 million. As of June 30, there is just over $342 million of outstanding principal on our 11.5% notes, a 27% reduction from where it stood at the beginning of 2020. The decrease in aggregate principal outstanding provides us with annualized interest savings of $15 million.

Our primary focus as we traverse the remainder of 2020 is on our liquidity and refinancing. The company and the world have faced significant challenges during the first half of 2020. Our businesses have stood up well during these times. However, we have begun to feel the impacts of various factors included unanticipated costs and COVID on our upstream cash. As such, we are focused on pursuing the right strategic transactions across our portfolio to generate cash, along with other meaningful strategies for liquidity purposes.

This includes our announcement on PTGI, and as Wayne touched on earlier, potential options with respect to our HMN interest. While we are confident we will be able to execute on such measures, we also have various internal measures we can put into play to provide corporate level liquidity from our subsidiaries in the near-term in excess of $25 million. Based on these factors and plans, we feel comfortable in our ability to meet our liquidity needs over the next 12 months. We remain keenly focused on our overall liquidity position, further expense reductions and pursuing our strategic initiatives to reduce holding company debt and unlock value within the HC2 portfolio.

I'd now like to open the call up for questions. Operator?

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Questions and Answers

Operator [1]

(Operator Instructions) Our first question is from Sarkis Sherbetchyan with B. Riley.

Sarkis Sherbetchyan, B. Riley FBR, Inc., Research Division - Associate Analyst [2]

Just to start. So I guess trying to get some clarity on what segments or assets does the board and management view as core today? Or I suppose, strategic to HC2's operations from this point forward?

Wayne Barr, HC2 Holdings, Inc. - Interim CEO & Director [3]

Sure. Sarkis, it's Wayne. So obviously, there can be different approaches as to in different views as to what is core and what isn't core, but I think the main thing to kind of think about is that there's just been the singular and kind of uniting at the Board and at the management around the commitment to kind of reduce the debt obviously and to reduce our corporate overhead and kind of -- and continuing along those lines, we're looking at all of the assets that we have. We're taking a fresh look from a Board perspective and making -- trying to make those determinations. And as soon as those decisions are made, we'll be announcing those paths forward, and we'll be getting back to you.

Sarkis Sherbetchyan, B. Riley FBR, Inc., Research Division - Associate Analyst [4]

And for kind of the corporate level overhead, I think you had some comments on the prepared remarks. I guess if we look at the run rate of corporate overhead costs going forward, what should we kind of expect as both an opportunity and kind of the run rate from this point forward?

Michael J. Sena, HC2 Holdings, Inc. - CFO [5]

Yes. Sarkis, this is Mike. As you can see, we have been continuing to work down our corporate overheads. And this quarter, we continued on that trend. We're looking at everything across the Board to continue to push those down. I think that we're starting to get to a real level. So for the quarter, we were $3.6 million. And that is where we're at today, and we will continue to try and work to find ways to bring that number down over the next few quarters.

Sarkis Sherbetchyan, B. Riley FBR, Inc., Research Division - Associate Analyst [6]

Got it. And in a recently filed proxy statement, there were some changes mentioned to the incentive comp program. I guess, moving from a bonus plan based on NAV to one that's maybe more so key business goals or objectives, I guess can you maybe specifically highlight what those objectives are over and above the obvious need to successfully refi the debt?

Wayne Barr, HC2 Holdings, Inc. - Interim CEO & Director [7]

Yes. Well, for 2020, you hit the nail on the head. That is the key KPI that we're all operating to. And that is to get this debt refinanced. And so for 2020, while we've announced that we're moving away from the NAV and we are the KPI that we're focused on right now is the primary focus of the company across the Board, which is reducing the debt.

We are working on what the bonus plan will look like for 2021. And when the compensation committee finishes its work, we'll be able to provide a much more fulsome description of that particular plan.

Sarkis Sherbetchyan, B. Riley FBR, Inc., Research Division - Associate Analyst [8]

Got it. One more for me, and this more so relates to the Life Sciences portfolio asset. I think you mentioned kind of despite some of the challenges brought on from COVID that the R2 technology is likely to be for preorder here in 3Q and 4Q launch coming up, kind of want to understand what does that mean from either a operating expense standpoint for that division or maybe some target sales or kind of profit metrics that you guys can maybe share on that?

Michael J. Sena, HC2 Holdings, Inc. - CFO [9]

Yes. This is Mike, Sarkis. We don't really give guidance out as far as that goes. But they received the second tranche of their $10 million will continue to spend through that. That's to help them get through the launch here. And there's a ramp-up that's associated with launching the product. So I think right now, I would just focus on the spend through the $10 million.

Operator [10]

(Operator Instructions) Our next question is from Craig Carlozzi with Longfellow.

Craig N. Carlozzi, Longfellow Investment Management Co. LLC - Portfolio Manager [11]

I was wondering if you could give us a holding company liquidity number as of, I guess, today, ideally and perhaps walk through some of the sources and uses for the remainder of 2020, just to bridge our level of comfort should any asset sales be delayed?

Michael J. Sena, HC2 Holdings, Inc. - CFO [12]

Sure. Thanks for the question. We've pulled up over $20 million to date through deck -- through today, which includes the $5 million dividend or $4.5 million that came to HC2 in August. We're working on various strategic options to generate liquidity. However, to the extent those strategic options take longer than expected. We do have the ability to provide liquidity for the remainder of the year, and we're comfortable there. Our sources of cash, of course, are continued our overhead costs and along with our interest payment in December.

Craig N. Carlozzi, Longfellow Investment Management Co. LLC - Portfolio Manager [13]

Are you willing to disclose the liquidity today at the holding company?

Michael J. Sena, HC2 Holdings, Inc. - CFO [14]

Well, we have the -- we've disclosed our cash at June 30, which was just under $1 million. We received the $4.5 million from DBM, and we have the ability to pull additional $25 million of liquidity through the end of the year.

Operator [15]

We have reached the end of our question-and-answer session. I would like to turn the conference back over to Wayne for closing remarks.

Wayne Barr, HC2 Holdings, Inc. - Interim CEO & Director [16]

Thank you. I'd like to thank everybody for joining us this afternoon. And hope that you stay tuned for some exciting things that they're on the horizon for HC2 and hope that you and your families are staying safe through the pandemic. Have a nice evening.

Operator [17]

Thank you. This concludes today's conference. You may disconnect your lines at this time, and thank you for your participation.