

HC2 HOLDINGS, INC.  
Form 10-Q  
November 09, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended September 30, 2016

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

Commission File No. 001-35210

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

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Delaware (State or other jurisdiction of incorporation or organization)	54-1708481 (I.R.S. Employer Identification No.)
--	--

450 Park Avenue, 30 <sup>th</sup> Floor New York, NY (Address of principal executive offices)	10022 (Zip Code)
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(212) 235-2690  
(Registrant's telephone number, including area code)

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Former name or former address, if changed since last report

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  No

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

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

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Large accelerated filer  Accelerated filer  x

Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No  x

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding as of October 31, 2016
Common Stock, \$0.001 par value	41,818,944

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

## PART I: FINANCIAL INFORMATION

## Item 1. Financial Statements

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Services revenue	\$245,064	\$151,933	\$624,545	\$373,492
Sales revenue	133,474	125,534	379,729	386,765
Life, accident and health earned premiums, net	19,967	—	59,939	—
Net investment income	14,799	—	42,585	—
Net realized losses on investments	(220)	)—	(2,677)	)—
Net revenue	413,084	277,467	1,104,121	760,257
Operating expenses				
Cost of revenue - services	225,876	138,099	583,942	334,608
Cost of revenue - sales	107,984	102,395	308,951	324,820
Policy benefits, changes in reserves, and commissions	29,689	—	92,784	—
Selling, general and administrative	36,902	28,810	107,493	77,818
Depreciation and amortization	5,961	6,267	18,163	17,768
Gain on sale or disposal of assets	(23)	)(1,106)	)(973)	)(135)
Lease termination costs	(159)	)1,124	179	1,124
Total operating expenses	406,230	275,589	1,110,539	756,003
Income (loss) from operations	6,854	1,878	(6,418)	)4,254
Interest expense	(10,719)	)(10,383)	)(31,614)	)(29,208)
Other income (expense), net	(3,203)	)1,193	(4,220)	)(1,378)
Income from equity investees	335	918	3,153	427
Loss from continuing operations before income taxes	(6,733)	)(6,394)	)(39,099)	)(25,905)
Income tax benefit (expense)	1,334	(1,504)	)3,649	1,832
Loss from continuing operations	(5,399)	)(7,898)	)(35,450)	)(24,073)
Loss from discontinued operations	—	(24)	)—	(44)
Net loss	(5,399)	)(7,922)	)(35,450)	)(24,117)
Less: Net (income) loss attributable to noncontrolling interest and redeemable noncontrolling interest	841	(65)	)2,365	(8)
Net loss attributable to HC2 Holdings, Inc.	(4,558)	)(7,987)	)(33,085)	)(24,125)
Less: Preferred stock and deemed dividends	2,948	1,035	5,061	3,212
Net loss attributable to common stock and participating preferred stockholders	\$(7,506)	)\$ (9,022)	)\$ (38,146)	)\$ (27,337)
Basic loss per common share:				
Loss from continuing operations	\$(0.20)	)\$ (0.35)	)\$ (1.07)	)\$ (1.09)
Loss from discontinued operations	—	—	—	—
Basic and diluted loss per common share	\$(0.20)	)\$ (0.35)	)\$ (1.07)	)\$ (1.09)
Diluted loss per common share:				
Loss from continuing operations	\$(0.20)	)\$ (0.35)	)\$ (1.07)	)\$ (1.09)
Loss from discontinued operations	—	—	—	—

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Net loss attributable to common stock and participating preferred stockholders	\$ (0.20 )	\$ (0.35 )	\$ (1.07 )	\$ (1.09 )
Weighted average common shares outstanding:				
Basic	36,627	25,592	35,808	25,093
Diluted	36,627	25,592	35,808	25,093

See accompanying notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Net loss	\$(5,399)	\$(7,922 )	\$(35,450)	\$(24,117)
Other comprehensive income (loss)				
Foreign currency translation adjustment	672	(5,275 )	1,335	(7,147 )
Unrealized gain (loss) on available-for-sale securities, net of tax	8,972	(2,008 )	71,261	(4,186 )
Less: Comprehensive (income) loss attributable to the noncontrolling interest and redeemable noncontrolling interest	841	(65 )	2,365	(8 )
Comprehensive income (loss) attributable to HC2 Holdings, Inc.	\$5,086	\$(15,270)	\$39,511	\$(35,458)

See accompanying notes to Condensed Consolidated Financial Statements.

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

	September 30, 2016	December 31, 2015
Assets		
Investments:		
Fixed maturity securities, available-for-sale at fair value	\$ 1,331,677	\$ 1,231,841
Equity securities, available-for-sale at fair value	56,506	49,682
Mortgage loans	8,939	1,252
Policy loans	18,228	18,476
Other invested assets	60,870	53,119
Total investments	1,476,220	1,354,370
Cash and cash equivalents	121,321	158,624
Restricted cash	791	538
Accounts receivable (net of allowance for doubtful accounts of \$3,033 and \$794 at September 30, 2016 and December 31, 2015, respectively)	272,738	210,853
Costs and recognized earnings in excess of billings on uncompleted contracts	17,091	39,310
Inventory	8,973	12,120
Recoverable from reinsurers	525,599	522,562
Accrued investment income	15,751	15,300
Deferred tax asset	43,555	52,511
Property, plant and equipment, net	244,176	214,466
Goodwill	86,025	61,178
Intangibles, net	39,144	29,409
Other assets	35,520	65,206
Assets held for sale	1,093	6,065
Total assets	\$ 2,887,997	\$ 2,742,512
Liabilities, temporary equity and stockholders' equity		
Life, accident and health reserves	\$ 1,637,501	\$ 1,591,937
Annuity reserves	254,250	260,853
Value of business acquired	48,512	50,761
Accounts payable and other current liabilities	232,149	225,389
Billings in excess of costs and recognized earnings on uncompleted contracts	51,241	21,201
Deferred tax liability	12,807	4,281
Long-term obligations	396,688	371,876
Pension liability	20,744	25,156
Other liabilities	12,042	17,793
Total liabilities	2,665,934	2,569,247
Commitments and contingencies		
Temporary equity:		
Preferred stock, \$.001 par value - 20,000,000 shares authorized; Series A - 27,308 and 29,172 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively; Series A-1 - 1,000 and 10,000 shares issued and outstanding at September 30, 2016 and December 31, 2015; Series A-2 - 14,000 shares issued and outstanding at September 30, 2016 and December 31, 2015	41,659	52,619
Redeemable noncontrolling interest	1,993	3,122

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Total temporary equity	43,652	55,741
Stockholders' equity:		
Common stock, \$.001 par value - 80,000,000 shares authorized; 38,263,606 and 35,281,375 shares issued and 38,031,325 and 35,249,749 shares outstanding at September 30, 2016 and December 31, 2015, respectively		35
Additional paid-in capital	228,842	209,477
Accumulated deficit	(112,814)	(79,729)
Treasury stock, at cost	(1,262)	(378)
Accumulated other comprehensive gain (loss)	37,221	(35,375)
Total HC2 Holdings, Inc. stockholders' equity before noncontrolling interest	152,025	94,030
Noncontrolling interest	26,386	23,494
Total stockholders' equity	178,411	117,524
Total liabilities, temporary equity and stockholders' equity	\$ 2,887,997	\$ 2,742,512
See accompanying notes to Condensed Consolidated Financial Statements.		



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

	Common Stock Shares	Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interest	Total
Balance as of December 31, 2014	23,813	\$ 24	\$141,948	\$(378 )	\$(44,164 )	\$(18,243 )	\$25,208	\$104,395
Share-based compensation expense	—	—	7,402	—	—	—	—	7,402
Dividend paid to noncontrolling interest	—	—	—	—	—	—	(1,038 )	(1,038 )
Preferred stock dividends and accretion	—	—	(3,212 )	—	—	—	—	(3,212 )
Amortization of issuance costs and beneficial conversion feature	—	—	(375 )	—	—	—	—	(375 )
Issuance of Common Stock	5	—	—	—	—	—	—	—
Issuance of restricted stock	1,539	2	—	—	—	—	—	2
Conversion of Preferred Stock	235	—	1,000	—	—	—	—	1,000
Acquisition of controlling interest	—	—	—	—	—	—	(822 )	(822 )
Excess book value over fair value of purchased noncontrolling interest	—	—	43	—	—	—	(43 )	—
Excess of fair value of net assets over purchase price of acquired company	—	—	182	—	—	—	—	182
Net loss	—	—	—	—	(24,125 )	—	8	(24,117 )
Foreign currency translation adjustment	—	—	—	—	—	(7,147 )	—	(7,147 )
Unrealized loss on available-for-sale securities, net of tax	—	—	—	—	—	(4,186 )	—	(4,186 )
Balance as of September 30, 2015	25,592	\$ 26	\$146,988	\$(378 )	\$(68,289 )	\$(29,576 )	\$23,313	\$72,084

	Common Stock Shares	Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Non- controlling Interest	Total
Balance as of December 31, 2015	35,250	\$ 35	\$209,477	\$(378 )	\$(79,729 )	\$(35,375 )	\$23,494	\$117,524
	—	—	6,667	—	—	—	—	6,667

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Share-based compensation expense									
Fair value adjustment of Redeemable noncontrolling interest	—	—	(99)	)	—	—	—	—	(99)
Exercise of Warrants and Stock Options	2	—	—	—	—	—	—	—	—
Shares withheld to satisfy tax withholdings	(201)	)	—	—	(884)	)	—	—	(884)
Preferred stock dividend and accretion	—	—	(2,386)	)	—	—	—	—	(2,386)
Amortization of issuance costs and beneficial conversion feature	—	—	(309)	)	—	—	—	—	(309)
Issuance of common stock	65	—	—	—	—	—	—	—	—
Issuance of restricted stock	199	—	—	—	—	—	—	—	—
Conversion of Preferred Stock	2,564	3	10,850	—	—	—	—	—	10,853
Deemed dividend to induce conversion of Preferred Stock	152	—	(1,490)	)	—	—	—	—	(1,490)
Acquisition of controlling interests	—	—	—	—	—	—	—	2,161	2,161
Sale of controlling interest	—	—	—	—	—	—	—	8,000	8,000
Excess fair value over book value of noncontrolling interest sold	—	—	6,132	—	—	—	—	(6,132)	)
Net loss	—	—	—	—	—	(33,085)	)	—	(2,365)
Net income attributable to redeemable noncontrolling interest	—	—	—	—	—	—	—	1,228	1,228
Foreign currency translation adjustment	—	—	—	—	—	—	1,335	—	1,335
Unrealized gain on available-for-sale securities, net of tax	—	—	—	—	—	—	71,261	—	71,261
Balance as of September 30, 2016	38,031	\$ 38	\$228,842	\$(1,262)	\$(112,814)	)	\$ 37,221	\$ 26,386	\$178,411

See accompanying notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,	
	2016	2015
Cash flows from operating activities:		
Net loss	\$(35,450)	\$(24,117)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Provision for doubtful accounts receivable	827	325
Share-based compensation expense	6,667	7,402
Depreciation and amortization	19,602	23,503
Amortization of deferred financing costs and debt discount	1,530	1,246
Amortization of fixed maturities discount/premium	8,966	—
(Gain) loss on sale or disposal of assets	251	(135 )
Net realized (gains) losses on investments	2,519	(431 )
Impairment of investments	4,321	—
Equity investment (income) loss	(3,153 )	(427 )
Lease termination costs	179	1,124
Deferred income taxes	(18,940 )	(5,957 )
Receipt of dividends from equity investees	7,214	2,448
Annuity benefits	6,737	—
All other operating activities	(224 )	315
Changes in assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	(56,463 )	(36,099 )
(Increase) decrease in costs and recognized earnings in excess of billings on uncompleted contracts	22,219	(9,253 )
(Increase) decrease in inventory	3,518	455
(Increase) decrease in other assets	26,725	(3,316 )
Increase (decrease) in life, accident and health reserves	41,942	—
Increase (decrease) in accounts payable, current and other liabilities	(12,625 )	42,364
Increase (decrease) in billings in excess of costs and recognized earnings on uncompleted contracts	30,040	(21,933 )
Increase (decrease) in pension liability	(1,423 )	(8,665 )
Net cash provided by (used in) operating activities	54,979	(31,151 )
Cash flows from investing activities:		
Purchase of property, plant and equipment	(21,689 )	(16,751 )
Sale of property and equipment	511	4,994
Purchase of investments	(179,291 )	(41,710 )
Sale of investments	72,188	6,876
Sale of assets held for sale	5,900	1,479
Cash paid for business acquisitions, net of cash acquired	(10,871 )	(568 )
Maturities and redemptions of fixed maturity securities	53,663	—
Change in restricted cash	(253 )	(727 )
All other investing activities	(230 )	—
Net cash used in investing activities	(80,072 )	(46,407 )
Cash flows from financing activities:		

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Proceeds from long-term obligations	11,672	54,963
Principal payments on long-term obligations	(11,441 )	(8,473 )
Payment of deferred financing costs	—	(1,137 )
Annuity receipts	2,522	—
Annuity surrenders	(15,562 )	—

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Proceeds from issuance of common stock of subsidiary	8,000	
Proceeds from sale of preferred stock, net	—	14,033
Purchase of noncontrolling interest	(2,163 )	(239 )
Payment of withholdings related to net settlements	(884 )	—
Payment of dividends	(3,007 )	(3,855 )
Net cash provided by (used in) financing activities	(10,863 )	55,292
Effect of currency exchange rate changes on cash and cash equivalents	(1,347 )	(4,646 )
Net change in cash and cash equivalents	(37,303 )	(26,912 )
Cash and cash equivalents, beginning of period	158,624	107,978
Cash and cash equivalents, end of period	\$121,321	\$81,066
Supplemental cash flow information:		
Cash paid for interest	\$21,491	\$21,445
Cash paid for taxes	\$13,469	\$1,701
Non-cash investing and financing activities:		
Purchases of property, plant and equipment under financing arrangements	\$—	\$1,808
Property, plant and equipment included in accounts payable	\$1,542	\$1,521
Fair value of contingent asset assumed in other acquisitions	\$2,992	\$—
Fair value of deferred liability assumed in other acquisitions	\$2,589	\$—
Debt assumed in other acquisitions	\$20,813	\$—
Deemed dividend from conversion of preferred stock	\$1,490	\$—
Conversion of preferred stock	\$10,853	\$1,000

See accompanying 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 subsidiaries, the "Company", "we", "us" and "our") is a diversified holding company which seeks to acquire and grow attractive businesses that the Company believes 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 also invests to a more limited extent in a variety of debt instruments or noncontrolling equity interest positions. HC2's common stock trades on the NYSE MKT LLC under the symbol "HCHC".

The Company currently has seven reportable segments based on management's organization of the enterprise - Manufacturing, Marine Services, Insurance, Utilities, Telecommunications, Life Sciences, and Other which includes operations that do not meet the separately reportable segment thresholds.

1. Our Manufacturing segment includes DBM Global Inc. ("DBM Global", f/k/a Schuff International, Inc.) and its wholly-owned subsidiaries. DBM Global offers integrated steel construction services from a single source and professional services that include design-assist, design-build, engineering, building information modeling participation, 3D steel modeling / detailing, fabrication, advanced field erection, project management and state-of-the-art steel management systems. Major market segments for DBM Global include commercial, healthcare, convention centers, stadiums, gaming and hospitality, mixed use and retail, industrial, public works, bridges, transportation, and international projects. Headquartered in Phoenix, Arizona, DBM Global has operations in Arizona, California, Georgia, Kansas, and Texas, with construction projects primarily located in the aforementioned states, in addition to international construction projects in select markets, primarily Panama, through its Panamanian joint venture Schuff Hopsa Engineering. The Company maintains a 92% controlling interest in DBM Global.

2. Our Marine Services segment includes Global Marine Systems Limited ("GMSL"). GMSL is a leading provider of engineering and underwater services on submarine cables. The Company maintains a 95% equity interest in GMSL.

3. Our Insurance segment includes United Teacher Associates Insurance Company ("UTA") and Continental General Insurance Company ("CGI", and together with UTA, the "Insurance Companies"). The Insurance Companies provide 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 owns 100% of the Insurance Companies.

4. Our Utilities segment includes American Natural Gas ("ANG"). Headquartered in the Northeast, 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 effective control of, and a 49.99% ownership interest in ANG.

5. Our Telecommunications segment includes PTGi International Carrier Services, ("ICS"). ICS operates a telecommunications business including a network of direct routes and provides premium voice communication services for national telecom operators, mobile operators, wholesale carriers, prepaid operators, Voice over Internet Protocol ("VOIP") service operators and Internet service providers from our International Carrier Services business unit. ICS provides a quality service via direct routes and by forming strong relationships with carefully selected partners. The Company owns 100% of ICS.

6. Our Life Sciences segment includes Pansend Life Sciences, LLC ("Pansend"). Pansend owns a (i) 77% interest in Genovel Orthopedics, Inc., which seeks to develop products to treat early osteoarthritis of the knee, (ii) 61% interest in R2 Dermatology Incorporated (f/k/a GemDerm Aesthetics, Inc.), which develops skin lightening technology, and (iii) 80% interest in BeneVir Biopharm, Inc. ("BeneVir"), which focuses on immunotherapy for the treatment of solid tumors. Pansend also invests in other early stage or developmental stage healthcare companies.

7. In our Other segment, we invest in and grow developmental stage companies that we believe have significant growth potential. Among the businesses included in this segment are the Company's 56% ownership interest in DMi, Inc. ("DMi"), which owns licenses to create and distribute NASCAR® video games, and the Company's 72% interest in NerVve Technologies Inc. ("NerVve"), which provides analytics on broadcast TV, digital and social media online platforms.

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

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial reporting and Securities and Exchange Commission (“SEC”) regulations. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such principles and regulations. In the opinion of management, the financial statements reflect all adjustments (all of which are of a normal and recurring nature), which are necessary to present fairly the financial position, results of operations, cash flows and comprehensive income (loss) for the interim periods. The results for the Company’s nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the calendar year ending December 31, 2016. The financial statements should be read in conjunction with the Company’s audited consolidated financial statements included in the Company’s most recently filed Annual Report on Form 10-K.

### 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, 2016, the Company has a 100% interest in the Insurance Companies, a 100% interest in ICS, a 95% interest in GMSL, a 92% interest in DBM Global, a 56% interest in DMi, a 72% interest in NerVve, and board control of, and a 49.99% interest in ANG. Because the Company controls the operations of ANG through its control of the board, the assets, liabilities, revenues and expenses of ANG are included in our Condensed Consolidated Financial Statements. Through its subsidiary, Pansend, the Company has a 77% interest in Genovel Orthopedics, Inc., a 61% interest in R2 Dermatology and an 80% interest in BeneVir. The results of each of these entities are consolidated with the Company’s results from and after their respective acquisition dates based on guidance from the Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 810, “Consolidation” (“ASC 810”). The remaining interests not owned by the Company are presented as a noncontrolling interest component of total equity. DBM Global uses a 4-4-5 week quarterly cycle, which for the third quarter of 2016 ended on October 1, 2016.

### Reclassification

Certain previous year amounts have been reclassified to conform with current year presentations related to the reporting of new financial statement line items.

### Adjustments

During the second quarter of 2016, the Company identified an immaterial error in its calculation of depreciation expense for the twelve months ended December 31, 2015 and 2014 and the three months ended March 31, 2016 related to purchase accounting associated with the acquisition of DBM Global in May of 2014. This resulted in an excess depreciation expense being recorded in each of the periods noted. In addition, certain gains and losses on assets that were disposed of by DBM Global were incorrectly recorded during the same periods as a result of these adjustments. The net impact of these adjustments to net income would have been an increase of \$0.7 million and a decrease of \$0.2 million for the twelve months ended December 31, 2015 and 2014, respectively, and an increase of \$0.8 million for the three months ended March 31, 2016.



The Company determined to correct the cumulative effect of these adjustments in the second quarter of 2016, which resulted in a net adjustment to net income (loss) attributable to common and participating preferred stockholders for the nine months ended September 30, 2016 of \$1.3 million. Excluding this adjustment, net loss attributable to common and participating preferred stockholders would have been \$39.4 million or \$1.10 per fully diluted share for the nine months ended September 30, 2016, instead of the \$38.1 million recorded.

#### Newly Adopted Accounting Principles

In September 2015, the FASB issued Accounting Standards Update ("ASU") 2015-16, "Business Combination Topic No. 805: Simplifying the Accounting for Measurement - Period Adjustments", which requires adjustments to provisional amounts that are identified during the measurement period to be recognized in the reporting period in which the adjustment amounts are determined.

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This includes any effect on earnings of changes in depreciation, amortization, or other income effects as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In August 2015, the FASB issued ASU 2015-15, "Interest - Imputation of Interest Subtopic No. 835-30: Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements," which codifies an SEC staff announcement that entities are permitted to defer and present debt issuance costs related to line-of-credit arrangements as assets, rather than as a direct offset to the liability as is required now under ASU 2015-03. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In July 2015, the FASB issued ASU 2015-12, "(Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, and (Part III) Measurement Date Practical Expedient". Part I of this ASU is related to one area of several potential simplifications for employee benefit plans and designates contract value as the only required measure for fully benefit-responsive investment contracts, which maintains the relevant information while reducing the cost and complexity of reporting for fully benefit responsive investment contracts. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In May 2015, the FASB has issued ASU 2015-9, "Disclosures About Short-Duration Contracts". This ASU requires insurance entities to disclose for annual reporting periods certain information in respect of liability for unpaid claims and claim adjustment expenses. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In May 2015, the FASB issued ASU 2015-8, "Business Combinations Topic No. 805: Pushdown Accounting-Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115 (SEC Update)," which rescinds certain SEC guidance in order to conform with ASU 2014-17, "Pushdown Accounting" ("ASU 2014-17"). ASU 2014-17 was issued in November 2014 and provides a reporting entity that is a business or nonprofit activity (an "acquiree") the option to apply pushdown accounting to its separate financial statements when an acquirer obtains control of the acquiree. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In May 2015, the FASB issued ASU 2015-07, "Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)". The amendments in this ASU remove the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. The amendments also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In February 2015, the FASB issued ASU 2015-2, "Amendments to the Consolidation Analysis", which amends the consolidation requirements in ASC 810 and significantly changes the consolidation analysis required under U.S. GAAP relating to whether or not to consolidate certain legal entities. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

In January 2015, the FASB issued ASU 2015-1, "Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items", which eliminates from U.S. GAAP the concept of an extraordinary item. Under the ASU, an entity will no longer (1) segregate an extraordinary item from the results of ordinary operations; (2) separately present an extraordinary item on its income statement, net of tax, after income from continuing operations; or (3) disclose income taxes and earnings-per-share data applicable to an extraordinary item. On January 1, 2016, the Company adopted this update, which did not have a material impact on the Condensed Consolidated Financial Statements.

#### New Accounting Pronouncements

In August, 2016, the FASB issued ASU 2016-15, "Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force)" ("ASU 2016-15"). The amendments in ASU 2016-15 address eight specific cash flow issues and apply to all entities that are required to present a statement of cash flows under FASB ASC 230, "Statement of Cash Flows." The amendments in ASU 2016-15 are effective for public business entities for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted, including adoption during an interim period. The Company

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has not yet adopted this update and is currently evaluating the impact of ASU 2016-15 on its Condensed Consolidated Financial Statements.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments - Credit Losses" (Topic 326)" ("ASU-2016-13"), which amends guidance on reporting credit losses for assets held at amortized cost basis and available for sale debt securities. For assets held at amortized cost basis, ASU 2016-13 eliminates the probable initial recognition threshold in current U.S. GAAP and, instead, requires an entity to reflect its current estimate of all expected credit losses. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial assets to present the net amount expected to be collected. For available-for-sale debt securities, credit losses should be measured in a manner similar to current U.S. GAAP, however ASU 2016-13 will require that credit losses be presented as an allowance rather than as a write-down. For public business entities that file reports with the SEC, the amendments in the ASU are effective for fiscal years beginning after December 15, 2019. The Company has not yet adopted this update and is currently evaluating the impact of ASU 2016-13 on its Condensed Consolidated Financial Statements.

In May 2016, the FASB issued ASU 2016-12, "Revenue From Contracts With Customers" "(Topic 606)" ("ASU 2016-12"), which addresses narrow-scope improvements to the guidance on collectability, non-cash consideration, and completed contracts at transition. Additionally, the amendments in this update provide a practical expedient for contract modifications at transition and an accounting policy election related to the presentation of sales taxes and other similar taxes collected from customers. The effective date and transition requirements for the amendments in this update are the same as the effective date and transition requirements for ASU 2016-12 (and any other Topic amended by ASU 2014-09). "Revenue from Contracts with Customers (Topic 606), Section A - Summary and Amendments that Create Revenue from Contracts with Customers (Topic 606) and Other Assets and Deferred Costs - Contracts with Customers (Subtopic 340-40)" ("ASU 2014-09"). ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, defers the effective date of Update 2014-09 by one year. The Company has not yet adopted this update and is currently evaluating the impact of ASU 2016-12 on its Condensed Consolidated Financial Statements.

In April 2016, the FASB issued ASU 2016-10, "Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing" ("ASU 2016-10"), which clarifies guidance related to identifying performance obligations and licensing implementation guidance contained in the new revenue recognition standard. Further, this update includes targeted improvements based on input the Board received from the Transition Resource Group for Revenue Recognition and other stakeholders. ASU 2016-10 seeks to proactively address areas in which diversity in practice potentially could arise, as well as to reduce the cost and complexity of applying certain aspects of the guidance both at implementation and on an ongoing basis. The Company has not yet adopted ASU 2016-10 and is currently evaluating the impact the update would have on its Condensed Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting" "(Topic 718)" ("ASU 2016-09"), which introduces targeted amendments intended to simplify accounting for stock compensation. Specifically, ASU 2016-09 requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the income statement. Early adoption is permitted. The Company has not yet adopted this update and is currently evaluating the update would have on its Condensed Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-08, "Principal versus Agent Considerations" (Topic 606), which updates the new revenue standard by clarifying the principal versus agent implementation guidance. Early adoption is permitted. The Company's effective date for adoption is January 1, 2018. The Company has not yet adopted this

update and is currently evaluating the impact of ASU 2016-08 on its Condensed Consolidated Financial Statements.

In March 2016, the FASB issued ASU 2016-07, "Simplifying the Transition to the Equity Method of Accounting" "(Topic 323)" ("ASU 2016-07"), which requires an investor to initially apply the equity method of accounting from the date such investor qualifies for that method (i.e., the date such investor obtains significant influence over the operating and financial policies of an investee). The ASU eliminates the previous requirement to retroactively adjust the investment and record a cumulative catch up for the periods that the investment had been held, but did not qualify for the equity method of accounting. Early adoption is permitted. The Company's effective date for adoption is January 1, 2017. The Company has not yet adopted this update and is currently evaluating the impact of ASU 2016-07 on its Condensed Consolidated Financial Statements.

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In March 2016, the FASB issued ASU 2016-06, "Contingent Put and Call Options in Debt Instruments" "(Topic 815)" ("ASU 2016-06"), which addresses how an entity should assess whether contingent call or put options that can accelerate the payment of debt instruments are clearly and closely related to their debt hosts. This assessment is necessary to determine if the option(s) must be separately accounted for as a derivative. ASU 2016-06 clarifies that an entity is required to assess the embedded call or put options in accordance with a specific four-step decision sequence. This means that entities are not also required to assess whether the contingency for exercising the option(s) is indexed to interest rates or credit risk. For example, when evaluating debt instruments that may be put upon a change in control, the event triggering the change in control is not relevant to the assessment. Only the resulting settlement of debt is subject to the four-step decision sequence. Early adoption is permitted. The Company's effective date for adoption is January 1, 2017. The Company has not yet adopted ASU 2016-06 and is currently evaluating the impact the update would have on its Condensed Consolidated Financial Statements.

In February 2016, the FASB issued ASU 2016-02, "Leases" "(Topic 842)" ("ASU 2016-02"), which applies a right-of-use (ROU) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. ASU 2016-02 requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing U.S. GAAP requirements. Classification depends on the same five criteria used by lessees as well as certain additional factors. The new standard addresses other considerations including identification of a lease, separating lease and nonlease components of a contract, sale and leaseback transactions, modifications, combining contracts, reassessment of the lease term, and remeasurement of lease payments. Early adoption is permitted. The Company's effective date for adoption is January 1, 2019. The Company has not yet adopted ASU 2016-02 and is currently evaluating the impact the update would have on its Condensed Consolidated Financial Statements.

In January 2016, the FASB issued ASU 2016-01, "Recognition and Measurement of Financial Assets and Financial Liabilities" "(Subtopic 825-10)" ("ASU 2016-01") which, among other things, requires all equity securities currently classified as "available for sale" to be reported at fair value, with holding gains and losses recognized in net income instead of accumulated other comprehensive income ("AOCI"). Certain provisions of ASU 2016-01 are eligible for early adoption. The Company's effective date for adoption is January 1, 2018. The Company has not yet adopted ASU 2016-01 and is currently evaluating the impact the update would have on its Condensed Consolidated Financial Statements.

### 3. Business Combinations

The Company's acquisitions were accounted for using the acquisition method of accounting, which requires, among other things, that assets acquired and liabilities assumed be recognized at their estimated fair values as of the acquisition date. Estimates of fair value included in the Condensed Consolidated Financial Statements, in conformity with ASC 820, "Fair Value Measurements and Disclosures", represent the Company's best estimates and valuations developed, when needed, with the assistance of independent appraisers or, where such valuations have not yet been completed or are not available, industry data and trends and by reference to relevant market rates and transactions. The following estimates and assumptions are inherently subject to significant uncertainties and contingencies beyond the control of the Company. Accordingly, the Company cannot provide assurance that the estimates, assumptions, and values reflected in the valuations will be realized, and actual results could vary materially.

Any changes to the initial estimates of the fair value of the assets and liabilities will be recorded as adjustments to those assets and liabilities, and residual amounts will be allocated to goodwill. In accordance with ASC 805 "Business Combinations," if additional information is obtained about the initial estimates of the fair value of the assets acquired and liabilities assumed within the measurement period (not to exceed one year from the date of acquisition), including

finalization of asset appraisals, the Company will refine its estimates of fair value to allocate the purchase price more accurately.

#### Insurance Segment

On December 24, 2015, the Company completed the acquisitions of 100% of the interest in each of the Insurance Companies as well as all assets owned by the sellers of the Insurance Companies and their affiliates (the "Seller Parties") that are used exclusively or primarily in the business of the Insurance Companies, subject to certain exceptions. The operations of the Insurance Companies form the basis of our Insurance segment, and we plan to leverage their existing platform and industry expertise to identify strategic growth opportunities for managing closed blocks of long-term care businesses.

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The aggregate consideration paid in connection with the acquisition of the Insurance Companies and related transactions and agreements was valued at \$18.7 million, consisting of \$7.1 million of cash, \$2.0 million in aggregate principal amount of the Company's 11.0% Senior Secured Notes due 2019, 1,007,422 shares of the Company's common stock and five-year warrants to purchase 2,000,000 shares of the Company's common stock at an exercise price of \$7.08 per share (subject to customary adjustments for stock splits or similar transactions) exercisable on or after February 3, 2016 (the "Warrants").

#### Purchase Price Allocation

The preliminary fair values of identified assets acquired, liabilities assumed, residual goodwill and consideration transferred are summarized as follows (in thousands):

Fair value of consideration transferred

Cash	\$7,146
Company's Senior Secured Notes	1,879
Company's common stock	5,380
2016 Warrants	4,332
Total fair value of consideration transferred	\$18,737

#### Purchase price allocation

Fixed maturities, available for sale at fair value	\$1,230,038
Equity securities, available for sale at fair value	35,697
Mortgage loans	1,252
Policy loans	18,354
Other investments	183
Cash and cash equivalents	48,525
Recoverable from reinsurers	522,790
Accrued investment income	14,417
Goodwill	46,613
Intangibles	4,850
Other assets	12,869
Total assets acquired	1,935,588
Life, accident and health reserves	(1,592,722 )
Annuity reserves	(259,675 )
Value of business acquired	(51,584 )
Deferred tax liability	(1,704 )
Other liabilities	(11,166 )
Total liabilities assumed	(1,916,851 )
Total net assets acquired	\$18,737

The values of intangibles, life, accident and health reserves, annuity reserves, and value of business acquired are estimates and might change.

The acquisition of the Insurance Companies resulted in the recording of goodwill of approximately \$46.6 million. Goodwill consists of the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from other assets acquired that could not be individually identified and separately recognized. The Insurance Companies were recognized as a new stand-alone reporting unit. Goodwill is not amortized and is not deductible for tax purposes.



The Value of Business Acquired ("VOBA")

The VOBA was derived using a "Becker-ized" Present Value of Distributable Earnings ("PVDE") method. The PVDE was derived using the statutory after tax profits. The VOBA was valued at \$51.6 million and is amortized over the anticipated remaining

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future lifetime of the acquired long-term care blocks of business. VOBA is amortized in relation to the projected future premium of the acquired long-term care blocks of business.

#### Recoverable from Reinsurers

The recoverable from reinsurers balance represents amounts recoverable from third parties. U.S. GAAP requires insurance reserves and recoverable from reinsurers 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 \$515.9 million, to arrive at a gross insurance liability, and recognized an offsetting recoverable from reinsurers amount of approximately \$515.9 million. As part of this process, management analyzed 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 recoverable from reinsurers amount in respect of each of paid and unpaid losses, including an estimate for losses incurred but not reported. Recoverable from reinsurers represents expected cash inflows from reinsurers for liabilities ceded and therefore incorporate uncertainties as to the timing and amount of claim payments. Recoverable from reinsurers includes the balances due from reinsurers under the terms of the reinsurance agreements for these ceded balances as well as settlement amounts currently due.

#### Contingent Liability

Pursuant to the agreements governing the acquisition of the Insurance Companies, the Company also agreed to pay to the Seller Parties, on an annual basis with respect to the years 2015 through 2019, the amount, if any, by which the Insurance Companies' cash flow testing and premium deficiency reserves decrease from the amount of such reserves as of December 31, 2014. Such payments are capped at \$13.0 million in the aggregate. The balance is calculated based on the fluctuation of the statutory cash flow testing and premium deficiency reserves annually following each of the Insurance Companies' filing with its applicable insurance regulator of its annual statutory financial statements for each calendar year ending December 31 through and including December 31, 2019. Based on the 2015 statutory statements, the Company does not have a payment due. Further, the Company's current estimate is that the obligation will not be incurred through the calendar year ending December 31, 2019. This expectation is primarily driven by the following factors: (i) reduced confidence that treasury rates will increase to historical averages over the near term; (ii) uncertainty around future operating expenses historically performed by the Seller Parties; and (iii) the increase in the premium deficiency reserve as reported at December 31, 2015 of approximately \$8.0 million (because the balance is cumulative over the period, a decrease of approximately \$8.0 million would be required before there would be any obligation to the Seller Parties under the earn-out). The Company will perform this assessment at each reporting period through December 31, 2019 or until the \$13.0 million is paid in full.

#### Control Level Risk-Based Capital

In connection with the consummation of the acquisition of the Insurance Companies, the Company agreed with the statutory regulator of CGI, the Ohio Department of Insurance ("ODOI"), that for five years following the closing of the transaction, the Company will contribute to CGI cash or marketable securities acceptable to the ODOI to the extent required for CGI's total adjusted capital to be not less than 400% of CGI's authorized control level risk-based capital (each as defined under Ohio law and reported in CGI's statutory statements filed with the ODOI). Similarly, the Company has agreed with the statutory regulator of UTA, the Texas Department of Insurance ("TDOI"), that, for five

years following the closing of the transaction, the Company will contribute to UTA cash or other admitted assets acceptable to the TDOI to the extent required for UTA's total adjusted capital to be not less than 400% of UTA's authorized control level risk-based capital (each as defined under Texas law and reported in UTA's statutory statements filed with the TDOI).

In connection with the consummation of the acquisition of the Insurance Companies, each of the Insurance Companies also entered into a capital maintenance agreement with Great American Financial Resources, Inc. ("GAFRI" and each such agreement, a "Capital Maintenance Agreement," and collectively, the "Capital Maintenance Agreements"). Under each Capital Maintenance Agreement, if the applicable Insurance Company's total adjusted capital reported in its annual statutory financial statements is less than 400% of its authorized control level risk-based capital, GAFRI will pay cash or assets to the applicable Insurance Company, as required, to eliminate such shortfall (after giving effect to any capital contributions made by the Company or its affiliates since the date of the relevant annual statutory financial statements). GAFRI's obligation to make such payments is capped at \$25.0

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million under the Capital Maintenance Agreement with UTA and \$10.0 million under the Capital Maintenance Agreement with CGI. Each of the Capital Maintenance Agreements will remain in effect from January 1, 2016 to January 1, 2021, or until payments by GAFRI thereunder equal the maximum amount payable under the applicable agreement. The Company will indemnify GAFRI for the amount of any payments made by it under the Capital Maintenance Agreements.

## Other

Transaction costs incurred in connection with the acquisition of the Insurance Companies were \$0.0 and \$0.5 million during the three and nine months ended September 30, 2016 and were included within Selling, general and administrative expenses. The Company recorded net revenue of \$34.5 million and \$99.8 million and net loss of \$2.0 million and \$12.6 million from the Insurance Companies for the three and nine months ended September 30, 2016.

## Pro Forma Adjusted Summary

The results of operations for the Insurance Companies have been included in the Condensed Consolidated Financial Statements subsequent to their acquisition date.

The following schedule presents unaudited consolidated pro forma results of operations data as if the acquisition of the Insurance Companies had occurred on January 1, 2015. This information neither purports to be indicative of the actual results that would have occurred if those 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, except per share amounts):

	Three Months Ended September 30, 2015	Nine Months Ended September 30, 2015
Net revenue	\$315,371	\$876,697
Net loss from continuing operations	\$(7,119 )	\$(22,451 )
Loss from discontinued operations	(24 )	(44 )
Net loss attributable to HC2	\$(7,143 )	\$(22,495 )

## Per share amounts:

Loss from continuing operations	\$(0.28 )	\$(0.89 )
Loss from discontinued operations	\$—	\$—
Net loss attributable to HC2	\$(0.28 )	\$(0.90 )

## Other Acquisitions

During the nine months ended September 30, 2016, we purchased three fueling stations, completed the acquisition of additional interests in and thereby control of NerVve and BeneVir, and acquired a 60% controlling interest in CWind Limited ("CWind") with an obligation to purchase the remaining 40% in equal amounts on September 30, 2016 and September 30, 2017 (based on agreed financial targets). The total consideration transferred for these acquisitions was \$21.9 million including \$13.7 million in cash. The results of each of the companies acquired have been reported in our results of operations from the date of acquisition.

We have preliminarily allocated the purchase price of these acquired businesses to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values. We are in the process of completing the valuation of identifiable intangible assets, fixed assets and debt; therefore, the fair values set forth below are subject to adjustment upon finalization of the valuations. The amounts in respect of these potential adjustments could be significant. We expect to complete the purchase price allocation for fiscal year 2016 acquisitions during fiscal year 2017.

The following table summarizes the preliminary allocation of the purchase price to the fair value of identifiable assets acquired and liabilities assumed for the fiscal year 2016 acquisitions at the date of acquisition, in accordance with the acquisition method of accounting:

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	Total
Consideration	
Cash	\$13,671
Convertible notes	2,915
Promissory note	1,128
Fair value of previously held interest	4,610
Contingent asset	(2,992 )
Deferred consideration	2,589
Total fair value of consideration transferred	\$21,921
Purchase price allocation	
Cash and cash equivalents	\$2,966
Accounts receivable	6,400
Inventory	528
Property, plant and equipment, net	32,439
Goodwill	7,242
Intangibles	12,557
Other assets	2,335
Total assets acquired	64,467
Accounts payable and other current liabilities	(11,180 )
Deferred tax liability	(5,494 )
Long-term obligations	(20,813 )
Other liabilities	(15 )
Noncontrolling interest	(815 )
Total liabilities assumed	(38,317 )
Enterprise value	26,150
Less fair value of noncontrolling interest	3,889
Bargain purchase gain	340
Purchase price attributable to controlling interest	\$21,921

#### 4. Investments

##### Fixed Maturity and Equity Securities Available-for-Sale

The following tables provide information relating to investments in fixed maturity and equity securities as of September 30, 2016 and December 31, 2015 (in thousands):

September 30, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Fixed maturity securities				
U.S. Government and government agencies	\$16,081	\$ 834	\$ —	\$16,915
States, municipalities and political subdivisions	375,661	25,988	(36 )	401,613
Foreign government	6,392	—	(113 )	6,279
Residential mortgage-backed securities	141,837	2,192	(550 )	143,479
Commercial mortgage-backed securities	59,114	1,113	(78 )	60,149
Asset-backed securities	68,865	1,912	(261 )	70,516
Corporate and other	587,499	48,194	(2,967 )	632,726
Total fixed maturity securities	\$1,255,449	\$ 80,233	\$ (4,005 )	\$1,331,677

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Equity securities				
Common stocks	\$17,485	\$ 2,402	\$ (393 )	\$19,494
Perpetual preferred stocks	36,752	734	(474 )	37,012
Total equity securities	\$54,237	\$ 3,136	\$ (867 )	\$56,506

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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December 31, 2015	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Fixed maturity securities				
U.S. Government and government agencies	\$17,131	\$ 1	\$(49 )	\$17,083
States, municipalities and political subdivisions	387,427	60	(1,227 )	386,260
Foreign government	6,426	3	—	6,429
Residential mortgage-backed securities	166,324	579	(588 )	166,315
Commercial mortgage-backed securities	74,898	233	(96 )	75,035
Asset-backed securities	34,396	106	(51 )	34,451
Corporate and other	553,487	318	(7,537 )	546,268
Total fixed maturity securities	\$1,240,089	\$ 1,300	\$(9,548 )	\$1,231,841
Equity securities				
Common stocks	\$19,935	\$ 1	\$(1,311 )	\$18,625
Perpetual preferred stocks	30,901	162	(6 )	31,057
Total equity securities	\$50,836	\$ 163	\$(1,317 )	\$49,682

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 losses on investments. These investments had a fair value of \$15.0 million and \$21.0 million as of September 30, 2016 and December 31, 2015, respectively. The change in fair value related to these securities resulted in a net loss of approximately \$0.1 million and \$2.4 million for the three and nine months ended September 30, 2016, respectively, and \$0 for each of the three and nine months ended September 30, 2015.

## Maturities of Fixed Maturity Securities Available-for-Sale

The amortized cost and fair value of fixed maturity securities available-for-sale as of September 30, 2016 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	\$40,777	\$38,312
Due after one year through five years	115,932	120,562
Due after five years through ten years	141,642	148,033
Due after ten years	687,282	750,626
Subtotal	985,633	1,057,533
Mortgage-backed securities	200,951	203,628
Asset-backed securities	68,865	70,516
Total	\$1,255,449	\$1,331,677

## Corporate Fixed Maturity Securities

The tables below show the major industry types of the Company's corporate and other fixed maturity securities as of September 30, 2016 and December 31, 2015 (in thousands):





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	September 30, 2016			December 31, 2015		
	Amortized Cost	Fair Value	% of Total	Amortized Cost	Fair Value	% of Total
Finance, insurance, and real estate	\$210,441	\$216,550	34.2 %	\$223,144	\$217,377	39.8 %
Transportation, communication and other services	166,645	181,405	28.7 %	156,022	155,175	28.4 %
Manufacturing	118,492	129,738	20.5 %	95,138	94,792	17.4 %
Other	91,921	105,033	16.6 %	79,183	78,924	14.4 %
Total	\$587,499	\$632,726	100.0 %	\$553,487	\$546,268	100.0 %

## Other-Than-Temporary Impairments - Fixed Maturity and Equity Securities

A portion of certain other-than-temporary impairment (“OTTI”) losses on fixed maturity securities is recognized in AOCI. For these securities the net amount recognized in the Condensed Consolidated Statements of Operations (“credit loss impairments”) represents the difference between the amortized cost of the securities and the net present value of their projected future cash flows discounted at the effective interest rate implicit in such securities prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in AOCI. The Company recorded a \$1.5 million and \$2.6 million impairment related to two fixed maturity securities for the three and nine months ended September 30, 2016, respectively. The Company reported a \$2.5 million impairment within Other income (expense), net and a \$0.2 million impairment within Net realized losses on investments. The Company did not record any impairments on fixed maturity or equity securities during the three and nine months ended September 30, 2015.

## Unrealized Losses for Fixed Maturity and Equity Securities Available-for-Sale

The following table presents the total unrealized losses for the 117 and 528 fixed maturity and equity securities held by the Company as of September 30, 2016 and December 31, 2015, respectively, where the estimated fair value had declined and remained below amortized cost by the indicated amount (in thousands):

	September 30, 2016		December 31, 2015	
	Unrealized Losses	% of Total	Unrealized Losses	% of Total
Fixed maturity and equity securities				
Less than 20%	\$(1,965)	40.3 %	\$(5,667)	52.2 %
20% or more for less than six months	(337)	6.9 %	—	— %
20% or more for six months or greater	(2,570)	52.8 %	(5,198)	47.8 %
Total	\$(4,872)	100.0 %	\$(10,865)	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.

The Company analyzes its MBS for other-than-temporary impairment 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, 2016 and December 31, 2015, respectively. However, unforeseen

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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 117 and 528 fixed maturity and equity securities held by the Company that have estimated fair values below amortized cost as of September 30, 2016 and December 31, 2015, 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):

	Less than 12 months		12 months of greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
September 30, 2016						
Fixed maturity securities						
U.S. Government and government agencies	\$ 131	\$ —	\$ —	\$ —	\$ 131	\$ —
States, municipalities and political subdivisions	7,080	(36 )	—	—	7,080	(36 )
Foreign government	6,279	(113 )	—	—	6,279	(113 )
Residential mortgage-backed securities	47,909	(550 )	—	—	47,909	(550 )
Commercial mortgage-backed securities	10,703	(78 )	—	—	10,703	(78 )
Asset-backed securities	17,939	(261 )	—	—	17,939	(261 )
Corporate and other	40,389	(396 )	5,040	(2,571 )	45,429	(2,967 )
Total fixed maturity securities	\$ 130,430	\$ (1,434 )	\$ 5,040	\$ (2,571 )	\$ 135,470	\$ (4,005 )
Equity securities						
Common stocks	\$ 5,515	\$ (393 )	\$ —	\$ —	\$ 5,515	\$ (393 )
Perpetual preferred stocks	11,520	(474 )	—	—	11,520	(474 )
Total equity securities	\$ 17,035	\$ (867 )	\$ —	\$ —	\$ 17,035	\$ (867 )
December 31, 2015						
Fixed maturity securities						
U.S. Government and government agencies	\$ 15,409	\$ (49 )	\$ —	\$ —	\$ 15,409	\$ (49 )
States, municipalities and political subdivisions	294,105	(1,227 )	—	—	294,105	(1,227 )
Residential mortgage-backed securities	77,695	(588 )	—	—	77,695	(588 )
Commercial mortgage-backed securities	44,618	(96 )	—	—	44,618	(96 )
Asset-backed securities	22,550	(51 )	—	—	22,550	(51 )
Corporate and other	466,293	(7,537 )	—	—	466,293	(7,537 )
Total fixed maturity securities	\$ 920,670	\$ (9,548 )	\$ —	\$ —	\$ 920,670	\$ (9,548 )
Equity securities						
Common stocks	\$ 13,657	\$ (1,311 )	\$ —	\$ —	\$ 13,657	\$ (1,311 )
Perpetual preferred stocks	7,378	(6 )	—	—	7,378	(6 )
Total equity securities	\$ 21,035	\$ (1,317 )	\$ —	\$ —	\$ 21,035	\$ (1,317 )

At September 30, 2016, investment grade fixed maturity securities (as determined by nationally recognized rating agencies) represented approximately 13.0% of the gross unrealized loss and 52.5% of the fair value. At December 31, 2015, investment grade fixed maturity securities represented approximately 33.2% of the gross unrealized loss and 88.3% 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.

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## Other Invested Assets

Other invested assets represent approximately 4.1% and 3.9% of the Company's total investments as of September 30, 2016 and December 31, 2015, respectively. Carrying values of other invested assets as of September 30, 2016 and December 31, 2015 are as follows (in thousands):

	September 30, 2016		December 31, 2015	
	Cost Method	Equity Method	Cost Method	Equity Method
Common Equity	\$ 138	\$ 1,382	\$ 249	\$ 6,475
Preferred Equity	2,484	10,763	1,655	7,522
Warrants	3,097	—	3,880	—
Limited Partnerships	—	1,141	—	1,171
Joint Ventures	—	37,153	—	27,324
Total	\$ 5,719	\$ 50,439	\$ 5,784	\$ 42,492

Additionally, as of September 30, 2016 and December 31, 2015, other invested assets include common stock purchase warrants and call options accounted for under ASC 815, "Derivatives and Hedging" ("ASC 815") (in thousands):

September 30, 2016	Cost	Gains	Losses	Fair Value
Warrants	\$ 6,332	\$ 280	\$ (2,130)	\$ 4,482
Call Options	230	—	—	230
Total	\$ 6,562	\$ 280	\$ (2,130)	\$ 4,712

  

December 31, 2015	Cost	Gains	Losses	Fair Value
Warrants	\$ 6,383	\$ 428	\$ (2,600)	\$ 4,211
Call Options	1,680	—	(1,048 )	632
Total	\$ 8,063	\$ 428	\$ (3,648)	\$ 4,843

## Net Investment Income

For the three and nine months ended September 30, 2016, the major sources of net investment income in the accompanying Condensed Consolidated Statements of Operations were as follows (in thousands):

	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016
Fixed maturity securities, available-for-sale at fair value	\$ 14,033	\$ 40,388
Equity securities, available-for-sale at fair value	430	1,526
Mortgage loans	120	155
Policy loans	312	876
Other invested assets	129	302
Gross investment income	15,024	43,247
External investment expense	(225 )	(662 )
Net investment income	\$ 14,799	\$ 42,585

Net Realized Gains (Losses) on Investments

For the three and nine months ended September 30, 2016, the major sources of net realized gains (losses) on investments in the accompanying Condensed Consolidated Statements of Operations were as follows (in thousands):

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	Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016
Realized gains on fixed maturity securities	\$ 455	\$ 1,663
Realized losses on fixed maturity securities	—	(2,338 )
Realized gains on equity securities	154	438
Realized losses on equity securities	—	(352 )
Net realized gains (losses) on derivative instruments	(829 )	(1,925 )
Impairment loss	—	(163 )
Net realized gains (losses)	\$ (220 )	\$ (2,677 )

## 5. Fair Value of Financial Instruments

## Assets by Hierarchy Level

Assets and liabilities measured at fair value on a recurring basis at September 30, 2016 and December 31, 2015 are summarized below (in thousands):

September 30, 2016	Total	Fair Value Measurement Using:		
		Level 1	Level 2	Level 3
<b>Assets</b>				
Fixed maturity securities				
U.S. Government and government agencies	\$ 16,915	\$ 5,337	\$ 11,546	\$ 32
States, municipalities and political subdivisions	401,613	—	395,644	5,969
Foreign government	6,279	—	6,279	—
Residential mortgage-backed securities	143,479	—	83,479	60,000
Commercial mortgage-backed securities	60,149	—	9,870	50,279
Asset-backed securities	70,516	—	3,772	66,744
Corporate and other	632,726	2,192	609,646	20,888
Total fixed maturity securities	1,331,677	7,529	1,120,236	203,912
Equity securities				
Common stocks	19,494	14,668	—	4,826
Perpetual preferred stocks	37,012	9,984	27,028	—
Total equity securities	56,506	24,652	27,028	4,826
Derivatives	4,712	—	—	4,712
Contingent asset	2,724	—	—	2,724
Total assets accounted for at fair value	\$ 1,395,619	\$ 32,181	\$ 1,147,264	\$ 216,174
<b>Liabilities</b>				
Warrant liability	\$ 3,511	\$ —	\$ —	\$ 3,511
Deferred consideration	748	—	—	748
Other	1,490	—	—	1,490
Total liabilities accounted for at fair value	\$ 5,749	\$ —	\$ —	\$ 5,749

Fair Value  
Measurement Using:

December 31, 2015



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	Total	Level 1	Level 2	Level 3
Assets				
Fixed maturity securities				
U.S. Government and government agencies	\$17,083	\$5,753	\$11,257	\$ 73
States, municipalities and political subdivisions	386,260	—	380,601	5,659
Foreign government	6,429	—	6,429	—
Residential mortgage-backed securities	166,315	—	87,296	79,019

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Commercial mortgage-backed securities	75,035	—	14,510	60,525
Asset-backed securities	34,451	—	6,798	27,653
Corporate and other	546,268	7,090	525,234	13,944
Total fixed maturity securities	1,231,841	12,843	1,032,125	186,873
Equity securities				
Common stocks	18,625	13,693	—	4,932
Perpetual preferred stocks	31,057	10,271	20,786	—
Total equity securities	49,682	23,964	20,786	4,932
Derivatives	4,843	632	—	4,211
Total assets accounted for at fair value	\$1,286,366	\$37,439	\$1,052,911	\$196,016
Liabilities				
Warrant liability	\$4,332	\$—	\$—	\$4,332
Total liabilities accounted for at fair value	\$4,332	\$—	\$—	\$4,332

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, or between other levels, at the beginning fair value for the reporting period in which the changes occur. The Company transferred \$1.1 million corporate and other bonds and \$0.5 million preferred stock from Level 1 into Level 2 during the nine months ended September 30, 2016, reflecting the level of market activity in these instruments. There were no transfers between Level 1 and Level 2 for the three months ended September 30, 2016 and the three and nine months ended September 30, 2015.

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 out of Level 3 of \$0.6 million and transfer into Level 3 of \$2.4 million during the three and nine months ended September 30, 2016, respectively. There were no transfers into or out of Level 3 for the three and nine months ended September 30, 2015.

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.

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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.

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.

Derivatives. The balance consists of common stock purchase warrants and call options. The fair values of the call options are primarily based on quoted market prices in active markets and are classified within Level 1 in the fair value hierarchy. Depending on the terms, the common stock warrants were valued using either Black-Scholes analysis or Monte Carlo Simulation. Fair value was determined using unobservable market inputs, including volatility and underlying security values, therefore the common stock purchase warrants were classified as Level 3.

Warrant Liability. The balance consists of the Warrants issued in connection with the acquisition of the Insurance Companies and recorded within other liabilities on the Condensed Consolidated Balance Sheets. Fair value was determined using the Monte Carlo Simulation because the adjustments for exercise price and warrant shares represent

path dependent features; the exercise price from prior periods needs to be known to determine whether a subsequent sale of shares occurs at a price that is lower than the then current exercise price. The analysis entails a Geometric Brownian Motion based simulation of 100 unique price paths of the Company's stock for each combination of assumptions. Fair value was determined using unobservable market inputs, including volatility, and a range of assumptions regarding a possibility of an equity capital raise each year and the expected size of future equity capital raises. The present value of a given simulated scenario was based on intrinsic value at expiration discounted to the valuation date, taking into account any adjustments to the exercise price or warrant shares issuable. The average present value across all 100 independent price paths represents the estimate of fair value for each combination of assumptions. Therefore, the warrant liability was classified as Level 3.

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## Level 3 Measurements and Transfers

Changes in balances of Level 3 financial assets carried at fair value during the three and nine months ended September 30, 2016 and 2015 are presented below (in thousands):

	Balance at June 30, 2016	Net earnings, (loss)	Total realized/unrealized gains (losses) included in Other comp. income (loss)	Purchases and issuances	Sales and settlements	Transfer to Level 3	Transfer out of Level 3	Balance at September 30, 2016
Assets								
Fixed maturity securities								
U.S. Government and government agencies States, municipalities and political subdivisions	\$58	\$—	\$—	\$—	\$(26)	\$—	\$—	\$32
Residential mortgage-backed securities	5,864	102	3	—	—	—	—	5,969
Commercial mortgage-backed securities	62,289	(422)	525	—	(2,973)	8,686	(8,105)	60,000
Asset-backed securities	57,563	(269)	(19)	—	(7,378)	2,629	(2,247)	50,279
Corporate and other	54,217	85	1,454	10,337	(720)	1,387	(16)	66,744
Total fixed maturity securities	16,661	(108)	550	7,899	(1,145)	—	(2,969)	20,888
Equity securities	196,652	(612)	2,513	18,236	(12,242)	12,702	(13,337)	203,912
Common stocks	4,826	—	—	—	—	—	—	4,826
Total equity securities	4,826	—	—	—	—	—	—	4,826
Derivatives	5,318	(94)	(694)	230	(48)	—	—	4,712
Contingent asset	2,813	(89)	—	—	—	—	—	2,724
Total financial assets	\$209,609	\$(795)	\$1,819	\$18,466	\$(12,290)	\$12,702	\$(13,337)	\$216,174

	Balance at June 30, 2016	Net earnings, (loss)	Total realized/unrealized (gains) losses included in Other comp. income (loss)	Purchases and issuances	Sales and settlements	Transfer to Level 3	Transfer out of Level 3	Balance at September 30, 2016
Liabilities								
Warrant liability	\$2,772	\$739	\$—	\$—	\$—	\$—	\$—	\$3,511
Deferred consideration	2,218	(1,470)	—	—	—	—	—	748
Other	—	—	—	1,490	—	—	—	1,490
Total financial liabilities	\$4,990	\$(731)	\$—	\$1,490	\$—	\$—	\$—	\$5,749

Total  
realized/unrealized

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	gains (losses) included in				Transfer		Balance	
	Balance at	Net	Other	Purchases	Sales and	to	out of	at
	December	earnings	comp.	and	settlements	Level	Level	September
	31, 2015	(loss)	income	issuances		3	3	30, 2016
			(loss)					
Assets								
Fixed maturity securities								
U.S. Government and government agencies	\$ 73	\$ —	\$ 2	\$ —	—\$ (43 )	\$ —	—\$ —	\$ 32
States, municipalities and political subdivisions	5,659	302	8	—	—	—	—	5,969
Residential mortgage-backed securities	79,019	(2,105)	910	—	(10,988)	16,569	(23,405)	60,000
Commercial mortgage-backed securities	60,525	(760)	920	—	(12,394)	9,779	(7,791)	50,279
Asset-backed securities	27,653	140	2,176	43,405	(14,742)	13,808	(5,696)	66,744

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Corporate and other	13,944	50	479	8,499	(1,206 )	2,091	(2,969 )	20,888
Total fixed maturity securities	186,873	(2,373 )	4,495	51,904	(39,373 )	42,247	(39,861 )	203,912
Equity securities								
Common stocks	4,932	—	(106 )	—	—	—	—	4,826
Total equity securities	4,932	—	(106 )	—	—	—	—	4,826
Derivatives	4,211	(1,119 )	1,438	230	(48 )	—	—	4,712
Contingent asset	—	(268 )	—	2,992	—	—	—	2,724
Total financial assets	\$ 196,016	\$ (3,760 )	\$ 5,827	\$ 55,126	\$ (39,421 )	\$ 42,247	\$ (39,861 )	\$ 216,174

Total  
realized/unrealized  
(gains) losses  
included in

	Balance at December 31, 2015	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, 2016
<b>Liabilities</b>								
Warrant liability	\$4,332	\$ (821 )	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 3,511
Deferred consideration	—	(1,841 )	—	2,589	—	—	—	748
Other	—	—	—	1,490	—	—	—	1,490
Total financial liabilities	\$4,332	\$ (2,662 )	\$ —	\$ 4,079	\$ —	\$ —	\$ —	\$ 5,749

Total  
realized/unrealized  
gains (losses) included  
in

	Balance at June 30, 2015	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, 2015
<b>Assets</b>								
Fixed maturity securities								
Corporate and other	\$13,265	\$ 123	\$ (1,542 )	\$ —	—\$ (4,684 )	\$ —	—\$ —	—\$ 7,162
Total fixed maturity securities	13,265	123	(1,542 )	—	(4,684 )	—	—	7,162
Derivatives	295	317	—	—	—	—	—	612
Total financial assets	\$13,560	\$ 440	\$ (1,542 )	\$ —	—\$ (4,684 )	\$ —	—\$ —	—\$ 7,774

Total  
realized/unrealized  
gains (losses) included  
in

	Balance at December 31, 2014	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, 2015
<b>Assets</b>								
Fixed maturity securities								
Corporate and other	\$ 250	\$ 123	\$ (1,542 )	\$ 13,015	\$ (4,684 )	\$ —	—\$ —	—\$ 7,162
Total fixed maturity securities	250	123	(1,542 )	13,015	(4,684 )	—	—	7,162



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Derivatives	—	317	—	295	—	—	—	612
Total financial assets	\$ 250	\$ 440	\$(1,542 )	\$ 13,310	\$(4,684 )	\$	—\$	—\$ 7,774

Since internally developed Level 3 asset fair values represent less than 1% of the Company's total assets, any justifiable changes in unobservable inputs used to determine internally developed fair values would not have a material impact on the Company's financial position.

Fair Value of Financial Instruments Not Measured at Fair Value

The Company is required by general accounting principles for Fair Value Measurements and Disclosures to disclose the fair value of certain financial instruments including those that are not carried at fair value. The following table presents the carrying amounts and estimated fair values of the Company's financial instruments, which were not measured at fair value on a recurring basis, at September 30, 2016 and December 31, 2015, respectively. This table excludes carrying amounts reported in the Condensed

## HC2 HOLDINGS, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Consolidated Balance Sheets for cash, accounts receivable, costs and recognized earnings in excess of billings, accounts payable, accrued expenses, billings in excess of costs and recognized earnings, and other current assets and liabilities approximate fair value due to relatively short periods to maturity (in thousands):

September 30, 2016	Carrying Value	Estimated Fair Value	Fair Value Measurement Using:	
			Level 1	Level 2 Level 3
<b>Assets</b>				
Mortgage loans	\$8,939	\$8,940	\$—	\$8,940
Policy loans	18,228	18,228	—18,228	—
Other invested assets	5,719	5,591	—	5,591
Total assets not accounted for at fair value	\$32,886	\$32,759	\$—18,228	\$14,531
<b>Liabilities</b>				
Annuity benefits accumulated <sup>(1)</sup>	\$254,250	\$252,306	\$—	\$252,306
Long-term obligations <sup>(2)</sup>	343,906	340,544	—340,544	—
Total liabilities not accounted for at fair value	\$598,156	\$592,850	\$—340,544	\$252,306
<b>December 31, 2015</b>				
December 31, 2015	Carrying Value	Estimated Fair Value	Fair Value Measurement Using:	
			Level 1	Level 2 Level 3
<b>Assets</b>				
Mortgage loans	\$1,252	\$1,252	\$—	\$1,252
Policy loans	18,476	18,476	—18,476	—
Other invested assets	5,784	3,434	—	3,434
Total assets not accounted for at fair value	\$25,512	\$23,162	\$—18,476	\$4,686
<b>Liabilities</b>				
Annuity benefits accumulated <sup>(1)</sup>	\$257,454	\$258,847	\$—	\$258,847
Long-term obligations <sup>(2)</sup>	319,180	310,307	—310,307	—
Total liabilities not accounted for at fair value	\$576,634	\$569,154	\$—310,307	\$258,847

(1) Excludes life contingent annuities in the payout phase.

(2) Excludes certain lease obligations accounted for under ASC 840, "Leases".

**Mortgage Loans on Real Estate.** The fair value of mortgage loans on real estate is estimated by discounting cash flows, both principal and interest, using current interest rates for mortgage loans with similar credit ratings and similar remaining maturities. As such, inputs include current treasury yields and spreads, which are based on the credit rating and average life of the loan, corresponding to the market spreads. The valuation of mortgage loans on real estate is considered Level 3 in the fair value hierarchy.

**Policy Loans.** The policy loans are reported at the unpaid principal balance and carry a fixed interest rate. The Company determined that the carrying value approximates fair value because (i) policy loans present no credit risk as the amount of the loan cannot exceed the obligation due upon the death of the insured or surrender of the underlying policy; (ii) there is no active market for policy loans (i.e., there is no commonly available exit price to determine the fair value of policy loans in the open market); (iii) policy loans are intricately linked to the underlying policy liability and, in many cases, policy loan balances are recovered through offsetting the loan balance against the benefits paid under the policy; and (iv) policy loans can be repaid by policyholders at any time, and this prepayment uncertainty

reduces the potential impact of a difference between amortized cost (carrying value) and fair value. The valuation of policy loans is considered Level 2 in the fair value hierarchy.

**Other Invested Assets.** The balance primarily includes common stock purchase warrants. The fair values were derived using Black-Scholes analysis using unobservable market inputs, including volatility and underlying security values; therefore, the common stock purchase warrants were classified as Level 3.

**Annuity Benefits Accumulated.** The fair value of annuity benefits was determined using the surrender values of the annuities and classified as Level 3.

**Long-term Obligations.** The fair value of the Company's long-term obligations was determined using Bloomberg Valuation Service BVAL. The methodology combines direct market observations from contributed sources with quantitative pricing models to generate evaluated prices and classified as Level 2.

HC2 HOLDINGS, INC.  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
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### 6. Accounts Receivable

Accounts receivable consist of the following (in thousands):

	September 30, December 31,	
	2016	2015
Contract receivables:		
Contracts in progress	\$ 148,536	\$ 103,178
Unbilled retentions	39,128	31,195
Trade receivables	87,891	77,084
Other receivables	216	190
Allowance for doubtful accounts	(3,033 )	(794 )
	\$ 272,738	\$ 210,853

### 7. Contracts in Progress

Costs and recognized earnings in excess of billings on uncompleted contracts and billings in excess of costs and recognized earnings on uncompleted contracts consist of the following (in thousands):

	September 30, December 31,	
	2016	2015
Costs incurred on contracts in progress	\$ 606,809	\$ 597,656
Estimated earnings	125,377	99,985
	732,186	697,641
Less progress billings	766,336	679,532
	\$ (34,150 )	\$ 18,109

The above is included in the accompanying Condensed Consolidated Balance Sheet under the following captions:

Costs and recognized earnings in excess of billings on uncompleted contracts	\$ 17,091	\$ 39,310
Billings in excess of costs and recognized earnings on uncompleted contracts	51,241	21,201
	\$ (34,150 )	\$ 18,109

### 8. Inventory

Inventory consists of the following (in thousands):

	September 30, December 31,	
	2016	2015
Raw materials	\$ 8,514	\$ 10,485
Work in process	235	1,289
Finished goods	224	346
	\$ 8,973	\$ 12,120

### 9. Recoverable from Reinsurers

The following table presents information for the Company's recoverable from reinsurers assets as of September 30, 2016 and December 31, 2015 (in thousands):

	September 30,	December 31,
	2016	2015

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Reinsurer	A.M. Best Rating	Amount	% of Total	Amount	% of Total
Loyal American Life Insurance Co (Cigna)	A-	\$138,393	26.3 %	\$133,646	25.5 %
Great American Life Insurance Co	A	46,939	8.9 %	44,748	8.6 %
Hannover Life Reassurance Co	A+	340,172	64.8 %	344,168	65.9 %
Other	A-	95	— %	—	— %
Total		\$525,599	100.0%	\$522,562	100.0%

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## 10. Goodwill and Other Intangible Assets

## Goodwill

The changes in the carrying amount of goodwill by segment for the nine months ended September 30, 2016 are as follows (in thousands):

	Manufacturing	Marine Services	Telecom	Utilities	Insurance	Life Sciences	Other	Total
Balance as of December 31, 2015	\$ 24,490	\$ 1,134	\$ 3,378	\$ 1,374	\$ 29,021	\$ —	\$ 1,781	\$ 61,178
Acquisition of business	—	1,528	—	1,257	17,592	3,633	824	24,834
Other	—	—	—	—	—	—	13	13
Balance as of September 30, 2016	\$ 24,490	\$ 2,662	\$ 3,378	\$ 2,631	\$ 46,613	\$ 3,633	\$ 2,618	\$ 86,025

## Indefinite-lived Intangible Assets

The acquisition of the Insurance Companies resulted in the acquisition of state licenses, which are indefinite-lived intangible assets not subject to amortization valued at \$4.8 million as of September 30, 2016. In addition, the acquisition of BeneVir resulted in the recording of an in-process research and development intangible asset not subject to amortization valued at \$6.4 million.

## Amortizable Intangible Assets

Intangible assets subject to amortization consisted of the following (in thousands):

	Manufacturing	Marine Services	Utilities	Life Sciences	Other	Corporate	Total
<b>Trade names</b>							
Balance as of December 31, 2015	\$ 4,005	\$ 601	\$ 5,407	\$ —	\$ —	\$ —	\$ 10,013
Amortization	(224 )	(243 )	(473 )	—	—	—	(940 )
Acquisition of business	—	2,626	—	—	—	—	2,626
Balance as of September 30, 2016	\$ 3,781	\$ 2,984	\$ 4,934	\$ —	\$ —	\$ —	\$ 11,699
<b>Customer relationships</b>							
Balance as of December 31, 2015	\$ —	\$ 6,794	\$ 4,444	\$ —	\$ —	\$ —	\$ 11,238
Amortization	—	(350 )	(355 )	—	—	—	(705 )
Acquisition of business	—	—	2,325	—	—	—	2,325
Balance as of September 30, 2016	\$ —	\$ 6,444	\$ 6,414	\$ —	\$ —	\$ —	\$ 12,858
<b>Developed technology</b>							
Balance as of December 31, 2015	\$ —	\$ 810	\$ —	\$ —	\$ 2,279	\$ —	\$ 3,089
Amortization	—	(208 )	—	—	(957 )	—	(1,165 )
Balance as of September 30, 2016	\$ —	\$ 602	\$ —	\$ —	\$ 1,322	\$ —	\$ 1,924
<b>Other</b>							
Balance as of December 31, 2015	\$ —	\$ —	\$ 20	\$ 177	\$ —	\$ 22	\$ 219
Amortization	—	—	—	(3 )	(21 )	(4 )	(28 )
Acquisition of business	—	—	68	48	1,214	—	1,330
Balance as of September 30, 2016	\$ —	\$ —	\$ 88	\$ 222	\$ 1,193	\$ 18	\$ 1,521

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Total amortizable intangible assets

Balance as of December 31, 2015	\$ 4,005	\$8,205	\$9,871	\$ 177	\$2,279	\$ 22	\$24,559
Amortization	(224 )	(801 )	(828 )	(3 )	(978 )	(4 )	(2,838 )
Acquisition of business	—	2,626	2,393	48	1,214	—	6,281
Balance as of September 30, 2016	\$ 3,781	\$10,030	\$11,436	\$ 222	\$2,515	\$ 18	\$28,002

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## 11. Life, Accident and Health Reserves

Life, accident and health reserves consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Long-term care insurance reserves	\$ 1,396,446	\$ 1,354,151
Traditional life insurance reserves	103,131	104,450
Other accident and health insurance reserves	137,924	133,336
Total life, accident and health reserves	\$ 1,637,501	\$ 1,591,937

## 12. Long-Term Obligations

Long-term debt consists of the following (in thousands):

	September 30, 2016	December 31, 2015
HC2		
11.0% Senior Secured Notes, due in 2019	\$ 307,000	\$ 307,000
GMSL		
Notes payable and revolving lines of credit, various maturity dates	20,765	—
LIBOR plus 3.65% Notes, due in 2019	3,025	5,260
Obligations under capital leases	52,782	52,697
DBM Global		
LIBOR plus 4.0% Notes, due in 2018 and 2019	10,114	14,378
Line of Credit	1,900	1,600
ANG		
5.5% Term Loan, due in 2018	541	660
LIBOR plus 3.0% Notes, due in 2023	3,500	—
4.36% Notes, due in 2022	2,500	—
4.25% Seller Note, due in 2022	2,919	—
Other	81	19
Total	405,127	381,614
Unamortized issuance discounts on debt, net of premiums	(8,439)	(9,738)
Total long-term obligations	\$ 396,688	\$ 371,876

Aggregate capital lease and debt payments are as follows (in thousands):

	Capital Leases	Debt	Total
2016	\$ 1,718	\$ 25,025	\$ 26,743
2017	6,848	47,068	53,916
2018	9,981	43,703	53,684
2019	9,849	348,041	357,890
2020	9,855	4,369	14,224
Thereafter	27,615	7,753	35,368
Total minimum principal & interest payments	65,866	475,959	541,825
Less: Amount representing interest	(13,084)	(123,614)	(136,698)
	\$ 52,782	\$ 352,345	\$ 405,127



11.0% Senior Secured Notes due 2019

On November 20, 2014, the Company issued \$250.0 million in aggregate principal amount of 11.0% Senior Secured Notes due 2019 (the “November 2014 Notes”). The November 2014 Notes were issued at a price of 99.05% of principal amount, which

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resulted in a discount of \$2.4 million. The net proceeds from the issuance of the November 2014 Notes were used to repay a senior secured credit facility, which had provided for a twelve month, floating interest rate term loan of \$214 million and a delayed draw term loan of \$36 million, entered into in connection with the Company's acquisition of GMSL. On March 26, 2015, the Company issued an additional \$50.0 million in aggregate principal amount of 11.0% Senior Secured Notes due 2019 (the "March 2015 Notes"). The March 2015 Notes were issued at a price of 100.5% of principal amount, plus accrued interest from November 20, 2014, which resulted in a premium of \$0.3 million. On August 5, 2015, the Company issued an additional \$5.0 million aggregate principal amount of its 11.0% Senior Secured Notes due 2019 (the "August 2015 Notes"). The August 2015 Notes were issued in consideration for a release of claims by holders of the Preferred Stock discussed below (see Note 17 - Equity for additional information). On December 24, 2015, the Company issued an additional \$2.0 million aggregate principal amount of its 11% Senior Secured Notes due 2019 (the "December 2015 Notes"). All of the 11.0% Senior Secured Notes due 2019 (collectively, the "11.0% Notes") were issued under an indenture dated November 20, 2014, by and among HC2, the guarantors party thereto and U.S. Bank National Association, a national banking association ("U.S. Bank"), as trustee (the "11.0% Notes Indenture").

**Maturity and Interest.** The 11.0% Notes mature on December 1, 2019. The 11.0% Notes accrue interest at a rate of 11.0% per year. Interest on the 11.0% Notes is paid semi-annually on December 1st and June 1st of each year.

**Ranking.** The 11.0% Notes and the guarantees thereof are HC2's and certain of its direct and indirect domestic subsidiaries' (the "Subsidiary Guarantors") general senior secured obligations. The 11.0% Notes and the guarantees thereof rank: (i) senior in right of payment to all of HC2's and the Subsidiary Guarantors' future subordinated debt; (ii) equal in right of payment with all of HC2's and the Subsidiary Guarantors' existing and future senior debt and effectively senior to all of the Company's unsecured debt to the extent of the value of the collateral; and (iii) effectively subordinated to all liabilities of its non-guarantor subsidiaries.

**Collateral.** The 11.0% Notes and the guarantees thereof are collateralized on a first-priority basis by substantially all of HC2's assets and the assets of the Subsidiary Guarantors (except for certain "Excluded Assets," and subject to certain "Permitted Liens," each as defined in the 11.0% Notes Indenture). The 11.0% Notes Indenture permits the Company, under specified circumstances, to incur additional debt that could equally and ratably share in the collateral. The amount of such debt is limited by the covenants contained in the 11.0% Notes Indenture.

**Certain Covenants.** The 11.0% Notes Indenture contains covenants limiting, among other things, the ability of HC2 and, in certain cases, HC2's subsidiaries, to incur additional indebtedness or issue certain types of redeemable equity interests; create liens; engage in sale-leaseback transactions; pay dividends; make distributions in respect of capital stock and make certain other restricted payments; sell assets; engage in transactions with affiliates; or consolidate or merge with, or sell substantially all of its assets to, another person. These covenants are subject to a number of important exceptions and qualifications. HC2 is also required to maintain compliance with certain financial tests, including minimum liquidity and collateral coverage ratios. As of September 30, 2016, HC2 was in compliance with these covenants.

**Redemption Premiums.** The Company may redeem the 11.0% Notes at a redemption price equal to 100.0% of the principal amount of the 11.0% Notes plus a make-whole premium if the 11.0% Notes are redeemed before December 1, 2016. The make-whole premium is the greater of (i) 1% of principal amount or (ii) the excess of the present value of the redemption price at December 1, 2016 plus all required interest payments through December 1, 2016 over the principal amount. On or after December 1, 2016 and until November 30, 2017, the Company may redeem the 11.0% Notes at a redemption price equal to 108.25% and on or after December 1, 2017 until November 30, 2018 at a redemption price equal to 105.50% of the principal amount plus accrued and unpaid interest. Beginning

December 1, 2018, the Company may redeem the 11.0% Notes at a redemption price equal to 100.00% plus accrued and unpaid interest. The Company is required to make an offer to purchase the 11.0% Notes upon a change of control at a purchase price equal to 101% of the principal amount of the 11.0% Notes on the date of purchase plus accrued and unpaid interest.

#### DBM Global Credit Facilities

DBM Global entered into a Credit and Security Agreement (“DBM Global Facility”) with Wells Fargo Credit, Inc. (“Wells Fargo”), pursuant to which Wells Fargo initially agreed to advance up to a maximum amount of \$50.0 million to DBM Global, including up to \$5.0 million of letters of credit.

On January 23, 2015, DBM Global entered into an amendment to the DBM Global Facility, pursuant to which Wells Fargo agreed to increase the maximum amount of the DBM Global Facility that could be used to issue letters of credit from \$5.0 million to \$14.5 million.

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The DBM Global Facility has a floating interest rate of LIBOR plus 3.0% (3.63% at September 30, 2016) and requires monthly interest payments. As of September 30, 2016 and December 31, 2015, DBM Global had \$3.9 million in outstanding letters of credit issued under the facility, of which \$0 have been drawn. The DBM Global Facility is secured by a first priority, perfected security interest in all of DBM Global's and its present and future subsidiaries' assets, excluding real estate, and a second priority, perfected security interest in all of DBM Global's real estate. The security agreements pursuant to which DBM Global's assets are pledged prohibit any further pledge of such assets without the written consent of the bank. The DBM Global Facility contains various restrictive covenants. At September 30, 2016, DBM Global was in compliance with these covenants.

On May 6, 2014, DBM Global entered into an amendment to the DBM Global Facility, pursuant to which Wells Fargo extended the maturity date of the DBM Global Facility to April 30, 2019, lowered the interest rate charged in connection with borrowings under the DBM Global Facility and allowed for the issuance of additional loans in the form of notes totaling up to \$5.0 million, secured by its real estate as a separate tranche under the DBM Global Facility ("Real Estate Term Advance"). At September 30, 2016 and December 31, 2015, DBM Global had borrowed \$3.5 million and \$4.0 million, respectively, under the Real Estate Term Advance. The Real Estate Term Advance has a five year amortization period requiring monthly principal payments and a final balloon payment at maturity. The Real Estate Term Advance has a floating interest rate of LIBOR plus 4.0% and requires monthly interest payments.

On October 21, 2014, DBM Global further amended the DBM Global Facility to allow for the issuance of additional loans in the form of notes of up to \$10.0 million, secured by its machinery and equipment ("Real Estate (2) Term Advance (M&E)") and the issuance of a note payable of up to \$5.0 million, secured by its real estate ("Real Estate (2) Term Advance (Working Capital)"), each as separate tranches of debt under the DBM Global Facility. The Real Estate (2) Term Advance (M&E) and Real Estate (2) Term Advance (Working Capital) have a five year amortization period requiring monthly principal payments and a final balloon payment at maturity. The Real Estate (2) Term Advance (M&E) and Real Estate (2) Term Advance (Working Capital) have a floating interest rate of LIBOR plus 4.0% and require monthly interest payments. At September 30, 2016 and December 31, 2015, there was \$6.6 million and \$8.1 million, respectively, outstanding under the Real Estate (2) Term Advance (M&E) and \$0.0 million and \$2.2 million, respectively, outstanding under the Real Estate (2) Term Advance (Working Capital).

Schuff Hopsa Engineering, Inc. ("SHE"), a joint venture which DBM Global consolidates, has a Line of Credit Agreement ("International LOC") with Banco General, S.A. ("Banco General") in Panama pursuant to which Banco General agreed to advance up to a maximum amount of \$3.5 million to SHE. The line of credit is secured by a first priority, perfected security interest in SHE's property and plant. The interest rate is 5.25% plus 1.0% of the special interest compensation fund. The International LOC contains covenants that, among other things, limit SHE's ability to incur additional indebtedness, change its business, merge, consolidate or dissolve and sell, lease, exchange or otherwise dispose of its assets, without prior written notice.

At September 30, 2016, SHE had \$1.9 million in borrowings and no outstanding letters of credit issued under its International LOC. There was \$1.6 million available under the International LOC at September 30, 2016.

#### GMSL Credit Facility

GMSL established a \$20.0 million term loan with DVB Bank in January 2014 (the "GMSL Facility"). The GMSL Facility has a 4.5 year term and bears interest at the rate of USD LIBOR plus 3.65% rate. As of September 30, 2016 and December 31, 2015, \$3.0 million and \$5.3 million, respectively, remained outstanding under the GMSL Facility. The GMSL Facility contains various restrictive covenants. At September 30, 2016, GMSL was in compliance with these covenants.

### CWind Credit Facilities

GMSL acquired CWind in February 2016 and assumed liability for all of CWind's outstanding loans. CWind currently maintains 14 notes payable related to its vessels, with maturities ranging between 2018 and 2024 and interest rates varying between 5.25% and 10.0%. The initial aggregate principle amount outstanding under all 14 notes was GBP 18.1 million. As of September 30, 2016, the outstanding aggregate principal amount of the notes was GBP 15.0 million. CWind also has a note payable related to a series of sundry assets, bearing an annual interest rate of 15.3% and maturing in 2018 with a principal of GBP 0.2 million and an outstanding debt balance of GBP 0.15 million as of September 30, 2016.

CWind also has two revolving lines of credit, one based in the UK with a capacity of GBP 3.0 million and an interest rate of 2.65% over Barclays' Base Rate of 0.5% and one based in Germany with a capacity of EUR 3.0 million and an interest rate of

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2.0% over Barclays' Base Rate of 0.5%. As of September 30, 2016 CWind had borrowings outstanding under the UK and German lines of credit of GBP 0.2 million and EUR 0.6 million, respectively.

#### GMSL Capital Leases

GMSL is a party to two leases to finance the use of two vessels: the Innovator (the "Innovator Lease") and the Cable Retriever (the "Cable Lease," and together with the Innovator Lease, the "GMSL Leases"). The Innovator Lease was restructured effective May 31, 2016, extending the lease to 2025. The principal amount thereunder bears interest at the rate of approximately 10.4%. The Cable Lease expires in 2023. The principal amount thereunder bears interest at the rate of approximately 4.0%.

As of September 30, 2016 and December 31, 2015, \$52.8 million and \$52.7 million, respectively, in aggregate principal amount remained outstanding under the GMSL Leases.

#### ANG Term Loan

ANG established a term loan with Signature Financial in October 2013. This term loan has a five year term and bears interest at the rate of 5.5% per annum. As of September 30, 2016 and December 31, 2015, \$0.5 million and \$0.7 million, respectively, remained outstanding under this term loan.

On June 13, 2016, ANG entered into a seven year delayed draw term note for \$6.5 million with Pioneer Savings Bank ("Pioneer"). The note includes an interest only provision for the first year and will mature on July 1, 2023. The interest rate on this loan is LIBOR plus 3.0% for the first year and a fixed rate of 4.3% thereafter. The agreement with Pioneer also includes a revolving demand note for \$1.0 million with an annual renewal provision and interest at monthly LIBOR plus 3.0%. As of September 30, 2016, ANG borrowed \$3.5 million of aggregate principal under the delayed draw term note.

On August 5, 2016, ANG entered into a six year seller note for \$3.0 million with the seller of a station, maturing on February 1, 2022. The interest rate on this loan is a fixed rate of 4.25%. Interest was pre-paid for the first month of the loan. As of September 30, 2016, the outstanding principal balance was \$2.9 million.

On September 19, 2016, ANG entered into a delayed draw term note for \$2.5 million, maturing on October 1, 2022. The note includes an interest only provision for the first month of the loan. The interest rate on this loan is a fixed rate of 4.3%.

### 13. Income Taxes

#### Income Tax Benefit

Income tax was a benefit of \$1.3 million and an expense of \$1.5 million for the three months ended September 30, 2016 and 2015, and a benefit of \$3.6 million and a benefit of \$1.8 million for the nine months ended September 30, 2016 and 2015.

The Company used the Annual Effective Tax Rate ("ETR") approach of ASC 740-270 (formerly FIN 18), "Interim Reporting," to calculate its 2016 interim tax provision.

#### NOL Limitation

The Company has an estimated NOL carryforward for U.S. federal tax purposes in the amount of \$80.7 million. In the first quarter of 2014, substantial acquisitions of the Company's stock were reported by new beneficial owners of 5.0% or more of the Company's common stock on Schedule 13D filings made with the SEC. On May 29, 2014, the Company issued 30,000 shares of Series A Convertible Participating Preferred Stock of the Company (the "Series A Preferred Stock") and 1,500,000 shares of common stock to finance the acquisition of DBM Global. During the second quarter of 2014 the Company completed a Section 382 review. The conclusions of this review indicate that an ownership change had occurred as of May 29, 2014. The Company's annual Section 382 base limit following the ownership change is estimated to be \$2.3 million per year. On November 4, 2015, HC2 issued 8,452,500 shares of its stock in a primary offering which the Company believes resulted in a Section 382 ownership change resulting in an additional annual limitation to cumulative carryforward. NOLs of approximately \$77.7 million are subject to this new limitation. The Company does not believe that any NOLs will expire as a result of the November 2015 ownership change.

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#### Unrecognized Tax Benefits

The Company follows the provision of ASC 740-10, "Income Taxes", which prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that the Company has taken or expects to take on a tax return. The Company is subject to challenge from various taxing authorities relative to certain tax planning strategies, including certain intercompany transactions as well as regulatory taxes. The amount of unrecognized tax benefits may change in the next 12 months; however, the Company does not expect any such change to have a significant impact on the results of operations or the financial position of the Company.

#### Examinations

The Company conducts business globally, and as a result, the Company or one or more of its subsidiaries files income tax returns in the United States federal jurisdiction and various state and foreign jurisdictions. In the normal course of business the Company is subject to examination by taxing authorities throughout the world. The open tax years contain matters that could be subject to differing interpretations of applicable tax laws and regulations as they relate to the amount, character, timing or inclusion of revenue and expenses or the applicability of income tax credits for the relevant tax period. Given the nature of tax audits there is a risk that disputes may arise. Tax years 2002 - 2015 remain open for examination.

#### 14. Commitments and Contingencies

##### Litigation

The Company is subject to claims and legal proceedings that arise in the ordinary course of business. Such matters are inherently uncertain, and there can be no guarantee that the outcome of any such matter will be decided favorably to the Company or that the resolution of any such matter will not have a material adverse effect upon the Company's Condensed Consolidated Financial Statements. The Company does not believe that any of such pending claims and legal proceedings will have a material adverse effect on its Condensed Consolidated Financial Statements. The Company records a liability in its Condensed Consolidated Financial Statements for these matters when a loss is known or considered probable and the amount can be reasonably estimated. The Company reviews these estimates each accounting period as additional information is known and adjusts the loss provision when appropriate. If a matter is both probable to result in a liability and the amounts of loss can be reasonably estimated, the Company estimates and discloses the possible loss or range of loss to the extent necessary for the Condensed Consolidated Financial Statements not to be misleading. If the loss is not probable or cannot be reasonably estimated, a liability is not recorded in its Condensed Consolidated Financial Statements.

On July 16, 2013, Plaintiffs Xplornet Communications Inc. and Xplornet Broadband, Inc. ("Xplornet") initiated an action against Inukshuk Wireless Inc. ("Inukshuk"), Globility Communications Corporation ("Globility"), MIPPS Inc., Primus Telecommunications Canada Inc. ("PTCI") and Primus Telecommunications Group, Incorporated (n/k/a HC2). Xplornet alleges that it entered into an agreement to acquire certain licenses for radio spectrum in Canada from Globility but that Globility breached the letter of intent by selling the licenses to Inukshuk. Xplornet also alleges similar claims against Inukshuk, and seeks damages from all defendants in the amount of \$50 million. On January 29, 2014, Globility, MIPPS Inc., and PTCI, demanded indemnification pursuant to the Equity Purchase Agreement among PTUS, Inc., PTCAN, Inc., the Company (f/k/a Primus Telecommunications Group, Incorporated), Primus Telecommunications Holding, Inc., Lingo Holdings, Inc., and Primus Telecommunications International, Inc., dated as of May 10, 2013. On February 14, 2014, the Company assumed the defense of this litigation, while reserving all of



its rights under the Equity Purchase Agreement. Inukshuk filed a cross claim against Globility, MIPPS, PTCI, and the Company. Inukshuk asserts that if Inukshuk is found liable to Xplornet, then Inukshuk is entitled to contribution and indemnity, compensatory damages, interest, and costs from the Company. The Company and Inukshuk have moved for summary judgment against Xplornet, arguing that there was no agreement between Globility and Xplornet to acquire the licenses at issue.

On January 19, 2016, PTCI sought and obtained an order under the Companies' Creditors Arrangement Act (the "CCAA") from the Ontario Superior Court of Justice. PTCI received an Initial Order staying all proceedings against PTCI until February 26, 2016 - which it has moved to extend through September 2016. On February 25, 2016, the Ontario Superior Court of Justice extended the stay of proceedings until September 19, 2016. PTCI has advised the Company that this stays all proceedings against PTCI, Globility, and MIPPS, except against the Company.

In October 2016, the Company settled the matter. On November 8, 2016, the Court entered a consent order dismissing this action.

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On November 6, 2014, a putative stockholder class action complaint challenging the tender offer by which HC2 acquired approximately 721,000 of the issued and outstanding common shares of DBM Global was filed in the Court of Chancery of the State of Delaware, captioned Mark Jacobs v. Philip A. Falcone, Keith M. Hladek, Paul Voigt, Michael R. Hill, Rustin Roach, D. Ronald Yagoda, Phillip O. Elbert, HC2 Holdings, Inc., and Schuff International, Inc., Civil Action No. 10323 (the "Complaint"). On November 17, 2014, a second lawsuit was filed in the Court of Chancery of the State of Delaware, captioned Arlen Diercks v. Schuff International, Inc. Philip A. Falcone, Keith M. Hladek, Paul Voigt, Michael R. Hill, Rustin Roach, D. Ronald Yagoda, Phillip O. Elbert, HC2 Holdings, Inc., Civil Action No. 10359. On February 19, 2015, the court consolidated the actions (now designated as Schuff International, Inc. Stockholders Litigation) and appointed lead plaintiff and counsel. The currently operative complaint is the Complaint filed by Mark Jacobs. The Complaint alleges, among other things, that in connection with the tender offer, the individual members of the DBM Global's Board of Directors and HC2, the now-controlling stockholder of DBM Global, breached their fiduciary duties to members of the plaintiff class. The Complaint also purports to challenge a potential short-form merger based upon plaintiff's expectation that the Company would cash out the remaining public stockholders of DBM Global following the completion of the tender offer. The Complaint seeks rescission of the tender offer and/or compensatory damages, as well as attorney's fees and other relief. The defendants filed answers to the Complaint on July 30, 2015. The litigation is currently in the discovery phase, and fact discovery is scheduled to be completed on March 27, 2017. Trial is scheduled for March 12-15, 2018. We believe that the allegations and claims set forth in the Complaint are without merit and intend to defend our interests vigorously.

#### Tax Matters

Currently, the Canada Revenue Agency ("CRA") is auditing a subsidiary previously held by the Company. The Company intends to cooperate in audit matters. To date, CRA has not proposed any specific adjustments and the audit is ongoing.

#### 15. Employee Retirement Plans

The following table presents the components of net periodic benefit cost for the three and nine months ended September 30, 2016 and 2015, respectively (in thousands):

	Three Months Ended September 30, 2016		Nine Months Ended September 30, 2015	
Service cost - benefits earning during the period	\$17	\$15	\$52	\$46
Interest cost on projected benefit obligation	1,878	1,833	5,633	5,498
Expected return on assets	(1,991)	(1,877)	(5,974)	(5,630)
Actuarial gain	—	128	—	384
Foreign currency gain (loss)	3	(3)	9	(9)
Net periodic benefit cost/(income)	\$(93)	\$96	(280)	\$289

The Company previously disclosed in its financial statements for the year ended December 31, 2015 that it expected to contribute \$7.2 million to its pension plans in 2016. As of September 30, 2016, \$1.4 million contributions have been made. Due to current funding levels, the Company does not anticipate contributing further funds to its pension plans in 2016.

## 16. Share-Based Compensation

On April 11, 2014, HC2's board of directors adopted the HC2 Holdings, Inc. 2014 Omnibus Equity Award Plan (the "Omnibus Plan"), which was approved by our stockholders at the annual meeting of stockholders held on June 12, 2014. The Omnibus Plan provides that no further awards will be granted pursuant to the Company's Management Compensation Plan, as amended (the "Prior Plan"). However, awards that had been previously granted pursuant to the Prior Plan will continue to be subject to and governed by the terms of the Prior Plan.

The Compensation Committee of HC2's board of directors administers HC2's Omnibus Plan and the Prior Plan and has broad authority to administer, construe and interpret the plans.

The Omnibus Plan provides for the grant of awards of non-qualified stock options, incentive (qualified) stock options, stock appreciation rights, restricted stock awards, restricted stock units, other stock based awards, performance compensation awards (including cash bonus awards) or any combination of the foregoing. The Company typically issues new shares of common stock

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upon the exercise of stock options, as opposed to using treasury shares. The Omnibus Plan authorizes the issuance of up to 5,000,000 shares of the Company's common stock, subject to adjustment as provided in the Omnibus Plan.

The Company follows guidance which addresses the accounting for share-based payment transactions whereby an entity receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The guidance generally requires that such transactions be accounted for using a fair-value based method and share-based compensation expense be recorded, based on the grant date fair value, estimated in accordance with the guidance, for all new and unvested stock awards that are ultimately expected to vest as the requisite service is rendered.

The Company granted 1,506,848 and 1,406,681 options during the nine months ended September 30, 2016 and 2015, respectively. Of the total options granted during the nine months ended September 30, 2016 and 2015, 6,848 and 885,173, respectively, of such options were granted to Philip Falcone, pursuant to a standalone option agreement entered in connection with Mr. Falcone's appointment as Chairman, President and Chief Executive Officer of the Company, and not pursuant to the Omnibus Plan. The anti-dilution protection provision contained in such standalone option agreement was canceled in April 2016 and replaced with an award consisting solely of 1,500,000 premium stock options issued under the Omnibus Plan. The weighted average fair value at date of grant for options granted during the nine months ended September 30, 2016 and 2015 was \$1.09 and \$1.55, respectively, per option. The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions shown as a weighted average for the year:

	Nine Months Ended September 30,	
	2016	2015
Expected option life (in years)	4.70 - 6.00	5.38
Risk-free interest rate	1.27% - 1.35%	1.49% - 1.68%
Expected volatility	39.58% - 55.58%	36.29% - 40.50%
Dividend yield	—	% — %

Total share-based compensation expense recognized by the Company and its subsidiaries under all equity compensation arrangements during the three months ended September 30, 2016 and 2015 was \$1.8 million and \$2.3 million, respectively. Total share-based compensation expense recognized by the Company and its subsidiaries under all equity compensation arrangements during the nine months ended September 30, 2016 and 2015 was \$6.7 million and \$7.4 million, respectively. Most of the Company's stock awards vest ratably during the vesting period. The Company recognizes compensation expense for equity awards, reduced by estimated forfeitures, using the straight-line basis.

## Restricted Stock and Restricted Stock Units

A summary of the Company's restricted stock and restricted stock unit activity for the nine months ended September 30, 2016 is as follows:

	Shares	Weighted Average Grant Date Fair Value
Unvested - December 31, 2015	790,688	\$ 8.14
Granted	295,899	\$ 3.89

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Vested	(882,918)	\$ 7.14
Forfeitures	(16,611 )	\$ 5.03
Unvested - September 30, 2016	187,058	\$ 6.44

As of September 30, 2016, the unvested restricted stock represented \$0.5 million of compensation expense that is expected to be recognized over the weighted average remaining vesting period of 1.1 years. The number of shares of unvested restricted stock expected to vest is 185,189.

#### Stock Options

A summary of the Company's stock option activity and respective weighted average exercise price during the nine months ended September 30, 2016 is as follows:

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	Shares	Weighted Average Exercise Price
Outstanding - December 31, 2015	5,361,285	\$ 5.48
Granted	1,506,848	\$ 10.49
Exercised	(2,000 )	\$ 4.06
Forfeitures	(2,800 )	\$ 4.06
Outstanding - September 30, 2016	6,863,333	\$ 6.58
Eligible for exercise	3,950,750	\$ 5.33

As of September 30, 2016, intrinsic value and average remaining life of the Company's outstanding and exercisable options were \$3.2 million and \$2.4 million and 8.29 and 7.88 years, respectively.

As of September 30, 2016, the Company had 2,912,583 unvested stock options outstanding, of which \$2.8 million of compensation expense is expected to be recognized over the weighted average remaining vesting period of 1.82 years. The number of unvested stock options expected to vest is 2,912,583 shares, with a weighted average remaining life of 8.84 years, a weighted average exercise price of \$8.27, and an intrinsic value of \$0.8 million.

## 17. Equity

## Preferred and Common Stock

At September 30, 2016 and December 31, 2015, there were 38,031,325 and 35,249,749 shares of common stock outstanding, respectively. At September 30, 2016 and December 31, 2015, there were 42,308 and 53,172 shares of the Company's Preferred Stock outstanding.

On May 29, 2014, the Company issued 30,000 shares of Series A Preferred Stock and 1,500,000 shares of common stock, the proceeds of which were used to pay for a portion of the purchase price related to the acquisition of DBM Global. Each share of Series A Preferred Stock is convertible into the Company's common stock at a conversion price of \$4.25. On September 22, 2014, the Company issued 11,000 shares of Series A-1 Convertible Participating Preferred Stock of the Company (the "Series A-1 Preferred Stock"). Each share of Series A-1 Preferred Stock is convertible into the Company's common stock at a conversion price of \$4.25. On January 5, 2015, the Company issued 14,000 shares of Series A-2 Convertible Participating Preferred Stock of the Company (the "Series A-2 Preferred Stock" and together with the Series A Preferred Stock and Series A-1 Preferred Stock, the "Preferred Stock"). Each share of Series A-2 Preferred Stock is convertible into the Company's common stock at a conversion price of \$7.85. The Company has amended the certificates of designation governing the Series A-1 Preferred Stock to reflect the issuance of the Series A-2 Preferred Stock as a class of preferred stock which ranks at parity with the Series A Preferred Stock and Series A-1 Preferred Stock and to make certain other technical and administrative changes to conform the terms of the Series A-1 Preferred Stock to those of the Series A-2 Preferred Stock.

The conversion prices for the Preferred Stock are subject to adjustments for dividends, certain distributions, stock splits, combinations, reclassifications, reorganizations, mergers, recapitalizations and similar events. The Preferred Stock accrues a cumulative quarterly cash dividend at an annualized rate of 7.5% of the accreted value thereof. In

addition, the accreted value of the Preferred Stock accretes quarterly at an annualized rate of 4.0% that will be reduced to 2.0% or 0.0% if the Company achieves specified rates of growth measured by increases in its net asset value.

Each share of Series A Preferred Stock may be converted by the holder into common stock at any time based on the then-applicable conversion price. On the seventh anniversary of the issue date of the Series A Preferred Stock, holders of the Series A Preferred Stock are entitled to cause the Company to redeem the Series A Preferred Stock at the accreted value per share plus accrued but unpaid dividends. Each share of Series A Preferred Stock that is not so redeemed will be automatically converted into shares of common stock at the conversion price then in effect. Upon a change of control, holders of the Series A Preferred Stock shall be entitled to cause the Company to redeem their Series A Preferred Stock at a price per share equal to the greater of (i) the accrued value of the Series A Preferred Stock, which amount would be multiplied by 150% in the event of a change of control

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occurring on or prior to the third anniversary of the issue date of the Series A Preferred Stock plus any accrued but unpaid dividends and (ii) the value that would be received if the share of Series A Preferred Stock were converted into common stock immediately prior to the change of control.

Certain certificates of amendment related to the Company's Series A Preferred Stock (the "Prior Amendments") did not become effective because they were filed without proper authorization of the stockholders of the Company. The holders of the Series A Preferred Stock agreed to release all claims against the Company relating to the ineffectiveness of the Prior Amendments, including the fact that the conversion price of the Series A Preferred Stock remains at \$4.25. As payment for the release of claims, the Company issued \$5.0 million aggregate principal amount of the 11.0% Notes to the holders of the Series A Preferred Stock. The Company recorded this payment to other income (expense), net in August 2015.

At any time after the third anniversary of the issue date of the Series A Preferred Stock, the Company may redeem the Series A Preferred Stock, in whole but not in part, at a price per share generally equal to 150% of the accrued value per share plus accrued but unpaid dividends. After the third anniversary of the issue date of the Series A Preferred Stock, the Company may force conversion of the Series A Preferred Stock into common stock if the common stock's thirty-day volume-weighted average price ("VWAP") exceeds 150% of the then-applicable conversion price and the common stock's daily VWAP exceeds 150% of the then-applicable conversion price for at least twenty trading days out of the thirty trading day period used to calculate the thirty-day VWAP.

During the nine months ended September 30, 2016, 1,864 and 9,000 shares of Series A and A-1 Preferred Stock were converted into 444,550 and 2,119,764 shares of the Company's common stock, respectively, in private exchange transactions. During the nine months ended September 30, 2015, 1,000 shares of Series A-1 Preferred Stock were converted into 235,526 shares of common stock in private exchange transactions. We refer to these transactions as the "Preferred Share Conversions".

In their Preferred Share conversions conjunction consummated during the nine months ended September 30, 2016, the Company issued 15,318 and 136,149 shares of its Common Stock (the "Conversion Share Consideration") to Corrib Master Fund, Ltd ("Corrib") and Luxor Capital Group, LLP ("Luxor"), respectively. The fair value of the Conversion Share Consideration was \$0.7 million on the date of the issuance.

The Company also agreed to provide the following two forms of additional consideration for as long as the Preferred Stock remained entitled to receive dividend payments (the "Additional Share Consideration").

In addition, the Company agreed that in the event that Corrib and Luxor would have been entitled to any Participating Dividends payable, had they not converted the Preferred Stock (as defined in the respective Series A and Series A-1 Certificate of Designation), after the date of their Preferred Share conversion, then the Company will issue to Corrib and Luxor, on the date such Participating Dividends become payable by the Company, in a transaction exempt from the registration requirements of the Securities Act the number of shares of common stock equal to (a) the value of the Participating Dividends Corrib or Luxor would have received pursuant to Sections (2)(c) and (2)(d) of the respective Series A and Series A-1 Certificate of Designation, divided by (b) the Thirty Day VWAP (as defined in the respective Series A and Series A-1 Certificate of Designation) for the period ending two business days prior to the underlying event or transaction that would have entitled Corrib or Luxor to such Participating Dividend had Corrib's or Luxor's Preferred Stock remain unconverted.

Further, the Company agreed that it will issue to Corrib and Luxor, on each quarterly anniversary of May 29, 2017 (or, if later, the date on which the corresponding dividend payment is made to the holders of the outstanding Preferred Stock), through and until the Maturity Date (as defined in the respective Series A and Series A-1 Certificate of



Designation), in a transaction exempt from the registration requirements of the Securities Act the number of shares of common stock equal to (a) 1.875% the Accrued Value (as defined in the respective Series A and Series A-1 Certificate of Designation) of Corrib's or Luxor's Preferred Stock as of the Closing Date (as defined in applicable Voluntary Conversion Agreements) divided by (b) the Thirty Day VWAP (as defined in the respective Series A and Series A-1 Certificate of Designation) for the period ending two business days prior to the applicable Dividend Payment Date (as defined in the respective Series A and Series A-1 Certificate of Designation).

The Additional Share Consideration was valued by the Company at \$1.5 million and recorded within other liabilities.

#### Dividends

During 2016, HC2's board of directors declared cash dividends with respect to HC2's issued and outstanding Preferred Stock, as presented in the following table (Total Dividend amount presented in thousands):

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Declaration Date and Holders of Record Date	March 31, 2016	June 30, 2016	September 30, 2016
Payment/Accrual Date	April 15, 2016	July 15, 2016	October 15, 2016
Total Dividend	\$ 988	\$ 988	\$ 800

18. Related Parties

HC2

In January 2015, the Company entered into a services agreement (the “Services Agreement”) with Harbinger Capital Partners with respect to the provision of