

HC2 Holdings, Inc.  
Form 10-Q  
May 11, 2015

**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, 2015**

**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** **(I.R.S. Employer**  
**incorporation or organization)** **Identification No.)**

**505 Huntmar Park Drive, Suite 325,**  
**Herndon, VA** **20170**  
**(Address of principal executive offices) (Zip Code)**

**(703) 456-4100**  
**(Registrant's telephone number, including area code)**

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):

Large accelerated filer  Accelerated filer

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

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

| <b>Class</b>                    | <b>Outstanding as of April 30, 2015</b> |
|---------------------------------|---|
| Common Stock, \$0.001 par value | 25,487,023                              |

**HC2 HOLDINGS, INC.**

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

|  | Three Months Ended<br>March 31, |            |
|--|---------------------------------|------------|
|  | 2015                            | 2014       |
| Services revenue   | \$73,718                        | \$43,354   |
| Sales revenue  | 128,090                         | —          |
| Net revenue  | 201,808                         | 43,354     |
| Operating expenses:  |                                 |            |
| Cost of revenue - services   | 61,920                          | 41,107     |
| Cost of revenue - sales  | 110,536                         | —          |
| Selling, general and administrative  | 23,053                          | 6,204      |
| Depreciation and amortization  | 5,006                           | 210        |
| (Gain) loss on sale or disposal of assets  | 473                             | (80 )      |
| Total operating expenses   | 200,988                         | 47,441     |
| Income/(loss) from operations  | 820                             | (4,087 )   |
| Interest expense   | (8,608 )                        | (1 )       |
| Amortization of debt discount  | (92 )                           | —          |
| Interest income and other expense, net   | 193                             | (49 )      |
| Foreign currency transaction loss  | (771 )                          | (34 )      |
| Loss from continuing operations before income taxes and loss from equity investees | (8,458 )                        | (4,171 )   |
| Loss from equity investees   | (2,688 )                        | —          |
| Income tax benefit (expense)   | 5,833                           | (9 )       |
| Loss from continuing operations  | (5,313 )                        | (4,180 )   |
| Gain/(loss) from discontinued operations   | (9 )                            | 17         |
| Loss from sale of discontinued operations  | —                               | (784 )     |
| Net loss   | (5,322 )                        | (4,947 )   |
| Less: Net loss attributable to noncontrolling interest                             | 261                             | —          |
| Net loss attributable to HC2 Holdings, Inc.  | (5,061 )                        | (4,947 )   |
| Less: Preferred stock dividends and accretion                                      | 1,088                           | —          |
| Net loss attributable to common stock and participating preferred stockholders     | \$(6,149 )                      | \$(4,947 ) |
| Basic loss per common share:   |                                 |            |
| Loss from continuing operations attributable to HC2 Holdings, Inc.                 | \$(0.25 )                       | \$(0.29 )  |
| Loss from discontinued operations  | —                               | —          |
| Loss from sale of discontinued operations  | —                               | (0.05 )    |
| Net income (loss) attributable to HC2 Holdings, Inc.                               | \$(0.25 )                       | \$(0.34 )  |
| Diluted loss per common share:   |                                 |            |
| Loss from continuing operations attributable to HC2 Holdings, Inc.                 | \$(0.25 )                       | \$(0.29 )  |
| Loss from discontinued operations  | —                               | —          |
| Loss from sale of discontinued operations  | —                               | (0.05 )    |

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|  |  |        |            |            |
|--|--|--------|------------|------------|
| Net loss attributable to HC2 Holdings, Inc.                        |  |        | \$(0.25 )  | \$(0.34 )  |
| Weighted average common shares outstanding:                        |  |        |            |            |
| Basic  |  | 24,146 |            | 14,631     |
| Diluted  |  | 24,146 |            | 14,631     |
| Amounts attributable to common shareholders of HC2 Holdings, Inc.  |  |        |            |            |
| Loss from continuing operations attributable to HC2 Holdings, Inc. |  |        | \$(6,140 ) | \$(4,180 ) |
| Gain/(loss) from discontinued operations                           |  |        | (9 )       | 17         |
| Loss from sale of discontinued operations                          |  |        | —          | (784 )     |
| Net loss attributable to HC2 Holdings, Inc.                        |  |        | \$(6,149 ) | \$(4,947 ) |

See notes to condensed consolidated financial statements.

**HC2 HOLDINGS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

**(in thousands)**

**(UNAUDITED)**

|   | Three Months<br>Ended March 31, |           |
|---|---------------------------------|-----------|
|   | 2015                            | 2014      |
| Net income (loss)   | \$(5,322 )                      | \$(4,947) |
| Other comprehensive income (loss)   |                                 |           |
| Foreign currency translation adjustment                                       | (4,361 )                        | (374 )    |
| Unrealized gain on available-for-sale securities, net of tax                  | (762 )                          | —         |
| Less: Comprehensive (income) loss attributable to the noncontrolling interest | 261                             | —         |
| Comprehensive income (loss) attributable to HC2 Holdings, Inc.                | \$(10,184)                      | \$(5,321) |

See notes to condensed consolidated financial statements.

**HC2 HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(in thousands, except share and per share amounts)****(UNAUDITED)**

|  | March 31,<br>2015 | December<br>31,<br>2014 |
|--|-------------------|-------------------------|
| Assets   |                   |                         |
| Current assets:  |                   |                         |
| Cash and cash equivalents  | \$128,872         | \$107,978               |
| Short-term investments   | 11,768            | 4,867                   |
| Accounts receivable (net of allowance for doubtful accounts receivable of \$2,675 and \$2,760 at March 31, 2015 and December 31, 2014, respectively) | 195,878           | 151,558                 |
| Costs and recognized earnings in excess of billings on uncompleted contracts   | 24,656            | 28,098                  |
| Deferred tax asset - current   | 1,701             | 1,701                   |
| Inventories  | 17,062            | 14,975                  |
| Prepaid expenses and other current assets  | 29,337            | 22,455                  |
| Assets held for sale   | 11,485            | 3,865                   |
| Total current assets   | 420,759           | 335,497                 |
| Restricted cash  | 7,063             | 6,467                   |
| Long-term investments  | 58,827            | 48,674                  |
| Property, plant and equipment, net   | 224,815           | 239,851                 |
| Goodwill   | 27,990            | 27,990                  |
| Other intangible assets, net   | 30,067            | 31,144                  |
| Deferred tax asset - long-term   | 15,198            | 15,811                  |
| Other assets   | 18,334            | 18,614                  |
| Total assets   | \$803,053         | \$724,048               |
| Liabilities, temporary equity and stockholders' equity   |                   |                         |
| Current liabilities:   |                   |                         |
| Accounts payable   | \$61,888          | \$79,794                |
| Accrued interconnection costs  | 19,507            | 9,717                   |
| Accrued payroll and employee benefits  | 22,883            | 20,023                  |
| Accrued expenses and other current liabilities   | 40,183            | 34,042                  |
| Billings in excess of costs and recognized earnings on uncompleted contracts   | 31,848            | 41,959                  |
| Accrued income taxes   | —                 | 512                     |
| Accrued interest   | 12,043            | 3,125                   |
| Current portion of long-term debt  | 38,811            | 10,444                  |
| Current portion of pension liability   | 5,697             | 5,966                   |
| Total current liabilities  | 232,860           | 205,582                 |
| Long-term debt   | 376,549           | 332,927                 |
| Pension liability  | 28,384            | 31,244                  |
| Other liabilities  | 8,002             | 1,617                   |



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|   |           |           |
|---|-----------|-----------|
| Total liabilities   | 645,795   | 571,370   |
| Commitments and contingencies (See Note 10)   |           |           |
| Temporary equity (See Note 12)  |           |           |
| Preferred stock, \$0.001 par value – 20,000,000 shares authorized; Series A - 30,000 shares issued and outstanding at March 31, 2015 and December 31, 2014; Series A-1 - 10,500 and 11,000 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively; Series A-2 - 14,000 and 0 shares issued and outstanding at March 31, 2015 and December 31, 2014, respectively | 53,444    | 39,845    |
| Stockholders' equity:   |           |           |
| Common stock, \$0.001 par value – 80,000,000 shares authorized; 25,400,886 and 23,844,711 shares issued and 25,369,260 and 23,813,085 shares outstanding at March 31, 2015 and December 31, 2014, respectively  | 25        | 24        |
| Additional paid-in capital  | 148,762   | 147,081   |
| Accumulated deficit   | (46,941 ) | (41,880 ) |
| Treasury stock, at cost – 31,626 shares at March 31, 2015 and December 31, 2014, respectively   | (378 )    | (378 )    |
| Accumulated other comprehensive loss  | (20,301 ) | (15,178 ) |
| Total HC2 Holdings, Inc. stockholders' equity before noncontrolling interest  | 81,167    | 89,669    |
| Noncontrolling interest   | 22,647    | 23,164    |
| Total stockholders' equity  | 103,814   | 112,833   |
| Total liabilities, temporary equity and stockholders' equity  | \$803,053 | \$724,048 |

See notes to condensed consolidated financial statements.

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

|   | <b>Total</b> | <b>Common<br/>Shares</b> | <b>Stock<br/>Amount</b> | <b>Additional<br/>Paid-In<br/>Capital</b> | <b>Treasury<br/>Stock</b> | <b>Accumulated<br/>Deficit</b> | <b>Accumulated<br/>Other<br/>Comprehensive<br/>Income (Loss)</b> | <b>Non-<br/>controlling<br/>Interest</b> |
|---|--------------|--------------------------|-------------------------|---|---------------------------|--------------------------------|--|--|
| Balance as of<br>December 31,<br>2014   | \$112,833    | 23,813                   | \$24                    | \$147,081                                 | \$(378)                   | \$(41,880)                     | \$(15,178)   | \$23,160                                 |
| Share-based<br>compensation<br>expense  | 2,235        | —                        | —                       | 2,235                                     | —                         | —                              | —  | —  |
| Preferred stock<br>dividend and<br>accretion  | (1,088)      | —                        | —                       | (1,088)                                   | —                         | —                              | —  | —  |
| Issuance of<br>common stock   | —            | 2                        | —                       | —   | —                         | —                              | —  | —  |
| Issuance of<br>restricted stock   | 1            | 1,436                    | 1                       | —   | —                         | —                              | —  | —  |
| Conversion of<br>preferred stock to<br>common stock                                   | 500          | 118                      | —                       | 500                                       | —                         | —                              | —  | —  |
| Acquisition of<br>noncontrolling<br>interest  | (222)        | —                        | —                       | —   | —                         | —                              | —  | (222)                                    |
| Excess book<br>value over fair<br>value of<br>purchased<br>noncontrolling<br>interest | —            | —                        | —                       | 34  | —                         | —                              | —  | (34)                                     |
| Net loss  | (5,322)      | —                        | —                       | —   | —                         | (5,061)                        | —  | (261)                                    |
| Foreign currency<br>translation<br>adjustment   | (4,361)      | —                        | —                       | —   | —                         | —                              | (4,361)  | —  |
| Unrealized gain<br>on<br>available-for-sale<br>securities, net of<br>tax              | (762)        | —                        | —                       | —   | —                         | —                              | (762)  | —  |

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|                                 |           |        |      |           |        |             |             |           |
|---------------------------------|-----------|--------|------|-----------|--------|-------------|-------------|-----------|
| Balance as of<br>March 31, 2015 | \$103,814 | 25,369 | \$25 | \$148,762 | \$(378 | ) \$(46,941 | ) \$(20,301 | ) \$22,64 |
|---------------------------------|-----------|--------|------|-----------|--------|-------------|-------------|-----------|

See notes to condensed consolidated financial statements.

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

|   | Three Months Ended<br>March 31, |            |
|---|---------------------------------|------------|
|   | 2015                            | 2014       |
| Cash flows from operating activities:   |                                 |            |
| Net income (loss)   | \$(5,322 )                      | \$(4,947 ) |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:  |                                 |            |
| Provision for doubtful accounts receivable  | 95                              | 107        |
| Share-based compensation expense  | 2,235                           | 238        |
| Depreciation and amortization   | 6,881                           | 210        |
| Amortization of deferred financing costs  | 329                             | —          |
| (Gain) loss on sale or disposal of assets   | 473                             | 704        |
| (Gain) loss on sale of investments  | (164 )                          | —          |
| Equity investment (income)/loss   | 2,688                           | —          |
| Amortization of debt discount   | 92                              | —          |
| Deferred income taxes   | (387 )                          | 1          |
| Unrealized foreign currency transaction (gain) loss on intercompany and foreign debt                | 172                             | (34 )      |
| Changes in assets and liabilities, net of acquisitions:   |                                 |            |
| (Increase) decrease in accounts receivable  | (45,764 )                       | 2,767      |
| (Increase) decrease in costs and recognized earnings in excess of billings on uncompleted contracts | 3,468                           | —          |
| (Increase) decrease in inventories  | (2,355 )                        | —          |
| (Increase) decrease in prepaid expenses and other current assets                                    | (1,492 )                        | 6,662      |
| (Increase) decrease in other assets   | (2,122 )                        | 798        |
| Increase (decrease) in accounts payable   | (18,908 )                       | (1,795 )   |
| Increase (decrease) in accrued interconnection costs  | 10,111                          | (1,181 )   |
| Increase (decrease) in accrued payroll and employee benefits  | 3,723                           | (846 )     |
| Increase (decrease) in accrued expenses and other current liabilities                               | 5,995                           | 279        |
| Increase (decrease) in billings in excess of costs and recognized earnings on uncompleted contracts | (10,116 )                       | —          |
| Increase (decrease) in accrued income taxes   | (6,238 )                        | (4 )       |
| Increase (decrease) in accrued interest   | 8,918                           | —          |
| Increase (decrease) in other liabilities  | (146 )                          | (856 )     |
| Increase (decrease) in pension liability  | (1,125 )                        | —          |
| Net cash provided by (used in) operating activities   | (48,959 )                       | 2,103      |
| Cash flows from investing activities:   |                                 |            |
| Purchase of property, plant and equipment   | (3,124 )                        | (89 )      |
| Sale of property and equipment and other assets   | 998                             | 80         |

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|   |            |           |
|---|------------|-----------|
| Purchase of equity investments  | (8,644 )   | —         |
| Sale of equity investments  | 1,026      | —         |
| Purchase of available-for-sale securities                               | (6,664 )   | —         |
| Investment in debt securities   | (3,250 )   | —         |
| Purchase of noncontrolling interest                                     | (222 )     | —         |
| (Increase) decrease in restricted cash                                  | (893 )     | —         |
| Net cash used in investing activities                                   | (20,773 )  | (9 )      |
| Cash flows from financing activities:                                   |            |           |
| Proceeds from long-term obligations                                     | 181,303    | —         |
| Principal payments on long-term obligations                             | (103,690)  | —         |
| Payment of deferred financing costs                                     | (1,136 )   | —         |
| Proceeds from sale of preferred stock, net                              | 14,032     | —         |
| Proceeds from the exercise of warrants and stock options                | —          | 2,891     |
| Payment of dividend equivalents   | —          | (550 )    |
| Net cash provided by (used) in financing activities                     | 90,509     | 2,341     |
| Effects of exchange rate changes on cash and cash equivalents           | 117        | (391 )    |
| Net change in cash and cash equivalents                                 | 20,894     | 4,044     |
| Cash and cash equivalents, beginning of period                          | 107,978    | 8,997     |
| Cash and cash equivalents, end of period                                | \$ 128,872 | \$ 13,041 |
| Supplemental cash flow information:                                     |            |           |
| Cash paid for interest  | \$ 1,287   | \$ 969    |
| Cash paid for taxes   | \$ 112     | \$ 22     |
| Preferred stock dividends and accretion                                 | \$ 1,088   | \$ —      |
| 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              | \$ 1,632   | \$ —      |
| Conversion of preferred stock to common stock                           | \$ 500     | \$ —      |

See notes to condensed consolidated financial statements.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. ORGANIZATION AND BUSINESS**

On May 29, 2014, HC2 Holdings, Inc. (“HC2” and, together with its subsidiaries, the “Company”, “we” and “our”) completed the acquisition of 2.5 million shares of common stock of Schuff International, Inc. (“Schuff”), a steel fabrication and erection company, and negotiated an agreement to purchase an additional 198,411 shares, representing an approximately 65% interest in Schuff. The aggregate consideration for the shares of Schuff acquired was approximately \$85 million, which was funded using the net proceeds from (i) the issuance of \$30 million of Series A Convertible Participating Preferred Stock of HC2 (the “Series A Preferred Stock”) and \$6 million of common stock of HC2, and (ii) the entry into a senior secured credit facility providing for an eighteen month, floating interest rate term loan of \$80 million (the “May Credit Facility”), each of which was also completed on May 29, 2014. Schuff repurchased a portion of its outstanding common stock in June 2014, which had the effect of increasing the Company’s ownership interest to 70%. During the fourth quarter of 2014, the final results of a tender offer for all outstanding shares of Schuff were announced and various open-market purchases were made, which resulted in the acquisition of 809,043 shares and an increase in our ownership interest to 91%. We intend to execute a short-form merger, which will increase our ownership of Schuff shares to 100%.

Schuff and its wholly-owned subsidiaries primarily operate as integrated fabricators and erectors of structural steel and heavy steel plates with headquarters in Phoenix, Arizona and operations in Arizona, Georgia, Texas, Kansas and California. Schuff’s construction projects are primarily in the aforementioned states. In addition, Schuff has construction projects in select international markets, primarily Panama. Schuff has a 49% interest in Schuff Hopsa Engineering, Inc. (“SHE”), a Panamanian joint venture with Empresas Hopsa, S.A., that provides steel fabrication services. Schuff controls the operations of SHE, as provided in the operating agreement. Therefore, the assets, liabilities, revenues and expenses of SHE are included in the condensed consolidated financial statements of Schuff. Empresas Hopsa, S.A.’s 51% interest in SHE is presented as a noncontrolling interest component of total stockholders’ equity.

On August 1, 2014, the Company paid \$15.5 million to acquire 15,500 shares of Series A Convertible Preferred Stock of American Natural Gas (“ANG”), representing an approximately 51% interest in ANG. ANG is a premier distributor of natural gas motor fuel headquartered in the Northeast that designs, builds, owns, acquires, operates and maintains compressed natural gas fueling stations for transportation.

On September 22, 2014, the Company completed the acquisition of Bridgehouse Marine Limited (“Bridgehouse”), the parent holding company of Global Marine Systems Limited (“GMSL”). The purchase price reflects an enterprise value of approximately \$260 million, including assumed indebtedness, and was funded using a portion of the net proceeds from (i) the issuance of \$11 million of Series A-1 Convertible Participating Preferred Stock of HC2 (the “Series A-1 Preferred Stock”) and (ii) a senior secured credit facility providing for a twelve month, floating interest rate term loan of \$214 million and a delayed draw term loan of \$36 million (the “September Credit Facility”), each of which was also completed on September 22, 2014. With a portion of the proceeds from the September Credit Facility, the Company paid off its May Credit Facility and its senior unsecured credit facility consisting of a term loan of \$17 million entered into on September 8, 2014 (the “Novatel Acquisition Term Loan”) for the purpose of acquiring an ownership interest in Novatel Wireless, Inc. The September Credit Facility was subsequently repaid using the proceeds from HC2’s issuance of its Existing Notes discussed below under Note 8—“Long-Term Obligations”. GMSL is a leading provider of engineering and underwater services on submarine cables. In conjunction with the acquisition, approximately 3% of the Company’s interest in GMSL was purchased by a group of individuals, leaving the Company’s controlling interest as of March 31, 2015 at approximately 97%.

In our Telecommunications segment, we operate a telecommunications business including a network of direct routes and provide 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 (“ISPs”) from our International Carrier Services (“ICS”) business unit.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

In our Life Sciences segment, we operate Pansend, LLC (“Pansend”), which has an 80% interest in Genovel Orthopedics, Inc., which seeks to develop products to treat early osteoarthritis of the knee, and a 61% interest in R2 Dermatology (f/k/a “GemDerm Aesthetics, Inc.”), which develops skin lightening technology.

Additionally, in 2014 we acquired a 100% ownership interest in DMi, Inc. (“DMi”), which owns licenses to create and distribute NASCAR® video games.

The Company currently has six reportable operating segments based on management’s organization of the enterprise—Manufacturing (Schuff), Marine Services (GMSL), Utilities (ANG), Telecommunications (ICS), Life Sciences and Other, which includes operations that do not meet the separately reportable segment thresholds.

HC2 was formed as a corporation under the laws of Delaware in 1994 and operates as a holding company of operating subsidiaries primarily in the United States and the United Kingdom.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*—The accompanying unaudited condensed consolidated financial statements of HC2 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 three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. 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 March 31, 2015, the Company has a 97% interest in GMSL, a 91% interest in Schuff, a 51% interest in ANG and a 100% interest in DMi. Through its subsidiary, Pansend, the Company has an 80% interest in Genovel Orthopedics, Inc. and a 61% interest in R2 Dermatology (f/k/a “GemDerm Aesthetics, Inc.”). 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”) No. 810, “Consolidation” (“ASC 810”). The remaining interests not owned by the Company are presented as a noncontrolling interest component of total equity. Schuff uses a 4-4-5 week quarterly cycle, which for the first quarter of 2015 ended on March 29, 2015.

*Foreign Currency Transactions*—Foreign currency transactions are transactions denominated in a currency other than a subsidiary’s functional currency. A change in the exchange rates between a subsidiary’s functional currency and the currency in which a transaction is denominated increases or decreases the expected amount of functional currency cash flows upon settlement of the transaction. That increase or decrease in expected functional currency cash flows is reported by the Company as a foreign currency transaction gain (loss).

*Foreign Currency Translation*—The assets and liabilities of the Company’s foreign subsidiaries are translated at the exchange rates in effect on the reporting date. Income and expenses are translated at the average exchange rate during the period. The net effect of such translation gains and losses are reflected within accumulated other comprehensive income (loss) in the stockholders’ equity section of the condensed consolidated balance sheets.

#### *Inventories*

Schuff—Inventories, primarily steel components, are stated at the lower of cost or market under the first-in, first-out method.

GMSL—Inventory is valued at the lower of cost or market value under the first-in first-out method. Provision for obsolescence is made where appropriate and is charged to cost of revenue in the condensed consolidated statements of operations. Short-term work in progress on contracts is stated at cost less foreseeable losses. These costs include only direct labor and expenses incurred to date and exclude any allocation of overhead. The policy for long-term work in progress contracts is disclosed within the *Revenue and Cost Recognition* accounting policy for GMSL.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*Short-term Investments*—The current investments are classified as available-for-sale securities and the change in value is recognized within accumulated other comprehensive income (loss).

*Long-term Investments* —Investments in non-wholly-owned companies are generally consolidated if the Company’s interest exceeds 50% or if the Company has the power to direct the economic activities of the entity and the obligation to absorb losses, or accounted for under the equity method of accounting when the Company exercises significant influence over the venture.

Under the equity method of accounting, the Company records its proportionate interest in the underlying income or loss of the equity method investee. Additional investments made or distributions received are recorded as increases and decreases, respectively, to the carrying value of the equity method investment. Equity method investments are evaluated for potential impairment as circumstances warrant and an impairment charge is recorded when an impairment is deemed to be other-than-temporary.

When the Company’s investment in an equity method investee is greater than its proportionate share of the underlying net assets of that investee, a basis difference is created under ASC No. 323, “Investments—Equity Method and Joint Ventures” (“ASC 323”). When this situation occurs, the Company is required to determine the acquisition date fair value of the identifiable assets and assumed liabilities in the same manner as for a business combination under ASC No. 805, “Business Combinations” (“ASC 805”). If the basis difference is assigned to amortizable assets, it is amortized (net of tax) against the Company’s investment in the equity method investee.

*Property, Plant and Equipment*—Property, plant and equipment are stated at cost less accumulated depreciation, which is provided on the straight-line method over the estimated useful lives of the assets. Cost includes major expenditures for improvements and replacements which extend useful lives or increase capacity of the assets as well as expenditures necessary to place assets into readiness for use. Cost includes the original purchase price of the asset and the costs attributable to bringing the asset to its working condition for its intended use. Cost includes finance costs incurred prior to the asset being available for use. Expenditures for maintenance and repairs are expensed as incurred. Depreciation is determined on a straight-line basis over the estimated useful lives of the assets, which range from 15 to 40 years for buildings and improvements, up to 35 years for cable-ships and submersibles, 3 to 15 years for machinery and equipment, and 3 to 20 years for plant and motor vehicles. Plant includes equipment on the cable-ships

that is portable and can be moved around the fleet and computer equipment. Leasehold improvements are amortized over the lives of the leases or estimated useful lives of the assets, whichever is shorter. Assets under construction are not depreciated until they are complete and available for use. Costs for internal use software that are incurred in the preliminary project stage and in the post-implementation stage are expensed as incurred. Costs incurred during the application development stage are capitalized and amortized over the estimated useful life of the software. When assets are sold or otherwise retired, the costs and accumulated depreciation are removed from the books and the resulting gain or loss is included in operating results. Property, plant and equipment that have been included as part of the assets held for sale are no longer depreciated from the time that they are classified as such. The Company periodically evaluates the carrying value of its property, plant and equipment based upon the estimated cash flows to be generated by the related assets. If impairment is indicated, a loss is recognized.

*Use of Estimates*—The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of net revenue and expenses during the reporting period. Actual results may differ from these estimates. Significant estimates include allowance for doubtful accounts receivable, the extent of progress towards completion on contracts, contract revenue and costs on long-term contracts, market assumptions used in estimating the fair values of certain assets and liabilities, the calculation used in determining the fair value of HC2's stock options required by ASC No. 718, "Compensation—Stock Compensation" ("ASC 718"), income taxes and various other contingencies.

Estimates of fair value represent the Company's best estimates developed with the assistance of independent appraisals or various valuation techniques and, where the foregoing have not yet been completed or are not available, industry data and trends and by reference to relevant market rates and transactions. The 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.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*Revenue and Cost Recognition*

*GMSL*—GMSL generates revenue by providing maintenance services for subsea telecommunications cabling. GMSL also generates revenue from the design and installation of subsea cables under contracts. GMSL also provides installation, maintenance and repair of fiber optic communication and power infrastructure to offshore oil and gas platforms and installs inter-array power cables for use in offshore wind farms and in the offshore wind market.

*Telecommunication/Maintenance*—GMSL provides vessels on standby to repair fiber optic telecommunications cables in defined geographic zones, and its maintenance business is provided through contracts with consortia of up to 60 global telecommunications providers. Typically, GMSL enters into five to seven year contracts to provide maintenance to cable systems that are located in specific geographical areas. Revenue from these maintenance agreements is recognized on a straight line basis unless the pattern of costs associated with repairs indicates otherwise.

*Telecommunications/Installation*—GMSL provides installation of cable systems including route planning, mapping, route engineering, cable laying, and trenching and burial. GMSL's installation business is project-based with fixed price contracts typically lasting one to five months. Revenue is recognized as time and costs are incurred.

*Charter hire*—rentals from short term operating leases in respect of vessels are recognized as revenue on a straight line basis over the term of the lease.

*Oil & Gas*—GMSL provides installation, maintenance and repair of fiber optic communication and power infrastructure to offshore platforms. Its primary activities include providing power from shore, enabling fiber-based communication between platforms and shore-based systems and installing permanent reservoir monitoring systems which allow customers to monitor subsea seismic data. The majority of GMSL's oil & gas business is contracted on a project-by-project basis with major energy producers or tier I engineering, procurement and construction (EPC) contractors. Revenue is recognized as time and costs are incurred.

A loss is recognized immediately if the expected costs during any contract exceed expected revenues. Amounts billed in advance of revenue recognition are recorded as deferred revenue.

*Schuff*—Schuff performs its services primarily under fixed-price contracts and recognizes revenues and costs from construction projects using the percentage of completion method. Under this method, revenue is recognized based upon either the ratio of the costs incurred to date to the total estimated costs to complete the project or the ratio of tons fabricated to date to total estimated tons. Revenue recognition begins when work has commenced. Costs include all direct material and labor costs related to contract performance, subcontractor costs, indirect labor, and fabrication plant overhead costs, which are charged to contract costs as incurred. Revenues relating to changes in the scope of a contract are recognized when the work has commenced, Schuff has made an estimate of the amount that is probable of being paid for the change and there is a high degree of probability that the charges will be approved by the customer or general contractor. At March 31, 2015, Schuff had \$66.9 million of unapproved change orders on open projects, for which it has recognized revenues on a percentage of completion basis. While Schuff has been successful in having the majority of its change orders approved in prior years, there is no guarantee that the unapproved change orders at March 31, 2015 will be approved. Revisions in estimates during the course of contract work are reflected in the accounting period in which the facts requiring the revision become known. Provisions for estimated losses on uncompleted contracts are made in the period a loss on a contract becomes determinable.

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

Costs and recognized earnings in excess of billings on uncompleted contracts primarily represent revenue earned under the percentage of completion method which has not been billed. Billings in excess of related costs and recognized earnings on uncompleted contracts represent amounts billed on contracts in excess of the revenue allowed to be recognized under the percentage of completion method on those contracts.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*ICS*—Net revenue is derived from carrying a mix of business, residential and carrier long-distance traffic, data and Internet traffic. For certain voice services, net revenue is earned based on the number of minutes during a call, and is recorded upon completion of a call. Revenue for a period is calculated from information received through the Company’s network switches. Customized software has been designed to track the information from the switch and analyze the call detail records against stored detailed information about revenue rates. This software provides the Company the ability to do a timely and accurate analysis of revenue earned in a period. Separate prepaid services software is used to track additional information related to prepaid service usage such as activation date, monthly usage amounts and expiration date. Revenue on these prepaid services is recognized as service is provided until expiration, when all unused minutes, which are no longer available to the customers, are recognized as revenue. Net revenue is also earned on a fixed monthly fee basis for unlimited local and long-distance voice plans and for the provision of data/Internet services (including retail VoIP), hosting, and colocation. In the United States, we charge customers Federal Universal Service Fund (“USF”) fees. We recognize revenue on a gross basis for USF and related fees. We record these fees as revenue when billed. Net revenue represents gross revenue, net of allowance for doubtful accounts receivable, service credits and service adjustments. Cost of revenue includes network costs that consist of access, transport and termination costs. The majority of the Company’s cost of revenue is variable, primarily based upon minutes of use, with transmission and termination costs being the most significant expense. Cost of revenue also includes fees such as Federal USF fees. Such costs are recognized when incurred in connection with the provision of telecommunications services.

*Share-Based Compensation*—The Company accounts for share-based compensation under ASC No. 718, “Compensation—Stock Compensation” (“ASC 718”), which addresses the accounting for share-based payment transactions whereby an entity receives employee services in exchange for equity instruments, including stock options and restricted stock units. ASC 718 generally requires that share-based compensation be accounted for using a fair-value based method. The Company records share-based compensation expense for all new and unvested stock options that are ultimately expected to vest as the requisite service is rendered. The Company issues new shares of common stock upon the exercise of stock options.

The Company elected to adopt the alternative transition method for calculating the tax effects of share-based compensation. The alternative transition method includes simplified methods to determine the beginning balance of the additional paid in capital (“APIC”) pool related to the tax effects of share-based compensation and to determine the subsequent impact on the APIC pool and the statement of cash flows of the tax effects of share-based awards that were fully vested and outstanding upon the adoption of ASC 718.

The Company uses a Black-Scholes option valuation model to determine the fair value of share-based compensation under ASC 718. The Black-Scholes model incorporates various assumptions including the expected term of awards, volatility of stock price, risk-free rates of return and dividend yield. The expected term of an award is no less than the option vesting period and is based on the Company's historical experience. Expected volatility is based upon the historical volatility of the Company's stock price. The risk-free interest rate is approximated using rates available on U.S. Treasury securities with a remaining term similar to the option's expected life. The Company uses a dividend yield of zero in the Black-Scholes option valuation model as it does not anticipate paying cash dividends in the foreseeable future that do not contain antidilution provisions requiring the adjustment of exercise prices and option shares. Share-based compensation is recorded net of expected forfeitures.

*Income (Loss) Per Common Share*—Basic income (loss) per common share is computed using the weighted average number of shares of common stock outstanding during the period. Diluted income (loss) per common share is computed using the weighted average number of shares of common stock, adjusted for the dilutive effect of potential common stock and related income from continuing operations, net of tax. Potential common stock, computed using the treasury stock method or the if-converted method, includes options, restricted stock, restricted stock units and convertible preferred stock.

In periods when the Company generates income, the Company calculates basic earnings per share using the two-class method, pursuant to ASC No. 260, "Earnings Per Share." The two-class method is required as the shares of the Company's Preferred Stock qualify as participating securities, having the right to receive dividends should dividends be declared on common stock. Under this method, earnings for the period are allocated on a pro-rata basis to the common stockholders and to the holders of preferred stock based on the weighted average number of common shares outstanding and the number of shares that could be converted. The Company does not use the two-class method in periods when it generates a loss as the holders of the Preferred Stock do not participate in losses.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*Reclassification*—Certain previous year amounts have been reclassified to conform with current year presentations, as related to the reporting of new balance sheet line items.

*Newly Adopted Accounting Principles*

In April 2014, an update was issued to the Presentation of Financial Statements Topic No. 205 and Property, Plant and Equipment Topic No. 360, ASU 2014-08, “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity”, which changes the criteria for reporting discontinued operations. The ASU revises the definition of a discontinued operation and expands the disclosure requirements. Entities should not apply the amendments to a component of an entity that is classified as held for sale before the effective date even if it is disposed of after the effective date. That is, the ASU must be adopted prospectively. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been previously reported in the financial statements. On January 1, 2015, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

*New Accounting Pronouncements*

In February 2015, the FASB issued ASU 2015-02, “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. Early adoption is permitted. The Company’s effective date for adoption is January 1, 2016. The Company does not expect this accounting update to have a material effect on its consolidated financial statements in future periods, although that could change.

In January 2015, the FASB issued ASU 2015-01, “Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items”, which eliminates the concept 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. Early



adoption is permitted. The Company's effective date for adoption is January 1, 2016. The Company does not expect this accounting update to have a material effect on its consolidated financial statements in future periods, although that could change.

### 3. ACCOUNTS RECEIVABLE AND CONTRACTS IN PROGRESS

Accounts receivable consist of the following (in thousands):

|                                 | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|---------------------------------|-------------------------------|----------------------------------|
| Contract receivables:           |                               |                                  |
| Contracts in progress           | \$134,457                     | \$105,071                        |
| Unbilled retentions             | 35,213                        | 32,850                           |
| Trade receivables               | 28,667                        | 16,202                           |
| Other receivables               | 216                           | 195                              |
| Allowance for doubtful accounts | (2,675 )                      | (2,760 )                         |
|                                 | <b>\$195,878</b>              | <b>\$151,558</b>                 |

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:

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

|   | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|---|-------------------------------|----------------------------------|
| Costs incurred on contracts in progress | \$576,733                     | \$531,129                        |
| Estimated earnings                      | 79,192                        | 73,540                           |
|   | 655,925                       | 604,669                          |
| Less progress billings                  | 663,117                       | 618,530                          |
|   | \$(7,192 )                    | \$(13,861 )                      |

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 | 24,656     | 28,098      |
| Billings in excess of costs and recognized earnings on uncompleted contracts | (31,848 )  | (41,959 )   |
|  | \$(7,192 ) | \$(13,861 ) |

**4. INVENTORIES**

Inventories consist of the following (in thousands):

|                 | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|-----------------|-------------------------------|----------------------------------|
| Raw materials   | \$ 14,908                     | \$ 12,956                        |
| Work in process | 1,918                         | 1,779                            |
| Finished goods  | 236                           | 240                              |
|                 | \$17,062                      | \$ 14,975                        |

**5. 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 No. 820, "Fair Value Measurements and Disclosures" ("ASC 820"), represent the Company's best estimates and valuations developed with the assistance of independent appraisers and, 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, if additional information is obtained about these assets and liabilities 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.

### *Schuff*

On May 29, 2014, the Company completed the acquisition of 2.5 million shares of common stock of Schuff, a steel fabrication and erection company and negotiated an agreement to purchase an additional 198,411 shares, representing an approximately 65% interest in Schuff. Schuff repurchased a portion of its outstanding common stock in June 2014, which had the effect of increasing the Company's ownership interest to 70%. During the fourth quarter, the final results of a tender offer for all outstanding shares of Schuff were announced and various open-market purchases were made, which resulted in the acquisition of 809,043 shares and an increase in our ownership interest to 91%. We intend to execute a short-form merger, which will increase our ownership of Schuff shares to 100%. Schuff and its wholly-owned subsidiaries primarily operate as integrated fabricators and erectors of structural steel and heavy steel plates with headquarters in Phoenix, Arizona and operations in Arizona, Georgia, Texas, Kansas and California. Schuff's construction projects are primarily in the aforementioned states. In addition, Schuff has construction projects in select international markets, primarily Panama. The Company acquired Schuff to diversify its portfolio of holdings and saw Schuff as an opportunity to enter the steel fabrication and erection market.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

The table below summarizes the preliminary estimates of fair value of the Schuff assets acquired and liabilities assumed as of the acquisition date. The Company purchased 2.5 million shares of common stock of Schuff for \$78.75 million. The purchase price of Schuff was valued at \$31.50 per share which represented both the cash paid by the Company for its 60% interest, and the fair value of the noncontrolling interest of 40%.

The preliminary purchase price allocation is as follows (in thousands):

|  |          |
|--|----------|
| Cash and cash equivalents  | \$(627 ) |
| Investments  | 1,714    |
| Accounts receivable  | 130,622  |
| Costs and recognized earnings in excess of billings on uncompleted contracts | 27,126   |
| Prepaid expenses and other current assets                                    | 3,079    |
| Inventories  | 14,487   |
| Assets held for sale   | —        |
| Property and equipment, net  | 85,662   |
| Goodwill   | 24,612   |
| Trade names  | 4,478    |
| Other assets   | 2,947    |
| Total assets acquired  | 294,100  |
| Accounts payable   | 37,621   |
| Accrued payroll and employee benefits  | 11,668   |
| Accrued expenses and other current liabilities                               | 12,532   |
| Billings in excess of costs and recognized earnings on uncompleted contracts | 65,985   |
| Accrued income taxes   | 1,202    |
| Accrued interest   | 76       |
| Current portion of long-term debt  | 15,460   |
| Liabilities held for sale  | —        |
| Long-term debt   | 4,375    |
| Deferred tax liability   | 7,815    |
| Other liabilities  | 604      |
| Noncontrolling interest  | 4,365    |
| Total liabilities assumed  | 161,703  |
| Enterprise value   | 132,397  |

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|   |          |
|---|----------|
| Less fair value of noncontrolling interest          | 53,647   |
| Purchase price attributable to controlling interest | \$78,750 |

The acquisition of Schuff resulted in goodwill of approximately \$24.6 million. Goodwill was 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. Goodwill was recognized as a new stand-alone reporting unit. Goodwill is not amortized and is not deductible for tax purposes.

The acquired amortizable intangible assets and the related estimated useful lives consist of the following (in thousands):

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

|                         | <b>Preliminary<br/>Estimated<br/>Useful<br/>Lives</b> | <b>Preliminary<br/>Estimated<br/>Value<br/>May 29,<br/>2014</b> |
|-------------------------|---|---|
| Trade names             | 15 years  | \$ 4,478  |
| Total intangible assets |   | \$ 4,478  |

ASC 810 requires that transactions that result in an increase in ownership of a subsidiary be accounted for as equity transactions. The carrying amount of the noncontrolling interest is adjusted to reflect the controlling interest's decreased ownership interest in the subsidiary's net assets and any difference between the consideration paid by the parent to a noncontrolling interest holder (or contributed by the parent to the net assets of the subsidiary) and the adjustment to the carrying amount of the noncontrolling interest in the subsidiary is recognized directly in equity attributable to the controlling interest. Due to the increase of the Company's ownership to 91% from the acquisition date through December 31, 2014, the Company recorded an adjustment of Schuff's noncontrolling interest by \$3.4 million and recorded as excess book value over fair value of purchased noncontrolling interest in the Company's condensed consolidated statement of stockholders' equity. In the three months ended March 31, 2015, the Company acquired an additional 6,800 shares of Schuff that resulted in less than \$0.1 million of excess book value over fair value of purchased noncontrolling interest in the Company's condensed consolidated statement of stockholders' equity. The ownership interest of 91% did not change.

**ANG**

On August 1, 2014, the Company paid \$15.5 million to acquire 15,500 shares of Series A Convertible Preferred Stock of ANG (the "ANG Preferred Stock"), representing an approximately 51% interest in ANG. The ANG Preferred Stock is convertible into 1,033,333 shares of common stock and also has voting rights. The noncontrolling interest represents 1,000,000 shares of common stock; thereby giving the Company a controlling interest. ANG is a premier distributor of natural gas motor fuel headquartered in the Northeast that designs, builds, owns, operates and maintains compressed natural gas fueling stations for transportation. The Company acquired ANG for its strong growth potential which is in line with the Company's strategy to find investments that can generate high returns and significant cash flow.

The table below summarizes the preliminary estimate of fair value of the ANG assets acquired and liabilities assumed as of the acquisition date. The purchase price of ANG was valued at \$17.7 million which represented both the cash paid by the Company for its 51% interest (\$15.5 million), and the fair value of the noncontrolling interest of 49%, which was determined by an outside appraisal to be \$2.2 million.

The preliminary purchase price allocation is as follows (in thousands):

|  |          |
|--|----------|
| Cash and cash equivalents  | \$15,704 |
| Accounts receivable  | 306      |
| Prepaid expenses and other current assets                                    | 31       |
| Inventories  | 27       |
| Property and equipment, net  | 1,921    |
| Customer contracts   | 2,700    |
| Trade names  | 6,300    |
| Other assets   | 2        |
| Total assets acquired  | 26,991   |
| Accounts payable   | 49       |
| Accrued payroll and employee benefits  | 5        |
| Accrued expenses and other current liabilities                               | 26       |
| Billings in excess of costs and recognized earnings on uncompleted contracts | 114      |
| Current portion of long-term debt  | 34       |
| Long-term debt   | 870      |
| Deferred tax liability   | 3,530    |
| Total liabilities assumed  | 4,628    |
| Fair value of net assets acquired  | 22,363   |
| Purchase price   | 17,689   |
| Excess of fair value of net assets over purchase price                       | \$4,674  |

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

The acquisition of ANG resulted in an excess of the fair value of the net assets acquired over the purchase price of \$4.7 million. The Company does not believe that the circumstances surrounding the transaction give rise to a bargain purchase. The existing shareholders of ANG continue to manage the day-to-day operations and own the noncontrolling interest. Accordingly, due to the related party nature of the transaction, management has recorded the excess of the fair value of the assets acquired over the purchase price in additional paid-in capital.

The acquired amortizable intangible assets and the related estimated useful lives consist of the following (in thousands):

|                         | <b>Preliminary<br/>Estimated<br/>Useful<br/>Lives</b> | <b>Preliminary<br/>Estimated<br/>Value<br/>August 1,<br/>2014</b> |
|-------------------------|---|---|
| Customer contracts      | 10 years  | \$2,700   |
| Trade names             | 10 years  | 6,300   |
| Total intangible assets |   | \$9,000   |

*GMSL*

On September 22, 2014, the Company completed the acquisition of Bridgehouse and its subsidiary, GMSL. The purchase price reflects an enterprise value of approximately \$260 million, including assumed indebtedness of approximately \$130 million leaving a net enterprise value of approximately \$130 million. GMSL is a leading provider of engineering and underwater services on submarine cables. The Company acquired GMSL for its attractive valuation and strong cash position.

The table below summarizes the preliminary estimates of fair value of the GMSL assets acquired and liabilities assumed as of the acquisition date. The net enterprise value of GMSL was valued at \$130.4 million which represented



both the cash paid by the Company for its 97% interest, and the fair value of the noncontrolling interest of 3%.

The preliminary purchase price allocation is as follows (in thousands):

|   |           |
|---|-----------|
| Cash and cash equivalents                           | \$62,555  |
| Accounts receivable                                 | 26,183    |
| Prepaid expenses and other current assets           | 9,886     |
| Inventories   | 7,395     |
| Restricted cash                                     | 4,682     |
| Property and equipment, net                         | 156,976   |
| Customer contracts                                  | 7,796     |
| Trade name  | 1,137     |
| Developed technology                                | 1,624     |
| Investments   | 24,266    |
| Other assets  | 7,482     |
| Total assets acquired                               | 309,982   |
| Accounts payable                                    | 8,965     |
| Accrued expenses and other current liabilities      | 34,767    |
| Accrued income taxes                                | 1,251     |
| Current portion of long-term debt                   | 8,140     |
| Long-term debt                                      | 78,356    |
| Pension liability                                   | 45,923    |
| Deferred tax liability                              | 1,013     |
| Other liabilities                                   | 1,179     |
| Total liabilities assumed                           | 179,594   |
| Enterprise value                                    | 130,388   |
| Less fair value of noncontrolling interest          | 3,803     |
| Purchase price attributable to controlling interest | \$126,585 |

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

The values for customer contracts, trade name, developed technology and investments are estimates and may change.

The acquired amortizable intangible assets and the related estimated useful lives consist of the following (in thousands):

|                         | <b>Preliminary<br/>Estimated<br/>Useful<br/>Lives</b> | <b>Preliminary<br/>Estimated<br/>Value<br/>September 22,<br/>2014</b> |
|-------------------------|---|---|
| Customer contracts      | 15 years  | \$7,796   |
| Trade name              | 3 years   | 1,137   |
| Developed technology    | 4 years   | 1,624   |
| Total intangible assets |   | \$10,557  |

*Pro Forma Adjusted Summary*

The results of operations for Schuff, ANG, and GMSL have been included in the consolidated financial statements subsequent to their acquisition dates.

The following schedule presents unaudited consolidated pro forma results of operations data as if the acquisitions had occurred on January 1, 2014. This information does not purport to be indicative of the actual results that would have occurred if the acquisitions had actually been completed on the date indicated, nor is it necessarily indicative of the future operating results or the financial position of the combined company (in thousands):

|  | Three<br>Months<br>Ended<br>March 31,<br>2014 |
|--|---|
| Net revenue  | \$193,632                                     |
| Net income (loss) from continuing operations         | 7,725   |
| Net income (loss) from discontinued operations       | 5   |
| Gain (loss) from sale of discontinued operations     | (784 )  |
| Net income (loss) attributable to HC2 Holdings, Inc. | \$6,946                                       |

All expenditures incurred in connection with the acquisitions were expensed and are included in selling, general and administrative expenses. The Company recorded revenue of \$126.9 million and net income of \$3.2 million from Schuff for the three months ended March 31, 2015. The Company recorded revenue of \$1.2 million and net loss of \$0.1 million from ANG for the three months ended March 31, 2015. The Company recorded revenue of \$27.0 million and net income of \$1.6 million from GMSL for the three months ended March 31, 2015.

## 6. INVESTMENTS

As of March 31, 2015, the Company had both current and long-term investments. The current investments are classified as available-for-sale securities and the change in value is recognized within accumulated other comprehensive income (loss). The fair market value is determined using quoted market prices (a Level 1 approach). The long-term investments are comprised of two types of investments; those accounted for under the equity method of accounting and investments in debt securities.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

The long-term investments accounted for under the equity method and cost method of accounting are as follows (in thousands):

| Company                               | Investment                                   | March<br>31, 2015 | December<br>31, 2014 |
|---------------------------------------|--|-------------------|----------------------|
| Equity Method                         |  |                   |                      |
| Global Cable Technology Ltd.          | Stock  | \$—               | \$49                 |
| SB Submarine Systems Co., Ltd.        | Stock  | 15,731            | 12,882               |
| International Cablesip Pte., Ltd.     | Stock  | 2,393             | 2,111                |
| Sembawang Cable Depot Ptd., Ltd.      | Stock  | 874               | 808                  |
| Huawei Marine Systems Co., Ltd.       | Stock  | 8,090             | 10,087               |
| Visser Smit Global Marine Partnership | Stock  | 414               | 464                  |
| Novatel Wireless, Inc.                | 11,473,799 shares and 1,593,583 warrants     | 19,368            | 13,419               |
| Kaneland, LLC                         | Stock  | 1,120             | 1,151                |
| NerVve Technologies, Inc.             | 885,286 shares of Series A-1 Preferred Stock | 5,538             | 5,538                |
| Benevir Biopharm, Inc.                | 2,000 shares of Series A-1 Preferred Stock   | 1,799             | 1,915                |
| Cost Method                           |  |                   |                      |
| DTV America Corporation               | Convertible Debt                             | 3,000             | —                    |
| mParticle                             | Convertible Debt                             | 500               | 250                  |
|                                       |  | \$58,827          | \$48,674             |

**2015 Activity***Novatel Wireless, Inc. ("Novatel")*

In February 2015, the Company sold 586,095 shares of common stock and 293,047 warrants for \$1.0 million which resulted in a gain of \$0.2 million.

In March 2015, the Company exercised its warrants which converted into 3,824,600 shares of common stock for \$8.6 million and also received a new warrant to purchase 1,593,583 shares of common stock at \$5.50 per share.

- The Company's ownership increased to approximately 23% of Novatel's common stock.

A basis difference, net of tax for the additional investment in March 2015 of \$5.6 million consists of a trade name of \$0.6 million (being amortized over 15 years), a technology and customer intangible of \$0.8 million (being amortized over 7 years) and goodwill of \$4.2 million.

*DTV America Corporation ("DTV")*

- During the three months ended March 31, 2015, the Company purchased \$3.0 million of convertible debt.

During the three months ended March 31, 2015, the Company recorded \$2.7 million of equity in net loss from these investments.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)****7. GOODWILL AND OTHER INTANGIBLE ASSETS***Goodwill*

The changes in the carrying amount of goodwill by reporting unit for the three months ended March 31, 2015 are as follows (in thousands):

|   | Schuff   | ICS     | Total    |
|---|----------|---------|----------|
| Balance as of December 31, 2014                     | \$24,612 | \$3,378 | \$27,990 |
| Effect of change in foreign currency exchange rates | —        | —       | —        |
| Acquisition of business                             | —        | —       | —        |
| Balance as of March 31, 2015                        | \$24,612 | \$3,378 | \$27,990 |

*Amortizable Intangible Assets*

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

|   | Schuff  | GMSL  | ANG     | Pansend | Other | Corporate | Total    |
|---|---------|-------|---------|---------|-------|-----------|----------|
| Trade names   |         |       |         |         |       |           |          |
| Balance as of December 31, 2014                     | \$4,304 | \$997 | \$6,037 | \$—     | \$—   | \$—       | \$11,338 |
| Effect of change in foreign currency exchange rates | —       | (49 ) | —       | —       | —     | —         | (49 )    |
| Amortization  | (75 )   | (86 ) | (158 )  | —       | —     | —         | (319 )   |
| Acquisition of business                             | —       | —     | —       | —       | —     | —         | —        |
| Balance as of March 31, 2015                        | \$4,229 | \$862 | \$5,879 | \$—     | \$—   | \$—       | \$10,970 |

Customer relationships

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|   |         |         |          |        |         |       |          |
|---|---------|---------|----------|--------|---------|-------|----------|
| Balance as of December 31, 2014                     | \$—     | \$7,333 | \$4,881  | \$—    | \$—     | \$—   | \$12,214 |
| Effect of change in foreign currency exchange rates | —       | (321 )  | —        | —      | —       | —     | (321 )   |
| Amortization  | —       | (119 )  | (106 )   | —      | —       | —     | (225 )   |
| Acquisition of business                             | —       | —       | —        | —      | —       | —     | —        |
| Balance as of March 31, 2015                        | \$—     | \$6,893 | \$4,775  | \$—    | \$—     | \$—   | \$11,668 |
| Developed technology                                |         |         |          |        |         |       |          |
| Balance as of December 31, 2014                     | \$—     | \$1,456 | \$—      | \$—    | \$—     | \$—   | \$1,456  |
| Effect of change in foreign currency exchange rates | —       | (70 )   | —        | —      | —       | —     | (70 )    |
| Amortization  | —       | (93 )   | —        | —      | —       | —     | (93 )    |
| Acquisition of business                             | —       | —       | —        | —      | —       | —     | —        |
| Balance as of March 31, 2015                        | \$—     | \$1,293 | \$—      | \$—    | \$—     | \$—   | \$1,293  |
| Other   |         |         |          |        |         |       |          |
| Balance as of December 31, 2014                     | \$—     | \$—     | \$—      | \$ 114 | \$6,000 | \$ 22 | \$6,136  |
| Amortization  | —       | —       | —        | —      | —       | —     | —        |
| Acquisition of business/development                 | —       | —       | —        | —      | —       | —     | —        |
| Balance as of March 31, 2015                        | \$—     | \$—     | \$—      | \$ 114 | \$6,000 | \$ 22 | \$6,136  |
| Total amortizable intangible assets                 |         |         |          |        |         |       |          |
| Balance as of December 31, 2014                     | \$4,304 | \$9,786 | \$10,918 | \$ 114 | \$6,000 | \$ 22 | \$31,144 |
| Effect of change in foreign currency exchange rates | —       | (440 )  | —        | —      | —       | —     | (440 )   |
| Amortization  | (75 )   | (298 )  | (264 )   | —      | —       | —     | (637 )   |
| Acquisition of business                             | —       | —       | —        | —      | —       | —     | —        |
| Balance as of March 31, 2015                        | \$4,229 | \$9,048 | \$10,654 | \$ 114 | \$6,000 | \$ 22 | \$30,067 |

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)****8. LONG-TERM OBLIGATIONS**

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

|   | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|---|-------------------------------|----------------------------------|
| Senior Secured Notes collateralized by the Company's assets, with interest payable semi-yearly based on a fixed annual interest rate of 11% with principal due in 2019                              | \$ 300,000                    | \$ 250,000                       |
| Note payable collateralized by GMSL's assets, with interest payable monthly at LIBOR plus 3.65% and principal payable monthly, maturing in 2019   | 15,692                        | 16,732                           |
| Note payable collateralized by Schuff's real estate, with interest payable monthly at LIBOR plus 4% and principal payable monthly with one final balloon payment of \$1.9 million, maturing in 2019 | 4,479                         | 4,635                            |
| Note payable collateralized by Schuff's equipment, with interest payable monthly at LIBOR plus 4% and principal payable monthly with one final balloon payment of \$1.9 million, maturing in 2019   | 12,352                        | 8,333                            |
| Line of credit collateralized by Schuff's assets, with interest payable monthly at LIBOR plus 3%  | 27,391                        | —                                |
| Note payable collateralized by ANG's assets, with interest payable monthly at 5.5% and principal payable monthly, maturing in 2018  | 773                           | 810                              |
| Obligations under capital leases  | 56,648                        | 65,176                           |
| Other   | 28                            | 30                               |
| Subtotal  | 417,363                       | 345,716                          |
| Original issue discount on Senior Secured Notes   | (2,003 )                      | (2,345 )                         |
| Subtotal  | 415,360                       | 343,371                          |
| Less: Current portion of long-term obligations  | (38,811 )                     | (10,444 )                        |
| Total long-term obligations   | \$ 376,549                    | \$ 332,927                       |

Aggregate debt maturities are as follows (in thousands):



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|            |           |
|------------|-----------|
| 2015       | \$36,054  |
| 2016       | 11,771    |
| 2017       | 12,043    |
| 2018       | 15,107    |
| 2019       | 313,142   |
| Thereafter | 29,246    |
|            | \$417,363 |

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

Aggregate maturities for the capital leases are as follows (in thousands):

|   |          |
|---|----------|
| 2015  | \$5,137  |
| 2016  | 6,843    |
| 2017  | 6,834    |
| 2018  | 10,479   |
| 2019  | 10,478   |
| Thereafter                                  | 31,813   |
| Total minimum principal & interest payments | 71,584   |
| Less: Amount representing interest          | (14,936) |
| Total capital lease obligations             | \$56,648 |

The interest rates on the capital leases range from approximately 4% to 10.4%.

*11% Senior Secured Notes due 2019*

On November 20, 2014, the Company issued \$250.0 million in aggregate principal amount of 11% Senior Secured Notes due 2019 (the “Existing Notes”). The Existing Notes were issued at 99.05% of par, which resulted in a discount of \$2.4 million. The net proceeds from the issuance of the Existing Notes were used to pay off the September Credit Facility entered into in connection with the GMSL acquisition. On March 26, 2015, the Company issued \$50.0 million in aggregate principal amount of 11% Senior Secured Notes due 2019 (the “New Notes” and together with the Existing Notes, the “11% Notes”). The New Notes were issued at 100.5% of par, plus accrued interest from November 20, 2014, which resulted in a premium of \$0.3 million. The 11% 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% Notes Indenture”).

*Maturity and Interest.* The 11% Notes mature on December 1, 2019. The 11% Notes accrue interest at a rate of 11% per year. Interest on the 11% Notes is paid semi-annually on December 1 and June 1 of each year.

*Ranking.* The 11% Notes and the guarantees thereof will be HC2's and certain of its direct and indirect domestic subsidiaries' (the "Subsidiary Guarantors") general senior secured obligations. The 11% Notes and the guarantees thereof will 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 its 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% Notes and the guarantees thereof will be 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% Notes Indenture). The 11% Notes Indenture permits the Company, under specified circumstances, to incur additional debt in the future that could equally and ratably share in the collateral. The amount of such debt is limited by the covenants contained in the 11% Notes Indenture.

*Certain Covenants.* The 11% Notes Indenture contains covenants limiting, among other things, the ability of HC2, and, in certain cases, HC2's subsidiaries, to incur additional indebtedness; create liens; engage in sale-leaseback transactions; pay dividends or make distributions in respect of capital stock; make certain 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 March 31, 2015, HC2 was in compliance with these covenants.

*Redemption Premiums.* The Company may redeem the 11% Notes at a redemption price equal to 100% of the principal amount of the 11% Notes plus a make-whole premium 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 redemption price at December 1, 2016 plus all required interest payments through December 1, 2016 over the principal amount. After December 1, 2016, the Company may redeem the 11% Notes at a redemption price equal to 100% of the principal amount plus accrued interest. The Company is required to make an offer to purchase the 11% Notes upon a change of control. The purchase price will equal 101% of the principal amount of the 11% Notes on the date of purchase plus accrued interest.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*Terminated HC2 Credit Facilities*

In 2014, HC2 entered into (i) the May Credit Facility to finance a portion of the acquisition of Schuff, (ii) the Novatel Acquisition Term Loan to finance the acquisition of Novatel and (iii) the September Credit Facility to finance a portion of the acquisition of GMSL. HC2 used a portion of the proceeds from the September Credit Facility to repay the May Credit Facility and the Novatel Acquisition Term Loan. HC2 used the net proceeds from the issuance of the Existing Notes to repay the September Credit Facility.

Prior to the payoff of the May Credit Facility, the Company made partial principal payments according to covenants within the agreement that required that portions of escrows received and proceeds from the exercise of warrants be used to pay down the May Credit Facility. In connection with those partial prepayments, the Company wrote off \$0.1 million of deferred financing costs and \$0.2 million of original issue discount in the second quarter of 2014 to amortization of debt discount. In connection with those partial prepayments, the Company wrote off \$0.1 million of deferred financing costs and \$1.9 million of original issue discount in the third quarter of 2014 to loss on early extinguishment or restructuring of debt. In connection with the payoff of the remaining balance of the May Credit Facility, the Company incurred \$0.9 million of prepayment premiums and wrote off \$0.3 million of deferred financing costs and \$2.5 million of original issue discount in the third quarter of 2014 to loss on early extinguishment or restructuring of debt. In connection with the payoff of the Novatel Acquisition Term Loan, the Company wrote off \$0.4 million of deferred financing costs and \$0.8 million of original issue discount in the third quarter of 2014 to loss on early extinguishment or restructuring of debt. In connection with the payoff of the September Credit Facility, the Company wrote off \$0.5 million of deferred financing costs and \$4.5 million of original issue discount, which is net of a credit for previous paid funding fees of \$2.3 million during the fourth quarter of 2014 to loss on early extinguishment or restructuring of debt.

*Schuff Credit Facilities*

Schuff has a Credit and Security Agreement (“Schuff Facility”) with Wells Fargo Credit, Inc. (“Wells Fargo”), pursuant to which Wells Fargo agreed to advance up to a maximum amount of \$50.0 million to Schuff. On October 21, 2014, Schuff amended the Schuff Facility, pursuant to which Wells Fargo allowed for the issuance of a note payable up to \$10.0 million, collateralized by its machinery and equipment (“Real Estate (2) Term Advance (M&E)”) and the issuance

of a note payable up to \$5.0 million, collateralized by its real estate (“Real Estate (2) Term Advance (Working Capital)”). At March 31, 2015 and December 31, 2014, Schuff had borrowed \$12.4 million and \$8.3, respectively, under the Real Estate (2) Term Advance (M&E) and Real Estate (2) Term Advance (Working Capital). The Real Estate (2) Term Advance (M&E) and Real Estate (2) Term Advance (Working Capital) have a 5 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 requires monthly interest payments.

On May 6, 2014, Schuff amended the Schuff Facility, pursuant to which Wells Fargo extended the maturity date of the Schuff Facility to April 30, 2019, lowered the interest rate charged in connection with borrowings under the line of credit and allowed for the issuance of a note payable totaling \$5.0 million, collateralized by its real estate (“Real Estate Term Advance”). At March 31, 2015 and December 31, 2014, Schuff had borrowed \$4.5 million and \$4.6 million, respectively, under the Real Estate Term Advance. The Real Estate Term Advance has a 5 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.

The Schuff Facility has a floating interest rate of LIBOR plus 3.00% (3.27% at March 31, 2015) and requires monthly interest payments. As of March 31, 2015 and December 31, 2014, Schuff had \$27.4 million and \$0, respectively, outstanding under the Schuff Facility. The Schuff Facility is secured by a first priority, perfected security interest in all of Schuff’s assets, excluding the real estate, and its present and future subsidiaries and a second priority, perfected security interest in all of Schuff’s real estate. The security agreements pursuant to which Schuff’s assets are pledged prohibit any further pledge of such assets without the written consent of the bank. The Schuff Facility contains various restrictive covenants. At March 31, 2015, the Company was in compliance with these covenants.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

SHE 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 \$2.5 million. The line of credit is secured by a first priority, perfected security interest in the SHE’s property and plant. The interest rate is 5.25% plus 1% of the special interest compensation fund (“FECI”). The line of credit contains covenants that, among other things, limit the 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.

There was \$3.9 million in outstanding letters of credit issued and \$18.7 million available under the Schuff Facility at March 31, 2015. At March 31, 2015, Schuff had no borrowings and no outstanding letters of credit issued under its International LOC. There was \$2.5 million available under Schuff’s International LOC at March 31, 2015.

*GMSL Credit Facility*

GMSL established a term loan with DVB Bank in January 2014 (the “GMSL Facility”). This GMSL facility has a 4.5 year term and bears interest at the rate of 3.65% plus the USD LIBOR rate. As of March 31, 2015 and December 31, 2014, \$15.7 million and \$16.7 million, respectively, remained outstanding under the GMSL Facility. The GMSL Facility contains various restrictive covenants. At March 31, 2015, GMSL was in compliance with these covenants.

*ANG Term Loan*

ANG established a term loan with Signature Financial in October 2013. This term loan has a 5 year term and bears interest at the rate of 5.5%. As of both March 31, 2015 and December 31, 2014, \$0.8 million remained outstanding under this term loan.

*GMSL Capital Leases*

GMSL is a party to two leases to finance the use of two vessels: the Innovator (such applicable lease, the “Innovator Lease”) and the Cable Retriever (such applicable lease, the “Cable Lease,” and together with the Innovator Lease, the “GMSL Leases”). The Innovator Lease expires in 2018, subject to the Company’s ability to extend the Innovator Lease for four one-year periods through 2022. 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 March 31, 2015 and December 31, 2014, \$56.6 million and \$65.2 million, respectively, in aggregate principal amount remained outstanding under the GMSL Leases.

## 9. INCOME TAXES

### *Income Tax Benefit*

Income tax benefit was \$5.8 million and \$0 for the three months ended March 31, 2015 and 2014, respectively. The tax provision benefit resulted primarily from the projected benefit as calculated under ASC 740 without applying a valuation allowance. The March 31, 2014 provision was under a full valuation allowance.

### *NOL Limitation*

As of March 31, 2015, the Company had an estimated NOL carryforward in the amount of \$60.1 million. This amount does not include 2015 activity. In the first quarter of 2014, substantial acquisitions of HC2 stock were reported by new beneficial owners of 5% 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 Preferred Stock and 1,500,000 shares of common stock to finance the acquisition of Schuff. During the second quarter 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 \$2.2 million per year.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*Unrecognized Tax Benefits*

The Company follows the provision of ASC No. 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 the 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, HC2 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 - 2014 remain open for examination.

**10. COMMITMENTS AND CONTINGENCIES**

Future minimum lease payments under non-cancellable operating leases as of March 31, 2015 are as follows (in thousands):

| Year Ending December 31, | Operating<br>Leases |
|--------------------------|---------------------|
|--------------------------|---------------------|



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|                             |           |
|-----------------------------|-----------|
| 2015 (as of March 31, 2015) | \$ 3,016  |
| 2016                        | 3,804     |
| 2017                        | 3,142     |
| 2018                        | 2,356     |
| 2019                        | 1,869     |
| Thereafter                  | 10,698    |
| Total long-term obligations | \$ 24,885 |

The Company has contractual obligations to utilize an external vendor for certain customer support functions and to utilize network facilities from certain carriers with terms greater than one year.

The Company's rent expense under operating leases was \$1.8 million and \$2.4 million for the three months ended March 31, 2015 and 2014, respectively. The rent expense for the three months ended March 31, 2014 includes costs associated with the terminations of facilities leases.

**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

*Litigation*

On November 6, 2014, a putative stockholder class action complaint challenging the buyout by HC2 Holdings, Inc. of the noncontrolling interest in Schuff International, Inc. (“Schuff International”) was filed in the Court of Chancery of the State of Delaware, captioned *Mark Jacobs v. Philip A. Falcone, Keith M. Hladak, 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. Hladak, Paul Voigt, Michael R. Hill, Rustin Roach, D. Ronald Yagoda, Phillip O. Elbert, HC2 Holdings, Inc.*, Civil Action No. 10359. The Complaints allege, among other things, that in connection with the buyout, the individual members of the Schuff International board of directors and HC2 Holdings, the controlling stockholder of Schuff, breached their fiduciary duties to members of the plaintiff class. The Complaints seek a rescission of the buyout and/or compensatory damages, as well as attorney’s fees and other relief. On February 19, 2015, the court consolidated the actions (now designated as *Schuff International, Inc. Stockholders Litigation*) and appointed lead plaintiff and counsel. No responsive pleading has been filed yet by the defendants. We believe that the allegations and claims set forth in the Complaint are without merit and intend to defend them vigorously.

On January 16, 2014, Xplornet Communications Inc. and Xplornet Broadband Inc. (“Xplornet”) instituted an action in the Ontario Superior Court of Justice styled *Xplornet Communications Inc. and Xplornet Broadband Inc. vs. Inukshuk Wireless Inc., et al.* Other defendants include Globility Communications Corporation (“Globility”), MIPPS Inc. (“MIPPS”), Primus Telecommunications Canada Inc. and the Company (sued under its previous name). In such action, Xplornet alleges that it entered into an agreement to acquire certain licenses for radio spectrum in Canada from Globility, a former subsidiary of the Company. Xplornet alleges that Globility agreed to sell Xplornet certain spectrum licenses in a Letter of Intent dated July 12, 2011 but then breached the Letter of Intent by selling the licenses to Inukshuk Wireless Inc. (“Inukshuk”) and that Globility further failed to negotiate with Xplornet in good faith. Xplornet also alleges that it reached an agreement with Inukshuk to purchase the licenses on June 26, 2012, but that Inukshuk breached that agreement by not completing the sale. Xplornet claims that, as a result of the foregoing, it has been damaged in the amount of \$50 million. Xplornet also seeks injunctive relief against Inukshuk, pre and post-judgment interest, and costs. We intend to assert that we have meritorious defenses in the foregoing matter and we intend to defend ourselves vigorously.

The Company is indemnifying Primus Telecommunications Canada, Inc., Globility, and MIPPS subject to a full reservation of rights pursuant to the Equity Purchase Agreement among PTUS, Inc., PTCAN, Inc. Primus Telecommunications Group, Incorporated, Primus Telecommunications Holding, Inc., Lingo Holdings, Inc. and Primus Telecommunications International, Inc. dated as of May 10, 2013 in connection with this case.

On March 13, 2015, Inukshuk Wireless Partnership filed a cross claim against Globility, MIPPS, Primus Telecommunications Canada Inc., 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. Inukshuk alleges that Globility represented and warranted that it owned the licenses at issue, that Globility held the licenses free and clear, and that no third party had any rights to acquire them. Inukshuk claims breach of contract and misrepresentation if the Court finds that any of these representations are untrue. We intend to assert that we have meritorious defenses to the cross claim and we intend to defend ourselves vigorously.

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 business, consolidated financial position, results of operations or cash flow. The Company does not believe that any of such pending claims and legal proceedings will have a material adverse effect on its business, consolidated financial position, results of operations or cash flow.

#### *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.

## **11. 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 HC2'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. As of March 31, 2015, there were 469,871 shares of HC2 common stock underlying outstanding awards under the Prior Plan.

The Compensation Committee (the "Committee") of the Board of Directors of HC2 administers HC2's Omnibus Plan and the Prior Plan and has broad authority to administer, construe and interpret the plans.



**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

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. HC2 typically issues new shares of common stock 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 HC2 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.

There were 691,205 and 8,521 options granted during the three months ended March 31, 2015 and 2014, respectively. Of the 691,205 options granted during the three months ended March 31, 2015, 169,697 of such options were granted to Philip Falcone, pursuant to anti-dilution provisions of a standalone option agreement entered in connection with Mr. Falcone's appointment as Chairman, President and Chief Executive Officer of HC2, and not pursuant to the Omnibus Plan. The weighted average fair value at date of grant for options granted during the three months ended March 31, 2015 was \$3.16 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:

|                         | Three Months Ended March 31, |              |
|-------------------------|------------------------------|--------------|
|                         | 2015                         | 2014         |
| Expected option life    | 5.25 years                   | 6 years      |
| Risk-free interest rate | 1.49 - 1.68%                 | 2.62 - 2.73% |
| Expected volatility     | 36.29- 39.58%                | 37.20%       |
| Dividend yield          | 0%                           | 0%           |

Total share-based compensation expense recognized by the Company during the three months ended March 31, 2015 and 2014 was \$2.2 million and \$0.2 million, respectively. Most of HC2'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*

A summary of HC2's restricted stock activity during the three months ended March 31, 2015 is as follows:

|                              | Shares     | Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|------------------------------|------------|---|
| Unvested – December 31, 2014 | 338,702    | \$ 4.26   |
| Granted                      | 1,436,281  | \$ 9.00   |
| Vested                       | (876,014 ) | \$ 8.99   |
| Forfeitures                  | —          | \$ —  |
| Unvested – March 31, 2015    | 898,969    | \$ 7.23   |

As of March 31, 2015, the unvested restricted stock represented \$5.7 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 898,969.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)***Stock Options*

A summary of HC2's stock option activity during the three months ended March 31, 2015 is as follows:

|                                 | Shares    | Weighted<br>Average<br>Exercise<br>Price |
|---------------------------------|-----------|--|
| Outstanding – December 31, 2014 | 3,573,141 | \$ 4.27                                  |
| Granted                         | 691,205   | \$ 8.82                                  |
| Exercised                       | —         | \$ —                                     |
| Forfeitures                     | (4,335 )  | \$ 2.79                                  |
| Outstanding – March 31, 2015    | 4,260,011 | \$ 5.01                                  |
| Eligible for exercise           | 1,576,470 | \$ 5.16                                  |

The following table summarizes the intrinsic values and remaining contractual terms of HC2's stock options (in thousands):

|                                      | Intrinsic<br>Value | Weighted<br>Average<br>Remaining<br>Life in<br>Years |
|--------------------------------------|--------------------|--|
| Options outstanding – March 31, 2015 | \$26,781           | 9.4  |
| Options exercisable – March 31, 2015 | \$9,649            | 9.3  |

During the three months ended March 31, 2015, the intrinsic value of the exercised options was \$0. As of March 31, 2015, the Company had 2,683,541 unvested stock options outstanding of which \$3.1 million of compensation expense is expected to be recognized over the weighted average remaining vesting period of 1.2 years. The number of unvested stock options expected to vest is 2,683,541 shares, with a weighted average remaining life of 9.4 years, a weighted

average exercise price of \$5.01, and an intrinsic value of \$26.8 million.

## 12. EQUITY

As of March 31, 2015 and December 31, 2014, there were 25,369,260 and 23,813,085 shares of common stock outstanding, respectively. As of March 31, 2015 and December 31, 2014, there were 54,500 and 41,000 shares of Preferred Stock outstanding, respectively.

### *Preferred and Common Stock*

On May 29, 2014, HC2 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 for the acquisition of Schuff. On September 22, 2014, HC2 issued 11,000 shares of Series A-1 Preferred Stock. Each share of Series A-1 Preferred Stock is convertible at a conversion price of \$4.25. In connection with the issuance of the Series A-1 Preferred Stock, HC2 amended the certificate of designation governing the Series A Preferred Stock on September 22, 2014, which changed the applicable conversion price from \$4.25 to \$4.00, reflected the issuance of the Series A-1 Preferred Stock as a class of preferred stock which ranks at parity with the Series A Preferred Stock and made certain other changes to conform the terms of the Series A Preferred Stock to those of the Series A-1 Preferred Stock. On January 5, 2015, HC2 issued 14,000 shares of Series A-2 Convertible Participating Preferred Stock of HC2 (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 at a conversion price of \$8.25. In connection with the issuance of the Series A-2 Preferred Stock, HC2 amended the certificates of designation governing the Series A Preferred Stock and Series A-1 Preferred Stock on January 5, 2015, which reflected 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 made certain other changes to conform the terms of the Series A Preferred Stock and 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 will accrue a cumulative quarterly cash dividend at an annualized rate of 7.5%. The accrued value of the Preferred Stock will accrete quarterly at an annualized rate of 4% that will be reduced to 2% or 0% if the Company achieves specified rates of growth measured by increases in its net asset value.



**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED**

**(UNAUDITED)**

The Company recorded a beneficial conversion feature on both of its Series A and Series A-1 Preferred Stock as a result of the fair market value of the Company's common stock exceeding the conversion price. The Company recorded a \$0.3 million beneficial conversion feature on its Series A-1 Preferred Stock which was calculated using the intrinsic value (\$4.36—\$4.25) multiplied by the number of convertible common shares (\$11,000,000 / \$4.25). The Company recorded a \$0.4 million beneficial conversion feature on its Series A Preferred Stock as a result of the adjustment to the conversion price from \$4.25 to \$4.00. The beneficial conversion feature was calculated using the intrinsic value (\$4.05—\$4.00) multiplied by the number of convertible common shares (\$30,000,000 / \$4.00).

Each share of 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 Preferred Stock shall be entitled to cause the Company to redeem the Preferred Stock at the accrued value per share plus accrued but unpaid dividends. Each share of 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 Preferred Stock shall be entitled to cause HC2 to redeem their Preferred Stock at a price per share equal to the greater of (i) the accrued value of the Preferred Stock, which amount would be multiplied by 150% in the event of a change in control occurring on or prior to the third anniversary of the issue date of the Series A Preferred Stock plus and accrued but unpaid dividends and (ii) the value that would be received if the share of Preferred Stock were converted into common stock immediately prior to the change of control.

At any time after the third anniversary of the issue date of the Series A Preferred Stock, HC2 may redeem the 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, HC2 may force conversion of the 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.

In the three months ended March 31, 2015, 500 shares of Series A-1 Preferred Stock were converted into 117,763 shares of common stock at the option of the holder.

*Dividends*

During 2015, 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):

|                        |                |
|------------------------|----------------|
| Declaration Date       | March 31, 2015 |
| Holders of Record Date | March 31, 2015 |
| Payment/Accrual Date   | April 15, 2015 |
| Total Dividend         | \$1,021        |

**13. FAIR VALUE OF FINANCIAL INSTRUMENTS AND DERIVATIVES**

The carrying amounts reported in the condensed consolidated balance sheets for cash and cash equivalents, 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. The Company's investments in available-for-sale securities, recorded at fair value using quoted market prices (a Level 1 approach), as of March 31, 2015 was \$11.8 million. The estimated aggregate fair value of the Company's debt, based on significant other observable inputs (a Level 2 approach) approximated \$419.0 million at March 31, 2015.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)****14. RELATED PARTIES**

GMSL has investments in various entities for which it exercises significant influence. Summary of transactions with such entities during the three months ended March 31, 2015 and balances outstanding at March 31, 2015 is as follows (in thousands):

|                                  |  |
|----------------------------------|--|
|                                  | Three<br>Months<br>Ended<br>March<br>31,<br>2015 |
| Revenue                          | \$5,688  |
| Operating costs                  | 970  |
| Capital lease interest           | 411  |
| Dividends received               | —  |
|                                  | <b>March<br/>31,<br/>2015</b>                    |
| Accounts receivable              | \$3,473  |
| Obligations under capital leases | 40,375   |
| Trade creditors                  | —  |

**15. OPERATING SEGMENT AND RELATED INFORMATION**

The Company currently has two primary reportable geographic segments—United States and United Kingdom; and Other. The Company has six reportable operating segments based on management’s organization of the enterprise—Telecommunications, Life Sciences, Manufacturing, Marine Services, Utilities and Other. The Company

also has a non-operating Corporate segment. Net revenue and long-lived assets by geographic segment is reported on the basis of where the entity is domiciled. All inter-segment revenues are eliminated. The Company has no single customer representing greater than 10% of its revenues.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

Summary information with respect to the Company's geographic and operating segments is as follows (in thousands):

|                                  | Three Months Ended |            |
|----------------------------------|--------------------|------------|
|                                  | March 31,          |            |
|                                  | 2015               | 2014       |
| Net Revenue by Geographic Region |                    |            |
| United States                    | \$147,135          | \$25,280   |
| United Kingdom                   | 50,995             | 18,074     |
| Other                            | 3,678              | —          |
| Total                            | \$201,808          | \$43,354   |
| Net Revenue by Segment           |                    |            |
| Telecommunications               | \$46,717           | \$43,354   |
| Manufacturing                    | 126,866            | —          |
| Utilities                        | 1,224              | —          |
| Marine Services                  | 27,001             | —          |
| Total                            | \$201,808          | \$43,354   |
| Income (Loss) from Operations    |                    |            |
| Telecommunications               | (207 )             | 333        |
| Life Sciences                    | (1,235 )           | —          |
| Manufacturing                    | 6,179              | —          |
| Utilities                        | (216 )             | —          |
| Marine Services                  | 3,765              | —          |
| Other                            | (241 )             | —          |
| Corporate                        | (7,225 )           | (4,420 )   |
| Total                            | \$820              | \$(4,087 ) |
| Capital Expenditures             |                    |            |
| Telecommunications               | \$(11 )            | \$(67 )    |
| Manufacturing                    | (1,157 )           | —          |
| Utilities                        | (389 )             | —          |
| Marine Services                  | (1,567 )           | —          |
| Corporate                        | —                  | (22 )      |
| Total                            | \$(3,124 )         | \$(89 )    |

The above capital expenditures exclude assets acquired under terms of capital lease and vendor financing obligations.



**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

|                       | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|-----------------------|-------------------------------|----------------------------------|
| Long-term investments |                               |                                  |
| Life Sciences         | \$1,799                       | \$ 1,916                         |
| Marine Services       | 27,502                        | 26,401                           |
| Corporate             | 29,526                        | 20,357                           |
| Total                 | \$58,827                      | \$ 48,674                        |

|                                     | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|-------------------------------------|-------------------------------|----------------------------------|
| Property, Plant and Equipment – Net |                               |                                  |
| United States                       | \$79,036                      | \$ 87,091                        |
| United Kingdom                      | 140,462                       | 147,323                          |
| Other                               | 5,317                         | 5,437                            |
| Total                               | \$224,815                     | \$ 239,851                       |

|                    | <b>March<br/>31,<br/>2015</b> | <b>December<br/>31,<br/>2014</b> |
|--------------------|-------------------------------|----------------------------------|
| Total Assets       |                               |                                  |
| Telecommunications | \$42,457                      | \$ 24,501                        |
| Life Sciences      | 10,235                        | 11,007                           |
| Manufacturing      | 289,892                       | 281,067                          |
| Utilities          | 24,481                        | 25,391                           |
| Marine Services    | 275,582                       | 283,948                          |
| Other (1)          | 6,610                         | 6,369                            |
| Corporate          | 153,796                       | 91,765                           |
| Total              | \$803,053                     | \$ 724,048                       |

(1) Other also includes property, plant and equipment—net and total assets related to discontinued operations.

## 16. BACKLOG

Schuff's backlog was \$306.1 million (\$253.3 million under contracts or purchase orders and \$52.8 million under letters of intent) at March 31, 2015. Schuff's backlog increases as contract commitments, letters of intent, notices to proceed and purchase orders are obtained, decreases as revenues are recognized and increases or decreases to reflect modifications in the work to be performed under the contracts, notices to proceed, letters of intent or purchase orders. Schuff's backlog can be significantly affected by the receipt, or loss, of individual contracts. Approximately \$172.4 million, representing 56.3% of Schuff's backlog at March 31, 2015, was attributable to five contracts, letters of intent, notices to proceed or purchase orders. If one or more of these large contracts or other commitments are terminated or their scope reduced, Schuff's backlog could decrease substantially.

## 17. DISCONTINUED OPERATIONS

On July 31, 2013, the Company completed the sale of Lingo, Inc., iPrimus, USA, Inc., 3620212 Canada Inc., Primus Telecommunications Canada, Telesonic Communications Inc., and Globility Communications Corporation to affiliates of York Capital Management, an investment firm (together "York"), for \$129 million. The sale of Primus Telecommunications, Inc. ("PTI") was also contemplated as part of this transaction but was deferred pending receipt of regulatory approval of such sale. The closing of the sale of PTI, which constituted the remainder of our North America Telecom segment, was completed on July 31, 2014 upon receipt of the necessary regulatory approval. The Company recorded a \$13.8 million gain from the sale of this segment during the year ended December 31, 2013. In addition, the purchase agreement contains customary indemnification obligations, representations, warranties and covenants for a transaction of this nature. The Company received \$126.0 million, net of \$15.25 million held in escrow as part of the initial closing, with an additional \$3.0 million held in escrow and paid upon closing of the sale of PTI.



**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

Pursuant to the terms of the purchase agreement, \$6.45 million of the purchase price was placed in escrow to be released 14 months after the closing date, subject to any deductions required to satisfy indemnification obligations of HC2 under the purchase agreement, which amount was released to the Company in October 2014. In addition, \$4.0 million of the purchase price was placed in escrow to cover any payments required in connection with the post-closing working capital and cash adjustments, of which \$3.2 million was disbursed to the Company and \$0.8 million was disbursed to York upon completion of such adjustments in February 2014. The \$0.8 million was recorded as an adjustment to the gain that was recorded in 2013, which resulted in a net gain from this transaction of \$13.0 million. Furthermore, \$4.8 million of the purchase price was placed in escrow to cover certain tax liabilities, which escrow amount will be released after a positive ruling with respect to the underlying matter is received or 30 days after expiration of the applicable statute of limitations relating to the underlying matter. The \$4.8 million escrow deposit is recorded in other assets in the condensed consolidated balance sheets, of which \$0.4 million is reserved.

Summarized operating results of the discontinued operations are as follows (in thousands):

|  | Three Months<br>Ended March<br>31, |         |
|--|------------------------------------|---------|
|  | 2015                               | 2014    |
| Net revenue                                | \$—                                | \$3,278 |
| Operating expenses                         | 19                                 | 3,229   |
| Income from operations                     | (19)                               | 49      |
| Interest income and other income (expense) | 4                                  | (26 )   |
| Loss before income tax                     | (15)                               | 23      |
| Income tax benefit (expense)               | 6                                  | (6 )    |
| Income from discontinued operations        | \$(9 )                             | \$17    |

**18. BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE**

Basic income (loss) per common share is calculated by dividing income (loss) attributable to common shareholders by the weighted average common shares outstanding during the period. Diluted income per common share adjusts basic income per common share for the effects of potentially dilutive common share equivalents.

The Company had no dilutive common share equivalents during the three months ended March 31, 2015 and 2014 due to the results of operations being a loss from continuing operations, net of tax. For the three months ended March 31, 2015 and 2014, the following were potentially dilutive but were excluded from the calculation of diluted loss per common share due to their antidilutive effect:

*Three months ended March 31, 2015*

1.8 million shares issuable upon exercise of stock options and vesting of RSUs under the Prior Plan and Omnibus Plan.

*Three months ended March 31, 2014*

- 0.3 million shares issuable upon exercise of stock options and vesting of RSUs under the Prior Plan; and
- 18.6 million shares issuable upon exercise of Warrants.

**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—CONTINUED****(UNAUDITED)**

A calculation of basic income (loss) per common share to diluted income (loss) per common share is set forth below (in thousands, except per share amounts):

|  | Three Months<br>Ended March 31, |            |
|--|---------------------------------|------------|
|  | 2015                            | 2014       |
| Loss from continuing operations attributable to HC2 Holdings, Inc. | (6,140 )                        | (4,180 )   |
| Income (loss) from discontinued operations                         | (9 )                            | 17         |
| Loss from sale of discontinued operations                          | —                               | (784 )     |
| Net loss - basic   | \$(6,149 )                      | \$(4,947 ) |
| Net loss - diluted   | \$(6,149 )                      | \$(4,947 ) |
| Weighted average common shares outstanding-basic                   | 24,146                          | 14,631     |
| Weighted average common shares outstanding-diluted                 | 24,146                          | 14,631     |
| Basic loss per common share:                                       |                                 |            |
| Loss from continuing operations attributable to HC2 Holdings, Inc. | \$(0.25 )                       | \$(0.29 )  |
| Income (loss) from discontinued operations                         | —                               | —          |
| Loss from sale of discontinued operations                          | —                               | (0.05 )    |
| Loss attributable to HC2 Holdings, Inc.                            | \$(0.25 )                       | \$(0.34 )  |
| Diluted loss per common share:                                     |                                 |            |
| Loss from continuing operations attributable to HC2 Holdings, Inc. | \$ (0.25)                       | \$ (0.29)  |
| Income (loss) from discontinued operations                         | —                               | —          |
| Loss from sale of discontinued operations                          | —                               | (0.05 )    |
| Net loss attributable to HC2 Holdings, Inc.                        | \$(0.25 )                       | \$(0.34 )  |

**19. SUBSEQUENT EVENTS***Purchase of United Teacher Associates Insurance Company and Continental General Insurance Company*

On April 13, 2015, the Company entered into a Stock Purchase Agreement with Continental General Corporation and Great American Financial Resources, Inc. (collectively, the “Sellers”), pursuant to which the Company agreed to purchase all of the issued and outstanding shares of common stock of United Teacher Associates Insurance Company

and Continental General Insurance Company (collectively, the “Targets”), as well as all assets owned by the Sellers or their affiliates that are used exclusively or primarily in the business of the Targets, subject to certain exceptions. The consideration payable by the Company at closing is approximately \$7 million, which amount will be increased or decreased by the amount by which the Targets’ adjusted capital and surplus exceeds or falls short of, respectively, an agreed-upon target capital and surplus amount (the “Closing Purchase Price”). The Closing Purchase Price will be paid in a mix of cash, debt and/or common stock of the Company, depending on the amount of the Closing Purchase Price. The Company also agreed to contribute to the Targets, at the closing, \$13 million in cash or assets (the “Reserve Release Amount”), and to pay to the Sellers, on an annual basis with respect to the years 2015 through 2019, the amount, if any, by which the Targets’ cash flow testing and premium deficiency reserves decrease from the amount of such reserves as of December 31, 2014, up to the Reserve Release Amount. The transaction is expected to close during the third quarter of 2015, subject to receipt of required governmental approvals.

*Purchase of Convertible Debt of Gaming Nation Acquisition Corporation*

In April 2015, the Company invested CAD\$20 million (or approximately \$16 million) in convertible debentures of Gaming Nation Acquisition Corporation. The convertible debentures, which have a maturity date of April 6, 2017, are convertible into future shares of common stock, by the holder at various percentages that are dependent upon the timing of the conversion. The convertible debentures accrue interest at 6% which is compounded annually.

## **ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*You should read the following discussion and analysis of our financial condition and results of operations together with the information in our unaudited condensed consolidated financial statements and the notes thereto included herein, as well as our audited consolidated financial statements and the notes thereto contained in our Annual Report on Form 10-K for the year ended December 31, 2014. Some of the information contained in this discussion and analysis includes forward-looking statements that involve risks and uncertainties. You should review the “Risk Factors” section in Part II, Item 1A of this Quarterly Report on Form 10-Q, the “Risk Factors” section in our Annual Report on Form 10-K for the year ended December 31, 2014 as well as the section below entitled “—Special Note Regarding Forward-Looking Statements” for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.*

*Unless the context otherwise requires, in this Quarterly Report on Form 10-Q, “HC2” means HC2 Holdings, Inc. and the “Company,” “we” and “our” mean HC2 together with its subsidiaries. “U.S. GAAP” means accounting principles accepted in the United States of America.*

### **Introduction and Overview of Operations**

We are a diversified holding company with six reportable operating segments based on management’s organization of the enterprise—Manufacturing, Marine Services, Utilities, Telecommunications, Life Sciences and Other, which includes operations that do not meet the separately reportable segment thresholds. We expect to continue to focus on acquiring and investing in businesses with attractive assets that we consider to be undervalued or fairly valued and growing our acquired businesses.

On May 29, 2014, we completed the acquisition of 2.5 million shares of common stock of Schuff International, Inc. (“Schuff”), a steel fabrication and erection company and negotiated an agreement to purchase an additional 198,411 shares, representing an approximately 65% interest in Schuff. Schuff repurchased a portion of its outstanding common stock in June 2014, which had the effect of increasing the Company’s ownership interest to 70%. During the fourth quarter, the final results of a tender offer for all outstanding shares of Schuff were announced and various open-market purchases were made, which resulted in the acquisition of 809,043 shares and an increase in our ownership interest to 91%. We intend to execute a short-form merger, which will increase our ownership of Schuff shares to 100%. Schuff and its wholly-owned subsidiaries primarily operate as integrated fabricators and erectors of structural steel and heavy steel plates with headquarters in Phoenix, Arizona and operations in Arizona, Florida, Georgia, Texas, Kansas and California. Schuff’s construction projects are primarily in the aforementioned states. In addition, Schuff has construction projects in select international markets, primarily Panama.

On August 1, 2014, the Company paid \$15.5 million to acquire 15,500 shares of Series A Convertible Preferred Stock of American Natural Gas (“ANG”), representing an approximately 51% interest in ANG. ANG is a premier distributor of natural gas motor fuel headquartered in the Northeast that designs, builds, owns, acquires, operates and maintains compressed natural gas fueling stations for transportation.

On September 22, 2014, the Company completed the acquisition of Bridgehouse Marine Limited, the parent holding company of Global Marine Systems Limited (“GMSL”). The purchase price reflects an enterprise value of approximately \$260 million, including assumed indebtedness, and was funded using the net proceeds from (i) the issuance of \$11 million of Series A-1 Convertible Participating Preferred Stock of HC2 (the “Series A-1 Preferred Stock”) and (ii) a senior secured credit facility providing for a twelve month term loan of \$214 million and a delayed draw term loan of \$36 million (the “September Credit Facility”), each of which was also completed on September 22, 2014. With a portion of the proceeds from the September Credit Facility, the Company paid off its senior secured credit facility entered into on May 29, 2014 providing for an eighteen month term loan of \$80 million and its senior unsecured credit facility entered into on September 8, 2014 consisting of a term loan of \$17 million. The September Credit Facility was subsequently repaid using the proceeds from HC2’s issuance of its Existing Notes discussed below under—“Liquidity and Capital Resources”. GMSL is a leading provider of engineering and underwater services on submarine cables. In conjunction with the acquisition, approximately 3% of the Company’s interest in GMSL was purchased by a group of individuals, leaving the Company’s controlling interest as of March 31, 2015 at approximately 97%.

In our Telecommunications segment, we operate a telecommunications business including a network of direct routes and provide 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 (“ISPs”) from our International Carrier Services (“ICS”) business unit.

In our Life Sciences segment, we operate Pansend, LLC, which has an 80% interest in Genovel Orthopedics, Inc., which seeks to develop products to treat early osteoarthritis of the knee, and a 61% interest in R2 Dermatology (f/k/a “GemDerm Aesthetics, Inc.”), which develops skin lightening technology.

Additionally, we acquired a 100% ownership interest in DMi, Inc., which owns licenses to create and distribute NASCAR® video games.

We are evaluating several strategic and business alternatives, which may include the following: acquiring assets or businesses unrelated to our current or historical operations, operating, growing or acquiring additional assets or businesses related to our current or historical operations or winding down or selling our existing operations. As part of any acquisition strategy, we may raise capital in the form of debt or equity securities (including preferred stock) or a combination thereof. We have broad discretion in selecting a business strategy for the Company. If we elect to pursue an acquisition, we have broad discretion in identifying and selecting both the industries and the possible acquisition or business combination opportunities. We face significant competition for acquisition and business opportunities, including from numerous companies with a business plan similar to ours, and as such, there can be no assurance that any of these discussions will result in a definitive agreement and if they do, what the terms or timing of any agreement would be. While we search for additional acquisition opportunities, we manage a portion of our available cash and acquire interests in possible acquisition targets through our wholly-owned subsidiary, HC2 Investment Securities, Inc., a Delaware corporation.

## **Recent Developments**

### *Offering of Senior Notes*

On March 26, 2015, the Company issued \$50.0 million in aggregate principal amount of 11% Senior Secured Notes due 2019. See Note 8—“Long-Term Obligations” for additional terms of the 11% Senior Secured Notes.

### *Preferred Stock Issuance*

On January 5, 2015, HC2 issued 14,000 shares of Series A-2 Convertible Participating Preferred Stock (the “Series A-2 Preferred Stock”). Each share of Series A-2 Preferred Stock is convertible at a conversion price of \$8.25. In connection with the issuance of the Series A-2 Preferred Stock, HC2 amended the certificates of designation governing the Series A Convertible Participating Preferred Stock (the “Series A Preferred Stock” and, together with the Series A-1 Preferred Stock and the Series A-2 Preferred Stock, the “Preferred Stock”) and Series A-1 Preferred Stock on January 5, 2015,

which reflected 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 made certain other changes to conform the terms of the Series A Preferred Stock and Series A-1 Preferred Stock to those of the Series A-2 Preferred Stock. See Note 12—"Equity" for additional terms of the Preferred Stock.

## Foreign Currency

Foreign currency can impact our financial results. During the three months ended March 31, 2015, approximately 27.1% of our net revenue from continuing operations was derived from sales and operations outside the U.S. The reporting currency for our condensed consolidated financial statements is the United States dollar (the "USD"). The local currency of each country is the functional currency for each of our respective entities operating in that country. In the future, we expect to continue to derive a portion of our net revenue and incur a portion of our operating costs from outside the U.S., and therefore changes in exchange rates may continue to have a significant, and potentially adverse, effect on our results of operations. Our risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the USD/British pound sterling ("GBP") exchange rate. Due to a percentage of our revenue derived outside of the U.S., changes in the USD relative to the GBP could have an adverse impact on our future results of operations. We have agreements with certain subsidiaries for repayment of a portion of the investments and advances made to these subsidiaries. As we anticipate repayment in the foreseeable future, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the condensed consolidated statements of operations. The exposure of our income from operations to fluctuations in foreign currency exchange rates is reduced in part because a majority of the costs that we incur in connection with our foreign operations are also denominated in local currencies.

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of operations of our foreign subsidiaries into USD using the average exchange rate during the reporting period. Changes in foreign exchange rates affect the reported profits and losses and cash flows of our international subsidiaries and may distort comparisons from year to year. By way of example, when the USD strengthens compared to the GBP, there could be a negative or positive effect on the reported results for our Telecommunications and Marine Services segments, depending upon whether such businesses are operating profitably or at a loss. It takes more profits in GBP to generate the same amount of profits in USD and a greater loss in GBP to generate the same amount of loss in USD. The opposite is also true. For instance, when the USD weakens against the GBP, there is a positive effect on reported profits and a negative effect on reported losses.



For the three months ended March 31, 2015 as compared to the three months ended March 31, 2014, the USD was weaker on average as compared to the GBP. The following tables demonstrate the impact of currency fluctuations on our net revenue for the three months ended March 31, 2015 and 2014:

Net Revenue by Location—in USD (in thousands)

|                | Three Months Ended March 31, |        |                |               |
|----------------|------------------------------|--------|----------------|---------------|
|                | 2015                         | 2014   | Variance<br>\$ | Variance<br>% |
| United Kingdom | 50,995                       | 18,074 | 32,921         | 182.1 %       |

Net Revenue by Location—in Local Currencies (in thousands)

|                         | Three Months Ended March 31, |        |                |               |
|-------------------------|------------------------------|--------|----------------|---------------|
|                         | 2015                         | 2014   | Variance<br>\$ | Variance<br>% |
| United Kingdom (in GBP) | 33,702                       | 10,927 | 22,775         | 208.4 %       |

### Critical Accounting Policies

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2014 for a detailed discussion of our critical accounting policies. These policies include revenue recognition, accounting for cost of revenue, goodwill and other intangible assets, valuation of long-lived assets and accounting for income taxes.

No significant changes in our critical accounting policies have occurred since December 31, 2014.

### Financial Presentation Background

In the following presentations and narratives within this Management’s Discussion and Analysis of Financial Condition and Results of Operations, we compare the Company’s results of operations for the three months ended March 31, 2015 as compared to the three months ended March 31, 2014.



## Results of Operations

### *Results of operations for the three months ended March 31, 2015 as compared to the three months ended March 31, 2014*

The pro forma results of operations for the three months ended March 31, 2015 and 2014 include pro forma financial information for the Manufacturing and Marine Services operating segments. These pro forma results give effect to the acquisitions of Schuff and GMSL as if they had occurred on January 1, 2014, but do not include any purchase price accounting adjustments (if applicable). The pro forma results of operations are limited to the discussion of net revenue, cost of revenue and selling, general and administrative expenses, as presented below.

#### *Revenue*

| (in thousands)     | Quarter Ended March 31, |        |         |        | Quarter-over-Quarter |          |   |
|--------------------|-------------------------|--------|---------|--------|----------------------|----------|---|
|                    | 2015                    |        | 2014    |        | Variance             | Variance |   |
|                    | Net                     | % of   | Net     | % of   |                      |          | % |
|                    | Revenue                 | Total  | Revenue | Total  |                      |          |   |
| Telecommunications | 46,717                  | 23.1 % | 43,354  | 100.0% | 3,363                | 7.8      | % |
| Manufacturing      | 126,866                 | 62.9 % | —       | 0.0 %  | 126,866              | 100.0    | % |
| Marine Services    | 27,001                  | 13.4 % | —       | 0.0 %  | 27,001               | 100.0    | % |
| Utilities          | 1,224                   | 0.6 %  | —       | 0.0 %  | 1,224                | 100.0    | % |
| Total Net Revenue  | 201,808                 | 100.0% | 43,354  | 100.0% | 158,454              | 365.5    | % |

#### *Pro forma Revenue*

| (in thousands)     | Quarter Ended March 31, |        |         |        | Quarter-over-Quarter |          |   |
|--------------------|-------------------------|--------|---------|--------|----------------------|----------|---|
|                    | 2015                    |        | 2014    |        | Variance             | Variance |   |
|                    | Net                     | % of   | Net     | % of   |                      |          | % |
|                    | Revenue                 | Total  | Revenue | Total  |                      |          |   |
| Telecommunications | 46,717                  | 23.1 % | 43,354  | 22.4 % | 3,363                | 7.8      | % |
| Manufacturing      | 126,866                 | 62.9 % | 105,142 | 54.4 % | 21,724               | 20.7     | % |
| Marine Services    | 27,001                  | 13.4 % | 44,920  | 23.2 % | (17,919 )            | -39.9    | % |
| Utilities          | 1,224                   | 0.6 %  | —       | 0.0 %  | 1,224                | 100.0    | % |
| Total Net Revenue  | 201,808                 | 100.0% | 193,416 | 100.0% | 8,392                | 4.3      | % |

**Net revenue:** Net revenue increased \$158.5 million, or 365.5%, to \$201.8 million for the three months ended March 31, 2015 from \$43.4 million for the three months ended March 31, 2014.

*Telecommunications:* The increase in Telecommunications is primarily due to an increase in both domestic and international terminations year over year.

*Manufacturing:* On a pro forma basis, manufacturing revenue increased by \$21.7 million or 20.7%. The increase in Manufacturing is primarily due to major commercial projects in the Southwest and Pacific regions of the United States that began in late 2014. Because of the timing of particular projects, there will be fluctuations in revenue throughout the year. Revenue from our Manufacturing segment was budgeted to be lower in the first quarter of 2015 as compared to the remaining portion of the year.

*Marine Services:* On a pro forma basis, marine services revenue decreased by \$17.9 million or 39.9%. The decrease is primarily due to vessel charters and installation project work in Q1 of 2014 that were not repeated in 2015. Revenue from our Marine Services segment is impacted by the weather. In any particular year, revenue can fluctuate depending on the average temperature in the winter months and will generally be lower as temperatures are lower. Revenue from our Marine Services segment was budgeted to be lower in the first quarter of 2015 as compared to the remaining portion of the year.

*Cost of Revenue*

|                       | Quarter Ended March 31,<br>2015 |                        | Quarter Ended March 31,<br>2014 |                        | Quarter-over-Quarter |               |
|-----------------------|---------------------------------|------------------------|---------------------------------|------------------------|----------------------|---------------|
|                       | Cost of<br>Revenue              | % of<br>Net<br>Revenue | Cost of<br>Revenue              | % of<br>Net<br>Revenue | Variance             | Variance<br>% |
| (in thousands)        |                                 |                        |                                 |                        |                      |               |
| Telecommunications    | 45,278                          | 96.9 %                 | 41,107                          | 94.8 %                 | 4,171                | 10.1 %        |
| Manufacturing         | 109,859                         | 86.6 %                 | —                               | 0.0 %                  | 109,859              | 100.0 %       |
| Marine Services       | 16,642                          | 61.6 %                 | —                               | 0.0 %                  | 16,642               | 100.0 %       |
| Utilities             | 677                             | 55.3 %                 | —                               | 0.0 %                  | 677                  | 100.0 %       |
| Total Cost of Revenue | 172,456                         | 85.5 %                 | 41,107                          | 94.8 %                 | 131,349              | 319.5 %       |

*Pro forma Cost of Revenue*

|                       | Quarter Ended March 31,<br>2015 |                        | Quarter Ended March 31,<br>2014 |                        | Quarter-over-Quarter |               |
|-----------------------|---------------------------------|------------------------|---------------------------------|------------------------|----------------------|---------------|
|                       | Cost of<br>Revenue              | % of<br>Net<br>Revenue | Cost of<br>Revenue              | % of<br>Net<br>Revenue | Variance             | Variance<br>% |
| (in thousands)        |                                 |                        |                                 |                        |                      |               |
| Telecommunications    | 45,278                          | 96.9 %                 | 41,107                          | 94.8 %                 | 4,171                | 10.1 %        |
| Manufacturing         | 109,859                         | 86.6 %                 | 88,701                          | 84.4 %                 | 21,158               | 23.9 %        |
| Marine Services       | 16,642                          | 61.6 %                 | 30,357                          | 67.6 %                 | (13,715 )            | -45.2 %       |
| Utilities             | 677                             | 55.3 %                 | —                               | 0.0 %                  | 677                  | 100.0 %       |
| Total Cost of Revenue | 172,456                         | 85.5 %                 | 160,165                         | 82.8 %                 | 12,291               | 7.7 %         |

**Cost of revenue:** Cost of revenue increased \$131.3 million to \$172.5 million, or 85.5% of net revenue, for the three months ended March 31, 2015 from \$41.1 million, or 94.8% of net revenue, for the three months ended March 31, 2014.

*Telecommunications:* The increase in Telecommunications is primarily due to the increase in net revenue in such segment. Cost of revenue as a percentage of net revenue for such segment increased 210 basis points quarter-over-quarter.

*Manufacturing:* On a pro forma basis, manufacturing cost of sales increased by \$21.2 million or 23.9%. The increase in Manufacturing is primarily due to the increase in revenue.

*Marine Services:* On a pro forma basis, marine services cost of sales decreased by \$13.7 million or 45.2%. The decrease is primarily due to a reduced cost base due to the non-recurring charters and installations in Q1 of 2014.

*Selling, General and Administrative Expenses*

| (in thousands)     | Quarter Ended March 31,<br>2015 |                 |             | Quarter Ended March 31,<br>2014 |                 |             | Quarter-over-Quarter |               |
|--------------------|---------------------------------|-----------------|-------------|---------------------------------|-----------------|-------------|----------------------|---------------|
|                    | SG&A                            | % of<br>Revenue | % of<br>Net | SG&A                            | % of<br>Revenue | % of<br>Net | Variance             | Variance<br>% |
| Telecommunications | 1,497                           | 3.2 %           | 2,566       | 5.9 %                           | (1,069 )        | -41.7 %     |                      |               |
| Life Sciences      | 1,234                           | 0.0 %           | —           | 0.0 %                           | 1,234           | 100.0 %     |                      |               |
| Manufacturing      | 9,926                           | 7.8 %           | —           | 0.0 %                           | 9,926           | 100.0 %     |                      |               |
| Marine Services    | 2,565                           | 9.5 %           | —           | 0.0 %                           | 2,565           | 100.0 %     |                      |               |
| Utilities          | 365                             | 29.8 %          | —           | 0.0 %                           | 365             | 100.0 %     |                      |               |
| Other              | 241                             | 0.0 %           | —           | 0.0 %                           | 241             | 100.0 %     |                      |               |
| Corporate          | 7,225                           | 0.0 %           | 3,638       | 0.0 %                           | 3,587           | 98.6 %      |                      |               |
| Total SG&A         | 23,053                          | 11.4 %          | 6,204       | 14.3 %                          | 16,849          | 271.6 %     |                      |               |

*Pro forma Selling, General and Administrative Expenses*

| (in thousands)     | Quarter Ended March 31,<br>2015 |                 |             | Quarter Ended March 31,<br>2014 |                 |             | Quarter-over-Quarter |               |
|--------------------|---------------------------------|-----------------|-------------|---------------------------------|-----------------|-------------|----------------------|---------------|
|                    | SG&A                            | % of<br>Revenue | % of<br>Net | SG&A                            | % of<br>Revenue | % of<br>Net | Variance             | Variance<br>% |
| Telecommunications | 1,497                           | 3.2 %           | 2,566       | 5.9 %                           | (1,069 )        | -41.7 %     |                      |               |
| Life Sciences      | 1,234                           | 0.0 %           | —           | 0.0 %                           | 1,234           | 100.0 %     |                      |               |
| Manufacturing      | 9,926                           | 7.8 %           | 11,386      | 10.8 %                          | (1,460 )        | -12.8 %     |                      |               |
| Marine Services    | 2,565                           | 9.5 %           | 2,752       | 6.1 %                           | (187 )          | -6.8 %      |                      |               |
| Utilities          | 365                             | 29.8 %          | —           | 0.0 %                           | 365             | 100.0 %     |                      |               |
| Other              | 241                             | 0.0 %           | —           | 0.0 %                           | 241             | 100.0 %     |                      |               |
| Corporate          | 7,225                           | 0.0 %           | 3,638       | 0.0 %                           | 3,587           | 98.6 %      |                      |               |
| Total SG&A         | 23,053                          | 11.4 %          | 20,342      | 10.5 %                          | 2,711           | 13.3 %      |                      |               |

**Selling, general and administrative expenses:** Selling, general and administrative expenses increased \$16.8 million to \$23.1 million, or 11.4% of net revenue, for the three months ended March 31, 2015 from \$6.2 million, or 14.3% of net revenue, for the three months ended March 31, 2014.

*Telecommunications* : The decrease in Telecommunications was primarily due to a \$0.7 million decrease in salaries and benefits resulting from headcount reductions and a \$0.3 million decrease in general and administrative expenses.

*Manufacturing:* On a pro forma basis, manufacturing selling, general and administrative expenses decreased by \$1.5 million or 12.8%. The decrease in Manufacturing is primarily due to lower employee-related and travel costs along with lower bonus expense due to a change in bonus plan structure in late 2014. We continue to make a concerted effort to control costs while continuing to invest in business development and information technology to increase profitability.

*Marine Services:* On a pro forma basis, marine services selling, general and administrative expenses decreased by \$0.2 million or 6.8%. The decrease in Marine Services is primarily due to improved cost control measures across general and administrative expenses.

*Corporate:* The increase in Corporate included \$3.5 million higher salaries and benefits resulting from increased headcount, \$0.8 million higher professional fees related to our acquisition activity and \$0.5 million higher general and administrative expenses partially offset by \$1.5 million lower occupancy costs.

**Depreciation and amortization expense:** Depreciation and amortization expense for the three months ended March 31, 2015 was \$6.9 million, a portion of which was included in cost of revenue. Depreciation and amortization expense for the three months ended March 31, 2014 was \$0.2 million.



**Gain/loss on sale or disposal of assets:** Loss on sale or disposal of assets was \$0.5 million and gain of \$0.1 million for the three months ended March 31, 2015 and 2014, respectively.

**Interest expense:** Interest expense was \$8.6 million and \$0 for the three months ended March 31, 2015 and 2014, respectively. The increase in interest expense in 2015 was due to the issuance of HC2's 11% Notes.

**Foreign currency transaction loss:** Foreign currency transactions resulted in a loss of \$0.8 million and \$0 for the three months ended March 31, 2015 and 2014, respectively. The losses are attributable to transactions denominated in a currency other than the subsidiaries' functional currency.

**Loss from equity investees:** Loss from equity investees was \$2.7 million and \$0 for the three months ended March 31, 2015 and 2014, respectively.

**Income tax benefit:** Income tax benefit was \$5.8 million and \$0 for the three months ended March 31, 2015 and 2014, respectively. The tax provision benefit resulted primarily from the projected benefit as calculated under ASC 740 without applying a valuation allowance. The March 31, 2014 provision was under a full valuation allowance.

## Non-GAAP Financial Measures and Other Information

### *Adjusted EBITDA*

Management believes that Adjusted EBITDA is significant to gaining an understanding of the Company's results as it is frequently used by the financial community to provide insight into an organization's operating trends and facilitates comparisons between peer companies, since interest, taxes, depreciation, amortization and the other items listed in the definition of Adjusted EBITDA below can differ greatly between organizations as a result of differing capital structures and tax strategies. Adjusted EBITDA can also be a useful measure of a company's ability to service debt. While management believes that non-US GAAP measurements are useful supplemental information, such adjusted results are not intended to replace the Company's US GAAP financial results.

|        |      |     |       |                          |
|--------|------|-----|-------|--------------------------|
| Schuff | GMSL | ICS | Other | HC2<br>Holdings,<br>Inc. |
|--------|------|-----|-------|--------------------------|

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|  | Three<br>Months<br>Ended<br>March<br>31,<br>2015 | Three<br>Months<br>Ended<br>March<br>31, 2015 | Three<br>Months<br>Ended<br>March<br>31,<br>2015 | Three<br>Months<br>Ended<br>March<br>31, 2015 | Three<br>Months<br>Ended<br>March 31,<br>2015 |
|--|--|---|--|---|---|
| Net income (loss)  | \$3,188  | \$1,607                                       | \$ (524 )  | \$ (9,332)                                    | \$ (5,061 )                                   |
| Adjustments to reconcile net income (loss) to Adjusted EBIT: |  |   |  |   |   |
| (Gain) loss on sale or disposal of assets                    | 423  | —   | 50   | —   | 473   |
| Interest expense   | 344  | 996   | —  | 7,268   | 8,608   |
| Amortization of debt discount                                | —  | —   | —  | 92  | 92  |
| Interest income and other expense, net                       | (17 )  | —   | (5 )   | (171 )  | (193 )  |
| Foreign currency (gain) loss                                 | —  | 448   | 322  | 1   | 771   |
| Income tax (benefit) expense                                 | 2,569  | 6   | —  | (8,408)                                       | (5,833 )                                      |
| Loss from discontinued operations                            | 9  | —   | —  | —   | 9   |
| Noncontrolling interest                                      | 85   | —   | —  | (346 )  | (261 )  |
| Share-based payment expense                                  | —  | —   | —  | 2,235   | 2,235   |
| Adjusted EBIT  | 6,601  | 3,057   | (157 )   | (8,661)                                       | 840   |
| Depreciation and amortization                                | 478  | 4,030   | 98   | 400   | 5,006   |
| Depreciation and amortization (included in cost of revenue)  | 1,875  | —   | —  | —   | 1,875   |
| Foreign currency (gain) loss (included in cost of revenue)   | —  | (1,823)                                       | —  | —   | (1,823 )                                      |
| Adjusted EBITDA  | \$8,954  | \$5,264                                       | \$ (59 )   | \$ (8,261)                                    | \$ 5,898                                      |

The calculation of Adjusted EBITDA, as defined by us on a pro forma basis, consists of Net income (loss) as adjusted for asset impairment expense; gain (loss) on sale or disposal of assets; amortization of debt discount; loss on early extinguishment or restructuring of debt; interest income and other income (expense), net; foreign currency transaction gain (loss); (gain) loss on sale of discontinued operations; gain (loss) from discontinued operations; income tax (benefit) expense; acquisition and related charges; non-controlling interests; share-based compensation expense; and depreciation and amortization expense.

***Pro forma Net Revenue, Cost of Revenue and SG&A***

Pro forma Net Revenue, Pro forma Cost of Revenue and Pro forma SG&A include the as reported net revenue, cost of revenue and SG&A, respectively, for the comparable prior period adjusted for net revenues, cost of revenue and SG&A from acquired businesses, subsequent to that period's end, made to facilitate direct comparison to the as reported amounts for the current period.

Management believes that presenting Pro forma Net Revenue, Pro Forma Cost of Revenue and Pro Forma SG&A is important to understanding the Company's financial performance, providing better analysis of trends in our underlying businesses as it allows for comparability to prior period results.

***Pro forma Net Revenue***

|                               | Quarter Ended March 31, |        |           |        | Quarter-over-Quarter |          |   |  |
|-------------------------------|-------------------------|--------|-----------|--------|----------------------|----------|---|--|
|                               | 2015                    |        | 2014      |        |                      |          |   |  |
| (in thousands)                | Net                     | % of   | Net       | % of   | Variance             | Variance |   |  |
|                               | Revenue                 | Total  | Revenue   | Total  |                      | %        |   |  |
| Telecommunications            | 46,717                  | 23.1 % | 43,354    | 22.4 % | 3,363                | 7.8      | % |  |
| Manufacturing                 | 126,866                 | 62.9 % | 105,142   | 54.4 % | 21,724               | 20.7     | % |  |
| Marine Services               | 27,001                  | 13.4 % | 44,920    | 23.2 % | (17,919 )            | -39.9    | % |  |
| Utilities                     | 1,224                   | 0.6 %  | —         | 0.0 %  | 1,224                | 100.0    | % |  |
| Total Net Revenue - pro forma | 201,808                 | 100.0% | 193,416   | 100.0% | 8,392                | 4.3      | % |  |
| Less net revenue from:        |                         |        |           |        |                      |          |   |  |
| Manufacturing                 | —                       |        | (105,142) |        |                      |          |   |  |
| Marine Services               | —                       |        | (44,920 ) |        |                      |          |   |  |
| Total Net Revenue - GAAP      | 201,808                 |        | 43,354    |        |                      |          |   |  |

***Pro forma Cost of Revenue***

|                    | Quarter Ended March 31, |         |         |         | Quarter-over-Quarter |          |   |  |
|--------------------|-------------------------|---------|---------|---------|----------------------|----------|---|--|
|                    | 2015                    |         | 2014    |         |                      |          |   |  |
| (in thousands)     | Cost of                 | % of    | Cost of | % of    | Variance             | Variance |   |  |
|                    | Revenue                 | Revenue | Revenue | Revenue |                      | %        |   |  |
| Telecommunications | 45,278                  | 96.9 %  | 41,107  | 94.8 %  | 4,171                | 10.1     | % |  |

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|                                   |         |        |           |        |           |         |
|-----------------------------------|---------|--------|-----------|--------|-----------|---------|
| Manufacturing                     | 109,859 | 86.6 % | 88,701    | 84.4 % | 21,158    | 23.9 %  |
| Marine Services                   | 16,642  | 61.6 % | 30,357    | 67.6 % | (13,715 ) | -45.2 % |
| Utilities                         | 677     | 55.3 % | —         | 0.0 %  | 677       | 100.0 % |
| Total Cost of Revenue - pro forma | 172,456 | 85.5 % | 160,165   | 82.8 % | 12,291    | 7.7 %   |
| Less cost of revenue from:        |         |        |           |        |           |         |
| Manufacturing                     | —       |        | (88,701 ) |        |           |         |
| Marine Services                   | —       |        | (30,357 ) |        |           |         |
| Total Cost of Revenue - GAAP      | 172,456 |        | 41,107    |        |           |         |

*Pro forma SG&A*

| (in thousands)         | Quarter Ended March 31,<br>2015 |                        |          | Quarter-over-Quarter   |          |               |
|------------------------|---------------------------------|------------------------|----------|------------------------|----------|---------------|
|                        | SG&A                            | % of<br>Revenue<br>Net | SG&A     | % of<br>Revenue<br>Net | Variance | Variance<br>% |
| Telecommunications     | 1,497                           | 3.2 %                  | 2,566    | 5.9 %                  | (1,069 ) | -41.7 %       |
| Life Sciences          | 1,234                           | 0.0 %                  | —        | 0.0 %                  | 1,234    | 100.0 %       |
| Manufacturing          | 9,926                           | 7.8 %                  | 11,386   | 10.8 %                 | (1,460 ) | -12.8 %       |
| Marine Services        | 2,565                           | 9.5 %                  | 2,752    | 6.1 %                  | (187 )   | -6.8 %        |
| Utilities              | 365                             | 29.8 %                 | —        | 0.0 %                  | 365      | 100.0 %       |
| Other                  | 241                             | 0.0 %                  | —        | 0.0 %                  | 241      | 100.0 %       |
| Corporate              | 7,225                           | 0.0 %                  | 3,638    | 0.0 %                  | 3,587    | 98.6 %        |
| Total SG&A - pro forma | 23,053                          | 11.4 %                 | 20,342   | 10.5 %                 | 2,711    | 13.3 %        |
| Less SG&A from:        |                                 |                        |          |                        |          |               |
| Manufacturing          | —                               |                        | (11,386) |                        |          |               |
| Marine Services        | —                               |                        | (2,752 ) |                        |          |               |
| Total SG&A - GAAP      | 23,053                          |                        | 6,204    |                        |          |               |

**Liquidity and Capital Resources**

*Issuance of 11% Senior Secured Notes*

On March 26, 2015, the Company issued an additional \$50.0 million in aggregate principal amount of 11% Senior Secured Notes due 2019. See Note 8—“Long-Term Obligations” for additional terms of the 11% Senior Secured Notes. The Company intends to use net proceeds from the issuance of the Notes for working capital for the Company and its subsidiaries and for general corporate purposes.

*Pro Forma Capital Expenditures*

Pro forma capital expenditures for the three months ended March 31, 2015 and 2014 include pro forma financial information for the Manufacturing and Marine Services operating segments. These pro forma capital expenditures give effect to the acquisitions of Schuff and GMSL as if they had occurred on January 1, 2014. Pro forma capital expenditures consist of the following (in thousands):

|         | As<br>Reported<br>Three Months<br>Ended March<br>31,<br>2015 | Pro<br>Forma<br>2014 |
|---------|--|----------------------|
| Schuff  | 1,157  | 7,839                |
| GMSL    | 1,567  | 3,491                |
| ICS (1) | 11   | 67                   |
| ANG     | 389  | —                    |
| Other   | —  | 22                   |
| Total   | 3,124  | 11,419               |

(1) ICS activity does not include any pro forma adjustments

The above capital expenditures exclude assets acquired under terms of capital lease and vendor financing obligations.

*Changes in Cash Flows*

Our principal liquidity requirements arise from cash used in operating activities, purchases of network equipment, including switches, related transmission equipment and capacity, steel manufacturing equipment and subsea cable equipment, development of back-office systems and income taxes. We have financed our growth and operations to date through public offerings and private placements of debt and equity securities, credit facilities, vendor financing, capital lease financing and other financing arrangements.

Net cash used in operating activities was \$49.0 million for the three months ended March 31, 2015 as compared to net cash provided of \$2.1 million for the three months ended March 31, 2014. For the three months ended March 31, 2015, net income, net of non-cash operating activity, provided \$7.1 million of cash. Other major drivers included an increase in accounts receivable of \$45.8 million, a decrease in accounts payable of \$18.9 million, a decrease in

billings in excess of costs and recognized earnings on uncompleted contracts of \$10.1 million and a decrease in accrued income taxes of \$6.2 million, partially offset by an increase in accrued interconnection costs of \$10.1 million, an increase in accrued interest of \$8.9 million and an increase in accrued expenses and other current liabilities of \$6.0 million. For the three months ended March 31, 2014, net income, net of non-cash operating activity, used \$3.7 million of cash. Other major drivers included a decrease in accounts payable of \$1.8 million and a decrease in accrued interconnection costs of \$1.2 million, offset by a decrease in prepaid expenses and other current assets of \$6.7 million and a decrease in accounts receivable of \$2.8 million.

Net cash used in investing activities was \$20.8 million for the three months ended March 31, 2015 as compared to a negligible amount for the three months ended March 31, 2014. Net cash used in investing activities for the three months ended March 31, 2015 included a purchase of \$8.6 million in equity investments, a purchase of \$6.7 million in marketable securities, \$3.1 million of capital expenditures and a purchase of \$3.3 million in debt securities. Net cash used in investing activities for the three months ended March 31, 2014 included \$0.1 million of capital expenditures, offset by \$0.1 million of proceeds from the sale of property and equipment.

Net cash provided by financing activities was \$90.5 million for the three months ended March 31, 2015 as compared to \$2.3 million for the three months ended March 31, 2014. Net cash provided by financing activities for the three months ended March 31, 2015 included \$181.3 million of proceeds from credit facilities and the 11% Notes and \$14.0 million of proceeds from the issuance of Preferred Stock, partially offset by \$103.7 million used to make principal payments on our credit facilities. Net cash provided by financing activities for the three months ended March 31, 2014 included \$2.9 million of proceeds from the exercise of warrants and stock options, partially offset by \$0.6 million used to pay dividend equivalents to our shareholders.

***Short- and Long-Term Liquidity Considerations and Risks; Contractual Obligations***

As of March 31, 2015, we had \$128.9 million of cash and cash equivalents. We believe that our existing cash and cash equivalents will be sufficient to fund our fixed obligations (such as operating leases), and other cash needs for our operations for at least the next twelve months. As of March 31, 2015, we had \$415.4 million of indebtedness.

HC2 is a holding company and its liquidity needs are primarily for dividend payments on its Preferred Stock, interest payments on any long-term debt, professional fees (including advisory services, legal and accounting fees), salaries and benefits, office rent, insurance costs and certain support services. HC2's current source of liquidity is its cash, cash equivalents and investments, and distributions from its subsidiaries.

The ability of HC2's subsidiaries to generate sufficient net income and cash flows to make upstream cash distributions is subject to numerous factors, including restrictions contained in such subsidiary's financing agreements, availability of sufficient funds in such subsidiary and the approval of such payment by such subsidiary's board of directors, which must consider various factors, including general economic and business conditions, tax considerations, strategic plans, financial results and condition, expansion plans, any contractual, legal or regulatory restrictions on the payment of dividends, and such other factors such subsidiary's board of directors considers relevant. In addition, one or more subsidiaries may issue, repurchase, retire or refinance, as applicable, their debt or equity securities for a variety of purposes, including in order to grow their business, pursue acquisition activities or to manage their liquidity needs. Any such issuance may limit such subsidiary's ability to make upstream cash distributions. HC2's liquidity may also be impacted by the capital needs of its current and future subsidiaries. Such entities may require additional capital to maintain or grow their businesses, or make payments on their indebtedness.

We expect our cash, cash equivalents and investments to continue to be a source of liquidity except to the extent they may be used to fund investments in operating businesses or assets. Depending on a variety of factors, including the general state of capital markets, operating needs or acquisition size and terms, HC2 and its subsidiaries may raise additional capital through the issuance of equity, debt or both. There is no assurance, however, that such capital will be available at that time, in the amounts necessary or on terms satisfactory to HC2. We expect to service any such new additional debt through raising dividends received from our subsidiaries. We may also seek to repurchase, retire or refinance, as applicable, all or a portion of, our indebtedness or our common or preferred stock through open market purchases, tender offers, negotiated transactions or otherwise.

The obligations set forth in the table below reflect the contractual payments of principal and interest that existed as of March 31, 2015 (in thousands):

Payments Due By Period

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| Contractual Obligations       | <b>Total</b> | <b>Less than 1 year</b> | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than 5 years</b> |
|-------------------------------|--------------|-------------------------|------------------|------------------|--------------------------|
| Operating leases              | \$24,885     | \$3,016                 | \$6,946          | \$4,225          | \$10,698                 |
| Capital leases                | 71,584       | 5,137                   | 13,677           | 20,957           | 31,813                   |
| Notes payable (1)             | 529,163      | 67,465                  | 83,562           | 378,136          | —                        |
| Total contractual obligations | \$625,632    | \$75,618                | \$104,185        | \$403,318        | \$42,511                 |

(1) Interest is calculated using stated interest rates as shown in Note 8—“Long Term Obligations” to our condensed consolidated financial statements.



We have contractual obligations to utilize network facilities from certain carriers with terms greater than one year. We generally do not purchase or commit to purchase quantities in excess of normal usage or amounts that cannot be used within the contract term.

### **Off-Balance Sheet Arrangements**

#### *Schuff*

Schuff's off-balance sheet arrangements at March 31, 2015 included letters of credit of \$3.9 million under the Schuff Facility and performance bonds of \$13.5 million.

Schuff's letters of credit are issued for the benefit of its workers' compensation insurance carrier. Schuff's workers' compensation insurance carrier requires standby letters of credit to be issued as collateral on all of its outstanding indemnity cases. The amount of collateral required is determined each year and is provided to the carrier for outstanding indemnity claims not greater than 54 months old. The prior years' levels of required collateral can be adjusted each year based upon the costs incurred and settlements reached on the outstanding indemnity cases.

Schuff's contract arrangements with customers sometimes require Schuff to provide performance bonds to partially secure its obligations under its contracts. Bonding requirements typically arise in connection with public works projects and sometimes with respect to certain private contracts. Schuff's performance bonds are obtained through surety companies and typically cover the entire project price.

### **New Accounting Pronouncements**

For a discussion of our "New Accounting Pronouncements," refer to Note 2—"Summary of Significant Accounting Policies" to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

### **Related Party Transactions**

HC2 has entered into indemnification agreements with each of its directors and executive officers. These agreements require HC2 to indemnify such individuals, to the fullest extent permitted by Delaware law, for certain liabilities to which they may become subject as a result of their affiliation with the Company. For a further discussion of related party transactions, refer to Note 14—“Related Parties” to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

### **Special Note Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains or incorporates a number of “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based on current expectations, and are not strictly historical statements. In some cases, you can identify forward-looking statements by terminology such as “if,” “may,” “should,” “believe,” “anticipate,” “future,” “forward,” “potential,” “estimate,” “opportunity,” “goal,” “objective,” “growth,” “outcome,” “could,” “expect,” “intend,” “strategy,” “provide,” “commitment,” “result,” “seek,” “pursue,” “ongoing,” “include” or in the negative of such terms or comparable terminology. These forward-looking statements inherently involve certain risks and uncertainties and are not guarantees of performance, results, or the creation of shareholder value, although they are based on our current plans or assessments which we believe to be reasonable as of the date hereof.

### ***HC2***

Factors or risks that could cause HC2’s actual results to differ materially from the results we anticipate include, but are not limited to:

- the possibility of indemnification claims arising out of divestitures of businesses;
- uncertain global economic conditions in the markets in which our operating segments conduct their businesses;
- the ability of our operating segments to attract and retain customers;
- increased competition in the markets in which our operating segments conduct their businesses;
- our possible inability to generate sufficient liquidity, margins, earnings per share, cash flow and working capital from our operating segments;

our expectations regarding the timing, extent and effectiveness of our cost reduction initiatives and management's ability to moderate or control discretionary spending;

management's plans, goals, forecasts, expectations, guidance, objectives, strategies and timing for future operations, acquisitions, synergies, asset dispositions, fixed asset and goodwill impairment charges, tax and withholding expense, selling, general and administrative expenses, product plans, performance and results;

management's assessment of market factors and competitive developments, including pricing actions and regulatory rulings;

limitations on our ability to successfully identify any strategic acquisitions or business opportunities and to compete for these opportunities with others who have greater resources;

the impact of additional material charges associated with our oversight of acquired or target businesses and the integration of our financial reporting;

the impact of expending significant resources in considering acquisition targets or business opportunities that are not consummated;

- tax consequences associated with our acquisition, holding and disposition of target companies and assets;
- our dependence on distributions from our subsidiaries to fund our operations and payments on our obligations;

the impact of covenants in the certificates of designation governing HC2's Preferred Stock, the 11% Notes Indenture, the credit agreements governing the Schuff Facility and the GMSL Facility and future financing or refinancing agreements, on our ability to operate our business and finance our pursuit of acquisition opportunities;

the impact on the holders of HC2's common stock if we issue additional shares of HC2 common stock or preferred stock;

the impact of decisions by HC2's significant stockholders, whose interest may differ from those of HC2's other stockholders, or their ceasing to remain significant stockholders;

the effect any interests our officers, directors, stockholders and their respective affiliates may have in certain transactions in which we are involved;

- our dependence on certain key personnel;
- our ability to effectively increase the size of our organization, if needed, and manage our growth;
- the impact of a determination that we are an investment company or personal holding company;

the impact of delays or difficulty in satisfying the requirements of Section 404 of the Sarbanes-Oxley Act of 2002 or negative reports concerning our internal controls;

- the impact on our business and financial condition of our substantial indebtedness and the significant additional indebtedness and other financing obligations we may incur;

our possible inability to raise additional capital when needed or refinance our existing debt, on attractive terms, or at all; and

- our possible inability to hire and retain qualified executive management, sales, technical and other personnel.

#### *Marine Services / GMSL*

Factors or risks that could cause GMSL's, and thus our Marine Services segment's, actual results to differ materially from the results we anticipate include, but are not limited to:

the possibility of global recession or market downturn with a reduction in capital spending within the targeted market segments the business operates in;

- project implementation issues and possible subsequent overruns;
- risks associated with operating outside of core competencies when moving into different market segments;
  - possible loss or severe damage to marine assets;
  - vessel equipment aging or reduced reliability;
- risks associated with operating two joint ventures in China (China Telecom, Huawei);

- risks related to foreign corrupt practices;

- changes to the local laws and regulatory environment in different geographical regions;
  - loss of key senior employees;
  - difficulties attracting enough skilled technical personnel;
  - foreign exchange rate risk;
  - liquidity risk; and

potential for financial loss arising from the failure by customers to fulfil their obligations as and when these obligations fall due.

#### *Manufacturing / Schuff*

Factors or risks that could cause Schuff's, and thus our Manufacturing segment's, actual results to differ materially from the results we anticipate include, but are not limited to:

its ability to realize cost savings from expected performance of contracts, whether as a result of improper estimates, performance, or otherwise;

- uncertain timing and funding of new contract awards, as well as project cancellations;

cost overruns on fixed-price or similar contracts or failure to receive timely or proper payments on cost-reimbursable contracts, whether as a result of improper estimates, performance, disputes, or otherwise;

risks associated with labor productivity, including performance of subcontractors that Schuff hires to complete projects;

- its ability to settle or negotiate unapproved change orders and claims;

changes in the costs or availability of, or delivery schedule for, equipment, components, materials, labor or subcontractors;

adverse impacts from weather affecting Schuff's performance and timeliness of completion of projects, which could lead to increased costs and affect the quality, costs or availability of, or delivery schedule for, equipment, components, materials, labor or subcontractors;

fluctuating revenue resulting from a number of factors, including the cyclical nature of the individual markets in which our customers operate;

adverse outcomes of pending claims or litigation or the possibility of new claims or litigation, and the potential effect of such claims or litigation on Schuff's business, financial condition, results of operations or cash flow; and

lack of necessary liquidity to provide bid, performance, advance payment and retention bonds, guarantees, or letters of credit securing Schuff's obligations under bids and contracts or to finance expenditures prior to the receipt of payment for the performance of contracts.

### *Telecommunications / ICS*

Factors or risks that could cause ICS's, and thus our Telecommunications segment's, actual results to differ materially from the results we anticipate include, but are not limited to:

our expectations regarding increased competition, pricing pressures and usage patterns with respect to ICS's product offerings;

significant changes in ICS's competitive environment, including as a result of industry consolidation, and the effect of competition in its markets, including pricing policies;

- its compliance with complex laws and regulations in the U.S. and internationally; and

further changes in the telecommunications industry, including rapid technological, regulatory and pricing changes in its principal markets.

Other unknown or unpredictable factors could also affect our business, financial condition and results. Although we believe that the expectations reflected in the forward-looking statements are reasonable, there can be no assurance that any of the estimated or projected results will be realized. You should not place undue reliance on these forward-looking statements, which apply only as of the date hereof. Subsequent events and developments may cause our views to change. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so.





### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Foreign Currency Exchange Rate Risk

Our primary market risk exposures relate to changes in foreign currency exchange rates.

Foreign currency can impact our financial results. During the three months ended March 31, 2015, approximately 27.1% of our net revenue from continuing operations was derived from sales and operations outside the U.S. The reporting currency for our condensed consolidated financial statements is the United States dollar (the "USD"). The local currency of each country is the functional currency for each of our respective entities operating in that country. In the future, we expect to continue to derive a portion of our net revenue and incur a portion of our operating costs from outside the U.S., and therefore changes in exchange rates may continue to have a significant, and potentially adverse, effect on our results of operations. Our risk of loss regarding foreign currency exchange rate risk is caused primarily by fluctuations in the USD/British pound sterling ("GBP") exchange rate. Due to a percentage of our revenue derived outside of the U.S., changes in the USD relative to the GBP could have an adverse impact on our future results of operations. We have agreements with certain subsidiaries for repayment of a portion of the investments and advances made to these subsidiaries. As we anticipate repayment in the foreseeable future, we recognize the unrealized gains and losses in foreign currency transaction gain (loss) on the condensed consolidated statements of operations. The exposure of our income from operations to fluctuations in foreign currency exchange rates is reduced in part because a majority of the costs that we incur in connection with our foreign operations are also denominated in local currencies.

We are exposed to financial statement gains and losses as a result of translating the operating results and financial position of our international subsidiaries. We translate the local currency statements of operations of our foreign subsidiaries into USD using the average exchange rate during the reporting period. Changes in foreign exchange rates affect the reported profits and losses and cash flows of our international subsidiaries and may distort comparisons from year to year. By way of example, when the USD strengthens compared to the GBP, there could be a negative or positive effect on the reported results for our Telecommunications and Marine Services segments, depending upon whether such businesses are operating profitably or at a loss. It takes more profits in GBP to generate the same amount of profits in USD and a greater loss in GBP to generate the same amount of loss in USD. The opposite is also true. For instance, when the USD weakens against the GBP, there is a positive effect on reported profits and a negative effect on reported losses.

For the three months ended March 31, 2015 as compared to the three months ended March 31, 2014, the USD was weaker on average as compared to the GBP. As a result, the revenue of our subsidiaries whose local currency is GBP increased 208.4% in their local currencies compared to the three months ended March 31, 2014 and increased 182.1% in USD.

## **Interest Rate Risk**

The Company has interest rate risk with respect to its long-term debt and credit facilities discussed in Note 8—“Long-Term Obligations” to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q. As of March 31, 2015, we have a substantial amount of debt with variable rates based generally on LIBOR. Increases in interest rates could therefore significantly increase the associated interest payments that we are required to make on this debt.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures.**

Our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, the material weakness described in the Company’s 2014 Annual Report on Form 10-K regarding our disclosure controls and procedures related to the preparation and review of our income tax provisions and related accounts was remediated and our disclosure controls and procedures are effective. Disclosure controls and procedures mean our controls and other procedures that are designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in our reports that we file or submit under the Securities Exchange Act of 1934, as amended, is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control.**

Except as stated below related to the steps taken in order to improve the internal control over income taxes, our Chief Executive Officer and Chief Financial Officer have concluded that there have been no changes in our internal control over financial reporting that occurred during the fiscal quarter ended March 31, 2015, that have materially affected, or are reasonably likely to affect materially, our internal control over financial reporting.

In response to the material weakness described in the Company's 2014 Annual Report on Form 10-K, the Company has implemented a number of remediation steps to address such matter and to improve its internal control over income tax accounting. Specifically, the following have been implemented: dedicated additional internal and external personnel resources with the appropriate level of proficiency to identify, evaluate, and review complex tax accounting matters; organizational structure changes which better integrate the tax accounting and finance functions; enhancement of our processes and procedures for determining, documenting and calculating our income tax provision; and increasing the level of certain tax review activities throughout the year and during the financial statement close process.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

For a description of certain pending legal proceedings, see Note 11—“Commitments and Contingencies—Litigation” to our condensed consolidated financial statements included in HC2’s Annual Report on Form 10-K for the year ended December 31, 2014, as updated in Note 10—“Commitments and Contingencies—Litigation” to our condensed consolidated financial statements included elsewhere in this Quarterly Report on Form 10-Q.

### **ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None.

**ITEM 6. EXHIBITS**

(a) Exhibits (see Exhibit Index following signature page below)

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on May 11, 2015.

HC2 HOLDINGS, INC.

Date: May 11, 2015 By: /s/ MESFIN DEMISE

**Mesfin Demise**

**Chief Financial Officer, Chief Compliance Officer,**

**Corporate Controller and Treasurer**

**(Principal Financial and Accounting Officer)**

**EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Description</b>  |
|---------------------------|---|
| 3.1                       | Second Amended and Restated Certificate of Incorporation of HC2 Holdings, Inc. (“HC2”) (incorporated by reference to Exhibit 3.1 to HC2’s Form 8-A, filed on June 20, 2011) (File No. 001-35210).   |
| 3.2                       | Certificate of Ownership of HC2 (incorporated by reference to Exhibit 3.1 to HC2’s Current Report on Form 8-K, filed on October 18, 2013) (File No. 001-35210).   |
| 3.3                       | Certificate of Ownership and Merger (incorporated by reference to Exhibit 3.1 to HC2’s Current Report on Form 8-K, filed on April 11, 2014) (File No. 001-35210).   |
| 3.4                       | Certificate of Amendment (incorporated by reference to Exhibit 3.1 to HC2’s Current Report on Form 8-K, filed on June 18, 2014) (File No. 001-35210).   |
| 4.1                       | Certificate of Amendment to the Certificate of Designation of Series A Convertible Participating Preferred Stock of HC2 (incorporated by reference to Exhibit 4.2 to HC2’s Current Report on Form 8-K, filed on January 9, 2015) (File No. 001-35210).  |
| 4.2                       | Certificate of Amendment to the Certificate of Designation of Series A-1 Convertible Participating Preferred Stock of HC2 (incorporated by reference to Exhibit 4.3 to HC2’s Current Report on Form 8-K, filed on January 9, 2015) (File No. 001-35210).  |
| 4.3                       | Certificate of Designation of Series A-2 Convertible Participating Preferred Stock of HC2 (incorporated by reference to Exhibit 4.1 to HC2’s Current Report on Form 8-K, filed on January 9, 2015) (File No. 001-35210).  |
| 10.1.1                    | Seventh Amendment to Second Amended and Restated Credit and Security Agreement, dated as of February 19, 2015, by and among Schuff, as Borrower, and Wells Fargo Credit, Inc. (filed herewith).   |
| 10.2                      | Employment Agreement, dated October 1, 2014, by and between HC2 and Paul Voigt (filed herewith).  |
| 10.3                      | Employment Agreement, dated May 12, 2014, by and between HC2 and Ian Estus (filed herewith).  |
| 31                        | Certifications (filed herewith).  |
| 32*                       | Certification (filed herewith).   |
| 101                       | The following materials from the Registrant’s Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2015, formatted in extensible business reporting language (XBRL); (i) Unaudited Condensed Consolidated Statements of Operations for the three months ended March 31, 2015 and 2014, (ii) Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, |

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2015 and 2014, (iii) Unaudited Condensed Consolidated Balance Sheets at March 31, 2015 and December 31, 2014, (iv) Unaudited Condensed Consolidated Statements of Permanent Equity for the three months ended March 31, 2015, (v) Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2015 and 2014, and (vi) Notes to Unaudited Condensed Consolidated Financial Statements (filed herewith).

These certifications are being “furnished” and will not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liability of that section. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, as amended, except to the extent that the registrant specifically incorporates it by reference.

^ Indicates management contract or compensatory plan or arrangement.