HC2 HOLDINGS, INC.
Form 10-Q
May 10, 2017

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

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

For the quarterly period ended March 31, 2017

OR

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

Commission File No. 001-35210

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

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

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

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

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.001 per share	NYSE MKT LLC

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

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

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

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

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

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

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 7(a)(2)(B) of the Securities Act.
† The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No ý
As of April 30, 2017, 42,155,860 shares of common stock, par value $0.001, were outstanding.

HC2 HOLDINGS, INC.
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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

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

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

	Three Months Ended March 31,	
	2017	2016
Services revenue	$235,928	$182,109
Sales revenue	118,614	120,497
Life, accident and health earned premiums, net	19,941	19,934
Net investment income	15,304	14,079
Net realized gains (losses) on investments	781	(4,875)
Net revenue	390,568	331,744
Operating expenses		
Cost of revenue - services	219,612	174,873
Cost of revenue - sales	94,802	99,677
Policy benefits, changes in reserves, and commissions	31,487	34,020
Selling, general and administrative	39,856	35,597
Depreciation and amortization	7,397	5,955
Other operating (income) expenses	(3,558)	887
Total operating expenses	389,596	351,009
Income (loss) from operations	972	(19,265)
Interest expense	(14,115)	(10,326)
Loss on contingent consideration	(231)	—
Income (loss) from equity investees	7,693	(3,576)
Other income (expense), net	(4,910)	(714)
Loss from continuing operations before income taxes	(10,591)	(33,881)
Income tax (expense) benefit	(5,291)	2,539
Net loss	(15,882)	(31,342)
Less: Net loss attributable to noncontrolling interest and redeemable noncontrolling interest	1,386	880
Net loss attributable to HC2 Holdings, Inc.	(14,496)	(30,462)
Less: Preferred stock and deemed dividends from conversions	583	1,069
Net loss attributable to common stock and participating preferred stockholders	$(15,079)	$(31,531)
Loss per Common Share		
Basic	$(0.36)	$(0.89)
Diluted	$(0.36)	$(0.89)
Weighted average common shares outstanding:		
Basic	41,948	35,262
Diluted	41,948	35,262

See notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2017	2016
Net loss	$(15,882)	$(31,342)
Other comprehensive income (loss)		
Foreign currency translation adjustment	1,125	1,823
Unrealized gain (loss) on available-for-sale securities	11,976	18,617
Other comprehensive income	13,101	20,440
Comprehensive loss	(2,781)	(10,902)
Less: Net loss attributable to noncontrolling interest and redeemable noncontrolling interest	1,386	880
Comprehensive loss attributable to HC2 Holdings, Inc.	$(1,395)	$(10,022)

See notes to consolidated financial statements.

HC2 HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	March 31, 2017	December 31, 2016
Assets		
Investments:		
Fixed maturities, available-for-sale at fair value	$1,302,549	$1,278,958
Equity securities, available-for-sale at fair value	51,897	51,519
Mortgage loans	21,824	16,831
Policy loans	18,106	18,247
Other invested assets	80,580	62,363
Total investments	1,474,956	1,427,918
Cash and cash equivalents	127,003	115,371
Accounts receivable, net	228,058	267,598
Recoverable from reinsurers	524,845	524,201
Deferred tax asset	440	1,108
Property, plant and equipment, net	284,304	286,458
Goodwill	98,086	98,086
Intangibles, net	38,382	39,722
Other assets	80,288	74,814
Total assets	$2,856,362	$2,835,276
Liabilities, temporary equity and stockholders' equity		
Life, accident and health reserves	$1,665,459	$1,648,565
Annuity reserves	249,371	251,270
Value of business acquired	46,509	47,613
Accounts payable and other current liabilities	236,157	251,733
Deferred tax liability	15,550	15,304
Long-term obligations	445,620	428,496
Other liabilities	98,795	92,871
Total liabilities	2,757,461	2,735,852
Commitments and contingencies		
Temporary equity:		
Preferred stock	29,479	29,459
Redeemable noncontrolling interest	2,958	2,526
Total temporary equity	32,437	31,985
Stockholders' equity		
Common stock, $.001 par value;	42	42
Shares authorized: 80,000,000 at March 31, 2017 and December 31, 2016;		
Shares issued: 42,520,073 and 42,070,675 at March 31, 2017 and December 31, 2016;		
Shares outstanding: 42,155,860 and 41,811,288 at March 31, 2017 and December 31, 2016, respectively		
Additional paid-in capital	243,698	241,485
Treasury stock, at cost; 364,213 and 259,387 shares at March 31, 2017 and December 31, 2016, respectively	(1,968)	(1,387)
Accumulated deficit	(188,774)	(174,278)
Accumulated other comprehensive loss	(8,546)	(21,647)

Total HC2 Holdings, Inc. stockholders’ equity	44,452	44,215
Noncontrolling interest	22,012	23,224
Total stockholders’ equity	66,464	67,439
Total liabilities, temporary equity and stockholders’ equity	$2,856,362	$2,835,276

See notes to consolidated financial statements.

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

	Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total HC2 Stockholders' Equity	Non-controlling Interest	Total Stockholders’ Equity	Temporary Equity
	Shares	Amount								
Balance as of December 31, 2016	41,811	$42	$241,485	$(1,387)	$(174,278)	$(21,647)	44,215	$23,224	$67,439	$31,985
Share-based compensation expense	—	—	2,593	—	—	—	2,593	—	2,593	—
Fair value adjustment of redeemable noncontrolling interest	—	—	(275)	—	—	—	(275)	—	(275)	275
Preferred stock dividend	—	—	(563)	—	—	—	(563)	—	(563)	—
Preferred stock beneficial conversion feature	—	—	(20)	—	—	—	(20)	—	(20)	20
Issuance of common stock	321	—	16	—	—	—	16	—	16	—
Exercise of stock options	129	—	462	—	—	—	462	—	462	—
Taxes paid in lieu of shares issued for share-based compensation	(105)	—	—	(581)	—	—	(581)	—	(581)	—
Transactions with noncontrolling interests	—	—	—	—	—	—	—	—	—	331
Net loss	—	—	—	—	(14,496)	—	(14,496)	(1,212)	(15,708)	(174)
Comprehensive loss attributable to HC2 Holdings, Inc.		—	—	—	—	13,101	13,101	—	13,101	—
Balance as of March 31, 2017	42,156	$42	$243,698	$(1,968)	$(188,774)	$(8,546)	$44,452	$22,012	$66,464	$32,437

	Common Stock		Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total HC2 Stockholders' Equity	Non-controlling Interest	Total Stockholders’ Equity	Temporary Equity
	Shares	Amount								
Balance as of December 31,	35,250	$35	$209,477	$(378)	$(79,729)	$(35,375)	$94,030	$23,494	$117,524	$55,741

2015										
Share-based compensation expense	—	—	2,582	—	—	—	2,582	—	2,582	609
Preferred stock dividend and accretion	—	—	(1,014)	—	—	—	(1,014)	—	(1,014)	—
Preferred stock beneficial conversion feature	—	—	(55)	—	—	—	(55)	—	(55)	55
Issuance of common stock	65	—	—	—	—	—	—	—	—	—
Transactions with noncontrolling interests	—	—	723	—	—	—	723	5,444	6,167	—
Net loss	—	—	—	—	(30,462)	—	(30,462)	(239)	(30,701)	(641)
Comprehensive loss attributable to HC2 Holdings, Inc.	—	—	—	—	—	20,440	20,440	—	20,440	—
Balance as of March 31, 2016	35,315	$ 35	$ 211,713	$ (378)	$ (110,191)	$ (14,935)	86,244	$ 28,699	$ 114,943	$ 55,764

See notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2017	2016
Cash flows from operating activities:		
Net loss	$(15,882)	$(31,342)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:		
Provision for doubtful accounts receivable	(411)	112
Share-based compensation expense	1,519	3,191
Depreciation and amortization	8,637	7,884
Amortization of deferred financing costs and debt discount / premium	2,707	495
Amortization of discount / premium on investments	2,834	3,361
(Gain) loss on sale or disposal of assets	(3,752)	887
(Income) loss from equity investees	(7,693)	3,576
Impairment of investments	3,269	2,686
Net realized / unrealized (gains) losses on investments	(368)	3,067
Loss on contingent consideration	231	—
Receipt of dividends from equity investees	917	7,214
Deferred income taxes	(4,443)	(12,311)
Annuity benefits	2,172	2,256
Other operating activities	203	112
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	40,322	15,211
Recoverable from reinsurers	(644)	3,689
Other assets	(5,131)	26,879
Life, accident and health and Annuity reserves	18,219	20,914
Accounts payable and other current liabilities	16,444	(42,324)
Other liabilities	(26,374)	1,268
Cash provided by operating activities:	32,776	16,825
Cash flows from investing activities:		
Purchase of property, plant and equipment	(9,413)	(6,512)
Disposal of property, plant and equipment	161	471
Purchase of investments	(56,636)	(73,606)
Sale of investments	23,073	32,765
Maturities and redemptions of investments	24,092	18,052
Purchase of equity method investments	(10,200)	—
Cash paid for business acquisitions, net of cash acquired	—	(6,469)
Other investing activities	154	172
Cash used in investing activities:	(28,769)	(35,127)
Cash flows from financing activities:		
Proceeds from long-term obligations	53,655	2,360
Principal payments on long-term obligations	(40,664)	(3,156)
Annuity receipts	873	785
Annuity surrenders	(6,269)	(5,149)
Transactions with noncontrolling interests	331	2,000
Payment of dividends	(1,322)	(1,014)
Other financing activities	(117)	—

Cash provided by financing activities:	6,487	(4,174)
Effects of exchange rate changes on cash and cash equivalents	1,138	1,552
Net change in cash and cash equivalents	11,632	(20,924)
Cash and cash equivalents, beginning of period	115,371	158,624
Cash and cash equivalents, end of period	$127,003	$137,700
Supplemental cash flow information:		
Cash paid for interest	$1,456	$1,465
Cash paid for taxes	$264	$639
Non-cash investing and financing activities:		
Property, plant and equipment included in accounts payable	$740	$946
Investments in accounts payable	$10,320	$7,180
Dividends payable to shareholders	$563	$988

See notes to consolidated financial statements.

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HC2 HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Business

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

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

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

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 Energy segment includes American Natural Gas ("ANG"). ANG is a premier distributor of natural gas motor fuel. ANG designs, builds, owns, acquires, operates and maintains compressed natural gas fueling stations for transportation vehicles. The Company maintains effective control of, and a 49.99% ownership interest in ANG.

4.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 telecommunications 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.

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

6.Our Life Sciences segment includes Pansend Life Sciences, LLC (“Pansend”). Pansend owns a (i) 77% interest in Genovel Orthopedics, Inc. ("Genovel"), which seeks to develop products to treat early osteoarthritis of the knee, (ii) 71% interest in R2 Dermatology Inc. ("R2", 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 including a 45% interest in Medibeacon Inc., and Triple Ring Technologies, Inc.

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 is the Company's 56% ownership interest in 704Games Company ("704Games" f/k/a DMi, Inc.), 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.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements of the Company included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”). The financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of such information. All such adjustments are of a normal recurring nature. Certain information and note disclosures, including a description of significant accounting policies normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”), have been condensed or omitted pursuant to such rules and regulations. Certain prior amounts have been reclassified or combined to conform to the current year presentation. These reclassifications and combinations had no effect on previously reported net loss attributable to controlling interest or accumulated deficit. These interim financial statements should be read in conjunction with the Company’s annual consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on March 9, 2017, as amended by amendment no.1, filed on March 28, 2017 (collectively "Form 10-K"). The results of operations for the three months ended March 31, 2017 are not necessarily indicative of the results for any subsequent periods or the entire fiscal year ending December 31, 2017.

New Accounting Pronouncements

The Company has implemented all new accounting pronouncements that are in effect and that may impact its Condensed Consolidated Financial Statements and does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on its financial condition, results of operations or liquidity.

Accounting Principles Early Adopted During the Fiscal Year

Testing for Goodwill Impairment

In January 2017, the FASB issued ASU 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. Topic 350, Intangibles - Goodwill and Other (Topic 350), currently requires an entity that has not elected the private company alternative for goodwill to perform a two-step test to determine the amount, if any, of goodwill impairment. In Step 1, an entity compares the fair value of a reporting unit with its carrying amount, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the entity performs Step 2 and compares the implied fair value of goodwill with the carrying amount of the goodwill for that reporting unit. An impairment charge equal to the amount by which the carrying amount of goodwill for the reporting unit exceeds the implied fair value of that goodwill is recorded, limited to the amount of goodwill allocated to that reporting unit. To address concerns over the cost and complexity of the two-step goodwill impairment test, the amendments in this ASU remove the second step of the test. An entity will now apply a one-step quantitative test and record the amount of goodwill impairment as the excess of a reporting unit's carrying amount over its fair value, not to exceed the total amount of goodwill allocated to the reporting unit. The new guidance does not amend the optional qualitative assessment of goodwill impairment. The Company elected to early adopt ASU 2017-04 effective March 31, 2017, resulting in no impact to the Condensed Consolidated Financial Statements.

New Accounting Pronouncements to be Adopted Subsequent to the Fiscal Year

Revenue Recognition

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU supersedes the revenue recognition requirements in Revenue Recognition (Topic 605). Under the new guidance, an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal Versus Agent Considerations, which clarifies the guidance in ASU 2014-09. In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, an update on identifying performance obligations and accounting for licenses of intellectual property. In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which includes amendments for enhanced clarification of the guidance. In December 2016, the FASB issued ASU 2016-20, Technical Corrections and Improvements to Revenue from Contracts with Customers (Topic 606), which includes amendments of a similar nature to the items typically addressed in the technical corrections and improvements project. Lastly, in February 2017, the FASB issued ASU 2017-05, clarifying the scope of asset derecognition guidance and accounting for partial sales of nonfinancial assets to clarify the scope of ASC

610-20, Other Income - Gains and Losses from Derecognition of Nonfinancial Assets, and provide guidance on partial sales of nonfinancial assets. This ASU clarifies that the unit of account under ASU 610-20 is each distinct nonfinancial or in substance nonfinancial asset and that a financial asset that meets the definition of an “in substance nonfinancial asset” is within the scope of ASC 610-20. This ASU eliminates rules specifically addressing sales of real estate and removes exceptions to the financial asset derecognition model. The ASUs described above are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period.

During the three month ended March 31, 2017, the Company continued its evaluation of ASU 2014-09, including the expected impact on its business processes, systems and controls, and potential differences in the timing and/or method of revenue recognition for its contracts. The Company expects to complete its assessment of the cumulative effect of adopting ASU 2014-09 as well as the expected impact of adoption during 2017. The Company will continue its evaluation of ASU 2014-09, including how it may impact new contracts it receives as well as new or emerging interpretations of the standard, through the date of adoption. The Company expects to adopt the revenue recognition ASUs described above in its Consolidated Financial Statements beginning in January 1, 2018 and is currently evaluating the impact the update would have.

Subsequent Events

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

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

3. Business Combinations

Construction Segment

On October 13, 2016, DBMG acquired the detailing and Building Information Modeling (“BIM”) management business of PDC Global Pty Ltd. (“PDC”). The new businesses provide steel detailing, BIM modelling and BIM management services for industrial and commercial construction projects in Australia and North America. On November 1, 2016, DBMG acquired BDS VirCon ("BDS"). BDS provides steel detailing, rebar detailing and BIM modelling services for industrial and commercial projects in Australia, New Zealand, North America and Europe. The aggregate fair value of the consideration paid in connection with the acquisition of PDC and BDS was $25.5 million, including $21.4 million in cash. Both transactions were accounted for as business acquisitions.

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

Purchase price allocation	
Cash and cash equivalents	$621
Accounts receivable, net	5,558
Costs and recognized earnings in excess of billings on uncompleted contracts	1,686
Property, plant and equipment, net	8,043
Goodwill	11,827
Intangibles	3,955
Other assets	1,209
Total assets acquired	32,899
Accounts payable and other current liabilities	(5,924)
Billings in excess of costs and recognized earnings on uncompleted contracts	(617)
Deferred tax liability	(169)
Other liabilities	(685)
Total liabilities assumed	(7,395)
Total net assets acquired	$25,504

The preliminary allocation of the fair value of the acquired businesses was based upon a preliminary valuation. Our estimates and assumptions are subject to change as we obtain additional information for our estimates during the measurement period. The primary areas of preliminary allocation of the fair values of consideration transferred that are not yet finalized relate to the fair values of certain tangible and intangible assets acquired and the residual goodwill. We expect to complete the purchase price allocation for fiscal year 2016 acquisitions during fiscal year 2017.

Goodwill was determined based on the residual differences between fair value of consideration transferred and the value assigned to tangible and intangible assets and liabilities. Among the factors that contributed to goodwill was approximately $2.9 million assigned to the assembled and trained workforce. Goodwill is not amortized and is not deductible for tax purposes.

Acquisition costs incurred by DMBG in connection with the acquisition of PDC and BDS were approximately $2.5 million of which $0.2 million were for the three months ended March 31, 2017, and were included in selling, general and administrative expenses. The acquisition costs were primarily related to legal, accounting and valuation services.

PDC's and BDS' results were included in our Condensed Consolidated Statement of Operations since their respective acquisition dates. Pro forma results of operations for the acquisition of PDC and BDS have not been presented because they are not material to our consolidated results of operations.

Energy Segment

For the year ended December 31, 2016, ANG completed four acquisitions of twenty-one fueling stations in aggregate. The total fair value of the consideration transferred by ANG in connection with the acquisitions was $42.1 million, comprised of $39.2 million in cash and a $2.9 million 4.25% seller note, due in 2022. See Note 12. Long-term Obligations for further details. Two of the transactions were accounted for as an asset acquisition because substantially all of the fair value of the gross assets acquired was concentrated in a group of similar identifiable assets related to acquired stations.

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

For the transactions accounted for as a business combination, the fair value of consideration transferred was allocated among the identified assets acquired, liabilities assumed, intangibles and residual goodwill. For the two transactions accounted for as asset acquisitions the preliminary fair value of consideration transferred was preliminarily allocated based on the relative fair value (in thousands):

Purchase price allocation	
Accounts receivable	$1,303
Property, plant and equipment, net	42,758
Goodwill	1,257
Intangibles	4,984
Other assets	79
Total assets acquired	50,381
Accounts payable and other current liabilities	(898)
Deferred tax liability	(7,086)
Total liabilities assumed	(7,984)
Bargain purchase gain	(340)
Total net assets acquired	$42,057

The preliminary allocation of the fair value of the acquired businesses was based upon a preliminary valuation. Our estimates and assumptions are subject to change as we obtain additional information for our estimates during the measurement period. The primary areas of preliminary allocation of the fair values of consideration transferred that are not yet finalized relate to the fair values of certain property, plant and equipment, deferred tax liability, intangible assets acquired and the residual goodwill. We expect to complete the purchase price allocation for fiscal year 2016 acquisitions during fiscal year 2017.

Approximately $5.0 million of the fair value of consideration transferred has been provisionally assigned to customer contracts with an estimated useful life ranging between four and fifteen years. The multi-period excess earnings method was used to assign fair value to the acquired customer contracts.

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

Results of operations from the acquired stations since acquisition dates have been included in our Condensed Consolidated Statement of Operations. Pro forma results of operations for ANG's acquisitions have not been presented because they are not material to our consolidated results of operations.

Other Acquisitions

During the year ended December 31, 2016 we 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 $14.9 million, including $9.2 million in cash. On November 1, 2016, we completed the renegotiation of the deferred purchase obligation to purchase the outstanding 40% minority interest of CWind and purchased the remaining 40% on that date. All three transactions were accounted for as business acquisitions.

Results of operations from other acquisitions since the respective acquisition dates have been included in our Condensed Consolidated Statement of Operations. Pro forma results of operations for other acquisitions have not been presented because they are not material to our consolidated results of operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

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

Purchase price allocation	
Cash and cash equivalents	$2,963
Restricted cash	3
Accounts receivable	6,400
Inventory	528
Property, plant and equipment, net	29,896
Goodwill	5,541
Intangibles	7,082
Other assets	2,051
Total assets acquired	54,464
Accounts payable and other current liabilities	(11,180)
Deferred tax liability	(2,819)
Long-term obligations	(20,813)
Other liabilities	(3)
Noncontrolling interest	(815)
Total liabilities assumed	(35,630)
Enterprise value	18,834
Less fair value of noncontrolling interest	3,889
Total net assets acquired	$14,945

4. Investments

Fixed Maturity and Equity Securities Available-for-Sale

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

March 31, 2017	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
Fixed maturity securities				
U.S. Government and government agencies	$15,720	$ 198	$ (64)	$15,854
States, municipalities and political subdivisions	375,894	7,760	(2,944)	380,710
Foreign government	6,368	—	(497)	5,871
Residential mortgage-backed securities	129,664	5,091	(2,498)	132,257
Commercial mortgage-backed securities	40,689	379	(173)	40,895
Asset-backed securities	96,593	830	(916)	96,507
Corporate and other	599,602	32,924	(2,071)	630,455
Total fixed maturity securities	$1,264,530	$ 47,182	$ (9,163)	$1,302,549
Equity securities				
Common stocks	$16,797	$ 44	$ (2,627)	$14,214
Perpetual preferred stocks	37,033	701	(51)	37,683
Total equity securities	$53,830	$ 745	$ (2,678)	$51,897

December 31, 2016	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value

Fixed maturity securities				
U.S. Government and government agencies	$15,910	$ 135	$(95)	$15,950
States, municipalities and political subdivisions	374,527	4,408	(3,858)	375,077
Foreign government	6,380	—	(402)	5,978
Residential mortgage-backed securities	136,126	2,634	(564)	138,196
Commercial mortgage-backed securities	48,715	427	(89)	49,053
Asset-backed securities	76,303	1,934	(572)	77,665
Corporate and other	600,458	23,635	(7,054)	617,039
Total fixed maturity securities	$1,258,419	$ 33,173	$(12,634)	$1,278,958

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

Equity securities				
Common stocks	$16,236	$—	$(1,371)	$14,865
Perpetual preferred stocks	37,041	191	(578)	36,654
Total equity securities	$53,277	$191	$(1,949)	$51,519

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 gains (losses) on investments. These investments had a fair value of $14.7 million and $15.2 million as of March 31, 2017 and December 31, 2016, respectively. The change in fair value related to these securities resulted in a net gain of approximately $0.1 million for the three months ended March 31, 2017 and a net loss of approximately $1.7 million for the three months ended March 31, 2016.

Maturities of Fixed Maturity Securities Available-for-Sale

The amortized cost and fair value of fixed maturity securities available-for-sale as of March 31, 2017 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	$48,251	$48,296
Due after one year through five years	112,721	117,770
Due after five years through ten years	140,161	143,746
Due after ten years	696,451	723,078
Subtotal	997,584	1,032,890
Mortgage-backed securities	170,353	173,152
Asset-backed securities	96,593	96,507
Total	$1,264,530	$1,302,549

Corporate and Other Fixed Maturity Securities

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

	March 31, 2017			December 31, 2016		
	Amortized Cost	Fair Value	% of Total	Amortized Cost	Fair Value	% of Total
Finance, insurance, and real estate	$203,453	$207,732	32.9 %	$214,911	$211,834	34.3 %
Transportation, communication and other services	177,685	187,253	29.7 %	180,647	189,163	30.7 %
Manufacturing	110,413	117,647	18.7 %	112,644	118,440	19.2 %
Other	108,051	117,823	18.7 %	92,256	97,602	15.8 %
Total	$599,602	$630,455	100.0%	$600,458	$617,039	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 consolidated statements of operations ("credit loss impairments") represents the difference between the amortized cost of the security and the net present value of its projected future cash flows discounted at the effective interest rate implicit in the debt security prior to impairment. Any remaining difference between the fair value and amortized cost is recognized in AOCI. The Company recorded a $3.3 million and a $1.0 million impairment, within Other income (expense), net, during the three months ended March 31, 2017 and 2016, respectively, related to one fixed maturity security.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – CONTINUED

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

The following table presents the total unrealized losses for the 217 and 269 fixed maturity and equity securities held by the Company as of March 31, 2017 and December 31, 2016, respectively, where the estimated fair value had declined and remained below amortized cost by the indicated amount (in thousands):

	March 31, 2017		December 31, 2016	
	Unrealized Losses	% of Total	Unrealized Losses	% of Total
Fixed maturity and equity securities				
Less than 20%	$(8,016)	67.7 %	$(10,069)	69.0 %
20% or more for less than six months	(2,825)	23.9 %	(482)	3.3 %
20% or more for six months or greater	(1,000)	8.4 %	(4,032)	27.7 %
Total	$(11,841)	100.0%	$(14,583)	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 March 31, 2017. However, unforeseen facts and circumstances may cause the Company to sell fixed maturity and equity securities in the ordinary course of managing its portfolio to meet certain diversification, credit quality and liquidity guidelines.

The following tables present the estimated fair values and gross unrealized losses for the 217 and 269 fixed maturity and equity securities held by the Company that have estimated fair values below amortized cost as of each of March 31, 2017 and December 31, 2016, 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):

March 31, 2017	Less than 12 months		12 months of greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses

Fixed maturity securities						
U.S. Government and government agencies	$5,833	$ (64)	$—	$ —	$5,833	$ (64)
States, municipalities and political subdivisions	114,135	(2,928)	365	(16)	114,500	(2,944)
Foreign government	—	—	5,871	(497)	5,871	(497)
Residential mortgage-backed securities	35,648	(2,105)	17,519	(393)	53,167	(2,498)
Commercial mortgage-backed securities	12,129	(56)	2,181	(117)	14,310	(173)
Asset-backed securities	46,595	(442)	11,924	(474)	58,519	(916)
Corporate and other	85,891	(2,017)	3,370	(54)	89,261	(2,071)
Total fixed maturity securities	$300,231	$ (7,612)	$41,230	$ (1,551)	$341,461	$ (9,163)
Equity securities						
Common stocks	$12,811	$ (2,167)	$518	$ (460)	$13,329	$ (2,627)
Perpetual preferred stocks	4,251	(51)	—	—	4,251	(51)
Total equity securities	$17,062	$ (2,218)	$518	$ (460)	$17,580	$ (2,678)

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

December 31, 2016	Less than 12 months		12 months of greater		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Fixed maturity securities						
U.S. Government and government agencies	$4,392	$ (95)	$—	$ —	$4,392	$ (95)
States, municipalities and political subdivisions	207,740	(3,858)	—	—	207,740	(3,858)
Foreign government	5,978	(402)	—	—	5,978	(402)
Residential mortgage-backed securities	54,385	(564)	—	—	54,385	(564)
Commercial mortgage-backed securities	13,159	(89)	—	—	13,159	(89)
Asset-backed securities	12,443	(572)	—	—	12,443	(572)
Corporate and other	147,653	(3,022)	3,579	(4,032)	151,232	(7,054)
Total fixed maturity securities	$445,750	$ (8,602)	$3,579	$ (4,032)	$449,329	$ (12,634)
Equity securities						
Common stocks	$14,585	$ (1,371)	$—	$ —	$14,585	$ (1,371)
Perpetual preferred stocks	20,464	(578)	—	—	20,464	(578)
Total equity securities	$35,049	$ (1,949)	$—	$ —	$35,049	$ (1,949)

As of March 31, 2017, investment grade fixed maturity securities (as determined by nationally recognized rating agencies) represented approximately 90.4% of the gross unrealized loss and 95.9% of the fair value. As of December 31, 2016, investment grade fixed maturity securities represented approximately 54.5% of the gross unrealized loss and 83.0% 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.

Other Invested Assets

Carrying values of other invested assets accounted for under cost and equity method are as follows (in thousands):

	March 31, 2017			December 31, 2016		
	Cost Method	Equity Method	Fair Value	Cost Method	Equity Method	Fair Value
Common Equity	$138	$1,083	$—	$138	$1,047	$—
Preferred Equity	2,484	19,044	—	2,484	9,971	—
Derivatives	3,097	—	3,694	3,097	—	3,813
Limited Partnerships	—	1,007	—	—	1,116	—
Joint Ventures	—	50,033	—	—	40,697	—
Total	$5,719	$71,167	$3,694	$5,719	$52,831	$3,813

The Company recognized losses of $0.1 million and $0.7 million on declines in the fair value of derivatives accounted for under ASC 815, "Derivatives and Hedging" during the three months ended March 31, 2017 and 2016, respectively.

Summarized information for the Company's equity method investments as of and for the three months ended March 31, 2017 is as follows (information for two of the investees is reported on a one month lag, in thousands):

Net revenue	$120,862
Gross profit	$38,258
Income (loss) from continuing operations	$(9,243)
Net income (loss)	$(16,292)
Current assets	$297,687
Noncurrent assets	$282,415
Current liabilities	$193,848
Noncurrent liabilities	$137,345

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Net Investment Income

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

	Three Months Ended March 31,	
	2017	2016
Fixed maturity securities, available-for-sale at fair value	$13,925	$13,266
Equity securities, available-for-sale at fair value	675	572
Mortgage loans	464	17
Policy loans	298	297
Other invested assets	4	142
Gross investment income	15,366	14,294
External investment expense	(62)	(215)
Net investment income	$15,304	$14,079

Net Realized Gains (Losses) on Investments

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

	Three Months Ended March 31,	
	2017	2016
Realized gains on fixed maturity securities	$961	$321
Realized losses on fixed maturity securities	(455)	(2,309)
Realized gains on equity securities	—	88
Realized losses on equity securities	—	(352)
Net realized gains (losses) on derivative instruments	275	(2,623)
Net realized gains (losses)	$781	$(4,875)

5. Fair Value of Financial Instruments

Assets by Hierarchy Level

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

March 31, 2017		Fair Value Measurement Using:		
	Total	Level 1	Level 2	Level 3
Assets				
Fixed maturity securities				
U.S. Government and government agencies	$15,854	$5,134	$10,705	$15
States, municipalities and political subdivisions	380,710	—	374,112	6,598
Foreign government	5,871	—	5,871	—
Residential mortgage-backed securities	132,257	—	78,520	53,737
Commercial mortgage-backed securities	40,895	—	4,922	35,973
Asset-backed securities	96,507	—	9,347	87,160

Corporate and other	630,455	2,131	601,604	26,720
Total fixed maturity securities	1,302,549	7,265	1,085,081	210,203
Equity securities				
Common stocks	14,214	10,683	—	3,531
Perpetual preferred stocks	37,683	9,676	28,007	—
Total equity securities	51,897	20,359	28,007	3,531
Derivatives	3,694	—	—	3,694
Total assets accounted for at fair value	$1,358,140	$27,624	$1,113,088	$217,428
Liabilities				
Warrant liability	$4,223	$—	$—	$4,223
Contingent liability	11,642	—	—	11,642
Other	675	—	—	675
Total liabilities accounted for at fair value	$16,540	$—	$—	$16,540

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December 31, 2016		Fair Value Measurement Using:		
	Total	Level 1	Level 2	Level 3
Assets				
Fixed maturity securities				
U.S. Government and government agencies	$15,950	$5,140	$10,778	$32
States, municipalities and political subdivisions	375,077	—	369,387	5,690
Foreign government	5,978	—	5,978	—
Residential mortgage-backed securities	138,196	—	82,242	55,954
Commercial mortgage-backed securities	49,053	—	6,035	43,018
Asset-backed securities	77,665	—	4,448	73,217
Corporate and other	617,039	2,020	594,653	20,366
Total fixed maturity securities	1,278,958	7,160	1,073,521	198,277
Equity securities				
Common stocks	14,865	10,290	—	4,575
Perpetual preferred stocks	36,654	9,312	27,342	—
Total equity securities	51,519	19,602	27,342	4,575
Derivatives	3,813	—	—	3,813
Total assets accounted for at fair value	$1,334,290	$26,762	$1,100,863	$206,665
Liabilities				
Warrant liability	$4,058	$—	$—	$4,058
Contingent liability	11,411	—	—	11,411
Other	816			