HC2 HOLDINGS, INC.
Form 10-Q
November 06, 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 September 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 every Interactive Data File required to be submitted 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", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

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

If an emerging growth company, 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 13(a) of the

Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).   Yes   No ý
As of October 31, 2018, 44,774,936 shares of common stock, par value $0.001, were outstanding.

HC2 HOLDINGS, INC.
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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 September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenue	$444,770	$368,672	$1,315,285	$1,063,597
Life, accident and health earned premiums, net	25,372	20,472	65,317	60,648
Net investment income	31,710	16,287	68,776	48,530
Net realized and unrealized gains (losses) on investments	(496)	978	2,447	2,854
Net revenue	501,356	406,409	1,451,825	1,175,629
Operating expenses				
Cost of revenue	402,922	324,673	1,179,205	947,751
Policy benefits, changes in reserves, and commissions	66,450	17,393	134,124	79,323
Selling, general and administrative	50,899	45,356	160,042	126,919
Depreciation and amortization	6,256	7,896	24,969	22,588
Other operating (income) expense, net	(819)	526	(2,886)	(1,294)
Total operating expenses	525,708	395,844	1,495,454	1,175,287
(Loss) income from operations	(24,352)	10,565	(43,629)	342
Interest expense	(17,456)	(13,222)	(53,962)	(39,410)
Gain on sale and deconsolidation of subsidiary	2,965	—	105,106	—
Gain on contingent consideration	—	6,320	—	6,001
Income from equity investees	8,134	971	13,655	12,667
Gain on bargain purchase	109,112	—	109,112	—
Other income (expenses), net	63,908	(97)	64,032	(8,112)
Income (loss) from continuing operations before income taxes	142,311	4,537	194,314	(28,512)
Income tax benefit (expense)	9,230	(12,861)	(1,863)	(16,167)
Net income (loss)	151,541	(8,324)	192,451	(44,679)
Less: Net (income) loss attributable to noncontrolling interest and redeemable noncontrolling interest	1,925	2,357	(18,615)	6,305
Net income (loss) attributable to HC2 Holdings, Inc.	153,466	(5,967)	173,836	(38,374)
Less: Preferred stock and deemed dividends from conversions	703	703	2,109	2,079
Net income (loss) attributable to common stock and participating preferred stockholders	$152,763	$(6,670)	$171,727	$(40,453)
Income (loss) per common share				
Basic	$3.09	$(0.16)	$3.48	$(0.95)
Diluted	$2.97	$(0.16)	$3.38	$(0.95)
Weighted average common shares outstanding:				
Basic	44,326	43,013	44,175	42,555
Diluted	46,217	43,013	45,575	42,555

See notes to Condensed Consolidated Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$151,541	$(8,324)	$192,451	$(44,679)
Other comprehensive income (loss)				
Foreign currency translation adjustment	(2,028)	548	(3,728)	3,897
Unrealized gain (loss) on available-for-sale securities	(22,712)	16,158	(74,305)	47,134
Other comprehensive income (loss)	(24,740)	16,706	(78,033)	51,031
Comprehensive income	126,801	8,382	114,418	6,352
Comprehensive (income) loss attributable to noncontrolling interests and redeemable noncontrolling interests	2,588	2,357	(17,644)	6,305
Comprehensive income attributable to HC2 Holdings, Inc.	$129,389	$10,739	$96,774	$12,657

See notes to Condensed Consolidated Financial Statements

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

	September 30, 2018	December 31, 2017
Assets		
Investments:		
Fixed maturity securities, available-for-sale at fair value	$2,985,443	$1,340,626
Equity securities	217,153	47,500
Mortgage loans	87,308	52,109
Policy loans	20,324	17,944
Other invested assets	70,965	85,419
Total investments	3,381,193	1,543,598
Cash and cash equivalents	831,634	97,885
Accounts receivable, net	350,864	322,446
Recoverable from reinsurers	1,305,038	526,337
Deferred tax asset	1,028	1,661
Property, plant and equipment, net	369,771	374,660
Goodwill	127,051	131,741
Intangibles, net	151,051	117,105
Other assets	212,367	102,258
Total assets	$6,729,997	$3,217,691
Liabilities, temporary equity and stockholders' equity		
Life, accident and health reserves	$4,707,400	$1,693,961
Annuity reserves	247,544	243,156
Value of business acquired	249,979	42,969
Accounts payable and other current liabilities	353,216	347,492
Deferred tax liability	33,876	10,740
Debt obligations	702,220	593,172
Other liabilities	108,076	70,174
Total liabilities	6,402,311	3,001,664
Commitments and contingencies		
Temporary equity		
Preferred stock	26,340	26,296
Redeemable noncontrolling interest	8,839	1,609
Total temporary equity	35,179	27,905
Stockholders' equity		
Common stock, $.001 par value	45	44
Shares authorized: 80,000,000 at September 30, 2018 and December 31, 2017;		
Shares issued: 45,188,169 and 44,570,004 at September 30, 2018 and December 31, 2017;		
Shares outstanding: 44,743,273 and 44,190,826 at September 30, 2018 and December 31, 2017, respectively		
Additional paid-in capital	263,887	254,685
Treasury stock, at cost: 444,896 and 379,178 shares at September 30, 2018 and December 31, 2017, respectively	(2,434)	(2,057)
Accumulated deficit	(43,682)	(221,189)
Accumulated other comprehensive income (loss)	(33,253)	41,688
Total HC2 Holdings, Inc. stockholders' equity	184,563	73,171
Noncontrolling interest	107,944	114,951

Total stockholders’ equity	292,507	188,122
Total liabilities, temporary equity and stockholders’ equity	$6,729,997	$3,217,691

See notes to Condensed Consolidated Financial Statements

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

	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, 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	—	—	10,887	—	—	—	10,887	—	10,887	—
Fair value adjustment of redeemable noncontrolling interest	—	—	(2,748)	—	—	—	(2,748)	—	(2,748)	2,748
Exercise of stock options	117	—	238	—	—	—	238	—	238	—
Taxes paid in lieu of shares issued for share-based compensation	(65)	—		(377)	—	—	(377)	—	(377)	—
Preferred stock dividend	—	—	(1,500)	—	—	—	(1,500)	—	(1,500)	—
Amortization of issuance costs	—	—	(45)	—	—	—	(45)	—	(45)	45
Issuance of common stock	502	1		—	—	—	1	—	1	—
Transactions with noncontrolling interests	—	—	2,370	—	—	3,781	6,151	(26,663)	(20,512)	6,202

Net income (loss)	—	—	—	—	173,836	—	173,836	19,494	193,330	(879)
Other comprehensive loss	—	—	—	—	—	(77,062)	(77,062)	(129)	(77,191)	(842)
Balance as of September 30, 2018	44,744	$45	$263,887	$(2,434)	$(43,682)	$(33,253)	$184,563	$107,944	$292,507	$35,179

(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	—	—	5,630	—	—	—	5,630	—	5,630	—
Dividend paid to noncontrolling interests	—	—	—	—	—	—	—	(378)	(378)	—
Fair value adjustment of redeemable noncontrolling interest	—	—	(673)	—	—	—	(673)	—	(673)	673
Exercise of stock options	135	—	486	—	—	—	486	—	486	—
Taxes paid in lieu of shares issued for share-based compensation	(107)	—	—	(594)	—	—	(594)	—	(594)	—
Preferred stock dividend	—	—	(1,562)	—	—	—	(1,562)	—	(1,562)	—
Amortization of issuance costs and beneficial conversion feature	—	—	(50)	—	—	—	(50)	—	(50)	50
Issuance of common stock	374	—	81	—	—	—	81	—	81	—
Conversion of preferred stock to common stock	803	1	2,838	—	—	—	2,839	—	2,839	(3,228)
Transactions with	—	—	—	—	—	—	—	—	—	665

noncontrolling interests										
Net loss	—	—	—	—	(38,374)	—	(38,374)	(3,967)	(42,341)	(2,338)
Other comprehensive income	—	—	—	—	—	51,031	51,031	—	51,031	—
Balance as of September 30, 2017	43,016	$43	$248,235	$(1,981)	$(212,652)	$29,384	$63,029	$18,879	$81,908	$27,807

See notes to Condensed Consolidated Financial Statements

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

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income (loss)	$192,451	$(44,679)
Adjustments to reconcile net income (loss) to cash provided by operating activities:		
Provision for doubtful accounts receivable	1,129	108
Share-based compensation expense	8,106	4,006
Depreciation and amortization	30,040	26,423
Amortization of deferred financing costs and debt discount	5,602	4,203
Amortization of (discount) premium on investments	4,354	6,126
Gain on sale or disposal of assets	(3,267)	(3,368)
Gain on sale and deconsolidation of subsidiary	(105,106)	—
Gain on bargain purchase	(109,112)	—
Asset impairment expense	381	1,810
Income from equity investees	(13,655)	(12,667)
Impairment of investments	623	6,112
Net realized and unrealized gains on investments	(49,130)	(2,881)
Gain on contingent consideration	—	(6,001)
Receipt of dividends from equity investees	11,380	917
Annuity benefits	6,282	6,519
Loss on early extinguishment of debt	2,537	—
Other operating activities	(613)	2,727
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	(28,689)	2,725
Recoverable from reinsurers	122,327	(6,478)
Other assets	(52,122)	(27,274)
Life, accident and health reserves	82,036	34,841
Accounts payable and other current liabilities	9,674	45,650
Other liabilities	21,437	(1,561)
Cash provided by operating activities:	136,665	37,258
Cash flows from investing activities:		
Purchase of property, plant and equipment	(32,290)	(25,324)
Disposal of property, plant and equipment	4,878	1,610
Purchase of investments	(515,600)	(231,881)
Sale of investments	192,306	101,080
Maturities and redemptions of investments	56,532	100,691
Purchase of equity method investments	(751)	(11,390)
Cash received from dispositions, net	92,039	—
Cash received from acquisitions, net	729,111	—
Other investing activities	(812)	(1,748)
Cash provided by (used in) investing activities:	525,413	(66,962)
Cash flows from financing activities:		
Proceeds from debt obligations	266,660	108,469
Principal payments on debt obligations	(163,748)	(48,146)
Annuity receipts	1,815	2,190

Annuity surrenders	(14,881)	(14,764)
Transactions with noncontrolling interest	(11,821)	665
Payment of dividends	(1,500)	(2,763)
Other financing activities	(835)	(230)
Cash provided by financing activities:	75,690	45,421
Effects of exchange rate changes on cash and cash equivalents	(442)	(149)
Net change in cash and cash equivalents and restricted cash	737,326	15,568
Cash and cash equivalents and restricted cash, beginning of period	98,853	115,869
Cash and cash equivalents and restricted cash, end of period	$836,179	$131,437
Supplemental cash flow information:		
Cash paid for interest	$36,232	$24,601
Cash paid for taxes	$13,259	$11,113
Non-cash investing and financing activities:		
Property, plant and equipment included in accounts payable	$2,627	$547
Investments included in accounts payable	$35,029	$4,785
Conversion of preferred stock to common stock	$—	$4,433
Declared but unpaid dividends from equity method investments included in other assets	$13,293	$—
Dividends payable to preferred shareholders	$500	$500

See notes to Condensed Consolidated Financial Statements

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 Manufacturing, 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. HC2 maintains controlling interests of approximately 98% in Broadcasting. 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. HC2 maintains an indirect interest of approximately 49% in DTV America Corporation ("DTV") as well as control of DTV due to the approximately 10% proxy and voting rights from minority holders.

8.Our Other segment represents all other businesses or investments we believe have significant growth potential, that do not meet the definition of a segment individually or in the aggregate.

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

2. Summary of Significant Accounting Policies

Principles of Consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company, its wholly owned subsidiaries and all other subsidiaries over which the Company exerts control. All intercompany profits, transactions and balances have been eliminated in consolidation. As of September 30, 2018, the results of DBMG and its subsidiaries, GMSL and its subsidiaries, ANG, ICS, CGI, Genovel, R2, Broadcasting, LPTV, HC2 Station Group, and DTV have been consolidated into the Company's results based on guidance from the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC" 810, Consolidation). The remaining interests not owned by the Company are presented as a noncontrolling interest component of total equity.

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 nine months ended September 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):

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

	September 30, 2018	September 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	$ 831,634	$ 130,791
Restricted cash included in other assets	4,545	646
Total cash and cash equivalents and restricted cash	$ 836,179	$ 131,437

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 U.S. 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.

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

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.

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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

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

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Revenue [1]		
Construction	$ 195,358	$ 531,209
Marine Services	44,825	149,923
Energy	4,561	16,141
Telecommunications	187,798	580,630
Broadcasting	11,957	33,702
Other	271	3,680
Total revenue	$ 444,770	$ 1,315,285

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

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

	September 30, 2018
Accounts receivables with customers	
Construction	$ 200,830
Marine Services	42,002
Energy	2,940
Telecommunications	90,978
Broadcasting	10,616
Other	—
Total accounts receivables with customers	$ 347,366

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.

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

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

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Commercial	$ 65,156	$ 202,597
Convention	54,199	108,027
Healthcare	28,389	85,475
Industrial	13,802	49,797
Other	33,745	85,222
Total revenue from contracts with customers	195,291	531,118
Other revenue	67	91
Total Construction segment revenue	$ 195,358	$ 531,209

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 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):

	September 30, 2018	December 31, 2017
Contract assets	$48,062	$25,676
Contract liabilities	$(53,796)	$(29,862)

The change in contract assets is a result of the recording of $45.8 million of costs in excess of billings driven by new commercial projects, offset by $23.4 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 $53.3 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 $29.4 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	$135,262	$11	$135,273
Convention	118,023	—	118,023
Healthcare	53,116	89	53,205
Industrial	43,035	34,607	77,642
Other	101,082	130,142	231,224
Remaining unsatisfied performance obligations	$450,518	$164,849	$615,367

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 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 77% and 73% we recognized over time during the three and nine months ended September 30, 2018, respectively.

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

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Telecommunication - Maintenance	$ 21,944	$ 65,816
Telecommunication - Installation	5,532	29,328
Power - Operations, Maintenance & Construction Support	9,304	25,889
Power - Cable Installation & Repair	8,045	28,890
Total revenue from contracts with customers	44,825	149,923
Other revenue	—	—
Total Marine Services segment revenue	$ 44,825	$ 149,923

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 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):

	September 30, 2018	December 31, 2017
Contract assets	$ 14,237	$ 6,610
Contract liabilities	$ (2,642)	$ (3,106)

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	$ 18,260	$ 267,160	$ 39,844	$ 325,264
Telecommunication - Installation	10,104	—	—	10,104
Power - Operations, Maintenance & Construction Support	4,090	16,427	—	20,517
Power - Cable Installation & Repair	1,861	—	—	1,861
Remaining unsatisfied performance obligations	$ 34,315	$ 283,587	$ 39,844	$ 357,746

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.

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

Disaggregation of Revenues

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

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Volume-related	$ 4,160	$ 12,283
Maintenance services	20	68
Total revenue from contracts with customers	4,180	12,351
RNG Incentives	285	1,027
Alternative Fuel Tax Credit	64	2,640
Other revenue	32	123
Total Energy segment revenue	$ 4,561	$ 16,141

Telecommunications Segment

ICS operates an extensive network of direct routes and offers premium voice communication services for carrying a mix of business, residential and carrier long-distance traffic, data and transit traffic. Customers may have a bilateral relationship with ICS, meaning they have both a customer and vendor relationship with ICS. In these cases, ICS sells the customer access to the ICS supplier routes but also purchases access to the customer's supplier routes.

Net revenue is derived from the long-distance data and transit traffic. Net revenue is earned based on the number of minutes during a call multiplied by the price per minute, and is recorded upon completion of a call. Completed calls are billable activity while incomplete calls are non-billable. Incomplete calls may occur as a result of technical issues or because the customer's credit limit was exceeded and thus the customer routing of traffic was prevented.

Revenue for a period is calculated from information received through ICS's billing software, such as minutes and market rates. Customized billing software has been implemented to track the information from the switch and analyze the call detail records against stored detailed information about revenue rates. This software provides ICS with the ability to perform a timely and accurate analysis of revenue earned in a period.

Net revenue represents gross revenue, net of allowance for doubtful accounts receivable, service credits and service adjustments. Cost of revenue includes network costs that consist of access, transport and termination costs. The majority of ICS's cost of revenue is variable, primarily based upon minutes of use, with transmission and termination costs being the most significant expense.

Disaggregation of Revenues

ICS's revenues are predominantly derived from wholesale of international long distance minutes (in thousands):

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Termination of long distance minutes	$ 187,798	$ 580,630

Total revenue from contracts with customers	187,798	580,630
Other revenue	—	—
Total Telecommunications segment revenue	$ 187,798	$ 580,630

Broadcasting Segment

Broadcasting advertising revenue is generated primarily from the sale of television airtime for programs or advertisements. Broadcasting advertising revenue is recognized when the program or advertisement is broadcast. Revenues are reported net of agency commissions, which are calculated as a stated percentage applied to gross billings. The broadcasting advertising contracts are generally short-term in nature.

Retransmission consent revenue consists of payments received from cable, satellite and other multiple video program distribution systems for their retransmission of our broadcast signals and generally based on per subscriber basis. Retransmission consent revenue is recognized as earned over the life of the retransmission consent contract and varies from month to month generally based on the average number of subscribers.

Local Marketing Agreements (“LMAs”) revenue is generated primarily from the sale of television airtime in return for a fixed fee or additional commission on the related sales incurred by the third party. In a typical LMA, the licensee of a station makes available, for a fee, airtime on its station to a party which supplies content to be broadcast during that airtime and collects revenue from advertising aired during such content. LMA revenue is recognized over the life of the contract, when the program is broadcast. The LMA fees that we charge can be fixed or commission-based and the LMA contracts that we enter into are generally short-term in nature.

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

Retransmission and LMA commission based revenues are usage/sales-based and recognized as revenue when the subsequent usage occurs. Transaction prices are based on the contract terms, with no material judgements or estimates.

The following table disaggregates the Broadcasting segment's revenue by type (in thousands):

	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Advertising	$ 7,388	$ 21,152
LMA	2,527	8,016
Retransmission	1,652	3,502
Other	390	1,032
Total revenue from contracts with customers	11,957	33,702
Other revenue	—	—
Total Broadcasting segment revenue	$ 11,957	$ 33,702

Contract Liabilities

Audience deficiency units ("ADU") liability is recognized as an available return to customers as fulfillment for under-delivered guaranteed viewership per the related agreement. ADU balance was $1.4 million and $1.6 million as of September 30, 2018 and December 31, 2017, respectively. Broadcasting measures the potential obligation based on audience measurement ratings and cost per view, and is subsequently made whole in the following period.

Transaction Price Allocated to Remaining Unsatisfied Performance Obligations

The transaction price allocated to remaining unsatisfied performance obligations consisted of $9.4 million of advertising revenues of which $4.0 million is expected to be recognized within one year and $5.4 million is expected to be recognized within five years.

Other Segment

Our Other segment's revenues are driven by 704Games. 704Games derives revenue principally from sales of software games and related content and services on (1) consoles and (2) mobile devices. 704Games' results of operations were included through August 14, 2018 at which point 704Games was deconsolidated, see Note 4. Acquisitions, Dispositions, and Deconsolidations for further detail.

4. Acquisitions, Dispositions, and Deconsolidations

Construction Segment

2017 Acquisitions

On November 1, 2017, DBMG consummated the acquisition of 100% of the shares of North American operations of Candraft VSI ("Candraft"). Candraft is a premier bridge infrastructure detailing and modeling company. On December 1, 2017, DBMG consummated the acquisition of the assets from Mountain States Steel, Inc. ("MSS") including

inventory, machinery & equipment, real estate, employees and certain intangible assets. MSS is a premier custom structural steel fabricator for construction projects including bridges, stadiums and power plants. The aggregate fair value of the consideration paid in connection with the acquisitions of Candraft and MSS was $17.8 million, including $16.1 million in cash. Both transactions were accounted for as business acquisitions.

The fair value of consideration transferred and its allocation among the identified assets acquired, liabilities assumed, intangibles and residual goodwill are summarized as follows (in thousands):

Purchase price allocation	
Accounts receivable	$473
Property, plant and equipment	12,730
Goodwill	2,290
Intangibles	1,608
Other assets	909
Total assets acquired	18,010
Accounts payable and other current liabilities	(23)
Other liabilities	(167)
Total liabilities assumed	(190)
Total net assets acquired	$17,820

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HC2 HOLDINGS, INC.
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Goodwill was determined based on the residual differences between fair value of consideration transferred and the value assigned to tangible and intangible assets and liabilities. Among the factors that contributed to goodwill was approximately $1.5 million assigned to the assembled and trained workforce for 2017. Goodwill is not amortized and is not deductible for tax purposes.

Acquisition costs incurred by DBMG in 2017, in connection with the 2017 acquisitions were approximately $3.3 million, which were included in selling, general and administrative expenses. The acquisition costs were primarily related to legal, accounting and valuation services. Results of acquired businesses were included in our Consolidated Statements of Operations since their respective acquisition dates. Pro forma results of operations have not been presented because they are not material to our consolidated results of operations.

Marine Services Segment

2017 Acquisitions

On November 30, 2017, GMSL acquired 5 assets and 19 employees and contractors based in Aberdeen, Scotland from Fugro N.V. The fair value of the purchase consideration was $87.2 million and comprised of 23.6% share in GMH LLC and a short-term loan of $7.5 million to Fugro N.V. The decision to acquire was made to support the overall group strategy of growing the Power and Oil & Gas businesses. The transaction was accounted for as a business acquisition.

The limited liability company agreement of GMH LLC was amended and restated upon consummation of the acquisition to reflect such issuance and to provide the Fugro Member with certain rights, including the right to designate two out of the up to seven members of its board of directors, the right to approve certain actions outside the ordinary course of business, certain "tag-along" rights to participate in sales of membership units by other members and, after five years and subject to the Fugro Member first offering its membership units to the other members at a price based upon independent valuations, the right to cause GMH LLC to be put up for sale in a process led by an investment banking firm.

Fair value of consideration transferred and its allocation among the identified assets acquired, liabilities assumed, intangibles, and residual goodwill are summarized as follows (in thousands):

Purchase price allocation	
Cash and cash equivalents	$2,212
Property, plant and equipment	73,320
Goodwill	11,783
Other assets	596
Total assets acquired	87,911
Accounts payable and other current liabilities	(676)
Total liabilities assumed	(676)
Total net assets acquired	$87,235

Goodwill was determined based on the residual differences between fair value of consideration transferred and the value assigned to tangible and intangible assets and liabilities. Goodwill is not amortized and is not deductible for tax purposes.

Acquisition costs incurred by GMSL in 2017, in connection with the 2017 acquisition were approximately $1.8 million, which were included in selling, general and administrative expenses. The acquisition costs were primarily

related to legal, accounting and valuation services.

Results of acquired businesses were included in our Consolidated Statements of Operations since their respective acquisition dates. Pro forma results of operations are also presented because the Fugro acquisition was material to our consolidated results of operations.

Insurance Segment

On August 9, 2018, CGI completed the acquisition all of the outstanding shares of KMG America Corporation ("KMG"), the parent company of Kanawha Insurance Company ("KIC"), Humana Inc.'s long-term care insurance subsidiary for a cash consideration of ten thousand dollars.

The preliminary allocation of fair value of consideration transferred and its allocation among the identified assets acquired, liabilities assumed and bargain purchase gain are summarized as follows (in thousands):

Preliminary purchase price allocation	
Fixed maturity securities, available-for-sale at fair value	$1,575,428
Equity securities	309
Mortgage loans	940
Policy loans	2,915
Cash and cash equivalents	806,667
Recoverable from reinsurers	901,823
Other assets	27,374
Total assets acquired	3,315,456
Life, accident and health reserves	2,931,270
Annuity reserves	11,303
Value of business acquired	214,401
Accounts payable and other current liabilities	6,022
Deferred tax liability	25,498
Other liabilities	17,840
Total liabilities assumed	3,206,334
Total net assets acquired	109,122
Total fair value of consideration	10
Gain on bargain purchase	$109,112

Gain on bargain purchase

Gain on bargain purchase was driven by the Tax Cuts and Jobs Act, which was not stipulated in the negotiations for the transaction and resulted in a material decline in the Value of Business Acquired balance, corresponding deferred tax position and, ultimately, recognition of a bargain purchase gain, largely driven by the following attributes:

- The Unified Loss Rules tax attribute reduction to tax value of assets and the seller tax adjustments to tax value of liabilities contribute significantly to the bargain purchase price.
- The reduction in the federal income tax rate, from 35% at the time the seller contribution was established to 21% effective January 1, 2018, effectively generates the remaining balance for the bargain purchase price.
- Changes in fair value of acquired assets and assumed liabilities between the date the deal was signed and the closing date was driven by the time it took to obtain regulatory approvals, amongst other closing conditions.

Reinsurance Recoverable

The reinsurance recoverable balance represents amounts recoverable from third parties. U.S. GAAP requires insurance reserves and reinsurance recoverable balances to be presented on a gross basis, as opposed to U.S. statutory

accounting principles, where reserves are presented net of reinsurance. Accordingly, the Company grossed up the fair value of the net insurance contract liability for the amount of reinsurance of approximately $901.8 million, to arrive at a gross insurance liability, and recognized an offsetting reinsurance recoverable amount of approximately $901.8 million. As part of this process, management considered reinsurance counterparty credit risk and considers it to have an immaterial impact on the reinsurance fair value gross-up. To mitigate this risk substantially all reinsurance is ceded to companies with investment grade S&P ratings.

Amounts recoverable from reinsurers were estimated in a manner consistent with the liability associated with the reinsured policies and were an estimate of the reinsurance recoverable on paid and unpaid losses, including an estimate for losses incurred but not reported. Reinsurance recoverable represent expected cash inflows from reinsurers for liabilities ceded and therefore incorporate uncertainties as to the timing and amount of claim payments. Reinsurance recoverable includes the balances due from reinsurers under the terms of the reinsurance agreements for these ceded balances as well as settlement amounts currently due.

The Value of Business Acquired

VOBA reflects the estimated fair value of in-force contracts in a life insurance company acquisition less the amount recorded as insurance contract liabilities. It represents the portion of the purchase price that is allocated to the value of the rights to receive future cash flows from the business in force at the acquisition date. A VOBA liability (negative asset) occurs when the estimated fair value of in-force contracts in a life insurance company acquisition is less than the amount recorded as insurance contract liabilities. HC2 calculated VOBA by adjusting the purchase price, which was derived on a statutory accounting basis, for differences between statutory and US GAAP accounting requirements. Amortization is based on assumptions consistent with those used in the development of the underlying contract adjusted for emerging experience and expected trends.

Life, accident and health reserves

HC2 estimated the fair value of reserves on a fair value basis, using actuarial assumptions consistent with those used for the buyer's valuation of the acquired business, and discount rates reflecting capital market conditions. The reserve accounts for the present value of all future cash flows, net of reinsurance, of the acquired block of insurance, including premium, benefit payments, and expenses. HC2 estimated the fair value of recoverable from reinsurers using the same assumptions as those for reserves of the net retained business, but applied to business ceded through various, existing reinsurance agreements.

Life Sciences Segment

On June 8, 2018, Pansend closed on the sale of its approximately 75.9% ownership in BeneVir to Janssen Biotech, Inc. ("Janssen"). In conjunction with the closing of the transaction, Janssen made an upfront cash payment of $140.0 million. Pansend received a cash payment of $93.4 million and expects to receive an additional cash payment of $13.3 million, currently held in an escrow, for a total consideration of $106.7 million. The escrow will be released within fifteen months subsequent to the closing date, assuming there are no pending or unresolved indemnified claims. Pansend recorded a gain on the sale of $102.1 million, of which $21.7 million was allocated to noncontrolling interests. HC2 received a cash payment of $72.8 million and expects to receive an additional cash payment of $9.2 million upon the release of the escrow.

Under the terms of the merger agreement, Pansend is eligible to receive payments of up to $189.7 million upon the achievement of specified development milestones and up to $493.1 million upon the achievement of specified levels of annual net sales of licensed products. From these potential milestone payments, HC2 is eligible to receive up to $512.2 million.

Broadcasting Segment

2018 Acquisitions

During the nine months ended September 30, 2018, Broadcasting completed a series of transactions for a total consideration of $46.5 million, including $44.8 million paid in cash. All transactions were accounted for as asset acquisitions.

The following table summarizes the allocation of the purchase price to the fair value of identifiable assets acquired, liabilities assumed, and intangibles (in thousands):

Purchase price allocation	
Property, plant and equipment	$840

Intangibles	44,231
Other assets	1,442
Total assets acquired	46,513
Total liabilities assumed	—
Enterprise value	46,513
Total net assets acquired	$46,513

2017 Acquisitions

During the year ended December 31, 2017, Broadcasting and its subsidiaries completed the following transactions (in thousands):

	DTV	Mako	Azteca	Other	Total
Cash	$13,467	$18,192	$—	$12,104	$43,763
Accounts payable	—	—	33,000	—	33,000
Equity	—	4,994	—	—	4,994
Debt obligations	2,405	5,250	—	—	7,655
Fair value of previously held interest	1,780	—	—	—	1,780
Fair value of consideration	$17,652	$28,436	$33,000	$12,104	$91,192

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In November 2017, Broadcasting closed a series of transactions that resulted in the ownership of over 50% of the shares of common stock of DTV for a total consideration of $17.7 million. DTV is an aggregator and operator of Low Power Television ("LPTV") licenses and stations across the United States. DTV currently owns and operates 52 LPTV stations in more than 40 cities. DTV's distribution platform currently provides carriage for more than 30 television broadcast networks. DTV maintains a focus on technological innovation. DTV exclusively adopted Internet Protocol (IP) as a transport to provide Broadcast-as-a-Service, making it the only adopter of all IP-transport to the home. The transaction was accounted for as business acquisition.

In November 2017, HC2 LPTV Holdings Inc. ("HC2 LPTV"), a wholly-owned subsidiary of Broadcasting, closed on a transaction with Mako Communications, LLC and certain of its affiliates ("Mako") to purchase all the assets in connection with Mako's ownership and operation of LPTV stations that resulted in HC2 acquiring 38 operating stations in 28 cities, for a total consideration of $28.4 million. Mako is a family owned and operated business headquartered in Corpus Christi, Texas, that has been acquiring, building, and maintaining Class A and LPTV stations all across the United States since 2000. The transaction was accounted for as business acquisition.

In November 2017, Network acquired Azteca America, a Spanish-language broadcast network, from affiliates of TV Azteca, S.A.B. de C.V. ("Azteca") (AZTECACPO.MX) (Latibex:XTZA). As part of the bifurcated transaction structure, a wholly-owned subsidiary of Broadcasting signed a definitive acquisition agreement with Northstar Media, LLC ("Northstar"), a licensee of numerous broadcast television licenses in the United States. Under the agreement with Northstar, a wholly-owned subsidiary of Broadcasting acquired Northstar's broadcast television stations, which carry Azteca America programming. In February 2018, Broadcasting closed on the acquisition and funded the $33.0 million consideration balance. The transaction was accounted for as business acquisition.

In November and December of 2017, Broadcasting closed three additional acquisitions for a total consideration of $12.1 million. All three transactions were accounted for as asset acquisitions.

The following table summarizes the allocation of the purchase price to the fair value of identifiable assets acquired, liabilities assumed, intangibles and residual goodwill (in thousands):

Purchase price allocation	
Cash and cash equivalents	$61
Accounts receivable	9,134
Property, plant and equipment	12,097
Goodwill	21,402
Intangibles	80,378
Other assets	1,290
Total assets acquired	124,362
Accounts payable and other current liabilities	(8,036)
Deferred tax liability	(6,072)
Debt obligations [1]	(4,480)
Other liabilities	(86)
Total liabilities assumed	(18,674)
Enterprise value	105,688
Less fair value of noncontrolling interest	14,496
Total net assets acquired	$91,192

[1] Debt obligations includes a $2.0 million note with CGI, which is eliminated on the Condensed Consolidated Balance Sheet.

The following table summarizes acquired intangible assets (in thousands):

FCC licenses	$75,852
Trade name	208
Other	4,318
Total intangibles	$80,378

Goodwill was determined based on the residual differences between fair value of consideration transferred and the value assigned to tangible and intangible assets and liabilities. Goodwill is not amortized and is not deductible for tax purposes.

Results of operations from acquisitions completed by Broadcasting segment since their respective acquisition dates have been included in our Consolidated Statements of Operations.

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

Other Segment

On August 14, 2018, 704Games issued a 53.5% equity interest to international media and technology company Motorsport Network. As a result, HC2's ownership percentage in 704Games was diluted to 26.2% resulting in the loss of control and the deconsolidation of the entity. HC2 recognized a gain of $3.0 million within the Gain on sale and deconsolidation of subsidiary line of the Condensed Consolidated Statements of Operations.

Pro Forma Adjusted Summary

Disclosure of proforma information under ASC 805 related to the Azteca acquisition has not been provided as it would be impracticable to do so. After making every reasonable effort to do so, the Company is unable to obtain reliable historical U.S. GAAP financial statements for Azteca. Amounts would require estimates so significant as to render the disclosure irrelevant.

The following schedule presents unaudited consolidated pro forma results of operations data as if the acquisition of Fugro and KMG had occurred on January 1, 2017. This information does not purport to be indicative of the actual results that would have occurred if the acquisitions had actually been completed on the date indicated, nor is it necessarily indicative of the future operating results or the financial position of the combined company (in thousands):

	Three months ended September 30, 2017	Nine Months Ended September 30, 2017
Net revenue	$453,832	$1,320,574
Net income (loss) from continuing operations	$12,390	$(198)
Net income (loss) attributable to HC2 Holdings, Inc.	$(830)	$(19,750)

5. Investments

Fixed Maturity Securities

The following tables provide information relating to investments in fixed maturity securities (in thousands):

September 30, 2018	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Fixed maturity securities				
U.S. Government and government agencies	$28,491	$ 225	$(158)	$28,558
States, municipalities and political subdivisions	413,554	5,678	(2,842)	416,390
Residential mortgage-backed securities	98,420	3,229	(972)	100,677
Commercial mortgage-backed securities	60,735	144	(509)	60,370
Asset-backed securities	287,497	1,078	(2,776)	285,799
Corporate and other	2,096,940	20,277	(23,568)	2,093,649
Total fixed maturity securities	$2,985,637	$ 30,631	$(30,825)	$2,985,443

December 31, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Fixed maturity securities				
U.S. Government and government agencies	$15,283	$ 470	$ (31)	$15,722
States, municipalities and political subdivisions	377,549	18,953	(1,052)	395,450

Foreign government	6,331	—	(333)	5,998
Residential mortgage-backed securities	101,974	4,185	(1,264)	104,895
Commercial mortgage-backed securities	30,152	269	(16)	30,405
Asset-backed securities	145,479	2,610	(163)	147,926
Corporate and other	589,803	51,891	(1,464)	640,230
Total fixed maturity securities	$1,266,571	$ 78,378	$ (4,323)	$1,340,626

The Company has investments in mortgage-backed securities ("MBS") that contain embedded derivatives (primarily interest-only MBS) that do not qualify for hedge accounting. The Company recorded the change in the fair value of these securities within Net realized and unrealized gains (losses) on investments. These investments had a fair value of $10.7 million and $12.3 million as of September 30, 2018 and December 31, 2017, respectively. The change in fair value related to these securities resulted in a loss of $0.2 million and a gain of $0.6 million for the three months ended September 30, 2018 and 2017, respectively and gains of $0.5 million and zero gain for the nine months ended September 30, 2018 and 2017, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

The amortized cost and fair value of fixed maturity securities available-for-sale as of September 30, 2018 are shown by contractual maturity in the table below (in thousands). Actual maturities can differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Asset and mortgage-backed securities are shown separately in the table below, as they are not due at a single maturity date:

	Amortized Cost	Fair Value
Corporate, Municipal, U.S. Government and Other securities		
Due in one year or less	$23,754	$23,612
Due after one year through five years	200,595	200,684
Due after five years through ten years	276,546	276,146
Due after ten years	2,038,090	2,038,155
Subtotal	2,538,985	2,538,597
Mortgage-backed securities	159,155	161,047
Asset-backed securities	287,497	285,799
Total	$2,985,637	$2,985,443

The tables below show the major industry types of the Company’s corporate and other fixed maturity securities (in thousands):

	September 30, 2018			December 31, 2017		
	Amortized Cost	Fair Value	% of Total	Amortized Cost	Fair Value	% of Total
Finance, insurance, and real estate	$385,333	$384,306	18.4 %	$191,234	$203,735	31.8 %
Transportation, communication and other services	626,457	631,183	30.1 %	186,114	201,802	31.5 %
Manufacturing	715,322	708,375	33.8 %	100,942	111,391	17.4 %
Other	369,828	369,785	17.7 %	111,513	123,302	19.3 %
Total	$2,096,940	$2,093,649	100.0%	$589,803	$640,230	100.0%

A portion of certain other-than-temporary impairment ("OTTI") losses on fixed maturity securities is recognized in Accumulated Other Comprehensive Income ("AOCI"). For these securities the net amount, which is recognized in the Condensed Consolidated Statements of Operations in the below line items, represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in AOCI. The Company recorded the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net realized and unrealized gains (losses) on investments	$ 623	$ —	$623	$—
Other income (expenses), net	—	—	—	6,112
Total other-than-temporary impairments	$ 623	$ —	$623	$6,112

The following table presents the total unrealized losses for the 738 and 126 fixed maturity securities held by the Company as of September 30, 2018 and December 31, 2017, respectively, where the estimated fair value had declined and remained below amortized cost by the indicated amount (in thousands):

September 30, 2018	December 31, 2017

	Unrealized Losses	% of Total	Unrealized Losses	% of Total
Fixed maturity securities				
Less than 20%	$(30,817)	100.0%	$(4,230)	93.7 %
20% or more for less than six months	—	— %	(174)	3.9 %
20% or more for six months or greater	(8)	— %	(110)	2.4 %
Total	$(30,825)	100.0%	$(4,514)	100.0%

The determination of whether unrealized losses are "other-than-temporary" requires judgment based on subjective as well as objective factors. Factors considered and resources used by management include (i) whether the unrealized loss is credit-driven or a result of changes in market interest rates, (ii) the extent to which fair value is less than cost basis, (iii) cash flow projections received from independent sources, (iv) historical operating, balance sheet and cash flow data contained in issuer SEC filings and news releases, (v) near-term prospects for improvement in the issuer and/or its industry, (vi) third party research and communications with industry specialists, (vii) financial models and forecasts, (viii) the continuity of dividend payments, maintenance of investment grade ratings and hybrid nature of certain investments, (ix) discussions with issuer management, and (x) ability and intent to hold the investment for a period of time sufficient to allow for anticipated recovery in fair value.

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The Company analyzes its MBS for OTTI each quarter based upon expected future cash flows. Management estimates expected future cash flows based upon its knowledge of the MBS market, cash flow projections (which reflect loan-to-collateral values, subordination, vintage and geographic concentration) received from independent sources, implied cash flows inherent in security ratings and analysis of historical payment data.

The Company believes it will recover its cost basis in the non-impaired securities with unrealized losses and that the Company has the ability to hold the securities until they recover in value. The Company neither intends to sell nor does it expect to be required to sell the securities with unrealized losses as of September 30, 2018. However, unforeseen facts and circumstances may cause the Company to sell fixed maturity and equity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality and liquidity guidelines.

The following tables present the estimated fair values and gross unrealized losses for the 738 and 126 fixed maturity and equity securities held by the Company that have estimated fair values below amortized cost as of each of September 30, 2018 and December 31, 2017, respectively. The Company does not have any OTTI losses reported in AOCI. These investments are presented by investment category and the length of time the related fair value has remained below amortized cost (in thousands):

September 30, 2018	Less than 12 months		12 months of greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed maturity securities						
U.S. Government and government agencies	$26,378	$(158)	$—	$—	$26,378	$(158)
States, municipalities and political subdivisions	204,991	(2,583)	7,051	(259)	212,042	(2,842)
Residential mortgage-backed securities	53,126	(850)	2,260	(122)	55,386	(972)
Commercial mortgage-backed securities	40,963	(509)	—	—	40,963	(509)
Asset-backed securities	164,675	(2,637)	2,250	(139)	166,925	(2,776)
Corporate and other	1,438,360	(20,842)	25,854	(2,726)	1,464,214	(23,568)
Total fixed maturity securities	$1,928,493	$(27,579)	$37,415	$(3,246)	$1,965,908	$(30,825)

December 31, 2017	Less than 12 months		12 months of greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed maturity securities						
U.S. Government and government agencies	$5,044	$(17)	$2,199	$(14)	$7,243	$(31)
States, municipalities and political subdivisions	32,939	(834)	10,757	(218)	43,696	(1,052)
Foreign government	—	—	5,999	(333)	5,999	(333)
Residential mortgage-backed securities	5,139	(546)	16,150	(718)	21,289	(1,264)
Commercial mortgage-backed securities	5,053	(12)	1,003	(4)	6,056	(16)
Asset-backed securities	19,771	(64)	3,963	(99)	23,734	(163)
Corporate and other	18,478	(824)	19,433	(640)	37,911	(1,464)
Total fixed maturity securities	$86,424	$(2,297)	$59,504	$(2,026)	$145,928	$(4,323)

As of September 30, 2018, investment grade fixed maturity securities (as determined by nationally recognized rating agencies) represented approximately 85.3% of the gross unrealized loss and 94.0% of the fair value. As of December 31, 2017, investment grade fixed maturity securities represented approximately 7.3% of the gross unrealized loss and 10.4% of the fair value. Certain risks are inherent in connection with fixed maturity securities, including loss upon default, price volatility in reaction to changes in interest rates, and general market factors and

risks associated with reinvestment of proceeds due to prepayments or redemptions in a period of declining interest rates.

Equity Securities

Beginning in 2018 upon adopting ASU 2016-01, changes in fair value of equity securities are reported in earnings. The following tables provide information relating to investments in equity securities measured at fair value (in thousands):

	September 30, 2018	December 31, 2017
Equity securities		
Common stocks	$ 63,298	$ 4,928
Perpetual preferred stocks	153,855	42,572
Total equity securities	$ 217,153	$ 47,500

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

On August 4, 2018, HC2 Chairman and Chief Executive Officer Philip Falcone informed Inseego Corp's ("INSG") Board of Directors (the "Board") of his resignation from his position as a Director and Chairman of the Board of INSG effective upon consummation of a private placement at INSG. The INSG private placement consisted of an issuance of an aggregate of 12.0 million shares of its common stock to two investors for a purchase price of $1.63 per share, resulting in aggregate gross proceeds to INSG of approximately $19.7 million. Concurrently, INSG amended HC2's Investors' Rights Agreement where HC2 agreed to eliminate its board observation and nomination rights. As a result, HC2 lost its ability to exercise significant influence. HC2's equity investment in INSG security no longer qualifies to be accounted for under the equity method. Beginning in the third quarter of 2018, the investment will be recorded at fair value. The investment basis in INSG under the equity method had been reduced to zero as a result of losses incurred for the duration of the investment. The change in the accounting method resulted in a gain of $44.2 million for the three months ended September 30, 2018 and recorded in Other income (expenses), net.

Other Invested Assets

Beginning in 2018 upon adopting ASU 2016-01, certain investments in equity securities that do not have a readily determinable fair value are carried at cost minus impairment, if any, plus or minus changes resulting from observable price changes or at fair value. Carrying values of other invested assets were as follows (in thousands):

	September 30, 2018			December 31, 2017		
	Measurement Alternative	Equity Method	Fair Value	Cost Method	Equity Method	Fair Value
Common Equity	$—	$1,914	$ —	$—	$1,484	$ —
Preferred Equity	1,600	10,757	—	2,484	14,197	—
Derivatives	—	—	290	422	—	260
Other	—	56,404	—	—	66,572	—
Total	$1,600	$69,075	$ 290	$2,906	$82,253	$ 260

Summarized financial information for subsidiaries not consolidated as of and for the nine months ended September 30, 2018 and 2017 were as follows (information for two of the investees is reported on a one month lag, in thousands):

	2018	2017
Net revenue	$220,694	$369,336
Gross profit	$71,365	$109,543
Income (loss) from continuing operations	$34,805	$(10,118)
Net income (loss)	$27,799	$(31,453)
Current assets	$312,252	$317,786
Noncurrent assets	$93,099	$189,278
Current liabilities	$210,510	$197,855
Noncurrent liabilities	$18,507	$152,879

Net Investment Income

The major sources of net investment income were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Fixed maturity securities, available-for-sale at fair value	$26,687	$14,951	$58,574	$44,426

Equity securities	1,501	578	2,763	1,827
Mortgage loans	1,971	447	4,824	1,475
Policy loans	316	289	873	878
Other invested assets	1,410	68	2,007	75
Gross investment income	31,885	16,333	69,041	48,681
External investment expense	(175)	(46)	(265)	(151)
Net investment income	$31,710	$16,287	$68,776	$48,530

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

Net Realized and Unrealized Gains (Losses) on Investments

The major sources of net realized and unrealized gains and losses on investments were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Realized gains on fixed maturity securities	$1,013	$125	$4,733	$3,510
Realized losses on fixed maturity securities	(90)	(42)	(1,355)	(959)
Realized gains on equity securities	350	265	350	375
Realized losses on equity securities	—	—	(26)	(31)
Net unrealized gains (losses) on equity securities	(934)	—	(1,125)	—
Net unrealized gains (losses) on derivative instruments	(212)	630	493	(41)
Impairment loss	(623)	—	(623)	—
Net realized and unrealized gains (losses)	$(496)	$978	$2,447	$2,854

6. Fair Value of Financial Instruments

Assets by Hierarchy Level

Assets and liabilities measured at fair value on a recurring basis are summarized below (in thousands):

September 30, 2018		Fair Value Measurement Using:		
	Total	Level 1	Level 2	Level 3
Assets				
Fixed maturity securities				
U.S. Government and government agencies	$28,558	$9,155	$17,131	$2,272
States, municipalities and political subdivisions	416,390	—	415,998	392
Residential mortgage-backed securities	100,677	—	53,828	46,849
Commercial mortgage-backed securities	60,370	—	34,522	25,848
Asset-backed securities	285,799	—	46,191	239,608
Corporate and other	2,093,649	7,010	1,955,642	130,997
Total fixed maturity securities	2,985,443	16,165	2,523,312	445,966
Equity securities				
Common stocks	63,298	56,592	—	6,706
Perpetual preferred stocks	153,855	7,402	89,421	57,032
Total equity securities	217,153	63,994	89,421	63,738
Derivatives	290	—	—	290
Total assets accounted for at fair value	$3,202,886	$80,159	$2,612,733	$509,994
Liabilities				
Warrant liability	$4,018	$—	$—	$4,018
Contingent liability	1,763	—	—	1,763
Other	738	—	—	738
Total liabilities accounted for at fair value	$6,519	$—	$—	$6,519

December 31, 2017		Fair Value Measurement Using:	
	Total	Level 2	Level 3

		Level 1		
Assets				
Fixed maturity securities				
U.S. Government and government agencies	$ 15,722	$5,094	$ 10,628	$ —
States, municipalities and political subdivisions	395,450	—	389,439	6,011
Foreign government	5,998	—	5,998	—
Residential mortgage-backed securities	104,895	—	90,283	14,612
Commercial mortgage-backed securities	30,405	—	18,248	12,157
Asset-backed securities	147,926	—	14,184	133,742
Corporate and other	640,230	2,098	611,844	26,288
Total fixed maturity securities	1,340,626	7,192	1,140,624	192,810

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Equity securities				
Common stocks	4,928	4,771	—	157
Perpetual preferred stocks	42,572	7,665	28,470	6,437
Total equity securities	47,500	12,436	28,470	6,594
Derivatives	260	—	—	260
Total assets accounted for at fair value	$1,388,386	$19,628	$1,169,094	$199,664
Liabilities				
Warrant liability	$3,826	$—	$—	$3,826
Other	944	—	—	944
Total liabilities accounted for at fair value	$4,770	$—	$—	$4,770

The Company reviews the fair value hierarchy classifications each reporting period. Changes in the observability of the valuation attributes may result in a reclassification of certain financial assets or liabilities. Such reclassifications are reported as transfers in and out of Level 3 at the beginning fair value for the reporting period in which the changes occur. Availability of secondary market activity and consistency of pricing from third-party sources impacts the Company's ability to classify securities as Level 2 or Level 3. The Company’s assessment resulted in a net transfer into Level 3 of $31.2 million primarily related to structured securities during the nine months ended September 30, 2018. The Company’s assessment resulted in a net transfer out of Level 3 of $57.0 million primarily related to structured securities during the nine months ended September 30, 2017.

The methods and assumptions the Company uses to estimate the fair value of assets and liabilities measured at fair value on a recurring basis are summarized below:

Fixed Maturity Securities. The fair values of the Company’s publicly-traded fixed maturity securities are generally based on prices obtained from independent pricing services. Prices from pricing services are sourced from multiple vendors, and a vendor hierarchy is maintained by asset type based on historical pricing experience and vendor expertise. In some cases, the Company receives prices from multiple pricing services for each security, but ultimately uses the price from the pricing service highest in the vendor hierarchy based on the respective asset type. Consistent with the fair value hierarchy described above, securities with validated quotes from pricing services are generally reflected within Level 2, as they are primarily based on observable pricing for similar assets and/or other market observable inputs.

If the Company ultimately concludes that pricing information received from the independent pricing service is not reflective of market activity, non-binding broker quotes are used, if available. If the Company concludes the values from both pricing services and brokers are not reflective of market activity, it may override the information from the pricing service or broker with an internally developed valuation, however, this occurs infrequently. Internally developed valuations or non-binding broker quotes are also used to determine fair value in circumstances where vendor pricing is not available. These estimates may use significant unobservable inputs, which reflect the Company’s assumptions about the inputs that market participants would use in pricing the asset. Pricing service overrides, internally developed valuations and non-binding broker quotes are generally based on significant unobservable inputs and are reflected as Level 3 in the valuation hierarchy.

The inputs used in the valuation of corporate and government securities include, but are not limited to, standard market observable inputs which are derived from, or corroborated by, market observable data including market yield curve, duration, call provisions, observable prices and spreads for similar publicly traded or privately traded issues that incorporate the credit quality and industry sector of the issuer.

For structured securities, valuation is based primarily on matrix pricing or other similar techniques using standard market inputs including spreads for actively traded securities, spreads off benchmark yields, expected prepayment speeds and volumes, current and forecasted loss severity, rating, weighted average coupon, weighted average maturity, average delinquency rates, geographic region, debt-service coverage ratios and issuance-specific information including, but not limited to: collateral type, payment terms of the underlying assets, payment priority within the tranche, structure of the security, deal performance and vintage of loans.

When observable inputs are not available, the market standard valuation techniques for determining the estimated fair value of certain types of securities that trade infrequently, and therefore have little or no price transparency, rely on inputs that are significant to the estimated fair value but that are not observable in the market or cannot be derived principally from or corroborated by observable market data. These unobservable inputs are sometimes based in large part on management judgment or estimation, and cannot be supported by reference to market activity. Even though unobservable, these inputs are based on assumptions deemed appropriate given the circumstances and are believed to be consistent with what other market participants would use when pricing such securities.

The fair values of private placement securities are primarily determined using a discounted cash flow model. In certain cases, these models primarily use observable inputs with a discount rate based upon the average of spread surveys collected from private market intermediaries who are active in both primary and secondary transactions, taking into account, among other factors, the credit quality and industry sector of the issuer and the reduced liquidity associated with private placements. Generally, these securities have been reflected within Level 3. For certain private fixed maturities, the discounted cash flow model may also incorporate significant unobservable inputs, which reflect the Company’s own assumptions about the inputs market participants would use in pricing the security. To the extent management determines that such unobservable inputs are not significant to the price of a security, a Level 2 classification is made. Otherwise, a Level 3 classification is used.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

Equity Securities. The balance consists principally of common and preferred stock of publicly and privately traded companies. The fair values of publicly traded equity securities are primarily based on quoted market prices in active markets and are classified within Level 1 in the fair value hierarchy. The fair values of preferred equity securities, for which quoted market prices are not readily available, are based on prices obtained from independent pricing services and these securities are generally classified within Level 2 in the fair value hierarchy. The fair value of common stock of privately held companies was determined using unobservable market inputs, including volatility and underlying security values and was classified as Level 3.

Cash Equivalents. The balance consists of money market instruments, which are generally valued using unadjusted quoted prices in active markets that are accessible for identical assets and are primarily classified as Level 1. Various time deposits carried as cash equivalents are not measured at estimated fair value and, therefore, are excluded from the tables presented.

Level 3 Measurements and Transfers

The following tables summarize changes to the Company’s financial instruments carried at fair value and classified within Level 3 of the fair value hierarchy for the three and nine months ended September 30, 2018 and 2017, respectively (in thousands):

		Total realized/unrealized gains (losses) included in						
	Balance at June 30, 2018	Net earnings (loss)	Other comp. income (loss)	Purchases and issuances	Sales and settlements	Transfer to Level 3	Transfer out of Level 3	Balance at September 30, 2018
Assets								
Fixed maturity securities								
U.S. Government and government agencies	$—	$(11)	$(2)	$2,285	$—	$—	$ —	$2,272
States, municipalities and political subdivisions	409	(1)	(16)	—	—	—	—	392
Residential mortgage-backed securities	12,267	42	(373)	33,726	(1,375)	2,562	—	46,849
Commercial mortgage-backed securities	22,051	(39)	18	2,086	(63)	1,795	—	25,848
Asset-backed securities	132,744	(39)	(665)	116,833	(9,265)	—	—	239,608
Corporate and other	67,292	162	(832)	65,019	(9,780)	9,136	—	130,997
Total fixed maturity securities	234,763	114	(1,870)	219,949	(20,483)	13,493	—	445,966
Equity securities								
Common stocks	483	1,784	—	100	—	4,339	—	6,706
Perpetual preferred stocks	24,365	(350)	—	32,007	—	1,010	—	57,032
Total equity securities	24,848	1,434	—	32,107	—	5,349	—	63,738
Derivatives	280	10	—	—	—	—	—	290
Total financial assets	$259,891	$1,558	$(1,870)	$252,056	$(20,483)	$18,842	$ —	$509,994