HC2 HOLDINGS, INC.
Form 10-Q
August 08, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the quarterly period ended June 30, 2018
OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

Commission File No. 001-35210

HC2 HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Delaware	54-1708481
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
450 Park Avenue, 30th Floor, New York, NY	10022
(Address of principal executive offices)	(Zip Code)

(212) 235-2690
(Registrant’s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.001 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
N/A

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer	x
Non-accelerated filer	Smaller reporting company	

Indicate by check mark whether the registrant is an emerging growth company as defined in Rule 405 of the Securities Act of 1933.

Emerging Growth Company
If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No ý
As of July 31, 2018, 44,707,771 shares of common stock, par value $0.001, were outstanding.

HC2 HOLDINGS, INC.
INDEX TO FORM 10-Q

HC2 HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, in thousands, except per share amounts)

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenue	$455,038	$340,383	$870,515	$694,925
Life, accident and health earned premiums, net	19,905	20,235	39,945	40,176
Net investment income	19,342	16,939	37,066	32,243
Net realized and unrealized gains on investments	2,494	1,095	2,943	1,876
Net revenue	496,779	378,652	950,469	769,220
Operating expenses				
Cost of revenue	400,609	308,664	776,283	623,078
Policy benefits, changes in reserves, and commissions	35,391	30,443	67,674	61,930
Selling, general and administrative	57,055	41,707	109,143	81,563
Depreciation and amortization	9,057	7,295	18,713	14,692
Other operating (income) expense, net	185	1,738	(2,067)	(1,820)
Total operating expenses	502,297	389,847	969,746	779,443
Loss from operations	(5,518)	(11,195)	(19,277)	(10,223)
Interest expense	(17,181)	(12,073)	(36,506)	(26,188)
Gain on sale of subsidiary	102,141	—	102,141	—
Income from equity investees	10,752	4,003	5,521	11,696
Other income (expenses), net	(968)	(3,193)	124	(8,334)
Income (loss) from continuing operations before income taxes	89,226	(22,458)	52,003	(33,049)
Income tax (expense) benefit	(9,462)	1,985	(11,093)	(3,306)
Net income (loss)	79,764	(20,473)	40,910	(36,355)
Less: Net (income) loss attributable to noncontrolling interest and redeemable noncontrolling interest	(24,398)	2,562	(20,540)	3,948
Net income (loss) attributable to HC2 Holdings, Inc.	55,366	(17,911)	20,370	(32,407)
Less: Preferred stock and deemed dividends from conversions	703	793	1,406	1,376
Net income (loss) attributable to common stock and participating preferred stockholders	$54,663	$(18,704)	$18,964	$(33,783)
Income (loss) per Common Share				
Basic	$1.11	$(0.44)	$0.39	$(0.80)
Diluted	$1.08	$(0.44)	$0.38	$(0.80)
Weighted average common shares outstanding:				
Basic	44,180	42,691	44,114	42,322
Diluted	45,503	42,691	45,284	42,322

See notes to Condensed Consolidated Financial Statements

HC2 HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income (loss)	$79,764	$(20,473)	$40,910	$(36,355)
Other comprehensive income (loss)				
Foreign currency translation adjustment	(6,205)	2,224	(1,700)	3,349
Unrealized gain (loss) on available-for-sale securities	(22,931)	19,000	(51,593)	30,976
Other comprehensive income (loss)	(29,136)	21,224	(53,293)	34,325
Comprehensive income (loss)	50,628	751	(12,383)	(2,030)
Comprehensive (income) loss attributable to noncontrolling interests and redeemable noncontrolling interests	(24,090)	2,562	(20,232)	3,948
Comprehensive income (loss) attributable to HC2 Holdings, Inc.	$26,538	$3,313	$(32,615)	$1,918

See notes to Condensed Consolidated Financial Statements

HC2 HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands, except share amounts)

	June 30, 2018	December 31, 2017
Assets		
Investments:		
Fixed maturity securities, available-for-sale at fair value	$1,249,253	$1,340,626
Equity securities	79,557	47,500
Mortgage loans	69,890	52,109
Policy loans	17,768	17,944
Other invested assets	86,109	85,419
Total investments	1,502,577	1,543,598
Cash and cash equivalents	112,304	97,885
Accounts receivable, net	346,702	322,446
Recoverable from reinsurers	531,269	526,337
Deferred tax asset	991	1,661
Property, plant and equipment, net	368,914	374,660
Goodwill	128,846	131,741
Intangibles, net	120,280	117,105
Other assets	142,453	102,258
Total assets	$3,254,336	$3,217,691
Liabilities, temporary equity and stockholders’ equity		
Life, accident and health reserves	$1,728,167	$1,693,961
Annuity reserves	237,373	243,156
Value of business acquired	40,500	42,969
Accounts payable and other current liabilities	296,339	347,492
Deferred tax liability	8,634	10,740
Debt obligations	668,505	593,172
Other liabilities	79,529	70,174
Total liabilities	3,059,047	3,001,664
Commitments and contingencies		
Temporary equity		
Preferred stock	26,325	26,296
Redeemable noncontrolling interest	8,396	1,609
Total temporary equity	34,721	27,905
Stockholders’ equity		
Common stock, $.001 par value	45	44
Shares authorized: 80,000,000 at June 30, 2018 and December 31, 2017;		
Shares issued: 45,121,231 and 44,570,004 at June 30, 2018 and December 31, 2017;		
Shares outstanding: 44,676,335 and 44,190,826 at June 30, 2018 and December 31, 2017, respectively		
Additional paid-in capital	259,999	254,685
Treasury stock, at cost: 444,896 and 379,178 shares at June 30, 2018 and December 31, 2017, respectively	(2,434)	(2,057)
Accumulated deficit	(197,148)	(221,189)
Accumulated other comprehensive income (loss)	(9,175)	41,688
Total HC2 Holdings, Inc. stockholders’ equity	51,287	73,171
Noncontrolling interest	109,281	114,951

Total stockholders' equity	160,568	188,122
Total liabilities, temporary equity and stockholders' equity	$3,254,336	$3,217,691

See notes to Condensed Consolidated Financial Statements

HC2 HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited, in thousands)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total HC2 Stockholders' Equity	Non-controlling Interest	Total Stockholders' Equity	Temporary Equity
Balance as of December 31, 2017	44,190	$44	$254,685	$(2,057)	$(221,189)	$41,688	$73,171	$114,951	$188,122	$27,905
Cumulative effect of accounting for revenue recognition (1)	—	—	—	—	376	—	376	291	667	—
Cumulative effect of accounting for the recognition and measurement of financial assets and financial liabilities (1)	—	—	—	—	3,295	(1,660)	1,635	—	1,635	—
Share-based compensation	—	—	6,605	—	—	—	6,605	—	6,605	—
Fair value adjustment of redeemable noncontrolling interest	—	—	(3,311)	—	—	—	(3,311)	—	(3,311)	3,311
Exercise of stock options	82	—	372	—	—	—	372	—	372	—
Taxes paid in lieu of shares issued for share-based compensation	(65)	—		(377)	—	—	(377)	—	(377)	—
Preferred stock dividend	—	—	(1,000)	—	—	—	(1,000)	—	(1,000)	—
Amortization of issuance costs	—	—	(30)	—	—	—	(30)	—	(30)	30
Issuance of common stock	470	1		—	—	—	1	—	1	—
Transactions with noncontrolling interests	—	—	2,678	—	—	3,781	6,459	(27,686)	(21,227)	4,968

Net income (loss)	—	—	—	—	20,370	—	20,370	21,281	41,651	(741)
Other comprehensive (loss) income	—	—	—	—	—	(52,984)	(52,984)	444	(52,540)	(752)
Balance as of June 30, 2018	44,677	$45	$259,999	$(2,434)	$(197,148)	$(9,175)	$51,287	$109,281	$160,568	$34,721

(1) See Note 2 for further information about adjustments resulting from the Company's adoption of new accounting standards in 2018.

	Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total HC2 Stockholders' Equity	Non-controlling Interest	Total Stockholders' Equity	Temporary Equity
	Shares	Amount								
Balance as of December 31, 2016	41,811	$42	$241,485	$(1,387)	$(174,278)	$(21,647)	$44,215	$23,224	$67,439	$31,985
Share-based compensation	—	—	3,809	—	—	—	3,809	—	3,809	—
Dividend paid to noncontrolling interests	—	—	—	—	—	—	—	(378)	(378)	—
Fair value adjustment of redeemable noncontrolling interest	—	—	(533)	—	—	—	(533)	—	(533)	533
Exercise of stock options	129	—	462	—	—	—	462	—	462	—
Taxes paid in lieu of shares issued for share-based compensation	(105)	—	—	(582)	—	—	(582)	—	(582)	—
Preferred stock dividend	—	—	(1,063)	—	—	—	(1,063)	—	(1,063)	—
Amortization of issuance costs and beneficial conversion feature	—	—	(35)	—	—	—	(35)	—	(35)	35
Issuance of common stock	363	—	16	—	—	—	16	—	16	—
Conversion of preferred stock to common stock	803	1	3,026	—	—	—	3,027	—	3,027	(3,228)
Transactions with noncontrolling	—	—	—	—	—	—	—	—	—	332

interests										
Net loss	—	—	—	—	(32,407)	—	(32,407)	(2,930)	(35,337)	(1,018)
Other comprehensive income	—	—	—	—	—	34,325	34,325	—	34,325	—
Balance as of June 30, 2017	43,001	$43	$247,167	$(1,969)	$(206,685)	$12,678	$51,234	$19,916	$71,150	$28,639

See notes to Condensed Consolidated Financial Statements

5

HC2 HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Six Months Ended June 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$40,910	$(36,355)
Adjustments to reconcile net income (loss) to cash (used in) provided by operating activities:		
Provision for doubtful accounts receivable	818	(506)
Share-based compensation expense	4,793	2,624
Depreciation and amortization	21,993	17,234
Amortization of deferred financing costs and debt discount	4,658	3,460
Amortization of (discount) premium on investments	2,418	4,255
Gain on sale of subsidiary	(2,448)	(3,879)
(Gain) loss on sale or disposal of a subsidiary	(102,141)	—
Lease termination costs	—	249
Asset impairment expense	381	1,810
Income from equity investees	(5,521)	(11,696)
Impairment of investments	—	6,089
Net realized and unrealized gains on investments	(2,988)	(1,896)
Loss on contingent consideration	—	319
Receipt of dividends from equity investees	3,081	917
Deferred income taxes	423	(8,784)
Annuity benefits	4,191	4,346
Loss on early extinguishment of debt	2,537	—
Other operating activities	(1,241)	2,718
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(23,082)	19,848
Recoverable from reinsurers	(4,931)	(3,595)
Other assets	(21,434)	(12,729)
Life, accident and health reserves	34,133	34,700
Accounts payable and other current liabilities	(9,712)	(8,056)
Other liabilities	12,008	5,843
Cash (used in) provided by operating activities:	(41,154)	16,916
Cash flows from investing activities:		
Purchase of property, plant and equipment	(20,234)	(17,019)
Disposal of property, plant and equipment	3,500	382
Purchase of investments	(207,548)	(157,599)
Sale of investments	155,545	70,750
Maturities and redemptions of investments	40,000	74,957
Purchase of equity method investments	(127)	(10,390)
Cash received for business disposition, net of cash disposed	93,272	—
Cash paid for business acquisitions, net of cash acquired	(45,965)	—
Other investing activities	(2,023)	373
Cash provided by (used in) investing activities:	16,420	(38,546)
Cash flows from financing activities:		
Proceeds from debt obligations	180,326	104,410
Principal payments on debt obligations	(110,736)	(44,127)

Annuity receipts	1,308	1,563
Annuity surrenders	(11,208)	(10,600)
Transactions with noncontrolling interest	(14,889)	332
Payment of dividends	(1,000)	(2,262)
Taxes paid in lieu of shares issued for share-based compensation	(377)	(583)
Proceeds from the exercise of warrants and stock options	488	450
Other financing activities	(805)	(116)
Cash provided by financing activities:	43,107	49,067
Effects of exchange rate changes on cash and cash equivalents	(371)	319
Net change in cash and cash equivalents and restricted cash	18,002	27,756
Cash and cash equivalents and restricted cash, beginning of period	98,853	115,869
Cash and cash equivalents and restricted cash, end of period	$116,855	$143,625
Supplemental cash flow information:		
Cash paid for interest	$33,944	$23,224
Cash paid for taxes	$11,512	$8,647
Non-cash investing and financing activities:		
Property, plant and equipment included in accounts payable	$1,202	$1,630
Investments included in accounts payable	$750	$21,433
Conversion of preferred stock to common stock	$—	$4,433
Dividends payable to shareholders	$500	$500

See notes to Condensed Consolidated Financial Statements

6

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization and Business

HC2 Holdings, Inc. ("HC2" and, together with its consolidated subsidiaries, the "Company", "we" and "our") is a diversified holding company which seeks to acquire and grow attractive businesses that we believe can generate long-term sustainable free cash flow and attractive returns. While the Company generally intends to acquire controlling equity interests in its operating subsidiaries, the Company may invest to a limited extent in a variety of debt instruments or noncontrolling equity interest positions. The Company's shares of common stock trade on the NYSE under the symbol "HCHC".

The Company currently has eight reportable segments based on management's organization of the enterprise - Construction, Marine Services, Energy, Telecommunications, Insurance, Life Sciences, Broadcasting, and Other, which includes businesses that do not meet the separately reportable segment thresholds.

1.Our Construction segment is comprised of DBM Global Inc. ("DBMG") and its wholly-owned subsidiaries. DBMG is a fully integrated Building Information Modelling modeler, detailer, fabricator and erector of structural steel and heavy steel plate. DBMG models, details, fabricates and erects structural steel for commercial and industrial construction projects such as high- and low-rise buildings and office complexes, hotels and casinos, convention centers, sports arenas, shopping malls, hospitals, dams, bridges, mines and power plants. DBMG also fabricates trusses and girders and specializes in the fabrication and erection of large-diameter water pipe and water storage tanks. Through Aitken, DBMG manufactures pollution control scrubbers, tunnel liners, pressure vessels, strainers, filters, separators and a variety of customized products. The Company maintains an approximately 92% controlling interest in DBMG.

2.Our Marine Services segment is comprised of Global Marine Systems Limited ("GMSL"). GMSL is a leading provider of engineering and underwater services on submarine cables. GMSL aims to maintain its leading market position in the telecommunications maintenance segment and seeks opportunities to grow its installation activities in the three market sectors (telecommunications, offshore power, and oil and gas) while capitalizing on high market growth in the offshore power sector through expansion of its installation and maintenance services in that sector. The Company maintains an approximately 72% controlling interest in GMSL.

3.Our Energy segment is comprised of American Natural Gas, LLC ("ANG"). ANG is a premier distributor of natural gas motor fuel. ANG designs, builds, owns, acquires, operates and maintains compressed natural gas fueling stations for transportation vehicles. The Company maintains an approximately 68% controlling interest in ANG.

4.Our Telecommunications segment is comprised of PTGi International Carrier Services ("ICS"). ICS operates a telecommunications business including a network of direct routes and provides premium voice communication services for national telecommunications operators, mobile operators, wholesale carriers, prepaid operators, voice over internet protocol service operators and internet service providers. ICS provides a quality service via direct routes and by forming strong relationships with carefully selected partners. The Company maintains a 100% interest in ICS.

5.Our Insurance segment is comprised of Continental General Insurance Company ("CGI" or the "Insurance Company"). CGI provides long-term care, life and annuity coverage that help protect policy and certificate holders from the financial hardships associated with illness, injury, loss of life, or income continuation. The Company maintains a 100% interest in CGI.

6.Our Life Sciences segment is comprised of Pansend Life Sciences, LLC ("Pansend"). Pansend maintains controlling interests of approximately 80% in Genovel Orthopedics, Inc. ("Genovel"), which seeks to develop products to treat early osteoarthritis of the knee and approximately 74% in R2 Dermatology Inc. ("R2"), which develops skin lightening technology. Pansend also invests in other early stage or developmental stage healthcare companies including an approximately 50% interest in Medibeacon Inc., and an investment in Triple Ring Technologies, Inc.

7.Our Broadcasting segment is comprised of HC2 Broadcasting Holdings Inc. (“Broadcasting”) and its subsidiaries. Broadcasting strategically acquires and operates Over-The-Air ("OTA") broadcasting stations across the United States. In addition, Broadcasting, through its wholly-owned subsidiary, HC2 Network Inc. (“Network”), operates Azteca America, a Spanish-language broadcast network offering high quality Hispanic content to a diverse demographic across the United States. Broadcasting maintains an approximately 50% controlling interest in DTV America Corporation ("DTV").

8.In our Other segment, we invest in and grow developmental stage companies that we believe have significant growth potential. Among the businesses included in this segment is the Company's approximately 56% controlling interest in 704Games Company ("704Games"), which owns licenses to create and distribute NASCAR® video games.

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of the Company included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. All such adjustments are of a normal recurring nature. Certain information and note disclosures, including a description of significant accounting policies normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP"), have been condensed or omitted pursuant to such rules and regulations. Certain prior amounts have been reclassified or combined to conform to the current year presentation. These reclassifications and combinations had no effect on previously reported net loss attributable to controlling interest or accumulated deficit. These interim financial statements should be read in conjunction with the Company's annual consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017, filed with the SEC on March 14, 2018, as amended by amendment no.1, filed on April 2, 2018 (collectively, "Form 10-K"). The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results for any subsequent periods or the entire fiscal year ending December 31, 2018.

Use of Estimates and Assumptions

The preparation of the Company's Condensed Consolidated Financial Statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions used.

Accounting Pronouncements Adopted in the Current Year

The Company's 2017 Form 10-K includes discussion of significant recent accounting pronouncements that either have impacted or may impact our financial statements in the future. The following discussion provides information about recently adopted and recently issued or changed accounting guidance (applicable to the Company) that have occurred since the Company filed its 2017 Form 10-K. The Company has implemented all new accounting pronouncements that are in effect and that may impact its Condensed Consolidated Financial Statements and does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on its financial condition, results of operations or liquidity.

Effective January 1, 2018 the Company adopted the accounting pronouncements described below.

Statement of Cash Flows

In November 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Codification ("ASC") 2016-18, Restricted Cash - a consensus of the FASB Emerging Issues Task Force. This guidance requires entities to show the changes in the total cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash and cash equivalents in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. This reconciliation can be presented either on the face of the statement of cash flows or in the notes to the financial statements. This standard was applied retrospectively, which resulted in the recast of the prior reporting period in the condensed consolidated statements of cash flows. A reconciliation of cash and cash equivalents and restricted cash from our condensed consolidated statements of cash flows to the amounts reported within our condensed consolidated balance sheet is included in our condensed consolidated statements of cash flows.

The following table provides a reconciliation of cash and cash equivalents and restricted cash to amounts reported within the Condensed Consolidated Balance Sheets and Condensed Consolidated Statements of Cash Flows (in thousands):

	June 30, 2018	June 30, 2017
Cash and cash equivalents, beginning of period	$97,885	$115,371
Restricted cash included in other assets	968	498
Total cash and cash equivalents and restricted cash	$98,853	$115,869
Cash and cash equivalents, end of period	$112,304	$143,130
Restricted cash included in other assets	4,551	495
Total cash and cash equivalents and restricted cash	$116,855	$143,625

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. The update provides that equity investments with readily determinable values be measured at fair value and changes in the fair value flow through net income. These changes historically have run through other comprehensive income. Equity investments without readily determinable fair values have the option to be measured at fair value or at cost, adjusted for changes in observable prices minus impairment. Changes in either method are also recognized in net income. The standard requires a qualitative assessment of impairment indicators at each reporting period. For financial liabilities, entities that elect the fair value option must recognize the change in fair value attributable to instrument-specific credit risk in other comprehensive income rather than net income. Lastly, regarding deferred tax assets, the need for a valuation allowance on a deferred tax asset will need to be assessed related to available-for-sale debt securities. This standard was adopted prospectively as of January 1, 2018 and resulted in a $3.3 million cumulative effect adjustment credit to retained earnings related to the following investments:

Equity securities which were previously classified as available-for-sale	$ 1,660
Equity securities which were previously accounted for under the cost method	1,635
Total	$ 3,295

See Note 5. Investments and Note 6. Fair Value of Financial Instruments for further details.

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASC 606"). This ASU supersedes the revenue recognition requirements in Revenue Recognition (Topic 605). Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal Versus Agent Considerations, which clarifies the guidance in ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, an update on identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which includes amendments for enhanced clarification of the guidance. In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Revenue from Contracts with Customers (Topic 606), which includes amendments of a similar nature to the items typically addressed in the technical corrections and improvements project. Lastly, in February 2017, the FASB issued ASU 2017-05, clarifying the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets to clarify the scope of ASC 610-20, Other Income - Gains and Losses from Derecognition of Nonfinancial Assets, and provide guidance on partial sales of nonfinancial assets. This ASU clarifies that the unit of account under ASU 610-20 is each distinct nonfinancial or in substance nonfinancial asset and that a financial asset that meets the definition of an "in substance nonfinancial asset" is within the scope of ASC 610-20. This ASU eliminates rules specifically addressing sales of real estate and removes exceptions to the financial asset derecognition model. The ASUs described above are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. See Note 3. Revenue for further details.

New Accounting Pronouncements

Reporting Comprehensive Income

In February 2018, the FASB issued ASU 2018-02, Income Statement-Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from AOCI. The new guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years and should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate or law in U.S. Tax Reform is recognized. Early adoption is permitted. Current GAAP guidance requires that the effect of a change in tax laws or rates on deferred tax liabilities or assets to be included in income from continuing operations in the reporting period that includes the enactment date, even if the related income tax effects were originally charged or credited directly to AOCI. The new guidance allows a reclassification of AOCI to retained earnings for stranded tax effects resulting from U.S. Tax Reform. Also, the new guidance requires certain disclosures about stranded tax effects. The Company is currently in the process of evaluating the impact of this guidance on our consolidated financial statements and expects minimal impact.

Accounting for Leases

In February 2016, the FASB issued ASU 2016-02, Leases. The new standard establishes a right-of-use model that requires a lessee to record a right-of-use asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the consolidated financial statements, with certain practical expedients available. The Company has started evaluating its lease arrangements to determine the impact of this amendment on the financial statements. The evaluation includes an extensive review of the leases, which are primarily related to our vessels and office space. Additionally, the Company has begun tracking separate accounting records for leases entered into starting January 1, 2017 under the new guidance to facilitate future implementation. In January 2018, the FASB issued ASU 2018-01, Leases (Topic 842) - Land Easement Practical Expedient for Transition to Topic 842, which provides an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current leases guidance in Topic 840. The effective date and transition requirements for ASU 2018-01 are the same as ASU 2016-02. Early adoption is permitted. The Company is continuing to evaluate the impact this standard will have on its financial statements. While not yet quantified, the Company expects a material impact to its Condensed Consolidated Balance Sheets from recognizing additional assets and liabilities of operating leases upon adoption. The actual increase in assets and liabilities will depend on the volume and terms of leases in place at the time of adoption. The Company plans to elect the optional practical expedient to retain the current classification of leases, and therefore, does not anticipate a material impact to the Condensed Consolidated Statements of Income or Cash Flows. The Company also expects that adoption of the new standard will require changes to internal controls over financial reporting.

Subsequent Events

ASC 855, Subsequent Events ("ASC 855"), establishes general standards of accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or available to be issued. ASC 855 requires HC2 to evaluate events that occur after the balance date as of which HC2's financial statements are issued, and to determine whether adjustments to or additional disclosures in the financial statements are necessary. HC2 has evaluated subsequent events through the date these financial statements were issued. See Note 22. Subsequent Events for the summary of the subsequent events.

3. Revenue

The Company adopted ASC 606 on January 1, 2018. The adoption of ASC 606 represents a change in accounting principle that aligns revenue recognition with the timing of when promised goods or services are transferred to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. To achieve this core principle, the Company applies the following five steps in accordance with ASC 606:

Identify the contract with a customer

A contract with a customer exists when: (a) the parties have approved the contract and are committed to perform their respective obligations, (b) the rights of the parties can be identified, (c) payment terms can be identified, (d) the arrangement has commercial substance, and (e) collectibility of consideration is probable. Judgment is required when determining if the contractual criteria are met, specifically in the earlier stages of a project when a formally executed contract may not yet exist. In these situations, the Company evaluates all relevant facts and circumstances, including the existence of other forms of documentation or historical experience with our customers that may indicate a contractual agreement is in place and revenue should be recognized. In determining if the collectibility of consideration is probable, the Company considers the customer’s ability and intention to pay such consideration through an evaluation of several factors, including an assessment of the creditworthiness of the customer and our prior collection history with such customer.

Identify the performance obligations in the contract

At contract inception, the Company assesses the goods or services promised in a contract and identifies, as a separate performance obligation, each distinct promise to transfer goods or services to the customer. The identified performance obligations represent the “unit of account” for purposes of determining revenue recognition. In order to properly identify separate performance obligations, the Company applies judgment in determining whether each good or service provided is: (a) capable of being distinct, whereby the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer, and (b) distinct within the context of the contract, whereby the transfer of the good or service to the customer is separately identifiable from other promises in the contract.

In addition, when assessing performance obligations within a contract, the Company considers the warranty provisions included within such contract. To the extent the warranty terms provide the customer with an additional service, other than assurance that the promised good or service complies with agreed upon specifications, such warranty is accounted for as a separate performance obligation. In determining whether a warranty provides an additional service, the Company considers each warranty provision in comparison to warranty terms which are standard in the industry.

Determine the transaction price

The transaction price represents the amount of consideration to which the Company expects to be entitled in exchange for transferring promised goods or services to our customers. The consideration promised within a contract may include fixed amounts, variable amounts, or both. To the extent the performance obligation includes variable consideration, including contract bonuses and penalties that can either increase or decrease the transaction price, the Company estimates the amount of variable consideration to be included in the transaction price utilizing one of two prescribed methods, depending on which method better predicts the amount of consideration to which the entity will be entitled. Such methods include: (a) the expected value method, whereby the amount of variable consideration to be recognized represents the sum of probability weighted amounts in a range of possible consideration amounts, and (b) the most likely amount method, whereby the amount of variable consideration to be recognized represents the single most likely amount in a range of possible consideration amounts. When applying these methods, the Company considers all information that is reasonably available, including historical, current and estimates of future performance.

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

Variable consideration is included in the transaction price only to the extent it is probable, in the Company's judgment, that a significant future reversal in the amount of cumulative revenue recognized under the contract will not occur when the uncertainty associated with the variable consideration is subsequently resolved. This threshold is referred to as the variable consideration constraint. In assessing whether to apply the variable consideration constraint, the Company considers if factors exist that could increase the likelihood or the magnitude of a potential reversal of revenue, including, but not limited to, whether: (a) the amount of consideration is highly susceptible to factors outside of the Company's influence, such as the actions of third parties, (b) the uncertainty surrounding the amount of consideration is not expected to be resolved for a long period of time, (c) the Company's experience with similar types of contracts is limited or that experience has limited predictive value, (d) the Company has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances, and (e) the contract has a large number and broad range of possible consideration amounts.

Pending change orders represent one of the most common forms of variable consideration included within contract value and typically represent contract modifications for which a change in scope has been authorized or acknowledged by our customer, but the final adjustment to contract price is yet to be negotiated. In estimating the transaction price for pending change orders, the Company considers all relevant facts, including documented correspondence with the customer regarding acknowledgment and/or agreement with the modification, as well as historical experience with the customer or similar contractual circumstances. Based upon this assessment, the Company estimates the transaction price, including whether the variable consideration constraint should be applied.

Changes in the estimates of transaction prices are recognized on a cumulative catch-up basis in the period in which the revisions to the estimates are made. Such changes in estimates can result in the recognition of revenue in a current period for performance obligations which were satisfied or partially satisfied in prior periods. Such changes in estimates may also result in the reversal of previously recognized revenue if the ultimate outcome differs from the Company's previous estimate.

Allocate the transaction price to performance obligations in the contract

For contracts that contain multiple performance obligations, the Company allocates the transaction price to each performance obligation based on a relative standalone selling price. The Company determines the standalone selling price based on the price at which the performance obligation would have been sold separately in similar circumstances to similar customers. If the standalone selling price is not observable, the Company estimates the standalone selling price taking into account all available information such as market conditions and internal pricing guidelines. In certain circumstances, the standalone selling price is determined using an expected profit margin on anticipated costs related to the performance obligation.

Recognize revenue as performance obligations are satisfied

The Company recognizes revenue at the time the related performance obligation is satisfied by transferring a promised good or service to its customers. A good or service is considered to be transferred when the customer obtains control. The Company can transfer control of a good or service and satisfy its performance obligations either over time or at a point in time. The Company transfers control of a good or service over time and, therefore, satisfies a performance obligation and recognizes revenue over time if one of the following three criteria are met: (a) the customer simultaneously receives and consumes the benefits provided by the Company's performance as we perform, (b) the Company's performance creates or enhances an asset that the customer controls as the asset is created or enhanced, or (c) the Company's performance does not create an asset with an alternative use to us, and we have an enforceable right to payment for performance completed to date.

For our performance obligations satisfied over time, we recognize revenue by measuring the progress toward complete satisfaction of that performance obligation. The selection of the method to measure progress towards completion can be either an input method or an output method and requires judgment based on the nature of the goods or services to be provided.

Revenue from contracts with customers consist of the following (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Revenue [(1)]		
Construction	$176,910	$335,851
Marine Services	68,376	105,098
Energy	7,078	11,580
Telecommunications	190,529	392,832
Broadcasting	11,089	21,745
Other	1,056	3,409
Total revenue	$455,038	$870,515

(1) The Insurance segment does not have revenues in scope of ASU 2014-09.

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

Accounts receivables, net from contracts with customers consist of the following (in thousands):

	June 30, 2018
Accounts receivables with customers	
Construction	$194,381
Marine Services	51,716
Energy	3,278
Telecommunications	80,223
Broadcasting	9,462
Other	3,988
Total accounts receivables with customers	$343,048

Construction Segment

DBMG performs its services primarily under fixed-price contracts and recognizes revenue over time using the input method to measure progress for its projects. The nature of the projects does not provide measurable value to the customer over time and control does not transfer to the customer at discrete points in time. The customer receives value over the term of the project based on the amount of work that has been completed towards the delivery of the completed project. The most reliable measure of progress is the cost incurred towards delivery of the completed project. Therefore, the input method provides the most reliable method to measure progress. Revenue recognition begins when work has commenced. Costs include all direct material and labor costs related to contract performance, subcontractor costs, indirect labor, and fabrication plant overhead costs, which are charged to contract costs as incurred. Revenues relating to changes in the scope of a contract are recognized when DBMG and customer or general contractor have agreed on both the scope and price of changes, the work has commenced, it is probable that the costs of the changes will be recovered and that realization of revenue exceeding the costs is assured beyond a reasonable doubt. Revisions in estimates during the course of contract work are reflected in the accounting period in which the facts requiring the revision become known. Provisions for estimated losses on uncompleted contracts are made in the period a loss on a contract becomes determinable.

Construction contracts with customers generally provide that billings are to be made monthly in amounts which are commensurate with the extent of performance under the contracts. Contract receivables arise principally from the balance of amounts due on progress billings on jobs under construction. Retentions on contract receivables are amounts due on progress billings, which are withheld until the completed project has been accepted by the customer.

Disaggregation of Revenues

DBMG's revenues are principally derived from contracts to provide fabrication and erection services to its customers. Contracts represent majority of the revenue of the Construction segment and are generally recognized over time. A majority of contracts are domestic, fixed priced, and are in excess of one year. Disaggregation of the Construction segment, by market or type of customer, is used to evaluate its financial performance.

The following table disaggregates DBMG's revenue by market (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018

Commercial	$67,790	$137,441
Convention	22,177	53,828
Healthcare	29,245	57,086
Other	57,692	87,472
Total revenue from contracts with customers	176,904	335,827
Other revenue	6	24
Total Construction segment revenue	$176,910	$335,851

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

Contract Assets and Contract Liabilities

The timing of revenue recognition may differ from the timing of invoicing to customers. Contract assets include unbilled amounts from our long-term construction projects when revenue recognized under the cost-to-cost measure of progress exceed the amounts invoiced to our customers, as the amounts cannot be billed under the terms of our contracts. Such amounts are recoverable from our customers based upon various measures of performance, including achievement of certain milestones, completion of specified units or completion of a contract. In addition, many of our time and materials arrangements, as well as our contracts to perform turnaround services within the United States industrial services segment, are billed in arrears pursuant to contract terms that are standard within the industry, resulting in contract assets and/or unbilled receivables being recorded, as revenue is recognized in advance of billings. Also included in contract assets are amounts we seek or will seek to collect from customers or others for errors or changes in contract specifications or design, contract change orders or modifications in dispute or unapproved as to both scope and/or price or other customer-related causes of unanticipated additional contract costs (claims and unapproved change orders). Our contract assets do not include capitalized costs to obtain and fulfill a contract. Contract assets are included in Other assets in the Condensed Consolidated Balance Sheets.

Contract assets and contract liabilities consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Contract assets	$32,871	$25,676
Contract liabilities	$(46,991)	$(29,862)

The change in contract assets is a result of the recording of $30.3 million of costs in excess of billings driven by new commercial projects, offset by $23.1 million of costs in excess of billings transferred to receivables from contract assets recognized at the beginning of the period. The change in contract liabilities is a results of periodic billing in excess of costs of $46.0 million driven largely by new commercial projects, offset by revenue recognized that was included in the contract liability balance at the beginning of the period $28.9 million.

Transaction Price Allocated to Remaining Unsatisfied Performance Obligations

The transaction price allocated to remaining unsatisfied performance obligations consisted of the following (in thousands):

	Within one year	Within five years	Total
Commercial	$161,867	$—	$161,867
Convention	138,511	15,000	153,511
Healthcare	66,253	—	66,253
Other	221,770	53,000	274,770
Remaining unsatisfied performance obligations	$588,401	$68,000	$656,401

DBMG's remaining unsatisfied performance obligations, otherwise referred to as backlog, increase with awards of new contracts and decrease as it performs work and recognizes revenue on existing contracts. DBMG includes a project within its remaining unsatisfied performance obligations at such time the project is awarded and agreement on contract terms has been reached. DBMG's remaining unsatisfied performance obligations include amounts related to contracts for which a fixed price contract value is not assigned when a reasonable estimate of total transaction price can be made. DBMG expects to recognize this revenue over the next twenty-four months.

Remaining unsatisfied performance obligations include unrecognized revenues to be realized from uncompleted construction contracts. Although many of DBMG's contracts are subject to cancellation at the election of its customers, in accordance with industry practice, DBMG does not limit the amount of unrecognized revenue included within its remaining unsatisfied performance obligations due to the inherent substantial economic penalty that would be incurred by its customers upon cancellation.

Marine Services Segment

GMSL generally generates revenue by providing maintenance services for subsea telecommunications cabling, installing subsea cables, providing installation, maintenance and repair of fiber optic communication and power infrastructure to offshore oil and gas platforms, and installing inter-array power cables for use in offshore wind farms.

Telecommunication - Maintenance & Installation

GMSL performs its services within telecommunication market primarily under fixed-price contracts and recognizes revenue over time using the input method to measure progress for its projects. The nature of the projects does not provide measurable value to the customer over time and control does not transfer to the customer at discrete points in time. The customer receives value over the term of the project based on the amount of work that has been completed towards the delivery of the completed project. Depending on the project, the most reliable measure of progress is either the cost incurred or time elapsed towards delivery of the completed project. Therefore, the input method provides the most reliable method to measure progress. Revenue recognition begins when work has commenced. Costs include all direct material and labor costs related to contract performance, indirect labor, and overhead costs, which are charged to contract costs as incurred. Revisions in estimates during the

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

course of contract work are reflected in the accounting period in which the facts requiring the revision become known. Provisions for estimated losses on uncompleted contracts are made in the period a loss on a contract becomes determinable.

Maintenance revenues within this market are attributable to standby vessels and the provision of cable storage depots for repair of fiber optic telecommunications cables in defined geographic zones, and its maintenance business is provided through contracts with consortia of approximately 60 global telecommunications providers. These contracts are generally five to seven years long.

Installation revenues within this market are generated through installation of cable systems including route planning, mapping, route engineering, cable laying, and trenching and burial. GMSL's installation business is project-based with contracts typically lasting one to five months.

Power - Operations, Maintenance & Construction Support

Majority of revenues within this market are generated through the provision of crew transfer vessels and turbine technicians on the maintenance of offshore windfarms. Services are provided at agreed day rates and are recognized as revenues at the point in time at which the performance obligations are met. Additional revenues are generated through the provision of approved safety training courses to personnel operating on offshore wind turbines. Courses are supplied at agreed rates and recognized at the point in time at which the courses are provided.

Power - Cable Installation & Repair

Installation and repair revenues within this market are attributable to the provision of engineering solutions, which includes the charter of cable laying vessels and related subsea assets. These contracts are either charged at agreed day rates and are recognized as revenues at the point in time at which the performance obligations are met, or are under fixed-price contracts, in which case revenue is recognized over time using the input method to measure progress for its projects.

Disaggregation of Revenues

GMSL's revenues are principally derived from contracts to provide maintenance and installation services to its customers. Contracts represent a majority of revenues at the Marine Services segment of which approximately 73% and 72% we recognized over time during the three and six months ended June 30, 2018, respectively.

The following table disaggregates GMSL's revenue by market (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Telecommunication - Maintenance	$22,090	$43,872
Telecommunication - Installation	16,498	23,796
Power - Operations, Maintenance & Construction Support	11,923	16,585
Power - Cable Installation & Repair	17,865	20,845
Total revenue from contracts with customers	68,376	105,098
Other revenue	—	—

Total Marine Services segment revenue	$68,376	$105,098

Contract Assets and Contract Liabilities

The timing of revenue recognition may differ from the timing of invoicing to customers. Contract assets include unbilled amounts from our long-term projects when revenue recognized exceeds the amounts invoiced to our customers, as the amounts cannot be billed under the terms of our contracts. Such amounts are recoverable from our customers based upon various measures of performance, including achievement of certain milestones, completion of specified units or completion of a contract. In addition, many of our time and materials arrangements, as well as our contracts to perform services are billed in arrears pursuant to contract terms that are standard within the industry, resulting in contract assets and/or unbilled receivables being recorded, as revenue is recognized in advance of billings. Contract assets are included in Other assets in the Condensed Consolidated Balance Sheets.

Contract liabilities from our long-term construction contracts occur when amounts invoiced to our customers exceed revenues recognized. Contract liabilities additionally include advanced payments from our customers on certain contracts. Contract liabilities decrease as we recognize revenue from the satisfaction of the related performance obligation. Contract liabilities are included in Other liabilities in the Condensed Consolidated Balance Sheets.

Contract assets and contract liabilities consisted of the following (in thousands):

	June 30, 2018	December 31, 2017
Contract assets	$16,687	$6,610
Contract liabilities	$(214)	$(3,106)

14

HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

Transaction Price Allocated to Remaining Unsatisfied Performance Obligations

The transaction price allocated to remaining unsatisfied performance obligations consisted of the following (in thousands):

	Within one year	Within five years	Thereafter	Total
Telecommunication - Maintenance	$36,567	$262,025	$ 40,836	$339,428
Telecommunication - Installation	3,804	—	—	3,804
Power - Operations, Maintenance & Construction Support	12,285	10,913	3,734	26,932
Power - Cable Installation & Repair	1,993	—	—	1,993
Remaining unsatisfied performance obligations	$54,649	$272,938	$ 44,570	$372,157

GMSL's remaining unsatisfied performance obligations, otherwise referred to as backlog, increase with awards of new contracts and decrease as it performs work and recognizes revenue on existing contracts. GMSL includes a project within its remaining unsatisfied performance obligations at such time the project is awarded and agreement on contract terms has been reached. GMSL's remaining unsatisfied performance obligations include amounts related to contracts for which a fixed price contract value is not assigned when a reasonable estimate of total transaction price can be made.

Remaining unsatisfied performance obligations consist predominantly from projects within telecommunication maintenance market. These revenues are generated through long-term contracts for the provision of vessels and cable depots in maintaining and repairing subsea telecoms cables around the globe. Revenues are recognized over time to reflect both the duration that the vessels and depots are provided on standby duties and the amount of work that has been completed.

Energy Segment

ANG's revenues are principally derived from sales of compressed natural gas. ANG recognizes revenue from the sale of natural gas fuel primarily at the time the fuel is dispensed.

As a result of the Bipartisan Budget Act of 2018, signed into law on February 9, 2018, all Alternative Fuel Tax Credit ("AFETC") revenue for vehicle fuel ANG sold in 2017 was collected in the second quarter of 2018. Net revenue after customer rebates for such credits for 2017 were $2.6 million, which was recognized during the second quarter of 2018, the period in which the credit became available.

Disaggregation of Revenues

The following table disaggregates ANG's revenue by type (in thousands):

	Three Months Ended June 30, 2018	Six Months Ended June 30, 2018
Volume-related	$ 4,059	$ 8,123
Maintenance services	19	48
Total revenue from contracts with customers	4,078	8,171
RNG Incentives	367	742

Alternative Fuel Tax Credit	2,576