

HC2 Holdings, Inc.  
Form 10-Q  
May 09, 2014  
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**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, 2014**

**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)**

<p><b>Delaware</b>                  (State or other jurisdiction of                  incorporation or organization)</p> <p><b>460 Herndon Parkway, Suite 150,</b>    <b>Herndon, VA</b>                  (Address of principal executive offices)</p> <p style="text-align: center;"><b>(703) 456-4100</b>                  (Registrant's telephone number, including area code)</p>	<p><b>54-1708481</b>                  (I.R.S. Employer                  Identification No.)</p> <p><b>20170</b>                  (Zip Code)</p>
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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 by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

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, 2014
	15,688,644

Common Stock, \$0.001 par  
value

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
NET REVENUE	\$ 43,354	\$ 58,789
OPERATING EXPENSES		
Cost of revenue (exclusive of depreciation included below)	41,107	55,516
Selling, general and administrative	6,204	8,779
Depreciation and amortization	210	1
Gain on sale or disposal of assets	(80)	(5)
Total operating expenses	47,441	64,291
LOSS FROM OPERATIONS	(4,087)	(5,502)
INTEREST EXPENSE	(1)	
GAIN FROM CONTINGENT VALUE RIGHTS VALUATION		112
INTEREST INCOME AND OTHER EXPENSE, net	(49)	(54)
FOREIGN CURRENCY TRANSACTION LOSS	(34)	(36)
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES		
TAXES	(4,171)	(5,480)
INCOME TAX EXPENSE	(9)	(111)
LOSS FROM CONTINUING OPERATIONS	(4,180)	(5,591)
INCOME FROM DISCONTINUED OPERATIONS, net of tax	17	2,379
LOSS FROM SALE OF DISCONTINUED OPERATIONS, net of tax	(784)	
NET LOSS	\$ (4,947)	\$ (3,212)
BASIC INCOME (LOSS) PER COMMON SHARE:		
Loss from continuing operations	\$ (0.29)	\$ (0.40)
Income from discontinued operations		0.17
Loss from sale of discontinued operations	(0.05)	
NET LOSS	\$ (0.34)	\$ (0.23)
DILUTED INCOME (LOSS) PER COMMON SHARE:		
Loss from continuing operations	\$ (0.29)	\$ (0.40)
Income from discontinued operations		0.17
Loss from sale of discontinued operations	(0.05)	

NET LOSS	\$ (0.34)	\$ (0.23)
<b>WEIGHTED AVERAGE COMMON SHARES OUTSTANDING</b>		
Basic	14,631	13,909
Diluted	14,631	13,909
Loss from continuing operations, net of tax	\$ (4,180)	\$ (5,591)
Income from discontinued operations, net of tax	17	2,379
Loss from sale of discontinued operations, net of tax	(784)	
Net loss	\$ (4,947)	\$ (3,212)

See notes to condensed consolidated financial statements.

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**HC2 HOLDINGS, INC.**

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

**(in thousands)**

**(UNAUDITED)**

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
NET LOSS	\$ (4,947)	\$ (3,212)
OTHER COMPREHENSIVE INCOME (LOSS)		
Foreign currency translation adjustment	(374)	(2,320)
COMPREHENSIVE LOSS	\$ (5,321)	\$ (5,532)

See notes to condensed consolidated financial statements.

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

	<b>March 31, 2014</b>	<b>December 31, 2013</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 13,041	\$ 8,997
Accounts receivable (net of allowance for doubtful accounts receivable of \$2,428 and \$2,476 at March 31, 2014 and December 31, 2013, respectively)	16,371	18,980
Prepaid expenses and other current assets	33,306	40,594
Assets held for sale	6,024	6,329
<b>Total current assets</b>	<b>68,742</b>	<b>74,900</b>
PROPERTY AND EQUIPMENT Net	2,846	2,962
GOODWILL	3,378	3,378
OTHER INTANGIBLE ASSETS Net	22	
OTHER ASSETS	5,630	6,440
<b>TOTAL ASSETS</b>	<b>\$ 80,618</b>	<b>\$ 87,680</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 5,411	\$ 6,964
Accrued interconnection costs	11,438	12,456
Deferred revenue	294	402
Accrued expenses and other current liabilities	5,977	7,002
Accrued income taxes	49	53
Liabilities held for sale	4,514	4,823
<b>Total current liabilities</b>	<b>27,683</b>	<b>31,700</b>
OTHER LIABILITIES	718	1,571
<b>Total liabilities</b>	<b>28,401</b>	<b>33,271</b>
<b>COMMITMENTS AND CONTINGENCIES (See Note 5)</b>		
<b>STOCKHOLDERS EQUITY:</b>		
Preferred stock, \$0.001 par value 20,000,000 shares authorized; none issued and outstanding		
Common stock, \$0.001 par value 80,000,000 shares authorized; 15,373,869 and 14,257,545 shares issued and 15,342,243 and 14,225,919 shares outstanding at March 31, 2014 and December 31, 2013, respectively	15	14



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Additional paid-in capital	101,726	98,598
Retained earnings (accumulated deficit)	(34,720)	(29,773)
Treasury stock, at cost 31,626 shares at March 31, 2014 and December 31, 2013, respectively	(378)	(378)
Accumulated other comprehensive loss	(14,426)	(14,052)
Total stockholders' equity	52,217	54,409
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 80,618</b>	<b>\$ 87,680</b>

See notes to condensed consolidated financial statements.

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

		Common Stock		Additional	Treasury	Retained	Accumulated
	Total	Shares	Amount	Paid-In	Stock	Earnings	Other
				Capital		(Accumulated	Comprehensive
						Deficit)	Income
							(Loss)
Balance as of December 31, 2013	\$ 54,409	14,226	\$ 14	\$ 98,598	\$ (378)	\$ (29,773)	\$ (14,052)
Share-based compensation expense	238			238			
Proceeds from the exercise of warrants and stock options	2,891	1,116	1	2,890			
Net loss	(4,947)					(4,947)	
Foreign currency translation adjustment	(374)						(374)
Balance as of March 31, 2014	\$ 52,217	15,342	\$ 15	\$ 101,726	\$ (378)	\$ (34,720)	\$ (14,426)

See notes to condensed consolidated financial statements.

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net loss	\$ (4,947)	\$ (3,212)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Provision for doubtful accounts receivable	107	736
Share-based compensation expense	238	523
Depreciation and amortization	210	6,600
(Gain) loss on sale or disposal of assets	704	(5)
Amortization of debt discount		32
Change in fair value of Contingent Value Rights		(112)
Deferred income taxes	1	(156)
Unrealized foreign currency transaction (gain) loss on intercompany and foreign debt	(34)	186
Changes in assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	2,767	(2,166)
(Increase) decrease in prepaid expenses and other current assets	6,662	1,019
(Increase) decrease in other assets	798	967
Increase (decrease) in accounts payable	(1,795)	(1,028)
Increase (decrease) in accrued interconnection costs	(1,181)	(1,698)
Increase (decrease) in accrued expenses, deferred revenue, other current liabilities and other liabilities, net	(1,423)	(6,374)
Increase (decrease) in accrued income taxes	(4)	94
Increase (decrease) in accrued interest		3,210
Net cash provided by (used in) operating activities	2,103	(1,384)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(89)	(6,517)
Sale of property and equipment and other assets	80	5
Cash acquired from business acquisitions, net of cash paid		(397)
Net cash used in investing activities	(9)	(6,909)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Principal payments on long-term obligations		(80)
Proceeds from the exercise of warrants and stock options	2,891	

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Payment of dividend equivalents	(550)	(394)
Taxes paid in lieu of shares issued for share-based compensation		(395)
Net cash provided by (used in) financing activities	2,341	(869)
<b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	<b>(391)</b>	<b>(191)</b>
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	<b>4,044</b>	<b>(9,353)</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>8,997</b>	<b>23,197</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 13,041</b>	<b>\$ 13,844</b>
<b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>		
Cash paid for interest	\$ 969	\$ 52
Cash paid for taxes	22	125
<b>Non-cash investing and financing activities:</b>		
Capital lease additions		148

See notes to condensed consolidated financial statements.

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**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. ORGANIZATION AND BUSINESS**

On April 9, 2014, we changed our name from PTGi Holding, Inc. to HC2 Holdings, Inc. The name change was effected pursuant to Section 253 of the General Corporation Law of the State of Delaware by the merger of our wholly owned subsidiary, HC2 Name Change, Inc., into us. In connection with the name change, we changed the ticker symbol of our common stock from PTGI to HCHC (see Note 11 Subsequent Events).

HC2 Holdings, Inc. ( HC2 and, together with its subsidiaries, the Company, we and our ) has historically operated a network of direct routes and provides premium voice communication services for national telecom operators, mobile operators, wholesale carriers, prepaid operators, Voice over Internet Protocol ( VoIP ) service operators and Internet service providers ( ISPs ). The Company classifies its services into two categories: Traditional Services and International Carrier Services ( ICS ); and has provided these services from our two business units: North America Telecom and ICS. In the second quarter of 2013, the Company entered into a definitive purchase agreement to sell its North America Telecom segment and sought shareholder approval of such transaction. On July 31, 2013, the Company completed the initial closing of the sale of substantially all of its North America Telecom segment. The closing of the sale of the remainder of our North America Telecom segment, consisting of our subsidiary Primus Telecommunications, Inc. ( PTI ), has been deferred pending the receipt of regulatory approvals.

During 2013, we also provided certain growth services through our BLACKIRON Data business unit, which operated our pure data center operations in Canada. On April 17, 2013, we consummated the divestiture of BLACKIRON Data. As a result of the foregoing, our reportable operating segment is ICS.

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, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. 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 Company s accounts, 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.

*Discontinued Operations* In the second quarter of 2012, the Company sold its Australian segment and committed to dispose of and actively solicited a sale or other disposition of ICS. In the second quarter of 2013, the Company sold its BLACKIRON Data segment and reiterated its commitment to dispose of ICS. In addition, in the second quarter of 2013, the Company entered into a definitive purchase agreement to sell its North America Telecom segment and sought shareholder approval of such transaction. On July 31, 2013, the Company

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

completed the initial closing of the sale of its North America Telecom segment (see Note 9 – Discontinued Operations ). In conjunction with the initial closing of the sale of the North America Telecom segment, the Company redeemed its outstanding debt on August 30, 2013. Because the debt was required to be repaid as a result of the sale of North America Telecom, the interest expense and loss on early extinguishment or restructuring of debt of PTGi International Holding, Inc. has been allocated to discontinued operations. In December 2013, based on management’s assessment of the requirements under Accounting Standards Codification ( ASC ) No. 360, Property, Plant and Equipment ( ASC 360 ), it was determined that ICS no longer met the criteria of a held for sale asset. On February 11, 2014, the Board of Directors officially ratified management’s December 2013 assessment, and reclassified ICS from held for sale to held and used, effective December 31, 2013.

The Company has applied retrospective adjustments for the three months ended March 31, 2013 to reflect the effects of the discontinued operations that occurred during 2013. Accordingly, revenue, costs and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. In addition, the Company has applied retrospective adjustments for the three months ended March 31, 2013 to reflect the Company’s decision to cease its sale process of ICS. Accordingly, revenue, costs and expenses of ICS are now included in the respective captions in the condensed consolidated statements of operations. The assets and liabilities of the remaining portion of North America Telecom, PTI, have been classified as held for sale assets and liabilities. The held for sale assets and liabilities were removed from the specific line items on the condensed consolidated balance sheets as of March 31, 2014 and December 31, 2013. See Note 9 – Discontinued Operations, for further information regarding these transactions.

*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). The primary component of the Company’s foreign currency transaction gain (loss) is due to agreements in place with certain subsidiaries in foreign countries regarding intercompany transactions. The Company anticipates repayment of these transactions in the foreseeable future, and recognizes the realized and unrealized gains or losses on these transactions that result from foreign currency changes in the period in which they occur as 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.

*Accounts Receivable* Accounts receivable is stated at amounts due from customers net of an allowance for doubtful accounts. Our allowance for doubtful accounts considers historical experience, the age of certain receivable balances, current economic conditions and other factors that may affect the counterparty’s ability to pay.

*Goodwill and Other Intangible Assets* Under ASC No. 350, Intangibles Goodwill and Other ( ASC 350 ), goodwill and indefinite lived intangible assets are not amortized but are reviewed annually for impairment, or more frequently, if impairment indicators arise. Intangible assets that have finite lives are amortized over their estimated useful lives and are subject to the provisions of ASC 360.



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**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

Goodwill impairment is tested at least annually (October 1<sup>st</sup>) or when factors indicate potential impairment using a two-step process that begins with an estimation of the fair value of each reporting unit. Step 1 is a screen for potential impairment pursuant to which the estimated fair value of each reporting unit is compared to its carrying value. The Company estimates the fair values of each reporting unit by an estimation of the discounted cash flows of each of the reporting units based on projected earnings in the future (the income approach). If there is a deficiency (the estimated fair value of a reporting unit is less than its carrying value), a Step 2 test is required.

Step 2 measures the amount of impairment loss, if any, by comparing the implied fair value of the reporting unit's goodwill with its carrying amount. The implied fair value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination is determined; i.e., through an allocation of the fair value of a reporting unit to all of the assets and liabilities of that unit as if the reporting unit had been acquired in a business combination. If the carrying amount of the reporting unit goodwill exceeds the implied fair value of that goodwill, an impairment loss shall be recognized in an amount equal to that excess.

The Company also may utilize the provisions of Accounting Standards Update (ASU) No. 2011-08, Testing Goodwill for Impairment (ASU 2011-08), which allows the Company to use qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount.

The Company's reporting units in 2011 were Australia, Canada and US/ICS. In May 2012, the Australian reporting unit was sold, and the reporting units were Canada and US/ICS. Subsequent to classifying ICS as a discontinued operation in the second quarter of 2012 and its goodwill being classified as a held for sale asset, the reporting units were Canada and US. Subsequent to the sale of North America Telecom (which included the Canada reporting unit) in the third quarter of 2013, the Company had no goodwill attributable to the remaining US reporting unit. The US reporting unit goodwill was attributable to PTI, the unsold portion of North America Telecom, and was included in assets held for sale. As a result of the decision to cease the sale process of ICS as of December 31, 2013, ICS became a reporting unit and its goodwill was reclassified as a held and used asset.

Estimating the fair value of a reporting unit requires various assumptions including projections of future cash flows, perpetual growth rates and discount rates. The assumptions about future cash flows and growth rates are based on the Company's assessment of a number of factors, including the reporting unit's recent performance against budget, performance in the market that the reporting unit serves, and industry and general economic data from third party sources. Discount rate assumptions are based on an assessment of the risk inherent in those future cash flows. Changes to the underlying businesses could affect the future cash flows, which in turn could affect the fair value of the reporting unit.

Intangible assets not subject to amortization consisted of certain trade names. Such indefinite lived intangible assets are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the asset might be impaired. The impairment test shall consist of a comparison of the fair value of an intangible asset with its carrying amount. If the carrying amount of the intangible asset exceeds its fair value, an impairment loss shall be

recognized in an amount equal to the excess.

Intangible assets subject to amortization consisted of certain trade names and customer relationships. These finite lived intangible assets are amortized based on their estimated useful lives. Such assets are subject to the impairment provisions of ASC 360, wherein impairment is recognized and measured only if there are events and circumstances that indicate that the carrying amount may not be recoverable. The carrying amount is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use of the asset group. An impairment loss is recorded if after determining that it is not recoverable, the carrying amount exceeds the fair value of the asset.

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

In addition to the foregoing, the Company reviews its goodwill and intangible assets for possible impairment whenever events or circumstances indicate that the carrying amounts of assets may not be recoverable. The factors that the Company considers important, and which could trigger an impairment review, include, but are not limited to: a more than likely than not expectation of selling or disposing all, or a portion, of a reporting unit; a significant decline in the market value of our common stock or debt securities for a sustained period; a material adverse change in economic, financial market, industry or sector trends; a material failure to achieve operating results relative to historical levels or projected future levels; and significant changes in operations or business strategy.

*Valuation of Long-lived Assets (Held for Sale)* In conjunction with the Company's entry into definitive agreements with respect to the sale of North America Telecom, which was substantially completed on July 31, 2013, the Company classifies the net assets of the remaining portion of North America Telecom, PTI, as held for sale and is required to measure them at the lower of carrying value or fair value less costs to sell.

Prior to December 31, 2013, ICS was included in held for sale assets. Under ASC 360, when a long-lived asset previously classified as held for sale is reclassified as held and used, the assets and liabilities are measured individually at the lower of the (1) carrying value prior to its held for sale classification, adjusted for any depreciation and amortization that would have been recognized and (2) the fair value as of the date of the decision not to sell. The Company determined that the carrying value of the current assets and current liabilities of ICS approximate fair value. With respect to the carrying value of the property and equipment of ICS, the Company first recorded depreciation for the period July 1, 2012 through December 31, 2013 and subsequently impaired any assets that had no future benefit. The resulting adjusted carrying value of ICS was lower than its fair value. The goodwill of ICS was tested for impairment under ASC 350 using a Step 1 and Step 2 approach. Because the fair value of ICS exceeded its adjusted carrying value under Step 1, no further analysis was required.

The Company makes significant assumptions and estimates in the process of determining fair value regarding matters that are inherently uncertain, such as estimating future cash flows, discount rates and growth rates. The resulting cash flows are projected over an extended period of time, which subjects those assumptions and estimates to an even larger degree of uncertainty. While the Company believes that its estimates are reasonable, different assumptions could materially affect the valuation of the net assets. The current year analysis of carrying value and fair value less costs to sell is disclosed in Note 9 – Discontinued Operations.

*Valuation of Long-lived Assets (Held and Used)* The Company reviews long-lived assets whenever events or changes indicate that the carrying amount of an asset may not be recoverable. In making such evaluations, the Company compares the expected undiscounted future cash flows to the carrying amount of the assets. If the total of the expected undiscounted future cash flows is less than the carrying amount of the assets, the Company is required to make estimates of the fair value of the long-lived assets in order to calculate the impairment loss equal to the difference between the fair value and carrying value of the assets.

The Company makes significant assumptions and estimates in this process regarding matters that are inherently uncertain, such as determining asset groups and estimating future cash flows, remaining useful lives, discount rates

and growth rates. The resulting undiscounted cash flows are projected over an extended period of time, which subjects those assumptions and estimates to an even larger degree of uncertainty. While the Company believes that its estimates are reasonable, different assumptions could materially affect the valuation of the long-lived assets. The Company derives future cash flow estimates from its historical experience and its internal business plans, which include consideration of industry trends, competitive actions, technology changes, regulatory actions, available financial resources for marketing and capital expenditures and changes in its underlying cost structure.

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**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

The Company has concluded that it has one asset group: the network. This is due to the nature of its telecommunications network which utilizes all of the points of presence (POPs), switches, cables and various other components throughout the network to form seamlessly the telecommunications gateway over which its products and services are carried for any given customer's phone call. Furthermore, outflows to many of the external network providers are not separately assignable to revenue inflows for any phone call or service plan.

The Company makes assumptions about the remaining useful life of its long-lived assets. The assumptions are based on the average life of its historical capital asset additions, its historical asset purchase trend and that its primary assets, its network switches, have a life of 5 to 7 years. Because of the nature of its industry, the Company also assumes that the technology changes in the industry render all equipment obsolete with no salvage value after their useful lives. In certain circumstances in which the underlying assets could be leased for an additional period of time, the Company includes such estimated cash flows in its estimate.

The estimate of the appropriate discount rate to be used to apply the present value technique in determining fair value was the Company's weighted average cost of capital which is based on the effective rate of its long-term debt obligations at the current market values (for periods during which the Company had long-term debt obligations) as well as the current volatility and trading value of the Company's common stock.

*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, accrued interconnection cost disputes, 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 tax 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.

*Reclassification* Certain previous year amounts have been reclassified to conform with current year presentations, as related to the reporting of the Company's discontinued operations.

*Newly Adopted Accounting Principles*

In July 2013, an update was issued to the Income Taxes Topic No. 740, ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which indicates that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward, except as follows. To the extent a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and

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

the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. Early adoption is permitted and this accounting update should be applied prospectively from the beginning of the fiscal year of adoption. On January 1, 2014, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

In March 2013, an update was issued to the Foreign Currency Matters Topic No. 830, ASU 2013-05, *Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity*, which indicates that the entire amount of a cumulative translation adjustment related to an entity's investment in a foreign entity should be released when there has been a (1) sale of a subsidiary or group of net assets within a foreign entity and the sale represents the substantially complete liquidation of the investment in the foreign entity; (2) loss of a controlling financial interest in an investment in a foreign entity; or (3) step acquisition for a foreign entity. Early adoption is permitted and this accounting update should be applied prospectively from the beginning of the fiscal year of adoption. On January 1, 2014, the Company adopted this update, which did not have a material impact on the condensed consolidated financial statements.

*New Accounting Pronouncements*

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. The Company's effective date for adoption is January 1, 2015. The Company does not expect this accounting update to have a material effect on its condensed consolidated financial statements in future periods, although that could change.

**3. LONG-TERM OBLIGATIONS***Redemption of 10% Notes, 10% Exchange Notes and 13% Notes and Satisfaction and Discharge of Related Indentures*

On August 30, 2013, PTGi International Holding, Inc. (f/k/a Primus Telecommunications Holding, Inc. PTHI), consummated the redemption of approximately \$125.3 million of its 10% Senior Secured Notes due 2017 (the 10% Notes) and 10% Senior Secured Exchange Notes due 2017 (the 10% Exchange Notes). The \$125.3 million consisted

of approximately \$12.7 million in aggregate principal amount of its 10% Notes at a redemption price equal to 106.50% of the principal amount thereof and \$112.6 million in aggregate principal amount of its 10% Exchange Notes at a redemption price equal to 100.00% of the principal amount thereof, plus accrued but unpaid interest to the date of redemption. PTHI thereby satisfied and discharged the indenture governing the 10% Notes and 10% Exchange Notes (the 10% Notes Indenture ), as a result of which all of the obligations of PTHI, as the issuer of the 10% Notes and 10% Exchange Notes, and the guarantors of the 10% Notes and 10% Exchange Notes (including HC2) under the 10% Notes Indenture ceased to be of further effect (subject to certain exceptions) and the liens on collateral of PTHI and the guarantors of the 10% Notes and 10%



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**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

Exchange Notes securing such notes were released. In connection with the August 2013 10% Notes and 10% Exchange Notes redemption, the Company incurred \$0.8 million of premiums and other costs and wrote off \$0.8 million and \$14.8 million of deferred financing costs, respectively, and \$0.1 million and \$0.5 million of original issue discount, respectively, in the third quarter of 2013. Aside from the applicable redemption price, no other redemption premium was paid for the 10% Exchange Notes.

On August 30, 2013, PTHI and Primus Telecommunications Canada Inc. ( PTCI ) consummated the redemption of approximately \$2.4 million in aggregate principal amount of its 13% Senior Secured Notes due 2016 (the 13% Notes ) at a redemption price equal to 106.50% of the principal amount thereof, plus accrued but unpaid interest to the date of redemption. PTHI and PTCI thereby satisfied and discharged the indenture governing the 13% Notes (the 13% Notes Indenture ), as a result of which all of the obligations of PTHI and PTCI, as the issuers of the 13% Notes, and the guarantors of the 13% Notes (including HC2) under the 13% Notes Indenture ceased to be of further effect (subject to certain exceptions). Liens on collateral securing the 13% Notes had previously been released in connection with the amendment of the 13% Notes Indenture that became effective on July 7, 2011. In connection with the August 2013 13% Notes redemption, the Company incurred \$0.2 million of premiums and other costs and wrote off \$3.7 million of deferred financing costs and \$0.02 million of original issue discount in the third quarter of 2013.

**4. INCOME TAXES**

*NOL Limitation*

As of December 31, 2013, the Company reported United States operating loss carryforwards available to reduce future United States taxable income in the amount of \$241.0 million, of which \$125.0 million is subject to limitation under Section 382 of the Internal Revenue Code ( Section 382 ), and of which \$116.0 million is not subject to the Section 382 limit. In the first quarter of 2014, Schedule 13D filings made with the SEC reported the acquisition of HC2 stock by new shareholders. The Company is currently evaluating the impact these stock acquisitions will have on the Company's ability to utilize NOLs as determined by Section 382.

*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. It is expected that the amount of unrecognized tax benefits, reflected in the Company's financial statements, will change in the next twelve 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. During the three months ended March 31, 2014, penalties and interest were immaterial.

*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 Company is currently under examination in various domestic and foreign tax jurisdictions, which when resolved, are not expected to have a material effect on its condensed consolidated financial statements.

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

The following table summarizes the open tax years for each major jurisdiction:

<b>Jurisdiction</b>	<b>Open Tax Years</b>
United States Federal	2002 2013
United Kingdom	2005 2013
Netherlands	2008 2013

**5. COMMITMENTS AND CONTINGENCIES**

Future minimum lease payments under non-cancellable operating leases, including continuing obligations of discontinued operations, as of March 31, 2014 are as follows (in thousands):

<b>Year Ending December 31,</b>	<b>Operating Leases</b>
2014 (as of March 31, 2014)	\$ 1,868
2015	2,353
2016	2,212
2017	1,737
2018	1,257
Thereafter	2,126
<b>Total long-term obligations</b>	<b>\$ 11,553</b>

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 \$2.4 million and \$0.7 million for the three months ended March 31, 2014 and 2013, respectively. The rent expense for the three months ended March 31, 2014 includes costs associated with the termination of a facilities lease.

*Litigation*

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., Globility Communications Corporation, MIPPS Inc., Primus Telecommunications Canada Inc. and HC2 Holdings, Inc.* In such action, Xplornet alleges that they entered into an agreement to acquire certain licenses for radio spectrum in Canada from Globility Communications Corporation ( 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 failed to negotiate in good faith. Xplornet also alleges that they 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. We intend to assert that we have meritorious defenses in the foregoing matter and we intend to defend ourselves vigorously.

The Company is subject to other 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

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

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.

**6. SHARE-BASED COMPENSATION**

The Compensation Committee (the Committee) of the Board of Directors of HC2 administers HC2's Management Compensation Plan, as amended (the Management Compensation Plan). The Committee has broad authority to administer, construe and interpret the Management Compensation Plan; however, except in connection with certain Corporate Transactions (as defined in the Management Compensation Plan), it may not take any action with respect to an award that would be treated, for accounting purposes, as a repricing of an award unless the action is approved by the shareholders of HC2.

The Management Compensation Plan provides for the grant of incentive stock options, nonqualified stock options, restricted stock, restricted stock units, and other stock-based or cash-based performance awards (collectively, awards). HC2 typically issues new shares of common stock upon the exercise of stock options, as opposed to using treasury shares. There are 2,000,000 shares authorized for awards under the Management Compensation 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 8,521 and zero options granted during the three months ended March 31, 2014 and 2013, respectively. The weighted average fair value at date of grant for options granted during the three months ended March 31, 2014 was \$1.46 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:

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Expected option life	6 years	
Risk-free interest rate	2.62%	2.73%
Expected volatility	37.20%	
Dividend yield	0%	

Total share-based compensation expense recognized by the Company during the three months ended March 31, 2014 and 2013 was \$0.2 million and \$0.5 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.

Table of Contents**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)***Restricted Stock Units (RSUs)*

A summary of HC2's RSU activity during the three months ended March 31, 2014 is as follows:

	<b>Shares</b>	<b>Weighted Average Grant Date Fair Value</b>
Unvested December 31, 2013	22,500	\$ 13.59
Granted	4,261	\$ 3.60
Vested	(15,000)	\$ 13.60
Forfeitures		\$
Unvested March 31, 2014	11,761	\$ 9.98

As of March 31, 2014, the unvested RSUs represented \$66,000 of compensation expense that is expected to be recognized over the weighted average remaining vesting period of 1.0 years. The number of unvested RSUs expected to vest is 11,761.

*Stock Options*

A summary of HC2's stock option activity during the three months ended March 31, 2014 is as follows:

	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding December 31, 2013	589,859	\$ 3.17
Granted	8,521	\$ 3.60
Exercised	(230,300)	\$ 2.43
Forfeitures	(78,243)	\$ 3.78
Outstanding March 31, 2014	289,837	\$ 3.61
Eligible for exercise	248,226	\$ 3.59

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

	<b>Intrinsic Value</b>	<b>Weighted Average Remaining Life in Years</b>
Options outstanding March 31, 2014	\$ 48,319	8.3
Options exercisable March 31, 2014	\$ 48,041	8.2

During the three months ended March 31, 2014, the intrinsic value of the exercised options was \$0.3 million. As of March 31, 2014, the Company had 41,611 unvested stock options outstanding of which \$34,000 of compensation expense is expected to be recognized over the weighted average remaining period of 1.0 years. The number of unvested stock options expected to vest is 41,611 shares, with a weighted average remaining life of 8.9 years, a weighted average exercise price of \$3.76, and an intrinsic value that was immaterial.



**Table of Contents****HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)****7. STOCKHOLDERS EQUITY**

As of March 31, 2014 and December 31, 2013, there were 15,342,243 and 14,225,919 shares of common stock outstanding, respectively.

*Class A and B Warrants*

In July 2009, HC2 issued (A) Class A warrants (the Class A Warrants ) to purchase shares of HC2 s common stock, which are divided into three separate series (Class A-1, Class A-2 and Class A-3 Warrants), each of which series consists of 1,000,000 warrants to purchase an original aggregate amount of up to 1,000,000 shares of HC2 common stock; and (B) Class B warrants (the Class B Warrants and, together with the Class A Warrants, the Warrants ) to purchase an original aggregate amount of up to 1,500,000 shares of HC2 common stock. In connection with the issuance of the Warrants, HC2 entered into a Warrant Agreement for each of the Class A Warrants and the Class B Warrants, in each case with Broadridge Financial Solutions, Inc. (successor-in-interest to StockTrans, Inc.), as warrant agent. The Warrants have a five-year term and will expire on July 1, 2014. As a result of special cash dividends paid in 2012 and 2013, antidilution adjustment provisions were triggered and the original exercise price and the number of shares of HC2 common stock issuable upon exercise were adjusted.

As of March 31, 2014, the exercise price with respect to (i) the Class A-1 Warrants is \$2.79, (ii) the Class A-2 Warrants is \$3.77, (iii) the Class A-3 Warrants is \$4.67, and (iv) the Class B Warrants is \$5.93; while the number of shares of HC2 common stock issuable upon exercise with respect to (i) the Class A-1 Warrants is 3,291,071, (ii) the Class A-2 Warrants is 4,386,214, (iii) the Class A-3 Warrants is 4,386,218, and (iv) the Class B Warrants is 6,579,322. There were 190,486 Class A-1 Warrants exercised during the three months ended March 31, 2014, which converted to 835,524 shares of HC2 s common stock.

**8. OPERATING SEGMENT AND RELATED INFORMATION**

The Company currently has two reportable geographic segments United States and United Kingdom; and one reportable operating segment. Net revenue and long-lived assets by geographic segment is reported on the basis of where services are provided and the location of the long-lived assets, respectively. All inter-segment revenues are eliminated. The Company has no single customer representing greater than 10% of its revenues.

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
<b>Net Revenue by Geographic Region</b>		
United States	\$ 25,280	\$ 23,628

United Kingdom	18,074	35,161
Total	\$ 43,354	\$ 58,789

	March 31, 2014	December 31, 2013
<b>Property and Equipment, Net by Geographic Region</b>		
United States	\$ 2,258	\$ 2,303
United Kingdom	588	659
Total	\$ 2,846	\$ 2,962

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**Table of Contents****HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)****9. DISCONTINUED OPERATIONS***Discontinued Operations year ended December 31, 2013*

On April 17, 2013, the Company completed the sale of its BLACKIRON Data segment to Rogers Communications Inc., a Canadian telecommunications company, and its affiliates for CAD\$200.0 million (or approximately USD\$195.6 million giving effect to the currency exchange rate on the day of sale). The Company recorded a \$135.0 million gain from the sale of this segment during the second quarter of 2013. In addition, the purchase agreement contains customary indemnification obligations, representations, warranties and covenants for a transaction of this nature. In connection with the closing of the transaction, CAD\$20.0 million (or approximately USD\$19.5 million giving effect to the currency exchange rate on the day of sale) was retained from the purchase price and placed into escrow until July 17, 2014 for purposes of satisfying potential indemnification claims pursuant to the purchase agreement. The escrow has been recorded as part of prepaid expenses and other current assets in the condensed consolidated balance sheets.

On July 31, 2013, the Company completed the sale of Lingo, Inc., iPrimus, USA, Inc., 3620212 Canada Inc., PTCI, Telesonic Communications Inc., and Globility Communications Corporation to affiliates of York Capital Management, an investment firm (together York ), for \$129 million. The sale of PTI is also contemplated as part of this transaction. The closing of the sale of PTI, which constitutes the remainder of our North America Telecom segment, has been deferred pending the receipt of 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. Certain indemnification obligations are subject to a cap of \$12.9 million. In addition, the purchase agreement provides that the Company must, for 14 months after the closing of the transaction, maintain a minimum balance of cash and cash equivalents necessary to satisfy potential indemnification obligations under the purchase agreement. 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 to be paid upon closing of the sale of PTI. The escrow has been recorded as part of prepaid expenses and other current assets in the condensed consolidated balance sheets.

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. 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 the purchaser 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 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 \$6.45 million escrow deposit is recorded in prepaid expenses and other current assets, while the \$4.8 million escrow deposit is recorded in other assets in the condensed consolidated balance sheet as of

March 31, 2014.

The Company evaluated the remaining carrying value of North America Telecom, i.e. PTI, in the third quarter of 2013 which resulted in it being higher than its fair value less costs to sell by \$0.3 million and have attributed such adjustment to the long-lived assets of PTI. As the adjustment is related to North America Telecom, it is classified within income (loss) from discontinued operations, net of tax on the condensed consolidated statements of operations.

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

As a result of these events, the Company's condensed consolidated financial statements reflect the BLACKIRON Data and North America Telecom, as well as PTHI's interest expense and loss on early extinguishment or restructuring of debt, as discontinued operations for the three months ended March 31, 2013. Accordingly, revenue, costs and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. The net operating results of the discontinued operations have been reported, net of applicable income taxes as income or loss (where applicable) from discontinued operations. Additionally, the assets and liabilities of the remaining portion of North America Telecom, PTI, have been classified as held for sale assets and liabilities as of March 31, 2014 and December 31, 2013. The held for sale assets and liabilities were removed from the specific line items on the condensed consolidated balance sheets as of March 31, 2014 and December 31, 2013.

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net revenue	\$ 3,278	\$ 60,883
Operating expenses	3,229	54,257
Income from operations	49	6,626
Interest expense		(4,249)
Interest income and other income (expense)	(26)	18
Foreign currency transaction loss		(77)
Income before income tax	23	2,318
Income tax (expense) benefit	(6)	61
Income from discontinued operations	\$ 17	\$ 2,379

Summarized assets and liabilities of the remaining portion of North America Telecom, PTI, classified as held for sale as of March 31, 2014 and December 31, 2013 are as follows (in thousands):

	<b>North America Telecom (1)</b>	
	<b>March 31,</b>	<b>December 31,</b>
	<b>2014</b>	<b>2013</b>
Accounts receivable	\$ 493	\$ 670
Prepaid expenses and other current assets	732	839

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Long-lived assets	4,799	4,820
Assets held for sale	\$ 6,024	\$ 6,329
Accounts payable	\$ 666	\$ 869
Accrued interconnection costs	299	420
Accrued expenses and other liabilities	3,549	3,534
Liabilities held for sale	\$ 4,514	\$ 4,823

- (1) Included in the table above is the remaining goodwill of the US reporting unit of \$3.7 million and customer relationships of \$0.4 million, applicable to PTI.

Table of Contents**HC2 HOLDINGS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED****(UNAUDITED)****10. 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, 2014 and 2013 due to the results of operations being a loss from continuing operations, net of tax. For the three months ended March 31, 2014 and 2013, 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, 2014*

0.3 million shares issuable upon exercise of stock options and RSUs under the Management Compensation Plan; and

18.6 million shares issuable upon exercise of Warrants.

*Three Months Ended March 31, 2013*

0.4 million shares issuable upon exercise of stock options and RSUs under the Management Compensation Plan;

6.2 million shares issuable upon exercise of Warrants; and

3.7 million shares issuable upon exercise of CVRs.

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):

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Loss from continuing operations, net of tax	\$ (4,180)	\$ (5,591)

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Income from discontinued operations, net of tax	17	2,379
Loss from sale of discontinued operations, net of tax	(784)	
Net loss basic	\$ (4,947)	\$ (3,212)
Net loss diluted	\$ (4,947)	\$ (3,212)
Weighted average common shares outstanding basic	14,631	13,909
Weighted average common shares outstanding diluted	14,631	13,909
Basic income (loss) per common share:		
Loss from continuing operations	\$ (0.29)	\$ (0.40)
Income from discontinued operations		0.17
Loss from sale of discontinued operations	(0.05)	
Net loss	\$ (0.34)	\$ (0.23)
Diluted income (loss) per common share:		
Loss from continuing operations	\$ (0.29)	\$ (0.40)
Income from discontinued operations		0.17
Loss from sale of discontinued operations	(0.05)	
Net loss	\$ (0.34)	\$ (0.23)



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**HC2 HOLDINGS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS CONTINUED**

**(UNAUDITED)**

**11. SUBSEQUENT EVENTS**

*Name Change*

On April 9, 2014, we changed our name from PTGi Holding, Inc. to HC2 Holdings, Inc. The name change was effected pursuant to Section 253 of the General Corporation Law of the State of Delaware by the merger of our wholly owned subsidiary, HC2 Name Change, Inc., into us. In connection with the name change, we changed the ticker symbol of our common stock from PTGI to HCHC.

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**Table of Contents****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, 2013. 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 and in our Annual Report on Form 10-K for the year ended December 31, 2013 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.*

**Introduction and Overview of Operations**

We have historically operated an extensive network of direct routes. We 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 ). We provide a quality service via direct routes and by forming strong relationships with carefully selected partners. We classify our services into two categories: Traditional Services and International Carrier Services ( ICS ). We have provided these services from our two business units: North America Telecom and ICS. In the second quarter of 2013, the Company entered into a definitive purchase agreement to sell its North America Telecom segment and sought shareholder approval of such transaction. On July 31, 2013, the Company completed the initial closing of the sale of substantially all of its North America Telecom segment. The closing of the sale of the remainder of our North America Telecom segment, consisting of our subsidiary Primus Telecommunications, Inc. ( PTI ), has been deferred pending the receipt of regulatory approvals. As a result of the disposition of substantially all of our North America Telecom operations, and the pending disposition of the remainder of such operations, the North America Telecom segment no longer is a separate reportable business segment and we have applied retrospective adjustments to reflect such segment as a discontinued operation.

During 2013, we also provided certain growth services through our BLACKIRON Data business unit, which operated our pure data center operations in Canada. On April 17, 2013, we consummated the divestiture of BLACKIRON Data, as a result of which we no longer operate the BLACKIRON Data business unit and have applied retrospective adjustments to reflect BLACKIRON Data as a discontinued operation.

As a result of the foregoing, our reportable operating segment is ICS. Effective in the fourth quarter of 2013, we determined to reclassify ICS as a continuing operation. Since the second quarter of 2012, ICS had been reported as a discontinued operation as a result of being held for sale.

Within ICS, we interconnect with major U.S. operators and route voice traffic to all 145,000+ NPA-NXX codes in the United States. We employ both LNP dipping and LRN capabilities to ensure that voice calls get to the termination point faster and more directly. This saves our customers money, and provides for a better end user experience. Destination networks are targeted dynamically for accurate routing, helping to eliminate incremental charges and reducing overall operating costs. We pride ourselves on a high quality of service with an emphasis on long-standing relationships with our customers and partners.

We manage our Traditional Services, which includes our domestic and international long-distance voice, local landline, wireless, prepaid cards, and dial-up Internet services, and ICS. Our primary markets are Asia Pacific, Latin America, North America/Canada/Mexico and Europe/Middle East/Asia.

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We are evaluating several strategic and business alternatives, which may include the following: acquiring assets or businesses unrelated to our current or historical telecommunications operations, operating, growing or acquiring additional assets or businesses related to our current or historical telecommunications operations, including expanding our ICS business, or winding down or selling our existing operations, including the ICS business. 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 have not identified a specific industry to focus on and there can be no assurance that we will, or we will be able to, identify or successfully complete any such transactions. In connection with evaluating these strategic and business alternatives, we may at any time be engaged in ongoing discussions with respect to possible acquisitions, business combinations and debt or equity securities offerings of widely varying sizes. 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.

Based on Schedule 13D filings of Harbinger Group Inc. ( HGI ) and Philip Falcone, HGI, Mr. Falcone and other HGI-affiliated entities acquired approximately 40.5% of HC2 s outstanding common stock in January 2014 (based on the amount of HC2 s outstanding common stock as of October 31, 2013). Our new affiliation with HGI and its personnel may give us access to new acquisition and business combination opportunities, which may include businesses which are controlled by, affiliated with or otherwise known to HGI or its affiliates or personnel. However, HGI and its affiliates and personnel are not obligated to provide us with access to any acquisition or business combination opportunities and may at any time be seeking investment opportunities similar to those being considered by the Company.

**Recent Developments***Name Change*

On April 9, 2014, we changed our name from PTGi Holding, Inc. to HC2 Holdings, Inc. The name change was effected pursuant to Section 253 of the General Corporation Law of the State of Delaware by the merger of our wholly owned subsidiary, HC2 Name Change, Inc., into us. In connection with the name change, we changed the ticker symbol of our common stock from PTGI to HCHC.

**Foreign Currency**

Foreign currency can impact our financial results. During the three months ended March 31, 2014, approximately 42% 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. In addition, prior to the sale of BLACKIRON Data and North America Telecom during the second and third quarters of 2013, respectively, we also experienced risk of loss regarding foreign currency exchange rates due to fluctuations in the USD/Canadian dollar ( CAD ) exchange rates. 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.

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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 ICS, depending upon whether the business in ICS is 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 the reported losses for ICS.

For the three months ended March 31, 2014 as compared to the three months ended March 31, 2013, 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, 2014 and 2013:

Net Revenue by Location, including Discontinued Operations in USD (in thousands)

	<b>Three Months Ended March 31,</b>				
	<b>2014</b>	<b>2013</b>	<b>Variance \$</b>	<b>Variance %</b>	
Canada (1)	\$	\$ 53,069	\$ (53,069)	-100.0%	
United Kingdom		18,074	35,161	(17,087)	-48.6%

Net Revenue by Location, including Discontinued Operations in Local Currencies (in thousands)

	<b>Three Months Ended March 31,</b>				
	<b>2014</b>	<b>2013</b>	<b>Variance \$</b>	<b>Variance %</b>	
Canada (1) (in CAD)	\$	\$ 53,478	\$ (53,478)	-100.0%	
United Kingdom (in GBP)		10,927	22,612	(11,685)	-51.7%

(1) Table includes revenues from discontinued operations which are subject to currency risk.

**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, 2013 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, 2013.

**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, pursuant to accounting principles generally accepted in the United States of America ( US GAAP ) and SEC disclosure rules, the Company's results of operations for the three months ended March 31, 2014 as compared to the three months ended March 31, 2013.

We also present detailed changes in results, excluding currency impacts, since a portion of our revenues is derived outside of the United States, and currency changes can influence or mask underlying changes in foreign operating unit performance. For purposes of calculating constant currency rates between periods in connection with presentations that describe changes in values excluding currency effects herein, we have taken results from foreign operations for a given year (that were computed in accordance with US GAAP using local currency) and converted such amounts utilizing the same USD to applicable local currency exchange rates that were used

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for purposes of calculating corresponding preceding period US GAAP presentations. We believe that the comparison of the combined financial results provides management and investors with a meaningful analysis of our performance and trends for comparative purposes.

**Discontinued Operations**

*2013 Developments* In the second quarter of 2013, the Company sold its BLACKIRON Data segment. In addition, in the second quarter of 2013, the Company entered into a definitive purchase agreement to sell its North America Telecom segment and sought shareholder approval of such transaction. On July 31, 2013, the Company completed the initial closing of the sale of its North America Telecom segment. In conjunction with the initial closing of the sale of the North America Telecom segment, the Company redeemed its outstanding debt issued by PTGi International Holding, Inc. ( PTHI ) on August 30, 2013. Because the debt was required to be repaid as a result of the sale of North America Telecom, the interest expense and loss on early extinguishment or restructuring of debt of PTHI has been allocated to discontinued operations. In December 2013, based on management's assessment of the requirements under ASC 360, it was determined that ICS no longer met the criteria of a held for sale asset. On February 11, 2014, the Board of Directors officially ratified management's December 2013 assessment, and reclassified ICS from held for sale to held and used, effective December 31, 2013. As a result, ICS became classified as a continuing operation. ICS had been classified as a discontinued operation since the second quarter of 2012 as a result of being held for sale.

As a result of these events, the Company's condensed consolidated financial statements reflect BLACKIRON Data and North America Telecom, as well as PTHI's interest expense and loss on early extinguishment or restructuring of debt as discontinued operations for the three months ended March 31, 2013. Accordingly, revenue, costs and expenses of the discontinued operations have been excluded from the respective captions in the condensed consolidated statements of operations. The net operating results of the discontinued operations have been reported, net of applicable income taxes as income or loss (where applicable) from discontinued operations. Additionally, the assets and liabilities of the remaining portion of North America Telecom, PTI, have been classified as held for sale assets and liabilities as of March 31, 2014 and December 31, 2013. The held for sale assets and liabilities were removed from the specific line items on the condensed consolidated balance sheets as of March 31, 2014 and December 31, 2013.

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

	<b>Three Months Ended March 31,</b>	
	<b>2014</b>	<b>2013</b>
Net revenue	\$ 3,278	\$ 60,883
Operating expenses	3,229	54,257
Income from operations	49	6,626
Interest expense		(4,249)
Interest income and other income (expense)	(26)	18
Foreign currency transaction loss		(77)
Income before income tax	23	2,318
Income tax (expense) benefit	(6)	61



Income from discontinued operations	\$ 17	\$ 2,379
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*Results of operations for the three months ended March 31, 2014 as compared to the three months ended March 31, 2013*

(in thousands)	Exclusive of Currency Effect						Inclusive of Currency Effect		
	Quarter Ended		Quarter Ended		Quarter-over-Quarter		Quarter Ended		
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013	Variance	Currency	March 31, 2014		
	Net Revenue	% of Total	Net Revenue	% of Total	Variance	%	Effect	Net Revenue	% of Total
International Carrier Services	42,287	100.0%	58,789	100.0%	(16,502)	-28.1%	1,067	43,354	100.0%
Total Net Revenue	42,287	100.0%	58,789	100.0%	(16,502)	-28.1%	1,067	43,354	100.0%

**Net revenue:** Net revenue, exclusive of the currency effect, decreased \$16.5 million, or 28.1%, to \$42.3 million for the three months ended March 31, 2014 from \$58.8 million for the three months ended March 31, 2013. Inclusive of the currency effect which accounted for an increase of \$1.1 million, net revenue decreased \$15.4 million to \$43.4 million for the three months ended March 31, 2014 from \$58.8 million for the three months ended March 31, 2013. The decrease is primarily due to a significant decline in both domestic and international terminations quarter over quarter.

(in thousands)	Exclusive of Currency Effect						Inclusive of Currency Effect		
	Quarter Ended		Quarter Ended		Quarter-over-Quarter		Quarter Ended		
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013	Variance	Currency	March 31, 2014		
	Cost of Revenue	% of Net Revenue	Cost of Revenue	% of Net Revenue	Variance	%	Effect	Cost of Revenue	% of Net Revenue
International Carrier Services	40,090	94.8%	55,516	94.4%	(15,426)	-27.8%	1,017	41,107	94.8%
Total Cost of Revenue	40,090	94.8%	55,516	94.4%	(15,426)	-27.8%	1,017	41,107	94.8%

**Cost of revenue:** Cost of revenue, exclusive of the currency effect, decreased \$15.4 million to \$40.1 million, or 94.8% of net revenue, for the three months ended March 31, 2014 from \$55.5 million, or 94.4% of net revenue, for the three months ended March 31, 2013. Inclusive of the currency effect, which accounted for an increase of \$1.0 million, cost of revenue decreased \$14.4 million to \$41.1 million for the three months ended March 31, 2014 from \$55.5 million for the three months ended March 31, 2013. The decrease is primarily due to the decrease in net revenue. While there have been significant declines in both net revenue and cost of revenue, exclusive of currency, cost of revenue as a percentage of net revenue increased 40 basis points quarter over quarter; and inclusive of currency, remained flat quarter over quarter.

(in thousands)	Exclusive of Currency Effect						Inclusive of Currency Effect	
	Quarter Ended		Quarter-over-Quarter		Quarter Ended			
	March 31, 2014	March 31, 2013	Variance	Variance %	March 31, 2014	March 31, 2014		
	SG&A	SG&A			SG&A	SG&A		
	% of Net	% of Net			Currency	% of Net		
	Revenue	Revenue			Effect	Revenue		
International Carrier								
Services	2,525	4,334	(1,809)	-41.7%	41	2,566		
Corporate	3,638	4,445	(807)	-18.2%		3,638		
<b>Total SG &amp; A</b>	<b>6,163</b>	<b>8,779</b>	<b>(2,616)</b>	<b>-29.8%</b>	<b>41</b>	<b>6,204</b>		
	14.6%	14.9%				14.3%		

**Selling, general and administrative expenses:** Selling, general and administrative expenses, exclusive of the currency effect, decreased \$2.6 million to \$6.2 million, or 14.6% of net revenue, for the three months ended March 31, 2014 from \$8.8 million, or 14.9% of net revenue, for the three months ended March 31, 2013. The

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currency effect was immaterial. The decrease is primarily due to a \$1.9 million decrease in salaries and benefits resulting from headcount reductions, a \$1.7 million decrease in professional fees resulting from a reduction in legal fees, and a \$0.5 million decrease in general and administrative expenses, partially offset by a \$1.5 million increase in occupancy resulting primarily from the costs associated with the termination of a facilities lease.

**Depreciation and amortization expense:** Depreciation and amortization expense for the three months ended March 31, 2014 was \$0.2 million. Depreciation expense was an immaterial amount for the three months ended March 31, 2013 as the property and equipment of ICS was included in assets held for sale. In accordance with US GAAP, held for sale assets are not depreciated. When ICS was no longer considered to be held for sale, we began to record depreciation based on the revised carrying values.

**Gain from contingent rights valuation:** The gain from the change in fair value of the CVRs for the three months ended March 31, 2013 was \$0.1 million. Estimates of fair value represent the Company's best estimates based on a pricing model and have historically been correlated to and reflective of our common stock trends. Generally, as the fair value of our common stock increased/decreased, the fair value of the CVRs increased/decreased and a loss/gain from CVR valuation was recorded. There was no gain or loss from the change in fair value of the CVRs for the three months ended March 31, 2014. The sale of substantially all of North America Telecom constituted a change of control under the CVR Agreement and resulted in the expiration of the CVRs and termination of the CVR Agreement in 2013.

**Interest income and other expense, net:** Interest income and other expense, net was an expense of \$0.1 million for the three months ended March 31, 2014 and 2013.

**Foreign currency transaction loss:** Foreign currency transaction loss remained relatively flat at less than \$0.1 million for the three months ended March 31, 2014 and 2013. The gains and losses are attributable to the impact of foreign currency exchange rate changes on intercompany debt balances and on receivables and payables denominated in a currency other than the subsidiaries' functional currency.

**Income tax expense:** Income tax expense was \$0.1 million for the three months ended March 31, 2013 and an immaterial amount for the three months ended March 31, 2014.

**Liquidity and Capital Resources*****Important Long-Term Liquidity and Capital Structure Developments:******Escrow Deposits***

The Company has certain escrow deposits associated with the sales of BLACKIRON Data and North America Telecom during 2013 which have various conditions for their release. In connection with the sale of BLACKIRON Data, CAD\$20.0 million (or approximately USD\$19.5 million giving effect to the currency exchange rate on the day of sale) was retained from the purchase price and placed into escrow until July 17, 2014 for purposes of satisfying potential indemnification claims pursuant to the purchase agreement. In connection with the sale of North America Telecom, several different escrow deposits were established, all with varying release conditions and dates which in total amounted to \$18.25 million. 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. 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 the purchaser.

upon completion of such adjustments in February 2014. Furthermore, \$4.8 million of the purchase price was placed in escrow to cover certain tax liabilities, which 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. Lastly, an additional \$3.0 million was

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placed in escrow to be paid upon closing of the sale of PTI. The \$19.5 million, \$6.45 million and \$3.0 million escrow deposits are recorded in prepaid expenses and other current assets, while the \$4.8 million escrow deposit is recorded in other assets in the condensed consolidated balance sheets.

***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, 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, vendor financing, capital lease financing and other financing arrangements.

Net cash provided by operating activities was \$2.1 million for the three months ended March 31, 2014 as compared to net cash used in operating activities of \$1.4 million for the three months ended March 31, 2013. 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, a decrease in accrued expenses, deferred revenue, other current liabilities and other liabilities, net of \$1.4 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, a decrease in accounts receivable of \$2.7 million and a decrease in other assets of \$0.8 million. For the three months ended March 31, 2013, net income, net of non-cash operating activity, provided \$4.6 million of cash. Other major drivers included an increase in accrued interest of \$3.2 million and a decrease in prepaid expenses and other current assets of \$1.0 million, partially offset by a decrease in accrued expenses, deferred revenue, other current liabilities and other liabilities, net of \$6.4 million, an increase in accounts receivable of \$2.2 million and a decrease in accrued interconnection costs of \$1.7 million.

Net cash used in investing activities was \$9 thousand for the three months ended March 31, 2014 as compared to \$6.9 million for the three months ended March 31, 2013. Net cash used in investing activities for the three months ended March 31, 2014 included \$89 thousand of capital expenditures, offset partially by \$80 thousand of proceeds from the sale of property and equipment. Net cash used in investing activities for the three months ended March 31, 2013 included \$6.5 million of capital expenditures and \$0.4 million used in the acquisition of businesses.

Net cash used provided by financing activities was \$2.3 million for the three months ended March 31, 2014 as compared to net cash used in financing activities of \$0.9 million for the three months ended March 31, 2013. 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. Net cash used in financing activities for the three months ended March 31, 2013 included \$0.4 million used to satisfy the tax obligations for shares issued under share-based compensation arrangements, \$0.4 million used to pay dividend equivalents to our shareholders and \$0.1 million used to reduce the principal amounts outstanding on capital leases.

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

As of March 31, 2014, we had \$13.0 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.

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The obligations set forth in the table below reflect the contractual payments of principal and interest that existed as of March 31, 2014:

Contractual Obligations	Total	Payments Due By Period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	\$ 11,553	\$ 1,868	\$ 4,565	\$ 2,994	\$ 2,126
Total minimum principal & interest payments	11,553	1,868	4,565	2,994	2,126
Less: Amount representing interest					
Total contractual obligations	\$ 11,553	\$ 1,868	\$ 4,565	\$ 2,994	\$ 2,126

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.

**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.

The Company had no transactions with related parties in the three months ended March 31, 2014 and 2013, other than as described above.

**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, strategy, provide, commitment, result, seek, pursue, ongoing, include or in the negative of such terms or 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.

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

the outcome of purchase price adjustments related to divested businesses or the possibility of indemnification claims arising out of such divestitures;

continuing uncertain global economic conditions;

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

the ability of ICS to generate sufficient revenue and cash flow to fund our ongoing operations;



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our ability to complete the sale of the remaining portion of our North America Telecom segment;

our possible inability to generate sufficient liquidity, margins, earnings per share, cash flow and working capital;

our ability to attract and retain customers;

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

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

further changes in the telecommunications industry, including rapid technological, regulatory and pricing changes in our principal markets;

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 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 of 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 of the relatively low market liquidity for HC2's common stock as a result of our delisting from the NYSE or other conditions, and the failure of HC2 to subsequently relist its common stock on a national securities exchange;

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

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

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

*Foreign currency exchange rates* Foreign currency can impact our financial results. During the three months ended March 31, 2014, approximately 42% 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. In addition, prior to the sale of BLACKIRON Data and North America Telecom during the second and third quarters of 2013, respectively, we also experienced risk of loss regarding foreign currency exchange rates due to fluctuations in the USD/Canadian dollar (CAD) exchange rates. 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 ICS, depending upon whether the business in ICS is 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 the reported losses for ICS.

For the three months March 31, 2014 as compared to the three months ended March 31, 2013, the USD was weaker on average as compared to the GBP. As a result, the revenue of our subsidiaries whose local currency is GBP decreased 51.7% in their local currencies compared to the three months ended March 31, 2013 and decreased 48.6% in USD.



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**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.**

Our management evaluated, with the participation of our principal executive officer and principal 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 principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were 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.**

No changes in our internal control over financial reporting occurred during the fiscal quarter ended March 31, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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., Globility Communications Corporation, MIPPS Inc., Primus Telecommunications Canada Inc. and HC2 Holdings, Inc.* In such action, Xplornet alleges that they entered into an agreement to acquire certain licenses for radio spectrum in Canada from Globility Communications Corporation ( 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 failed to negotiate in good faith. Xplornet also alleges that they 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. We intend to assert that we have meritorious defenses in the foregoing matter and we intend to defend ourselves vigorously.

The Company is subject to other claims and legal proceedings that arise in the ordinary course of its 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 flows. 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 flows.

**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, 2013.

**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**

On May 8, 2014, the Company's Board of Directors approved and adopted an amendment and restatement of the Company's Code of Conduct (the Code), which is applicable to all directors, officers and employees, including our principal executive officer, principal financial officer, principal accounting officer or controller or persons performing similar functions (the Key Personnel). The Code is a statement of business practices and principles of behavior that support our commitment to conducting business while maintaining the highest standards of business conduct and ethics. Our Code covers topics including, but not limited to, compliance resources, conflicts of interest, compliance with laws, rules and regulations, internal reporting of violations and accountability for adherence to the Code.

The amendment and restatement of the Code did not result in any waiver in favor of any of our Key Personnel, explicit or implicit, from any provision of the Code. Rather, the changes to the Code reflected in the amendment and restatement are principally designed to (i) clarify certain expectations with respect to compliance, the avoidance of conflicts of interest and procedural aspects of the Code and (ii) streamline the Code and coordinate its provisions with current practices and other policies of the Company.

A copy of the Code, as amended and restated, is available on our website at [www.HC2.com](http://www.HC2.com).

## **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 9, 2014.

Date: May 9, 2014

HC2 HOLDINGS, INC.

By: /s/ MESFIN DEMISE  
**Mesfin Demise**

**Chief Financial Officer, Corporate Controller  
and Treasurer**

**(Principal Financial and Accounting Officer)**



**Table of Contents****EXHIBIT INDEX****Exhibit**

<b>Number</b>	<b>Description</b>
10.9 <sup>^</sup>	Offer Letter, dated May 8, 2013, by and between HC2 Holdings, Inc. ( HC2 ) and Craig Denson (filed herewith).
10.10 <sup>^</sup>	Offer Letter, dated October 26, 2011, by and between HC2 and Andrea Mancuso (filed herewith).
10.11 <sup>^</sup>	Offer Letter, dated January 16, 2013, by and between HC2 and Andrea Mancuso (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, 2014, formatted in extensible business reporting language (XBRL); (i) Unaudited Condensed Consolidated Statements of Operations for the three months ended March 31, 2014 and 2013, (ii) Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2014 and 2013, (iii) Unaudited Condensed Consolidated Balance Sheets at March 31, 2014 and December 31, 2013, (iv) Unaudited Condensed Consolidated Statements of Stockholders' Equity for the three months ended March 31, 2014, (v) Unaudited Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2014 and 2013, 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.

\*\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

<sup>^</sup> Indicates management contract or compensatory plan or arrangement.