HC2 Holdings, Inc.
Form 10-Q
May 09, 2016

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

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended March 31, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

Commission File No. 001-35210

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

Delaware	54-1708481
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
505 Huntmar Park Drive, Suite 325	
Herndon, VA	20170
(Address of principal executive offices)	(Zip Code)

(703) 865-0700
(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 x No ¨

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

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

Large accelerated filer ¨ Accelerated filer x

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

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

Class	Outstanding as of April 30, 2016
Common Stock, $0.001 par value	35,520,967

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

PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

	Three Months Ended March 31,	
	2016	2015
Services revenue	$182,109	$73,718
Sales revenue	120,497	128,090
Life, accident and health earned premiums, net	19,934	—
Net investment income	14,079	—
Realized losses on investments	(4,875)	—
Net revenue	331,744	201,808
Operating expenses		
Cost of revenue - services	174,873	61,920
Cost of revenue - sales	99,677	110,536
Policy benefits, changes in reserves, and commissions	34,139	—
Selling, general and administrative	36,302	23,512
Depreciation and amortization	5,597	5,255
Loss on sale or disposal of assets	887	473
Total operating expenses	351,475	201,696
Income (loss) from operations	(19,731)	112
Interest expense	(10,326)	(8,700)
Other income (expense), net	110	(227)
Loss from equity investees	(3,934)	(2,688)
Loss from continuing operations before income taxes	(33,881)	(11,503)
Income tax benefit	2,539	6,014
Loss from continuing operations	(31,342)	(5,489)
Loss from discontinued operations	—	(9)
Net loss	(31,342)	(5,498)
Less: Net income attributable to noncontrolling interest and redeemable noncontrolling interest	880	261
Net loss attributable to HC2 Holdings, Inc.	(30,462)	(5,237)
Less: Preferred stock dividends and accretion	1,069	1,088
Net loss attributable to common stock and participating preferred stockholders	$(31,531)	$(6,325)
Basic loss per common share:		
Loss from continuing operations	$(0.89)	$(0.26)
Loss from discontinued operations	—	—
Net loss attributable to common stock and participating preferred stockholders	$(0.89)	$(0.26)
Diluted loss per common share:		
Loss from continuing operations	$(0.89)	$(0.26)
Loss from discontinued operations	—	—
Net loss attributable to common stock and participating preferred stockholders	$(0.89)	$(0.26)
Weighted average common shares outstanding:		
Basic	35,262	24,146

Diluted	35,262	24,146

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2016	2015
Net loss	$(31,342)	$(5,498)
Other comprehensive income (loss)		
Foreign currency translation adjustment	1,823	(4,361)
Unrealized gain (loss) on available-for-sale securities, net of tax	18,617	149
Less: Comprehensive income attributable to the noncontrolling interest and redeemable noncontrolling interest	880	261
Comprehensive loss attributable to HC2 Holdings, Inc.	$(10,022)	$(9,449)

See accompanying notes to condensed consolidated financial statements.

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

	March 31, 2016	December 31, 2015
Assets		
Investments:		
Fixed maturity securities, available-for-sale at fair value	$ 1,278,031	$ 1,231,841
Equity securities, available-for-sale at fair value	47,557	49,682
Mortgage loans	1,145	1,252
Policy loans	18,360	18,476
Other invested assets	46,009	53,119
Total investments	1,391,102	1,354,370
Cash and cash equivalents	137,700	158,624
Restricted cash	589	538
Accounts receivable (net of allowance for doubtful accounts of $1,621 and $794 at March 31, 2016 and December 31, 2015, respectively)	192,607	210,853
Costs and recognized earnings in excess of billings on uncompleted contracts	33,143	39,310
Inventory	10,636	12,120
Recoverable from reinsurers	526,251	522,562
Accrued investment income	16,420	15,300
Deferred tax asset	44,245	52,511
Property, plant and equipment, net	241,848	214,466
Goodwill	83,766	61,178
Intangibles	37,539	29,409
Other assets	44,142	65,206
Assets held for sale	4,976	6,065
Total assets	$ 2,764,964	$ 2,742,512
Liabilities, temporary equity and stockholders’ equity		
Life, accident and health reserves	$ 1,614,244	$ 1,593,330
Annuity reserves	258,644	259,460
Value of business acquired	51,130	50,761
Accounts payable and other current liabilities	193,137	225,389
Billings in excess of costs and recognized earnings on uncompleted contracts	24,643	21,201
Deferred tax liability	18,249	4,281
Long-term obligations	394,242	371,876
Pension liability	22,982	25,156
Other liabilities	16,986	17,793
Total liabilities	2,594,257	2,569,247
Commitments and contingencies		
Temporary equity:		
Preferred stock, $.001 par value - 20,000,000 shares authorized; Series A - 29,172 shares issued and outstanding at March 31, 2016 and December 31, 2015; Series A-1 - 10,000 shares issued and outstanding at March 31, 2016 and December 31, 2015; Series A-2 - 14,000 shares issued and outstanding at March 31, 2016 and December 31, 2015	52,674	52,619
Redeemable noncontrolling interest	3,090	3,122
Total temporary equity	55,764	55,741

Stockholders’ equity:		
Common stock, $.001 par value - 80,000,000 shares authorized; 35,346,536 and 35,281,375 shares issued and 35,314,910 and 35,249,749 shares outstanding at March 31, 2016 and December 31, 2015, respectively	35	35
Additional paid-in capital	211,713	209,477
Accumulated deficit	(110,191)	(79,729)
Treasury stock, at cost	(378)	(378)
Accumulated other comprehensive loss	(14,935)	(35,375)
Total HC2 Holdings, Inc. stockholders’ equity before noncontrolling interest	86,244	94,030
Noncontrolling interest	28,699	23,494
Total stockholders’ equity	114,943	117,524
Total liabilities, temporary equity and stockholders’ equity	$2,764,964	$2,742,512

See accompanying notes to condensed consolidated financial statements.

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Balance as of December 31, 2014	23,813	$ 24	$ 141,948	$ (378)	$ (44,164)	$ (18,243)	$ 25,208	$ 104,395
Share-based compensation expense	—	—	2,694	—	—	—	—	2,694
Preferred stock dividends and accretion	—	—	(1,088)	—	—	—	—	(1,088)
Issuance of common stock	2	—	—	—	—	—	—	—
Issuance of restricted stock	1,436	1	—	—	—	—	—	1
Conversion of preferred stock to common stock	118	—	500	—	—	—	—	500
Acquisition of noncontrolling interest	—	—	—	—	—	—	(271)	(271)
Excess book value over fair value of purchased noncontrolling interest	—	—	34	—	—	—	(34)	—
Net (loss) income	—	—	—	—	(5,237)	—	(261)	(5,498)
Foreign currency translation adjustment	—	—	—	—	—	(4,361)	—	(4,361)
Unrealized gain (loss) on available-for-sale securities, net of tax	—	—	—	—	—	149	—	149
Balance as of March 31, 2015	25,369	$ 25	$ 144,088	$ (378)	$ (49,401)	$ (22,455)	$ 24,642	$ 96,521

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Stock	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total
Balance as of December 31, 2015	35,250	$ 35	$ 209,477	$ (378)	$ (79,729)	$ (35,375)	$ 23,494	$ 117,524
Share-based compensation expense	—	—	2,582	—	—	—	609	3,191
Preferred stock dividend and accretion	—	—	(1,014)	—	—	—	—	(1,014)
Preferred stock beneficial conversion feature	—	—	(55)	—	—	—	—	(55)
Issuance of common stock	65	—	—	—	—	—	—	—
Acquisition of noncontrolling interest	—	—	—	—	—	—	822	822

Sale of controlling interest	—	—	—	—	—	—	5,345	5,345
Excess fair value over book value of noncontrolling interest sold	—	—	723	—	—	—	(723)	—
Net (loss) income	—	—	—	—	(30,462)	—	(880)	(31,342)
Net income (loss) attributable to noncontrolling interest and redeemable noncontrolling interest	—	—	—	—	—	—	32	32
Foreign currency translation adjustment	—	—	—	—	—	1,823	—	1,823
Unrealized gain (loss) on available-for-sale securities, net of tax	—	—	—	—	—	18,617	—	18,617
Balance as of March 31, 2016	35,315	$ 35	$211,713	$(378)	$(110,191)	$ (14,935)	$28,699	$114,943

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net loss	$(31,342)	$(5,498)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Provision for doubtful accounts receivable	112	95
Share-based compensation expense	3,191	2,694
Depreciation and amortization	7,526	7,130
Amortization of deferred financing costs and debt discount	495	421
Amortization of fixed maturities discount/premium	3,361	—
(Gain) loss on sale or disposal of assets	887	473
Realized (gain) loss on investments	4,649	(515)
Unrealized (gain) loss on investments	(1,582)	—
Impairment of investments	2,686	—
Equity investment (income)/loss	3,934	2,688
Deferred income taxes	(12,311)	(568)
Receipt of dividends from equity investees	7,214	—
Other	2,368	172
Changes in assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	18,900	(45,764)
(Increase) decrease in costs and recognized earnings in excess of billings on uncompleted contracts	6,167	3,468
(Increase) decrease in inventory	2,012	(2,355)
(Increase) decrease in other assets	18,700	(3,614)
Increase (decrease) in life, accident and health reserves	20,914	—
Increase (decrease) in accounts payable, current and other liabilities	(42,324)	3,455
Increase (decrease) in billings in excess of costs and recognized earnings on uncompleted contracts	3,442	(10,116)
Increase (decrease) in pension liability	(2,174)	(1,125)
Net change in cash due to operating activities	16,825	(48,959)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(6,512)	(3,124)
Sale of property and equipment and other assets	471	998
Purchase of investments	(73,606)	(18,558)
Sale of investments	51,040	1,026
Cash paid for business acquisitions, net of cash acquired	(6,469)	—
Purchase of noncontrolling interest	—	(222)
Sale of controlling interest	2,000	—
(Increase) decrease in restricted cash	(51)	(893)
Net change in cash due to investing activities	(33,127)	(20,773)
Cash flows from financing activities:		
Proceeds from long-term obligations	2,360	50,250
Principal payments on long-term obligations	(2,538)	(2,082)

Borrowings on line of credit, net	(618)	29,445
Payment of deferred financing costs	—	(1,136)
Annuity receipts	785	—
Annuity surrenders	(5,149)	—
Proceeds from sale of preferred stock, net	—	14,032
Payment of dividends	(1,014)	—

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Net change in cash due to financing activities	(6,174)	90,509
Effects of exchange rate changes on cash and cash equivalents	1,552	117
Net change in cash and cash equivalents	(20,924)	20,894
Cash and cash equivalents, beginning of period	158,624	107,978
Cash and cash equivalents, end of period	$137,700	$128,872
Supplemental cash flow information:		
Cash paid for interest	$1,465	$1,287
Cash paid for taxes	$639	$112
Preferred stock dividends and accretion	$55	$67
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	$946	$1,632
Conversion of preferred stock to common stock	$—	$500

See accompanying notes to condensed consolidated financial statements.

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

1. Organization and Business

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

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

1.Our Manufacturing segment includes Schuff International, Inc. ("Schuff") and its wholly-owned subsidiaries. Schuff is an integrated fabricator and erector of structural steel and heavy steel plates with headquarters in Phoenix, Arizona. Schuff has operations in Arizona, Georgia, Texas, Kansas and California, with its construction projects primarily located in the aforementioned states. In addition, Schuff has construction projects in select international markets, primarily Panama through, Schuff Hopsa Engineering, Inc., a Panamanian joint venture with Empresas Hopsa, S.A. that provides steel fabrication services. The Company maintains a 91% controlling interest in Schuff.

2.Our Marine Services segment includes Global Marine Systems Limited ("GMSL"). GMSL is a leading provider of engineering and underwater services on submarine cables. In conjunction with the acquisition of GMSL, approximately 3% of the Company’s interest in GMSL was purchased by a group of individuals. The Company maintains a 97% controlling interest in GMSL.

3.Our Insurance segment includes United Teacher Associates Insurance Company ("UTA") and Continental General Insurance Company ("CGI", and together with UTA, "CII" or the "Insurance Companies"). Insurance Companies provide long-term care, life and annuity coverage to approximately 99,000 individuals. The benefits provided help protect our policy and certificate holders from the financial hardships associated with illness, injury, loss of life, or income continuation.

4.Our Utilities segment includes American Natural Gas ("ANG"). ANG is a premier distributor of natural gas motor fuel headquartered in the Northeast. ANG designs, builds, owns, acquires, operates and maintains compressed natural gas fueling stations for transportation vehicles. ANG’s team is comprised of industry, legal, construction, engineering and entrepreneurial experts who are working directly with the leading natural gas companies to seek out opportunities for building successful natural gas fueling stations. Vehicle manufacturers and fleet operators are pursuing natural gas vehicles in the US markets to reduce carbon emissions and environmental impacts while providing a cost-effective alternative to foreign crude oil. The Company maintains a 55% controlling interest in ANG.

5.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 service operators and Internet service providers from our International Carrier Services ("ICS") business unit. We provide premium voice communications services for National Telecom operators, Mobile operators, wholesale carriers, Prepaid operators, VARS & VOIP service operators. ICS provides a quality service via direct routes & by forming strong relationships with carefully selected partners.

6.Our Life Sciences segment includes Pansend Life Sciences, LLC (“Pansend”). Pansend owns (i) a 77% interest in Genovel Orthopedics, Inc., which seeks to develop products to treat early osteoarthritis of the knee, (ii) a 61% interest in R2 Dermatology (f/k/a GemDerm Aesthetics, Inc.), which develops skin lightening technology, (iii) a 60% interest in Benevir Biopharm, Inc., which focuses on immunotherapy for the treatment of solid tumors and invests in other early stage or developmental stage healthcare companies.

7.In our Other segment, we invest in and grow developmental stage companies where we believe growth potential is significant. In this segment, we currently have a 72% ownership interest in DMi, Inc. ("DMi"), which owns licenses to create and distribute NASCAR® video games. See footnotes 17. Related Parties and 21. Subsequent Events.

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

2. Summary of Significant Accounting Policies

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

Principles of Consolidation - The condensed consolidated financial statements include the accounts of the Company, its wholly owned subsidiaries and all other subsidiaries over which the Company exerts control. All intercompany profits, transactions and balances have been eliminated in consolidation. As of March 31, 2016, the Company has a 100% interest in the Insurance Companies, a 97% interest in GMSL, a 91% interest in Schuff, a 55% interest in ANG and a 72% interest in DMi, Inc. Through its subsidiary, Pansend, the Company has a 77% interest in Genovel Orthopedics, Inc., a 61% interest in R2 Dermatology and a 60% interest in Benevir Biopharm, 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 2016 ended on April 2, 2016.

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

Newly Adopted Accounting Principles

In September 2015, the FASB issued Accounting Standards Update ("ASU") 2015-16, "Business Combination Topic No. 805: Simplifying the Accounting for Measurement - Period Adjustments", which requires adjustments to provisional amounts that are identified during the measurement period to be recognized in the reporting period in which the adjustment amounts are determined. This includes any effect on earnings of changes in depreciation, amortization, or other income effects as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. On January 1, 2016, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

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

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

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

In May 2015, the FASB issued ASU 2015-8, “Business Combinations Topic No. 805: Pushdown Accounting-Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115 (SEC Update)”, which rescinds certain SEC guidance in order

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

to confirm with ASU 2014-17, “Pushdown Accounting” (“ASU 2014-17”). ASU 2014-17 was issued in November 2014 and provides a reporting entity that is a business or nonprofit activity (an “acquiree”) the option to apply pushdown accounting to its separate financial statements when an acquirer obtains control of the acquiree. On January 1, 2016, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

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

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

In January 2015, the FASB issued ASU 2015-1, “Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items”, which eliminates 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. On January 1, 2016, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

New Accounting Pronouncements

In March 2016, the FASB issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting" (Topic 718), which introduces targeted amendments intended to simplify the accounting for stock compensation. Specifically, the ASU requires all excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) to be recognized as income tax expense or benefit in the income statement. Early adoption is permitted. The Company's effective date for adoption is January 1, 2017. The Company is currently evaluating the impact of the accounting update on its condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-08, "Principal versus Agent Considerations" (Topic 606), which updates the new revenue standard by clarifying the principal versus agent implementation guidance. Early adoption is permitted. The Company's effective date for adoption is January 1, 2018. The Company is currently evaluating the impact of the accounting update on its condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-07, "Simplifying the Transition to the Equity Method of Accounting" (Topic 323), which requires an investor to initially apply the equity method of accounting from the date it qualifies for that method, i.e., the date the investor obtains significant influence over the operating and financial policies of an investee. The ASU eliminates the previous requirement to retroactively adjust the investment and record a cumulative catch up for the periods that the investment had been held, but did not qualify for the equity method of accounting.

Early adoption is permitted. The Company's effective date for adoption is January 1, 2017. The Company is currently evaluating the impact of the accounting update on its condensed consolidated financial statements.

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

1, 2017. The Company is currently evaluating the impact of the accounting update on its condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-05, "Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships" (Topic 815), which requires an entity to discontinue a designated hedging relationship in certain circumstances, including termination of the derivative hedging instrument or if the entity wishes to change any of the critical terms of the hedging relationship. ASU 2016-05 amends Topic 815 to clarify that novation of a derivative (replacing one of the parties to a derivative instrument with a new party) designated as the hedging instrument would not, in and of itself, be considered a termination of the derivative instrument or a change in critical terms requiring discontinuation of the designated hedging relationship. Early adoption is permitted. The Company's effective date for adoption is January 1, 2017. The Company is currently evaluating the impact of the accounting update on its condensed consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases" (Topic 842), which applies a right-of-use (ROU) model that requires a lessee to record, for all leases with a lease term of more than 12 months, an asset representing its right to use the underlying asset and a liability to make lease payments. The ASU requires a lessor to classify leases as either sales-type, direct financing or operating, similar to existing U.S. GAAP. Classification depends on the same five criteria used by lessees plus certain additional factors. The new leases standard addresses other considerations including identification of a lease, separating lease and nonlease components of a contract, sale and leaseback transactions, modifications, combining contracts, reassessment of the lease term, and remeasurement of lease payments. Early adoption is permitted. The Company’s effective date for adoption is January 1, 2019. The Company is currently evaluating the impact of this accounting update on its consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Liabilities" (Topic 825-10) which, among other things, will require all equity securities currently classified as “available for sale” to be reported at fair value, with holding gains and losses recognized in net income instead of accumulated other comprehensive income. Certain provisions of the ASU are eligible for early adoption. The Company’s effective date for adoption is January 1, 2018. The Company is currently evaluating the impact of this accounting update on its consolidated financial statements.

3. Business Combinations

The Company’s acquisitions were accounted for using the acquisition method of accounting which requires, among other things, that assets acquired and liabilities assumed be recognized at their estimated fair values as of the acquisition date. Estimates of fair value included in the condensed consolidated financial statements, in conformity with ASC 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 “Business Combinations”, 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.

Insurance Companies

On December 24, 2015, the Company completed the acquisitions of 100% of the interests in the Insurance Companies as well as all assets owned by the sellers of the Insurance Companies or their affiliates that are used exclusively or primarily in the business of the Insurance Companies, subject to certain exceptions. The operations of the Insurance Companies were consolidated into our insurance operating segment, with a plan to leverage their existing platform and industry expertise to identify strategic growth opportunities for managing closed blocks of long-term care business.

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

The aggregate consideration provided in connection with the acquisition of the Insurance Companies and related transactions and agreements was valued at $18.6 million and consisted of $7.0 million of cash, $2.0 million in aggregate principal amount of the Company’s 11.0% Senior Secured Notes due 2019, 1,007,422 shares of the Company's common stock and five years warrants to purchase 2,000,000 shares of the Company's common stock at an exercise price of $7.08 per share (subject to customary adjustments upon stock splits or similar transactions) exercisable on or after February 3, 2016 (the "Warrant").

Purchase Price Allocation

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

Fair value of consideration transferred	
Cash	$6,981
Company’s Senior Secured Notes	1,879
Company's common stock	5,380
Warrant	4,332
Total fair value of consideration transferred	$18,572
Purchase price allocation	
Fixed maturities, available for sale at fair value	$1,230,038
Equity securities, available for sale at fair value	35,697
Mortgage loans	1,252
Policy loans	18,354
Other investments	183
Cash and cash equivalents	48,525
Recoverable from reinsurers	523,076
Accrued investment income	14,417
Goodwill	46,448
Intangibles	4,850
Other assets	12,869
Total assets acquired	1,935,709
Life, accident and health reserves	(1,592,722)
Annuity reserves	(259,675)
Value of business acquired	(51,870)
Deferred tax liability	(1,704)
Other liabilities	(11,166)
Total liabilities assumed	(1,917,137)
Total net assets acquired	$18,572

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

The acquisition of the Insurance Companies resulted in goodwill of approximately $46.4 million. Goodwill was the excess of the consideration transferred over the net assets recognized and represents the future economic be