

MCDERMOTT INTERNATIONAL INC  
Form 10-Q  
July 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-08430

McDERMOTT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

REPUBLIC OF PANAMA  
(State or Other Jurisdiction of  
Incorporation or Organization)

72-0593134  
(I.R.S. Employer  
Identification No.)

757 N. ELDRIDGE PKWY  
HOUSTON, TEXAS  
(Address of Principal Executive Offices) (Zip Code)

77079

Registrant's Telephone Number, Including Area Code: (281) 870-5000

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the registrant’s common stock outstanding at July 22, 2016 was 240,571,660.

McDERMOTT INTERNATIONAL, INC.

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## PART I—FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

McDERMOTT INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|   | Three Months Ended June 30,                        |             | Six Months Ended June 30, |             |
|---|--|-------------|---------------------------|-------------|
|   | 2016   | 2015        | 2016                      | 2015        |
|   | (In thousands, except share and per share amounts) |             |                           |             |
| Revenues  | \$706,627  | \$1,046,537 | \$1,435,659               | \$1,597,000 |
| Costs and Expenses:   |  |             |                           |             |
| Cost of operations  | 595,442  | 925,522     | 1,211,475                 | 1,400,981   |
| Selling, general and administrative expenses                              | 52,075   | 47,793      | 90,403                    | 99,469      |
| Impairment loss   | -  | 6,808       | 32,311                    | 6,808       |
| Loss (gain) on asset disposals  | (362 )   | 1,910       | (362 )                    | 1,543       |
| Restructuring expenses  | 2,484  | 15,391      | 8,851                     | 25,780      |
| Total costs and expenses  | 649,639  | 997,424     | 1,342,678                 | 1,534,581   |
| Operating income  | 56,988   | 49,113      | 92,981                    | 62,419      |
| Other income (expense):   |  |             |                           |             |
| Interest expense, net   | (12,655 )  | (12,985 )   | (23,893 )                 | (25,164 )   |
| Gain (loss) on foreign currency, net                                      | (1,974 )   | 1,943       | (5,157 )                  | 475         |
| Other expense, net  | (877 )   | (359 )      | (1,085 )                  | (456 )      |
| Total other expense   | (15,506 )  | (11,401 )   | (30,135 )                 | (25,145 )   |
| Income before provision for income taxes                                  | 41,482   | 37,712      | 62,846                    | 37,274      |
| Provision for income taxes  | 19,804   | 16,541      | 39,134                    | 21,410      |
| Income before income (loss) from investments in unconsolidated affiliates | 21,678   | 21,171      | 23,712                    | 15,864      |
| Income (loss) from investments in unconsolidated affiliates               | 127  | (7,481 )    | (4,351 )                  | (14,222 )   |
| Net income  | 21,805   | 13,690      | 19,361                    | 1,642       |
| Less: Net income attributable to noncontrolling interest                  | 1,148  | 2,164       | 876                       | 4,623       |
| Net income (loss) attributable to McDermott International, Inc.           | \$20,657   | \$11,526    | \$18,485                  | \$(2,981 )  |

Income (loss) per share

Net income (loss) attributable to McDermott  
International, Inc.

|          |      |      |      |         |
|----------|------|------|------|---------|
| Basic:   | 0.09 | 0.05 | 0.08 | (0.01 ) |
| Diluted: | 0.07 | 0.04 | 0.07 | (0.01 ) |

Shares used in the computation of income (loss) per  
share:

|          |             |             |             |             |
|----------|-------------|-------------|-------------|-------------|
| Basic:   | 240,338,540 | 238,332,012 | 239,739,204 | 237,918,366 |
| Diluted: | 284,909,414 | 289,689,981 | 283,132,238 | 237,918,366 |

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

|  | Three Months   |          | Six Months Ended |         |
|--|----------------|----------|------------------|---------|
|  | Ended June 30, |          | June 30,         |         |
|  | 2016           | 2015     | 2016             | 2015    |
|  | (in thousands) |          |                  |         |
| Net income   | \$21,805       | \$13,690 | \$19,361         | \$1,642 |
| Other comprehensive income, net of tax:                              |                |          |                  |         |
| Unrealized gain on investments                                       | 12             | 4        | 17               | 16      |
| Gain on derivatives  | 4,621          | 27,559   | 35,412           | 10,674  |
| Foreign currency translation   | (4,027)        | (4,944)  | (7,370)          | (6,986) |
| Other comprehensive income, net of tax                               | 606            | 22,619   | 28,059           | 3,704   |
| Total comprehensive income   | \$22,411       | \$36,309 | \$47,420         | \$5,346 |
| Less: Comprehensive income attributable to non-controlling interests | 1,140          | 2,117    | 855              | 4,543   |
| Comprehensive income attributable to McDermott International, Inc.   | \$21,271       | \$34,192 | \$46,565         | \$803   |

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS

|   | June 30,   | December 31, |
|---|--|--------------|
|   | 2016   | 2015         |
|   | (In thousands, except share and per share amounts) |              |
|   | (Unaudited)  |              |
| Assets  |  |              |
| Current assets:   |  |              |
| Cash and cash equivalents   | \$470,023  | \$664,844    |
| Restricted cash and cash equivalents  | 112,792  | 116,801      |
| Accounts receivable—trade, net  | 273,625  | 208,474      |
| Accounts receivable—other   | 54,998   | 66,689       |
| Contracts in progress   | 304,790  | 435,829      |
| Other current assets  | 44,549   | 34,641       |
| Total current assets  | 1,260,777  | 1,527,278    |
| Property, plant and equipment   | 2,559,108  | 2,467,352    |
| Less accumulated depreciation   | (853,463 )   | (856,493 )   |
| Net property, plant and equipment   | 1,705,645  | 1,610,859    |
| Accounts receivable—long-term retainages  | 128,190  | 155,061      |
| Investments in unconsolidated affiliates  | 27,866   | 26,551       |
| Deferred income taxes   | 13,154   | 18,822       |
| Other assets  | 38,296   | 48,505       |
| Total assets  | \$3,173,928  | \$3,387,076  |
| Liabilities and Equity  |  |              |
| Current liabilities:  |  |              |
| Notes payable and current maturities of long-term debt  | \$52,802   | \$24,882     |
| Accounts payable  | 215,987  | 279,821      |
| Accrued liabilities   | 269,277  | 330,943      |
| Advance billings on contracts   | 101,421  | 164,773      |
| Income taxes payable  | 21,833   | 23,787       |
| Total current liabilities   | 661,320  | 824,206      |
| Long-term debt  | 704,108  | 819,001      |
| Self-insurance  | 19,975   | 18,653       |
| Pension liability   | 23,940   | 24,066       |
| Non-current income taxes  | 58,379   | 52,559       |
| Other liabilities   | 109,746  | 101,870      |
| Commitments and contingencies   |  |              |
| Stockholders' Equity:   |  |              |
| Common stock, par value \$1.00 per share, authorized 400,000,000 shares;<br>issued 248,646,454 and 246,841,128 shares, respectively | 248,646  | 246,841      |
|   | 1,689,103  | 1,687,059    |

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|  |             |             |
|--|-------------|-------------|
| Capital in excess of par value (including prepaid common stock purchase contracts) |             |             |
| Accumulated deficit  | (242,399 )  | (260,884 )  |
| Accumulated other comprehensive loss   | (65,875 )   | (93,955 )   |
| Treasury stock, at cost: 8,074,794 and 7,824,204 shares, respectively              | (93,792 )   | (92,262 )   |
| Stockholders' Equity—McDermott International, Inc.                                 | 1,535,683   | 1,486,799   |
| Noncontrolling interest  | 60,777      | 59,922      |
| Total Equity   | 1,596,460   | 1,546,721   |
| Total Liabilities and Equity   | \$3,173,928 | \$3,387,076 |

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)

|   | Six Months Ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2016                         | 2015      |
|   | (In thousands)               |           |
| <b>Cash flows from operating activities:</b>                        |                              |           |
| Net income  | \$19,361                     | \$1,642   |
| <b>Non-cash items included in net income:</b>                       |                              |           |
| Depreciation and amortization                                       | 41,997                       | 51,371    |
| Drydock amortization  | 6,932                        | 9,658     |
| Impairment loss   | 32,311                       | 6,808     |
| Stock-based compensation charges                                    | 9,242                        | 9,891     |
| Loss from investments in unconsolidated affiliates                  | 4,351                        | 14,222    |
| Loss (gain) on asset disposals                                      | (362 )                       | 1,543     |
| Restructuring (gain) expense  | (1,500 )                     | 9,153     |
| Deferred income taxes   | 5,667                        | (1,215 )  |
| Other non-cash items  | 1,143                        | (495 )    |
| <b>Changes in assets and liabilities that provided (used) cash:</b> |                              |           |
| Accounts receivable   | (30,835 )                    | (147,293) |
| Contracts in progress, net of advance billings on contracts         | 67,698                       | (129,932) |
| Accounts payable  | (65,212 )                    | 120,586   |
| Accrued and other current liabilities                               | (45,523 )                    | 48,380    |
| Pension liability   | (751 )                       | (942 )    |
| Other assets and liabilities  | 31,271                       | (19,443 ) |
| Total cash provided by (used in) operating activities               | 75,790                       | (26,066 ) |
| <b>Cash flows from investing activities:</b>                        |                              |           |
| Purchases of property, plant and equipment                          | (170,674)                    | (47,985 ) |
| (Increase) decrease in restricted cash and cash equivalents         | 4,009                        | (6,842 )  |
| Investments in unconsolidated affiliates                            | (4,105 )                     | (4,783 )  |
| Proceeds from asset dispositions                                    | 388                          | 10,510    |
| Sales and maturities of available-for-sale securities               | -                            | 2,875     |
| Other investing activities  | -                            | (232 )    |
| Total cash used in investing activities                             | (170,382)                    | (46,457 ) |
| <b>Cash flows from financing activities:</b>                        |                              |           |
| Repayment of debt   | (88,845 )                    | (13,402 ) |
| Repurchase of common stock  | (2,572 )                     | (1,448 )  |
| Payment of debt issuance costs                                      | (8,211 )                     | -         |
| Other   | -                            | (13 )     |
| Total cash used in financing activities                             | (99,628 )                    | (14,863 ) |
| Effects of exchange rate changes on cash and cash equivalents       | (601 )                       | (1,348 )  |
| Net decrease in cash and cash equivalents                           | (194,821)                    | (88,734 ) |
| Cash and cash equivalents at beginning of period                    | 664,844                      | 665,309   |

|  |           |           |
|--|-----------|-----------|
| Cash and cash equivalents at end of period | \$470,023 | \$576,575 |
|--|-----------|-----------|

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF EQUITY  
(Unaudited)

|  | Common<br>Stock<br>Value<br>(in thousands) | Capital<br>in Excess<br>of Par<br>Value | Accumulated            |                                 |                   | Stockholders'<br>Equity | Noncontrol<br>Interest<br>("NCI") | Total<br>Equity |
|--|--|---|------------------------|---------------------------------|-------------------|-------------------------|-----------------------------------|-----------------|
|  |  |   | Accumulated<br>Deficit | Other<br>Comprehens<br>ive Loss | Treasury<br>Stock |                         |                                   |                 |
| Balance at<br>January 1, 2016                          | \$ 246,841                                 | \$ 1,687,059                            | \$(260,884 )           | \$(93,955 )                     | \$(92,262)        | \$ 1,486,799            | \$ 59,922                         | \$ 1,546,721    |
| Net income   | -  | -                                       | 18,485                 | -                               | -                 | 18,485                  | 876                               | 19,361          |
| Other<br>comprehensive<br>income (loss),<br>net of tax | -  | -                                       | -                      | 28,080                          | -                 | 28,080                  | (21 )                             | 28,059          |
| Common stock<br>issued                                 | 2,206                                      | (2,206 )                                | -                      | -                               | -                 | -                       | -                                 | -               |
| Stock-based<br>compensation<br>charges                 | -  | 4,891                                   | -                      | -                               | -                 | 4,891                   | -                                 | 4,891           |
| Purchase of<br>treasury shares                         | -  | -                                       | -                      | -                               | (2,572 )          | (2,572 )                | -                                 | (2,572 )        |
| Retirement of<br>common stock                          | (401 )                                     | (641 )                                  | -                      | -                               | 1,042             | -                       | -                                 | -               |
| Balance at June<br>30, 2016                            | \$ 248,646                                 | \$ 1,689,103                            | \$(242,399 )           | \$(65,875 )                     | \$(93,792)        | \$ 1,535,683            | \$ 60,777                         | \$ 1,596,460    |

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

NOTE 1—BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

#### Nature of Operations

McDermott International, Inc. (“MDR”), a corporation incorporated under the laws of the Republic of Panama in 1959, is a leading provider of integrated engineering, procurement, construction and installation (“EPCI”) and module fabrication services for upstream field developments worldwide. We deliver fixed and floating production facilities, pipeline installations and subsea systems from concept to commissioning for complex offshore and subsea oil and gas projects. Operating in approximately 20 countries across Americas, Europe, Africa, the Middle East, Asia and Australia, our integrated resources include a diversified fleet of marine vessels, fabrication facilities and engineering offices. We support our activities with comprehensive project management and procurement services, while utilizing our fully integrated capabilities in both shallow water and deepwater construction. Our customers include national, major integrated and other oil and gas companies, and we operate in most major offshore oil and gas producing regions throughout the world. We execute our contracts through a variety of methods, principally fixed-price, but also including cost reimbursable, cost-plus, day-rate and unit-rate basis or some combination of those methods. In these Notes to our Consolidated Financial Statements, unless the context otherwise indicates, “we,” “us” and “our” mean MDR and its consolidated subsidiaries.

#### Basis of Presentation

The accompanying Consolidated Financial Statements are unaudited and have been prepared from our books and records in accordance with Rule 10-1 of Regulation S-X for interim financial information. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States (“U.S. GAAP”) for complete financial statements. In the opinion of our management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. The results of operations for interim periods are not necessarily indicative of results of operations for a full year. These Consolidated Financial Statements should be read in conjunction with our Consolidated Financial Statements and Notes thereto included in MDR’s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC on February 22, 2016.

#### Classification

Certain prior year amounts have been reclassified for consistency with the current year presentation. Our Consolidated Financial Statements previously reported income and loss from investment in unconsolidated affiliates as components of operating income. In the first quarter of 2016, we concluded that classification of loss from investments in unconsolidated affiliates after provision for income tax better reflected how the operations of our unconsolidated affiliates relate to our business as a whole.

#### Recently Issued and Adopted Accounting Guidance

Stock Compensation—In March 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Compensation—Stock Compensation (Topic 718): Improvement to Employee Share-Based Payment Accounting. This ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, earnings per share and classification in the statement of cash flows. We adopted this ASU in the second quarter of 2016. Our adoption did not have a material impact on the presentation of our Consolidated Financial Statements.

**Income Tax**—In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes. Under this ASU an entity shall classify deferred tax assets and liabilities as noncurrent. We adopted ASU 2015-17 in the first quarter of 2016. Our adoption of that ASU did not have a material impact on the presentation of our Consolidated Financial Statements. All comparable periods presented have been revised to reflect this change.

**Consolidation**—In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments. This ASU eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement-period adjustment during the period in which it determines the amount of the adjustment.

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis, which amends and changes the consolidation analysis currently required under U.S. GAAP. This ASU modifies the process used to evaluate whether

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

limited partnerships and similar entities are variable interest entities or voting interest entities; affects the analysis performed by reporting entities regarding variable interest entities, particularly those with fee arrangements and related party relationships; and provides a scope exception for certain investment funds.

The amendments in ASUs 2015-16 and 2015-02 are effective for annual and interim periods beginning after December 15, 2015. Early adoption was permitted. We adopted these ASUs in the first quarter of 2016. Our adoption of these ASUs did not have a material impact on the accompanying Consolidated Financial Statements.

Accounting Guidance Issued But Not Adopted as of June 30, 2016

**Financial Instruments**—In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU will require a financial asset measured at amortized cost basis to be presented at the net amount expected to be collected. A valuation account, allowance for credit losses, will be deducted from the amortized cost basis of the financial asset to present the net carrying value at the amount expected to be collected on the financial asset. This ASU is effective for interim and annual periods beginning after December 15, 2019. We are currently assessing the impact of this guidance on our future Consolidated Financial Statements and related disclosures.

**Derivatives**—In March 2016, the FASB issued ASU 2016-06, Derivatives and hedging (Topic 815): Contingent Put and Call Options in Debt Instruments. This ASU clarifies that a contingent put or call option embedded in a debt instrument would be evaluated for possible separate accounting as a derivative instrument without regard to the nature of the exercise contingency. This ASU is effective for interim and annual periods beginning after December 15, 2016. Early adoption is permitted. We are currently assessing the impact of this guidance on our future Consolidated Financial Statements and related disclosures.

In March 2016, the FASB issued ASU 2016-05, Derivatives and hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships. The amendments in this ASU clarify that a change in the counterparty to a derivative instrument that has been designated as a hedging instrument under Topic 815 does not require de-designation of that hedging relationship, provided that all other hedge accounting criteria continue to be met. This ASU is effective for interim and annual periods beginning after December 15, 2016. Early adoption is permitted. The application of this ASU is not expected to have a material impact on our Consolidated Financial Statements.

**Leases**—In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The ASU will require entities that lease assets—referred to as “lessees”—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by leases with lease terms of more than 12 months. Consistent with current U.S. GAAP, the recognition, measurement and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. However, unlike current U.S. GAAP—which requires only capital leases to be recognized on the balance sheet—the new ASU will require both types of leases to be recognized on the balance sheet. This ASU is effective for interim and annual periods beginning after December 15, 2018. Early adoption is permitted. We are currently assessing the impact of this ASU on our future Consolidated Financial Statements and related disclosures.

**Financial Assets and Liabilities**—In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Under this new guidance, entities will be required to measure all investments in equity securities that are not subject to equity method or consolidation accounting at fair value, with changes recognized in net income. Fair value changes related to instrument-specific credit risk in financial liabilities

accounted for under the fair value option in Accounting Standards Codification 825 must be recorded in other comprehensive income instead of earnings. ASU 2016-01 also changes presentation and disclosure requirements for financial assets and liabilities. ASU 2016-01 is effective for interim and annual periods beginning after December 15, 2017, with early adoption not permitted except related to changes in fair value for financial liabilities. We are currently assessing the impact of these amendments on our future Consolidated Financial Statements and related disclosures.

Going Concern—In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. Currently, there is no guidance in effect under U.S. GAAP regarding management's responsibility to assess whether there is substantial doubt about an entity's ability to continue as a going concern. Under ASU 2014-15, we will be required to assess our ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about our ability to continue as a going concern, including management's plan to alleviate the substantial doubt. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter with early adoption permitted. We are currently assessing the impact of ASU 2014-15 on our future Consolidated Financial Statements and related disclosures.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

Revenue—In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU will supersede most of the existing revenue recognition requirements in U.S. GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. It also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

In August 2015, the FASB issued ASU 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which defers the effective date of ASU 2014-09 to annual periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

In March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting revenue Gross versus Net), which improves the operability and understandability of the Topic 606 implementation guidance on principal versus agent considerations. Effective date and transition requirements for this ASU are the same as effective date and transition requirements for ASU 2014-09.

In April 2016, the FASB issued ASU 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing, which provides clarifying guidance for identifying performance obligations and the licensing implementation guidance. The effective date and transition requirements for this ASU are the same as the effective date and transition requirements for ASU 2014-09.

In May 2016, the FASB issued ASU 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients, which provides clarifying guidance in a few narrow areas and adds some practical expedients to the guidance. The effective date and transition requirements for this ASU are the same as the effective date and transition requirements for ASU 2014-09.

We are currently evaluating the requirements of these ASUs and have not yet determined their impacts on our future Consolidated Financial Statements and related disclosures.

NOTE 2—REVENUE RECOGNITION

Unapproved Change Orders

As of June 30, 2016, total unapproved change orders included in our estimates at completion aggregated approximately \$122 million, of which approximately \$24 million was included in backlog. As of June 30, 2015, total unapproved change orders included in our estimates at completion aggregated approximately \$159 million, of which approximately \$38 million was included in backlog.

Claims Revenue

The amount of revenues and costs included in our estimates at completion (i.e., contract values) associated with claims was \$16 million and \$7 million as of June 30, 2016 and 2015, respectively, all in our Middle East segment. These amounts are determined based on various factors, including our analysis of the underlying contractual language and our experience in making and resolving claims. Our unconsolidated joint ventures did not include any material claims revenue or associated costs in their financial results for the quarters ended June 30, 2016 and 2015.

None of the claims included in our estimates at completion at June 30, 2016 were the subject of any litigation proceedings. We continue to actively engage in negotiations with our customers on our outstanding claims. However, these claims may be resolved at amounts that differ from our current estimates, which could result in increases or decreases in future estimated contract profits or losses.

#### Loss Recognition

We have provided for our estimated costs to complete on all of our ongoing contracts. However, it is possible that current estimates could change due to unforeseen events, which could result in adjustments to overall contract costs. Variations from estimated contract performance could result in material adjustments to operating results for any fiscal quarter or year. For all contracts, if a current estimate of total contract cost indicates a loss, the projected loss is recognized in full when determined.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

For loss projects, it is possible that our estimates of gross profit could increase or decrease based on changes in productivity, actual downtime and the resolution of change orders and claims with the customers.

As of June 30, 2016, there were no active projects which were in a significant loss position.

NOTE 3—USE OF ESTIMATES

We use estimates and assumptions to prepare our financial statements in conformity with U.S. GAAP. Those estimates and assumptions affect the amounts we report in our Consolidated Financial Statements and accompanying Notes. Our actual results could differ from those estimates, and variances could materially affect our financial condition and results of operations in future periods. Changes in project estimates generally exclude change orders and changes in scope, but may include, without limitation, changes in cost recovery estimates, unexpected changes in weather conditions, changes in productivity, unidentified required vessel repairs, customer and vendor delays and other costs. We generally expect to experience a reasonable amount of unanticipated events, and some of those events can result in significant cost increases above cost amounts we previously estimated. As of June 30, 2016, we have provided for our estimated costs to complete on all of our ongoing contracts. However, it is possible that current estimates could change due to unforeseen events, which could result in adjustments to overall contract costs. Variations from estimated contract performance could result in material adjustments to operating results. For all contracts, if a current estimate of total contract cost indicates a loss, the projected loss is recognized in full when determined.

The following is a discussion of our most significant changes in estimates that impacted operating income for the three and six months ended June 30, 2016 and 2015.

Three months ended June 30, 2016

Operating income for the three months ended June 30, 2016 was positively impacted by net favorable changes in estimates totaling approximately \$28 million across all segments.

Americas, Europe and Africa Segment (“AEA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$7 million, primarily attributable to productivity improvement and associated cost savings related to our DB 50 and NO 102 vessels’ marine campaigns undertaken in the Gulf of Mexico in the second quarter of 2016.

Middle East Segment (“MEA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$10 million, primarily due to (1) productivity improvements and associated cost savings related to the Intermac 406 vessel, and productivity improvements and associated cost savings related to the DB 27 vessel, both associated with Saudi Aramco projects; and (2) other miscellaneous projects, which individually were not material.

Asia Segment (“ASA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$11 million which were primarily driven by productivity improvements and associated cost savings and agreement on outstanding change orders on our active projects.

Six months ended June 30, 2016

Operating income for the six months ended June 30, 2016 was positively impacted by net favorable changes in estimates totaling approximately \$68 million across all segments.

AEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$23 million, primarily due to (1) successful execution and close-out improvements on two significant projects, PB Litoral and Exxon Julia Subsea Tieback; and (2) productivity improvement and associated cost savings related to our DB 50 and NO 102 vessels' marine campaigns undertaken in the Gulf of Mexico. Included in the change was a reversal of a \$7 million provision for liquidated damages due to an agreed extension of the PB Litoral project completion date. Those changes were partially offset by net unfavorable changes, none of which were material individually.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$17 million, primarily due to (1) productivity improvements and associated cost savings related to the DB 27 vessel and productivity improvements on the Intermac 406 vessel and associated cost savings, both associated with Saudi Aramco projects; and (2) other miscellaneous projects, none of which were material individually.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$28 million, primarily driven by productivity improvements and associated cost savings and agreement on outstanding change orders on active and completed projects.

Three months ended June 30, 2015

Operating income for the three months ended June 30, 2015 was positively impacted by net favorable changes in estimates totaling approximately \$7 million across all segments.

AEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$3 million, primarily due to reduced cost estimates attributable to the contract close-out process associated with the Papa Terra EPCI project in Brazil.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$1 million. A project in Saudi Arabia was positively impacted by \$7 million due to productivity improvements and associated cost savings on the Intermac 406 vessel, which was working on a cable lay project. These favorable changes were partially offset by a \$5 million increase in pipelay cost estimates on a U.A.E. project, primarily due to changes in execution plan, and a \$1 million unfavorable change in estimates for multiple projects.

ASA—This segment was positively impacted by net favorable changes in estimates and productivity bonuses earned totaling approximately \$3 million, driven by multiple projects, none of the individual results of which were material.

Six months ended June 30, 2015

Operating income for the six months ended June 30, 2015 was positively impacted by net favorable changes in estimates totaling approximately \$29 million across all segments.

AEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$10 million. Improvements primarily related to reduced cost estimates of approximately \$3 million attributable to the Papa Terra project, \$4 million due to productivity improvements on the Agile charter and reduced cost estimates of \$4 million attributable to a revised demobilization plan for one of our vessels, the North Ocean 105 (the “NO 105”), which was working on a subsea project in Brazil, partially offset by a \$1 million unfavorable impact driven by multiple projects.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$10 million. An EPCI project in Saudi Arabia was positively impacted by \$7 million due to changes in revenue recovery and cost savings based on an agreement with a customer on design optimization. Another project in Saudi Arabia was positively impacted by \$8 million of changes mostly due to productivity improvements and associated cost savings on the Intermac 406, which was working on a cable lay project. A project in the U.A.E. improved by \$5 million as a result of an agreement with the customer on compensation for vessel downtime due to weather and standby delays. We also had favorable changes of \$1 million from multiple projects, none of the individual results of which were material. These favorable changes were partially offset by a \$6 million negative impact on another EPCI project in Saudi Arabia, primarily due to an increase in cost estimates, as a result of a change in marine execution plans, and a \$5 million increase in pipelay cost estimates on a U.A.E. project, as a result of changes in execution plan.

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$9 million, driven by multiple projects, none of the individual results of which were material.

NOTE 4—RESTRUCTURING

In 2014 we completed a major review of our cost structure, and subsequently implemented a plan, which we referred to as the McDermott Profitability Initiative (the “MPI”), to increase our profitability and flexibility through reduced fixed and variable costs. The plan included personnel reductions, centralization of operational activities, other cost reduction initiatives and certain asset impairments. The previously announced move of our ASA regional headquarters from Singapore to Kuala Lumpur, along with additional sourcing initiatives, is substantially complete.

We continued our efforts to improve our cost structure by initiating the Additional Overhead Reduction program (“AOR”) during fourth quarter of 2015. AOR actions, which have included personnel reductions affecting direct operating and selling, general and administrative expenses are now expected to be substantially complete in the third quarter of 2016.

During 2013 and 2014, we implemented a restructuring of our Americas operations, which involved our Morgan City, Louisiana, Houston, Texas, New Orleans, Louisiana and some Brazil locations. The restructuring involved, among other things, reductions of management, administrative, fabrication and engineering personnel, and the discontinued utilization of the Morgan City facility.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

We completed a Corporate restructuring during 2014. Costs associated with our Corporate restructuring activities primarily included severance, relocation and other personnel-related costs and costs for advisors, as well as costs for certain executive management changes that became effective during the fourth quarter of 2013.

The following table presents amounts incurred during the three and six months ended June 30, 2016 and 2015, as well as amounts incurred from the inception of our restructuring efforts up to June 30, 2016 and amounts expected to be incurred in the future by major type of cost and by segment.

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## McDERMOTT INTERNATIONAL, INC.

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

|   | Incurred in the<br>three months<br>ended June 30, |        | Incurred in the six<br>months ended<br>June 30, |        | Incurred<br>from inception<br>to<br>June 30, 2016 | Estimate<br>of<br>remaining<br>amounts<br>to be<br>incurred | Total     |
|---|---|--------|---|--------|---|---|-----------|
|   | 2016  | 2015   | 2016  | 2015   |   |   |           |
|   | (in thousands)                                    |        |   |        |   |   |           |
| <b>Americas Restructuring</b>               |   |        |   |        |   |   |           |
| Impairments and write offs                  | \$-   | \$-    | \$-   | \$-    | \$ 12,923   | \$ -  | \$ 12,923 |
| Severance and other personnel-related costs | -   | 1,621  | -   | 2,502  | 13,981  | -   | 13,981    |
| Morgan City environmental reserve           | (1,500)   | -      | (1,500)   | -      | 4,425   | -   | 4,425     |
| Morgan City yard-related expenses           | -   | 820    | -   | 1,734  | 12,557  | -   | 12,557    |
| Other                                       | -   | -      | -   | -      | 158   | -   | 158       |
|   | (1,500)   | 2,441  | (1,500)   | 4,236  | 44,044  | -   | 44,044    |
| <b>Corporate Restructuring</b>              | -   | -      | -   | -      | 6,601   | -   | 6,601     |
| <b>MPI</b>                                  |   |        |   |        |   |   |           |
| Severance and other personnel-related costs |   |        |   |        |   |   |           |
| AEA   |   | 898    | -   | 2,150  | 6,646   | 250   | 6,896     |
| MEA   | -   | 304    | -   | 911    | 856   | -   | 856       |
| ASA   | 992   | 1,786  | 1,425   | 3,586  | 7,529   | 1,000   | 8,529     |
| Corporate and other                         |   | 400    | -   | 1,119  | 1,611   | -   | 1,611     |
| Asset impairment and disposal               |   |        |   |        |   |   | -         |
| ASA   | -   | 3,303  | -   | 7,471  | 7,471   | -   | 7,471     |
| Legal and other advisor fees                |   |        |   |        |   |   | -         |
| ASA   | -   | -      | -   | -      | -   | -   | -         |
| Corporate                                   | 49  | 2,732  | 222   | 2,780  | 11,639  | -   | 11,639    |
| Other                                       |   |        |   |        |   |   | -         |
| AEA   | -   | -      | -   | -      | 692   | -   | 692       |
| ASA   | 1,541   | 3,527  | 2,436   | 3,527  | 8,370   | -   | 8,370     |
| Corporate and other                         | -   | -      | -   | -      | 983   | -   | 983       |
|   | 2,582   | 12,950 | 4,083   | 21,544 | 45,797  | 1,250   | 47,047    |
| <b>AOR</b>                                  |   |        |   |        |   |   |           |
| Severance and other personnel-related costs |   |        |   |        |   |   |           |
| AEA   | 1,022   | -      | 3,208   | -      | 3,208   | -   | 3,208     |
| ASA   | -   | -      | -   | -      | -   | 400   | 400       |
| Corporate                                   | 51  | -      | 836   | -      | 836   | 100   | 936       |
| Legal and other advisor fees                |   |        |   |        |   |   | -         |
| Corporate                                   | 240   | -      | 1,968   | -      | 2,768   | -   | 2,768     |
| Other                                       |   |        |   |        |   |   | -         |
| AEA   | 16  | -      | 166   | -      | 166   | -   | 166       |

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|                   |                |                 |                |                 |                   |                 |                  |
|-------------------|----------------|-----------------|----------------|-----------------|-------------------|-----------------|------------------|
| MEA               | -              | -               | 17             | -               | 17                | -               | 17               |
| Corporate         | 73             | -               | 73             | -               | 73                | 1,000           | 1,073            |
|                   | 1,402          | -               | 6,268          | -               | 7,068             | 1,500           | 8,568            |
| <b>Total</b>      | <b>\$2,484</b> | <b>\$15,391</b> | <b>\$8,851</b> | <b>\$25,780</b> | <b>\$ 103,510</b> | <b>\$ 2,750</b> | <b>\$106,260</b> |
| <b>By segment</b> |                |                 |                |                 |                   |                 |                  |
| AEA               | \$(462 )       | \$3,339         | \$1,874        | \$6,386         | \$ 54,756         | \$ 250          | \$55,006         |
| MEA               | -              | 304             | 17             | 911             | 873               | -               | 873              |
| ASA               | 2,533          | 8,616           | 3,861          | 14,584          | 23,370            | 1,400           | 24,770           |
| Corporate         | 413            | 3,132           | 3,099          | 3,899           | 24,511            | 1,100           | 25,611           |
| <b>Total</b>      | <b>\$2,484</b> |                 |                |                 |                   |                 |                  |