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HC2 Holdings, Inc. (HCHC – $2.27*)

Diversified Industrials: Producer Manufacturing
Buy; $8.50 PT; $165.9M Market Cap
Company Update
Thursday, November 5, 2020

Discovery Group

3Q Earnings Preview; In Progress Rights Offering Could Help Alleviate HoldCo Interest/Overhead Until a Material Asset Conversion Event Occurs to Reduce Balance Sheet Leverage

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STOCK DATA

Market Cap (mil)	$165.9
52-Week Range	$1.29 – $4.32
3-Month ADTV	277,104
Shares Outstanding (mil)	73.1
Float (%)	71.7
Short Interest	3,723,952
Enterprise Val. (mil)	$732.2
Fiscal Year-End	December

EARNINGS DATA

EBITDA (mil) Operating	2019A	2020E	2021E
1Q	$14.3	$13.2A	$12.5
2Q	$34.8	$23.5A	$16.6
3Q	$34.2	$16.4	$24.2
4Q	$43.5	$19.4	$24.2
FY	$126.8	$72.6	$77.5
EV/EBITDA	5.8x	10.1x	9.4x

Core subsidiaries EBITDA (Construction, Energy, and Telecom segments).

FINANCIAL DATA

FY	2019A	2020E	2021E
Rev. (mil)	$1,984.1	$1,621.3	$1,672.0
ROE	(0.1)%	(0.4)%	(0.2)%
Debt/Capital	64.3%	63.4%	66.2%
BV/Share	$6.38	$6.07	$5.57

BALANCE SHEET DATA

	2Q20
Cash & Equivalents	$203.8
Accounts Receivable	$261.2
Accounts Payable	$283.0
Long-Term Debt	$633.8
Total Debt	$633.8
Shareholders' Equity	$319.3
Debt/Cap	66.5%

$ in millions unless otherwise specified.Cash & equivalents includes ~$140M in "Insurance" segment.

Summary and Recommendation

Buy-rated HC2 Holdings (HCHC, $8.50 PT) reports 3Q results after market close on Monday, 11/9, and will host its EPS call at 5:00PM ET (dial-in: 1.877.705.6003; ID: 13712462). We model revenues/adjusted EBITDA of $310M/$16M from HCHC's core operating subsidiaries (construction, telecom, and energy), and outline our 3Q expectations for the segments in Exhibit I: "Segment Level Estimates" on page 2 of this report. We are the only analyst with published estimates. Recall in early October, HCHC quietly disclosed the sale of its wholesale telecom subsidiary to GoIP Global Inc. for an undisclosed sum in an 8-K filing. In that regard, the segment could have been sold for a lower valuation vs. our ~$5M projection in our SOTP analysis. While an asset sale is encouraging, we reason this divestiture does not materially contribute to de-leveraging HCHC's current balance sheet. We further highlight: HCHC is in the process of raising up to ~$65M of capital via a common stock rights offering. We believe HCHC could use proceeds from the rights offering to help alleviate upcoming HoldCo interest/overhead expenses until a material asset monetization event occurs to reduce balance sheet leverage. As a reminder, HCHC continues to evaluate the portfolio for monetization opportunities to reduce the debt load, including reviewing options for the insurance and construction segments. We reiterate our Buy and $8.50 price target as we continue to believe multiple catalysts are on the horizon at HCHC, including the harvesting of one or more assets to reduce debt, refinancing the debt, and the reduction of corporate overhead, all of which, we believe, should contribute to narrowing the valuation gap between the share price and HCHC's net asset value.

Key Points

- **3Q estimates.** We model revenues/adjusted EBITDA of $310M/$16M from HCHC's "core" operating subsidiaries (construction, telecom, and energy). We model 3Q adjusted EBITDA of $12M for the construction segment, down from $19M in from the prior year period due as we attempt to factor in some level of disruption to active projects, as well as potential delays in new projects awarded to the segment due to the pandemic. While guidance was not provided, the contracted backlog stood at ~$410M as of 2Q, with the unit receiving ~$97M in net new awards last quarter and maintaining an adjusted backlog of ~$714M. We further forecast energy/telecom segment adjusted EBITDA of $4M/$0.5M, respectively. In that regard, we expect the energy segment to benefit from the alternative fuels tax credit (AFTC) and acquired stations vs. the year ago period. Meanwhile, we expect competitive pressures to continue in the international wholesale telecom market. To boot, HCHC disclosed the sale of the Telecom segment for an immaterial sum (see section below). We further forecast ($11M) of loss contribution from HCHC's life sciences, broadcasting, and other investments, and a pre-tax adjusted operating profit from the insurance division. Within the life sciences portfolio, R2 Technologies could start the pre-order process for its FDA-approved CryoAesthetic device, in advance of a 4Q20/early 2021 commercial launch, while R&D/clinical trials continue for MediBeacon's real-time kidney function measurement system. At the broadcast segment, we anticipate advertising revenues to face near-term pressure, but be well positioned for intermediate to long term growth factors. Finally, we model corporate expenses of $6M for the quarter.
- **Hangs-up on telecom.** On 10/5, the company disclosed the sale of its wholesale telecom subsidiary to GoIP Global Inc. for an undisclosed sum in an 8-K filing. As a reminder, PTGi provides voice and data call termination services in a highly competitive market, with declining usage rates, and strong pricing pressures. (Continued on page 2...)

This segment generated sales/EBITDA of $794M/$5M in FY18 vs. $696M/$3M in FY19. Even though segment sales are a material driver to HCHC's consolidated P&L, the profit contribution is minimal due to the low margin nature of PTGi. Thus, while we valued HCHC's wholesale telecom asset at ~$5M in our SOTP analysis (based on 3x our FY21 EBITDA estimate), this segment could have been sold for a lower valuation vs. our projection. Although we are encouraged with the announcement of PTGi's sale, we reason the disposal of this asset does not materially contribute to de-leveraging HCHC's current balance sheet.

- **Pursuing rights offering for up to $65M of common stock.** Recall, HCHC announced plans to raise ~$65M via a common stock rights offering (one transferable subscription right distributed to purchase 0.5462 shares of HCHC stock at $2.27 per whole share for each share held as of the record date of 10/2). HCHC's existing preferred stockholders are also entitled to participate. An over-subscription right is included, permitting each participating holder that exercises basic rights fully, the option to purchase additional unsubscribed shares at expiration, which is currently slated for 11/20 (unless extended by the company). On 10/7, HCHC commenced the rights offering. We reason HCHC could use the proceeds to help alleviate upcoming interest/corporate expenses until a more material asset monetization event occurs to reduce balance sheet leverage. Importantly, the company entered into an agreement with its largest shareholder (Lancer Capital) to partially backstop the rights offering (for a total of up to $35M). Recall, Lancer Capital is an investment fund led by HCHC's chairman of the board (Avram Glazer), who recently added to Lancer's ownership stake in HCHC during June at an average price per share of ~$3.70 (according to SEC filings). Further, board member Michael Gorzynski (representing Percy Rockdale, MG Capital, and Rio Royal) has informed HCHC of his intention to subscribe in the rights offering for at least their respective subscription rights (e.g., total ownership of ~2.8M HCHC shares, which could work out to ~$3.5M of equity capital injected). Similarly, Jefferies Group, which owns ~3.5M of HCHC's common stock, has informed the company of its desire to subscribe in the rights offering (which could work out to ~$4.4M). Assuming the parties discussed above decide to participate in their respective percentages, we estimate at least ~$43M (before transaction fees/expenses) of incremental equity capitalization coming to HCHC's balance sheet. Should HCHC successfully conclude the rights offering, we believe the cash added at the HoldCo level strengthens the company into a potential debt refinancing event.

Exhibit I: Segment Level Estimates

B. Riley Securities Estimates			
3Q20 (E) ($Ms)	**Revenues**	**Adj. EBITDA**	**Adj. EBITDA Margin %**
Construction	$150.0	$12.0	8.0%
Telecom	$150.0	$0.5	0.3%
Energy	$10.0	$4.0	40.0%
Core Total	**$310.0**	**$16.5**	**5.3%**
Life Sciences	$0.0	($10.0)	NM
Broadcasting	$9.5	($1.3)	-13.7%
Other*	$0.0	$0.7	NM
Corporate	$0.0	($6.0)	NM
Total, ex. Insurance	**$319.5**	**($0.2)**	**0.0%**
	Revenues	**Pre-tax AOI**	
Insurance	$80.0	$10.0	

Source: B. Riley Securities

Valuation

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

Business Unit	Financial Statistic Description	Statistic (Ms)	Multiple	Est. Valuation
DBM Global	FY21E EBITDA - 92.5% ownership	$65	7.0	$455
HMN JV 19% stake put-option	19% interest under 2-year put-option ($285M or FMV)	$285	19%	$54
PTGi (wholesale telecom)	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 $360M	$360	0.7	$234
American Natural Energy (ANG)	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				$1,239
Minus:				
Corporate expenses	FY21E Corporate Expenses	$25.0	5	$125
Total debt (2Q 2020)				$655
Less: cash, cash equivalents, restricted cash, and ~$140M insurance co. cash				$64
Net debt (cash)				$590
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				$53
Total HCHC equity value				$526
Est. diluted shares	Includes ~14.8M shares of HCHC stock assumed from conversions above			61.5
Est. HCHC Net Asset Value				$8.56

$ 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.

HC2 Holdings, Inc. - HCHC

Model ($ in 000s)

B. Riley Securities

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	2017(A)	2018(A)	2019(A)	Q1-Mar	Q2-Jun(A)	Q3-Sep(E)	Q4-Dec	2020(E)	Q1-Mar	Q2-Jun	Q3-Sep	Q4-Dec	2021(E)
Net revenues	**1,634,124**	**1,976,700**	**1,984,100**	**444,800**	**377,000**	**399,500**	**400,000**	**1,621,300**	**396,700**	**417,400**	**428,100**	**429,800**	**1,672,000**
Cost of revenue - services	0	0	0	0	0	0	0	0	0	0	0	0	0
Cost of revenue - sales	1,313,069	1,585,205	1,424,900	346,100	262,100	278,850	276,150	1,163,200	278,125	293,225	296,225	297,325	1,164,900
Insurance benefits and acquisition expenses	108,695	197,324	234,400	72,400	63,000	65,000	65,000	265,400	65,000	65,000	65,000	65,000	260,000
SG&A expenses	182,880	218,442	214,300	52,300	48,100	52,600	52,700	205,700	53,675	54,975	54,775	54,775	218,200
D&A	31,315	31,669	32,000	600	1,100	7,000	7,100	15,800	8,200	8,200	8,200	8,200	32,800
(Gain) loss on sale or disposal of assets	(704)	(86)	(5,600)	200	(2,200)	0	0	(2,000)	0	0	0	0	0
Lease termination costs	0	0	0	0	0	0	0	0	0	0	0	0	0
Asset impairment expense	0	0	55,000	0	0	0	0	0	0	0	0	0	0
Total operating expenses	1,635,255	2,032,554	1,955,000	471,600	372,100	403,450	400,950	1,648,100	405,000	421,400	424,200	425,300	1,675,900
Income (loss) from operations	**(1,131)**	**(55,854)**	**29,100**	**(26,800)**	**4,900**	**(3,950)**	**(950)**	**(26,800)**	**(8,300)**	**(4,000)**	**3,900**	**4,500**	**(3,900)**
Interest expense	(55,098)	(75,662)	(95,100)	(21,300)	(21,400)	(18,437)	(18,437)	(79,574)	(18,437)	(18,437)	(18,437)	(18,437)	(73,749)
(Gain) loss on extinguishment or restructuring of debt	0	102,141	0	(5,800)	(3,400)	0	0	(9,200)	0	0	0	0	0
Contingent rights valuation	0	0	0	0	0	0	0	0	0	0	0	0	0
Other income (expense), net	(1,361)	196,309	7,100	2,800	64,000	0	0	66,800	0	0	0	0	0
Income (loss) from equity investees	17,840	15,355	2,200	(2,500)	(200)	0	0	(2,700)	0	0	0	0	0
Income (loss) from continuing operations, before taxes	**(39,750)**	**182,289**	**(56,700)**	**(53,600)**	**43,900**	**(22,387)**	**(19,387)**	**(51,474)**	**(26,737)**	**(22,437)**	**(14,537)**	**(13,937)**	**(77,649)**
Income tax benefit (expense)	(10,740)	(2,363)	20,600	12,600	(15,400)	5,597	4,847	7,644	6,684	5,609	3,634	3,484	19,412
Income (loss) from continuing operations	**(50,490)**	**179,926**	**(36,100)**	**(41,000)**	**28,500**	**(16,790)**	**(14,540)**	**(43,831)**	**(20,053)**	**(16,828)**	**(10,903)**	**(10,453)**	**(58,236)**
Gain (loss) from discontinued operations	0	0	0	(60,000)	0	0	0	(60,000)	0	0	0	0	0
Net income (loss)	(50,490)	179,926	(36,100)	(101,000)	28,500	(16,790)	(14,540)	(103,831)	(20,053)	(16,828)	(10,903)	(10,453)	(58,236)
Attributable to noncontrolling interests	3,580	(17,915)	4,600	17,900	(15,400)	1,000	1,000	4,500	1,000	1,000	1,000	1,000	4,000
Net income (loss) to HC2 Holdings	(46,910)	162,011	(31,500)	(83,100)	13,100	(15,790)	(13,540)	(99,331)	(19,053)	(15,828)	(9,903)	(9,453)	(54,236)
Less: Preferred stock dividends and accretion	2,767	6,409	0	400	400	400	400	1,600	400	400	400	400	1,600
Net income (loss) to common stock	**(49,677)**	**155,602**	**(31,500)**	**(83,500)**	**12,700**	**(16,190)**	**(13,940)**	**(100,931)**	**(19,453)**	**(16,228)**	**(10,303)**	**(9,853)**	**(55,836)**
Basic shares	42,824	44,300	44,800	45,900	46,800	46,900	47,000	46,650	47,100	47,200	47,300	47,400	47,250
Diluted shares	42,977	46,800	54,857	58,400	46,900	47,000	47,100	49,850	47,200	47,300	47,400	47,500	47,350
GAAP EPS	**($1.16)**	**$3.32**	**($0.70)**	**($1.82)**	**$0.27**	**($0.35)**	**($0.30)**	**($2.16)**	**($0.41)**	**($0.34)**	**($0.22)**	**($0.21)**	**($1.18)**
Adj. EBITDA By Segment:													
Construction	51,588	60,853	75,700	9,000	19,100	12,000	15,000	55,100	9,500	13,500	21,000	21,000	65,000
Energy	2,911	5,457	17,000	3,800	4,200	4,000	4,000	16,000	2,625	2,725	2,825	2,825	11,000
Telecom	6,929	5,258	3,400	400	200	450	450	1,500	375	375	375	375	1,500
Core Adj. EBITDA	**105,455**	**104,292**	**126,800**	**13,200**	**23,500**	**16,450**	**19,450**	**72,600**	**12,500**	**16,600**	**24,200**	**24,200**	**77,500**
Life Sciences	(22,366)	(14,909)	(11,800)	(4,200)	(4,500)	(10,000)	(10,000)	(28,700)	(10,000)	(10,000)	(10,000)	(10,000)	(40,000)
Broadcasting	0	(16,884)	(6,300)	(1,000)	(1,100)	(1,300)	(1,100)	(4,500)	(1,075)	(875)	(575)	25	(2,500)
Other	(3,139)	(2,180)	0	(1,600)	900	700	700	700	700	700	700	700	2,800
Corporate	(29,153)	(25,785)	(17,900)	(5,000)	(3,600)	(6,000)	(6,000)	(20,600)	(6,250)	(6,250)	(6,250)	(6,250)	(25,000)
Total adj. EBITDA, ex. Insurance	**50,797**	**44,534**	**90,800**	**1,400**	**15,200**	**(150)**	**3,050**	**19,500**	**(4,125)**	**175**	**8,075**	**8,675**	**12,800**
Common Size:													
Gross margin	13.0%	9.8%	16.4%	5.9%	13.8%	13.9%	14.7%	11.9%	13.5%	14.2%	15.6%	15.7%	14.8%
SG&A	11.2%	11.1%	10.8%	11.8%	12.8%	13.2%	13.2%	12.7%	13.5%	13.2%	12.8%	12.7%	13.1%
D&A	2.2%	2.0%	2.1%	0.7%	0.9%	1.8%	1.8%	1.3%	2.1%	2.0%	1.9%	1.9%	2.0%
Adj. EBITDA margin, ex. Financial Services	**3.4%**	**2.5%**	**5.5%**	**4.4%**	**5.1%**	**0.0%**	**1.0%**	**1.5%**	**5.3%**	**0.1%**	**2.3%**	**2.5%**	**0.9%**
Tax rate	-27.0%	1.3%	36.3%	23.5%	35.1%	25.0%	25.0%	14.8%	25.0%	25.0%	25.0%	25.0%	25.0%
Selected Balance Sheet Data:													
Cash, cash equivalents, and restricted cash	97,885	325,000	239,000	186,900	203,800	98,412	55,825	55,825	46,958	26,341	54,295	35,148	35,148
Accounts receivable, net	322,446	379,200	337,800	333,300	261,200	229,068	275,828	275,828	274,862	280,865	249,423	270,239	270,239
Accounts payable and other current liabilities	347,492	344,900	339,600	334,400	283,000	286,704	294,150	294,150	293,766	285,675	282,936	284,904	284,904
Total debt (incl. capital lease obligations)	593,172	743,900	839,300	686,000	633,800	636,111	638,422	638,422	640,733	643,044	645,356	647,667	647,667
Preferred stock	26,296	20,300	10,300	10,300	10,300	10,700	11,100	11,100	11,500	11,900	12,300	12,700	12,700
HC2 stockholders' equity	73,171	88,100	349,800	14,100	319,300	311,965	302,380	302,380	287,283	275,411	269,463	263,966	263,966
Total stockholders' equity	216,027	222,000	465,200	79,100	383,900	376,965	367,780	367,780	353,083	341,611	336,063	330,966	330,966
Valuation:													
Price	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27	$2.27
Market cap	**97,558**	**106,236**	**124,526**	**132,568**	**106,463**	**106,690**	**106,917**	**113,160**	**107,144**	**107,371**	**107,598**	**107,825**	**107,485**
Total debt (incl. capital lease obligations)	593,172	743,900	839,300	686,000	633,800	636,111	638,422	638,422	640,733	643,044	645,356	647,667	647,667
Less: cash, cash equivalents, and restricted cash	97,885	325,000	239,000	186,900	203,800	98,412	55,825	55,825	46,958	26,341	54,295	35,148	35,148
Net debt (cash)	495,287	418,900	600,300	499,100	430,000	537,699	582,597	582,597	593,775	616,704	591,061	612,518	612,518
Preferred stock	26,296	20,300	10,300	10,300	10,300	10,700	11,100	11,100	11,500	11,900	12,300	12,700	12,700
Noncontrolling interest	114,951	105,600	93,800	46,400	45,900	45,900	45,900	45,900	45,900	45,900	45,900	45,900	45,900
Enterprise value	**734,092**	**651,036**	**828,926**	**688,368**	**592,663**	**700,989**	**746,514**	**752,757**	**758,319**	**781,875**	**756,859**	**778,943**	**778,603**
Net debt (cash) per share	11.52	8.95	10.94	8.55	9.17	11.44	12.37	11.69	12.58	13.04	12.47	12.90	12.94
EV/Sales (TTM)	0.4	0.3	0.4	0.4	0.3	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.5
EV/EBITDA (TTM)	14.5	14.6	9.1	6.6	6.4	10.2	21.5	38.6	21.8	39.6	27.0	23.2	60.8
P/BV - HC2 stockholders' equity	1.3	1.2	0.4	9.4	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4

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

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SELL [Sell]	0.24%	0.00%

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

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Rating and Price Target History for: HC2 Holdings, Inc. (HCHC) as of 11-04-2020
11/09/17 B:11.5
05/11/18 B:13.5
03/13/19 B:11
08/09/19 B:13
11/06/19 B:12.5
03/17/20 B:8.3
05/12/20 B:8.5
8
7
6
5
4
3
2
1
Q3
2018
Q1
Q2
Q3
2019
Q1
Q2
Q3
2020
Q1
Q2
Q3
2021
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