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Discovery Group

HC2 Holdings, Inc. (HCHC – $2.38*)
Diversified Industrials: Producer Manufacturing
Buy; $8.50 PT; $174.0M Market Cap
Company Update
Tuesday, November 10, 2020

3Q Adj. EBITDA Beats; Raising FY20/FY21 Adj. EBITDA Ests. on 3Q Beat and Lower Corp. OH; Closed Telecom Asset Sale; Continues to Evaluate Options for Infrastructure and Insurance Units

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STOCK DATA

Market Cap (mil)	$174.0
52-Week Range	$1.29 – $4.32
3-Month ADTV	278,090
Shares Outstanding (mil)	73.1
Float (%)	71.7
Short Interest	3,723,952
Enterprise Val. (mil)	$767.0
Fiscal Year-End	December

EARNINGS DATA

EBITDA (mil) Operating	2019A	2020E	2021E
1Q	$2.8	$1.4A	$(2.0)
2Q	$27.7	$15.2A	$2.3
3Q	$23.6	$11.9A	$10.2
4Q	$36.7	$8.1	$10.8
FY	$90.8	$36.6	$21.3
EV/EBITDA	8.4x	21.0x	36.0x

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

FINANCIAL DATA

FY	2019A	2020E	2021E
Rev. (mil)	$1,984.1	$1,465.1	$1,092.0
ROE	(0.1)%	(0.3)%	(0.1)%
Debt/Capital	64.3%	60.1%	62.2%
BV/Share	$6.38	$7.31	$6.99

BALANCE SHEET DATA

	3Q20
Cash & Equivalents	$163.6
Accounts Receivable	$252.3
Accounts Payable	$298.6
Long-Term Debt	$633.8
Total Debt	$646.4
Shareholders' Equity	$371.8
Debt/Cap	63.0%

$ in millions unless otherwise specified.Cash & equivalents includes ~$115M in "Insurance" segment.

Summary and Recommendation

Buy-rated HC2 Holdings (HCHC, $8.50 PT) reported 3Q total adjusted EBITDA of $12M from operating subsidiaries, excluding the insurance segment, nicely exceeding our breakeven projection. Better than forecast EBITDA from the infrastructure segment, narrower loss contributions from HCHC's life sciences and spectrum segments, and lower corporate overhead expenses drove the beat relative to our model. That said, we raise our FY20/FY21 adjusted EBITDA projections to reflect the company's 3Q beat and progress on reducing corporate overhead expenses. We also remove our prior telecom segment sales/adjusted EBITDA contributions to reflect the asset divestiture. (Refer to Exhibit II: "Estimate Revisions" on page 2 for details.) While an asset sale is encouraging, we note this divestiture does not materially contribute to de-leveraging HCHC's current balance sheet. Importantly, HCHC is in the process of raising up to ~$65M of capital via a common stock rights offering (we estimate at least ~ $43M, before transaction fees/expenses, of incremental equity capitalization coming to HCHC's balance sheet based on a partial ~$35M backstop by HCHC Chairman Avie Glazer's Lancer Capital, as well as two other large holders expressed intent to subscribe for at least their respective subscription rights). We believe HCHC could use proceeds from the rights offering to help alleviate upcoming HoldCo interest/overhead expenses until a material asset monetization event reduces balance sheet leverage. As a reminder, HCHC continues to evaluate the portfolio for monetization opportunities to reduce the HoldCo 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 results.** HCHC reported $12M of total adjusted EBITDA from operating subsidiaries, excluding the insurance segment, beating our model calling for breakeven. Specifically, the infrastructure segment (formerly construction) generated adjusted EBITDA of $18M, exceeding our $12M forecast. We were pleased to observe a Q/Q increase in the segment's contracted backlog, which stood at ~$436M as of 3Q, compared to ~$410M in the prior quarter. We note backlog would be ~$640M when considering awarded but unsigned contracts. As a reminder, HCHC remains in the process of reviewing strategic alternatives for the infrastructure segment, including a potential refinancing at the subsidiary level. In our view, potential net proceeds from a subsidiary refi could be used to reduce HoldCo level debt. Next, the clean energy segment adjusted EBITDA of $4M, and telecom segment's modest $0.4M contribution were both in line with our forecasts. HCHC's life sciences and spectrum (formerly broadcasting) segments generated a combined adjusted EBITDA loss of ($6M), which is less than our ($11M) forecast. In this regard, life sciences segment losses of $6M were better than our $10M loss projection. We highlight: MediBeacon received an additional $20M of funding commitment from Huadong over the next two years to finance the pursuit of "Class 1" status in China, potentially allowing MediBeacon's device to enter the Chinese hospital system. Further, R2 Technologies commenced pre-orders for its FDA-approved CryoAesthetic technology ahead of a launch expected in early 2021. We, therefore, expect expenses in these segments to ramp as the units begin to commercialize their respective technologies. (Both MediBeacon and R2 are fully funded for ongoing activities and do not require additional capital from HCHC.) Continued on page 2...

Meanwhile, we were also pleased to see breakeven adjusted EBITDA from the spectrum segment compared to our loss expectation of ~$1M. As a reminder, HCHC is in the process of selling several non-core stations in select markets to reduce the outstanding principal on segment level debt, which had recently extended the maturity by one year to 10/2021. Finally, HCHC's non-operating corporate expense of ($4M) was better than our ($6M) forecast. (Refer to Exhibit I: "Reported Results vs. Expectations" below for details.)

- **Raising FY20/FY22 adjusted EBITDA estimates to reflect 3Q beat and lower corporate overhead, despite removing the telecom segment operating results due to the asset sale.** We raise our FY20/FY21 adjusted EBITDA projections to reflect the company's 3Q beat, and progress on reducing corporate overhead expenses. In this regard, HCHC recently completed the downsizing of its corporate HQ in NYC, which is expected to substantially reduce annual lease expenses. Further, we remove telecom segment results from our projections going forward as HCHC recently completed the sale of this subsidiary for an undisclosed and, in our view, immaterial sum. Specifically, we remove 4Q20/FY21 sales and adjusted EBITDA contribution of $150M/$580M and $1M/$2M, respectively, from our prior forecasts. (Refer to Exhibit II: "Estimate Revisions" below for details.)

Exhibit I: Reported Results vs. Expectations

	3Q20E	3Q20A
	Adj. EBITDA	Adj. EBITDA
Infrastructure	$12.0M	$17.7M
Telecom	$0.5M	$0.4M
Clean energy	$4.0M	$3.7M
Life Sciences	-$10.0M	-$5.9M
Spectrum	-$1.3M	-$0.2M
Other	$0.7M	-$0.1M
Corporate	-$6.0M	-$3.7M
Total, ex. Insurance	**-$0.2M**	**$11.9M**
	Pre-tax AOI	Pre-tax AOI
Insurance	$10.0M	$14.3M

Source: B. Riley Securities and HCHC earnings release

Exhibit II: Estimate Revisions

B. Riley Securities Estimates ($Ms)				
	FY2020E		FY2021E	
Adj. EBITDA	Old	New	Old	New
Infrastructure	$55M	$61M	$65M	$65M
Clean energy	$16M	$16M	$11M	$11M
Telecom*	$2M	$1M	$2M	$0M
Life Sciences	-$29M	-$23M	-$40M	-$40M
Spectrum	-$5M	-$3M	-$3M	-$3M
Other	$1M	$0M	$3M	$3M
Corporate	-$21M	-$16M	-$25M	-$15M
Total, ex. Insurance	**$20M**	**$37M**	**$13M**	**$21M**

*Telecom segment forecasts removed from FY21 model, as the sale of this segment closed on 10/31/20.

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
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 $374M	$374	0.7	$243
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				$1,243
Minus:				
Corporate expenses	FY21E Corporate Expenses	$15.0	6.5	$98
Total debt (3Q 2020)				$665
Less: cash, cash equivalents, restricted cash, and ~$115M insurance co. cash				$49
Net debt (cash)				$616
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				$532
Est. diluted shares	Includes ~14.8M shares of HCHC stock assumed from conversions above			62.0
Est. HCHC Net Asset Value				$8.58

$ 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)
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	2017(A)	2018(A)	2019(A)	Q1-Mar	Q2-Jun	Q3-Sep(A)	Q4-Dec(E)	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**	**393,300**	**250,000**	**1,465,100**	**251,700**	**272,400**	**283,100**	**284,800**	**1,092,000**
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	278,700	128,400	1,015,300	135,300	150,400	153,400	154,500	593,600
Insurance benefits and acquisition expenses	108,695	197,324	234,400	72,400	63,000	59,600	65,000	260,000	65,000	65,000	65,000	65,000	260,000
SG&A expenses	182,880	218,442	214,300	52,300	48,100	45,200	45,000	190,600	48,375	49,675	49,475	49,475	197,000
D&A	31,315	31,669	32,000	600	1,100	2,400	7,100	11,200	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)	9,500	0	7,500	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	395,400	245,500	1,484,600	256,875	273,275	276,075	277,175	1,083,400
Income (loss) from operations	**(1,131)**	**(55,854)**	**29,100**	**(26,800)**	**4,900**	**(2,100)**	**4,500**	**(19,500)**	**(5,175)**	**(875)**	**7,025**	**7,625**	**8,600**
Interest expense	(55,098)	(75,662)	(95,100)	(21,300)	(21,400)	(19,700)	(18,331)	(80,731)	(18,331)	(18,331)	(18,331)	(18,331)	(73,325)
(Gain) loss on extinguishment or restructuring of debt	0	102,141	0	(5,800)	(3,400)	(4,200)	0	(13,400)	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	7,300	0	74,100	0	0	0	0	0
Income (loss) from equity investees	17,840	15,355	2,200	(2,500)	(200)	(1,300)	0	(4,000)	0	0	0	0	0
Income (loss) from continuing operations, before taxes	**(39,750)**	**182,289**	**(56,700)**	**(53,600)**	**43,900**	**(20,000)**	**(13,831)**	**(43,531)**	**(23,506)**	**(19,206)**	**(11,306)**	**(10,706)**	**(64,725)**
Income tax benefit (expense)	(10,740)	(2,363)	20,600	12,600	(15,400)	(1,600)	3,458	(942)	5,877	4,802	2,827	2,677	16,181
Income (loss) from continuing operations	**(50,490)**	**179,926**	**(36,100)**	**(41,000)**	**28,500**	**(21,600)**	**(10,373)**	**(44,473)**	**(17,630)**	**(14,405)**	**(8,480)**	**(8,030)**	**(48,544)**
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	(21,600)	(10,373)	(104,473)	(17,630)	(14,405)	(8,480)	(8,030)	(48,544)
Attributable to noncontrolling interests	3,580	(17,915)	4,600	17,900	(15,400)	4,300	1,000	7,800	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	(17,300)	(9,373)	(96,673)	(16,630)	(13,405)	(7,480)	(7,030)	(44,544)
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**	**(17,700)**	**(9,773)**	**(98,273)**	**(17,030)**	**(13,805)**	**(7,880)**	**(7,430)**	**(46,144)**
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	47,353	47,453	50,027	47,553	47,653	47,753	47,853	47,703
GAAP EPS	**($1.16)**	**$3.32**	**($0.70)**	**($1.82)**	**$0.27**	**($0.38)**	**($0.21)**	**($2.11)**	**($0.36)**	**($0.29)**	**($0.17)**	**($0.16)**	**($0.98)**
Adj. EBITDA By Segment:													
Infrastructure	51,588	60,853	75,700	9,000	19,100	17,700	15,000	60,800	9,500	13,500	21,000	21,000	65,000
Clean energy	2,911	5,457	17,000	3,800	4,200	3,700	4,000	15,700	2,625	2,725	2,825	2,825	11,000
Telecom	6,929	5,258	3,400	400	200	400	0	1,000	0	0	0	0	0
Life Sciences	(22,366)	(14,909)	(11,800)	(4,200)	(4,500)	(5,900)	(8,000)	(22,600)	(10,000)	(10,000)	(10,000)	(10,000)	(40,000)
Spectrum	0	(16,884)	(6,300)	(1,000)	(1,100)	(200)	(200)	(2,500)	(1,075)	(875)	(575)	25	(2,500)
Other	(3,139)	(2,180)	0	(1,600)	900	(100)	800	0	700	700	700	700	2,800
Corporate	(29,153)	(25,785)	(17,900)	(5,000)	(3,600)	(3,700)	(3,500)	(15,800)	(3,750)	(3,750)	(3,750)	(3,750)	(15,000)
Total adj. EBITDA, ex. Insurance	**50,797**	**44,534**	**90,800**	**1,400**	**15,200**	**11,900**	**8,100**	**36,600**	**(2,000)**	**2,300**	**10,200**	**10,800**	**21,300**
Common Size:													
Gross margin	13.0%	9.8%	16.4%	5.9%	13.8%	14.0%	22.6%	13.0%	20.4%	20.9%	22.9%	22.9%	21.8%
SG&A	11.2%	11.1%	10.8%	11.8%	12.8%	11.5%	18.0%	13.0%	19.2%	18.2%	17.5%	17.4%	18.0%
D&A	2.2%	2.0%	2.1%	0.7%	0.9%	1.2%	2.8%	1.2%	3.3%	3.0%	2.9%	2.9%	3.0%
Adj. EBITDA margin, ex. Financial Services	**3.4%**	**2.5%**	**5.5%**	**4.4%**	**5.1%**	**3.8%**	**4.8%**	**3.2%**	**9.7%**	**1.2%**	**5.0%**	**5.3%**	**2.8%**
Tax rate	-27.0%	1.3%	36.3%	23.5%	35.1%	-8.0%	25.0%	-2.2%	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	163,600	42,067	42,067	32,120	36,788	33,366	33,432	33,432
Accounts receivable, net	322,446	379,200	337,800	333,300	261,200	252,300	204,569	204,569	173,087	180,815	174,983	178,889	178,889
Accounts payable and other current liabilities	347,492	344,900	339,600	334,400	283,000	298,600	244,260	244,260	210,960	228,560	218,736	221,688	221,688
Total debt (incl. capital lease obligations)	593,172	743,900	839,300	686,000	633,800	646,400	648,467	648,467	650,533	652,600	654,667	656,733	656,733
Preferred stock	26,296	20,300	10,300	10,300	10,300	15,900	16,300	16,300	16,700	17,100	17,500	17,900	17,900
HC2 stockholders' equity	73,171	88,100	349,800	14,100	319,300	371,800	365,510	365,510	351,964	341,642	337,246	333,300	333,300
Total stockholders' equity	216,027	222,000	465,200	79,100	383,900	435,600	429,710	429,710	416,564	406,642	402,646	399,100	399,100
Valuation:													
Price	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38	$2.38
Market cap	**102,286**	**111,384**	**130,560**	**138,992**	**111,622**	**112,701**	**112,939**	**119,063**	**113,177**	**113,415**	**113,653**	**113,891**	**113,534**
Total debt (incl. capital lease obligations)	593,172	743,900	839,300	686,000	633,800	646,400	648,467	648,467	650,533	652,600	654,667	656,733	656,733
Less: cash, cash equivalents, and restricted cash	97,885	325,000	239,000	186,900	203,800	163,600	42,067	42,067	32,120	36,788	33,366	33,432	33,432
Net debt (cash)	495,287	418,900	600,300	499,100	430,000	482,800	606,399	606,399	618,413	615,812	621,301	623,301	623,301
Preferred stock	26,296	20,300	10,300	10,300	10,300	15,900	16,300	16,300	16,700	17,100	17,500	17,900	17,900
Noncontrolling interest	114,951	105,600	93,800	46,400	45,900	40,900	40,900	40,900	40,900	40,900	40,900	40,900	40,900
Enterprise value	**738,820**	**656,184**	**834,960**	**694,792**	**597,822**	**652,301**	**776,538**	**782,663**	**789,190**	**787,227**	**793,353**	**795,992**	**795,635**
Net debt (cash) per share	11.52	8.95	10.94	8.55	9.17	10.20	12.78	12.12	13.00	12.92	13.01	13.03	13.07
EV/Sales (TTM)	0.5	0.3	0.4	0.4	0.3	0.4	0.5	0.5	0.6	0.7	0.8	0.7	0.7
EV/EBITDA (TTM)	14.5	14.7	9.2	6.6	6.5	8.1	15.0	21.4	15.2	20.2	21.3	19.9	37.4
P/BV - HC2 stockholders' equity	1.4	1.3	0.4	9.9	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3

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

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Rating	B. Riley Securities, Inc. Research Distribution [1]	B. Riley Securities, Inc. Banking Services in the past 12 months[1]
BUY [Buy]	78.73%	36.96%
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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 11-09-2020
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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