

MCDERMOTT INTERNATIONAL INC  
Form 10-Q  
October 25, 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 September 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	77079

Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

(Address of Principal Executive Offices) (Zip Code)

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 October 21, 2016 was 241,339,574.

McDERMOTT INTERNATIONAL, INC.

INDEX—FORM 10-Q

	PAGE
<u>PART I—FINANCIAL INFORMATION</u>	1
<u>Item 1—Consolidated Financial Statements</u>	1
<u>Consolidated Statements of Operations</u>	1
<u>Consolidated Statements of Comprehensive Income</u>	2
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Cash Flows</u>	4
<u>Consolidated Statements of Stockholders' Equity</u>	5
<u>Notes to the Consolidated Financial Statements</u>	6
<u>Item 2—Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Item 3—Quantitative and Qualitative Disclosures about Market Risk</u>	41
<u>Item 4—Controls and Procedures</u>	42
<u>PART II—OTHER INFORMATION</u>	44
<u>Item 1—Legal Proceedings</u>	44
<u>Item 1A—Risk Factors</u>	44
<u>Item 6—Exhibits</u>	45
<u>SIGNATURES</u>	46

---

## PART I—FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements

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

	Three Months Ended		Nine Months Ended	
	September 30, 2016	2015	September 30, 2016	2015
	(In thousands, except share and per share amounts)			
Revenues	\$558,543	\$805,857	\$1,994,202	\$2,402,857
Costs and Expenses:				
Cost of operations	455,499	720,961	1,666,974	2,121,942
Selling, general and administrative expenses	46,983	44,664	137,386	144,133
Impairment loss	11,758	-	44,069	6,808
Loss (gain) on asset disposals	(588 )	(100 )	(950 )	1,443
Restructuring expenses	1,836	6,346	10,687	32,126
Total costs and expenses	515,488	771,871	1,858,166	2,306,452
Operating income	43,055	33,986	136,036	96,405
Other income (expense):				
Interest expense, net	(17,431 )	(13,015 )	(41,324 )	(38,179 )
Gain (loss) on foreign currency, net	376	(1,373 )	(4,781 )	(898 )
Other income, net	4,861	1,556	3,776	1,100
Total other expense	(12,194 )	(12,832 )	(42,329 )	(37,977 )
Income before provision for income taxes	30,861	21,154	93,707	58,428
Provision for income taxes	15,976	9,094	55,110	30,504
Income before income (loss) from Investments in Unconsolidated Affiliates	14,885	12,060	38,597	27,924
Income (loss) from Investments in Unconsolidated Affiliates	1,507	(4,526 )	(2,844 )	(18,748 )
Net income	16,392	7,534	35,753	9,176
Less: Net income attributable to noncontrolling interest	284	3,868	1,160	8,491

Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

Net income attributable to McDermott International, Inc.	\$16,108	\$3,666	\$34,593	\$685
--	----------	---------	----------	-------

Net income per share

Net income attributable to McDermott International, Inc.				
Basic:	\$0.07	\$0.02	\$0.14	\$-
Diluted:	\$0.06	\$0.01	\$0.12	\$-

Shares used in the computation of net income per share:

Basic:	240,899,888	238,594,178	240,093,169	238,128,962
Diluted:	283,907,353	280,797,155	283,132,920	279,025,262

See accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30, 2016	September 30, 2015	September 30, 2016	September 30, 2015
	(in thousands)			
Net income	\$16,392	\$7,534	\$35,753	\$9,176
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on investments	(3 )	(27 )	14	(11 )
Gain (loss) on derivatives	3,566	(701 )	38,978	9,973
Foreign currency translation	(5,031 )	(9,333 )	(12,401 )	(16,319 )
Other comprehensive income (loss), net of tax	(1,468 )	(10,061 )	26,591	(6,357 )
Total comprehensive income (loss)	\$14,924	\$(2,527 )	\$62,344	\$2,819
Less: Comprehensive income attributable to non-controlling interests	273	3,868	1,128	8,411
Comprehensive income (loss) attributable to McDermott International, Inc.	\$14,651	\$(6,395 )	\$61,216	\$(5,592 )

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.  
CONSOLIDATED BALANCE SHEETS

	September 30,	December 31,
	2016	2015
	(In thousands, except share and per share amounts) (Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 500,456	\$ 664,844
Restricted cash and cash equivalents	99,632	116,801
Accounts receivable—trade, net	274,700	208,474
Accounts receivable—other	43,140	66,689
Contracts in progress	301,736	435,829
Other current assets	37,253	34,641
Total current assets	1,256,917	1,527,278
Property, plant and equipment	2,566,534	2,467,352
Less accumulated depreciation	(876,010 )	(856,493 )
Property, plant and equipment, net	1,690,524	1,610,859
Accounts receivable—long-term retainages	125,941	155,061
Investments in Unconsolidated Affiliates	17,123	26,551
Deferred income taxes	6,932	18,822
Other assets	40,935	48,505
Total assets	\$ 3,138,372	\$ 3,387,076
Liabilities and Equity		
Current liabilities:		
Notes payable and current maturities of long-term debt	\$ 50,046	\$ 24,882
Accounts payable	169,108	279,821
Accrued liabilities	297,745	330,943
Advance billings on contracts	84,280	164,773
Income taxes payable	26,359	23,787
Total current liabilities	627,538	824,206
Long-term debt	704,346	819,001
Self-insurance	16,284	18,653
Pension liability	23,774	24,066
Non-current income taxes	60,440	52,559
Other liabilities	109,687	101,870
Commitments and contingencies		
Stockholders' Equity:		
Common stock, par value \$1.00 per share, authorized 400,000,000 shares; issued 249,628,949 and 246,841,128 shares, respectively	249,629	246,841
	1,691,918	1,687,059

Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

Capital in excess of par value (including prepaid common stock purchase contracts)		
Accumulated deficit	(226,291 )	(260,884 )
Accumulated other comprehensive loss	(67,332 )	(93,955 )
Treasury stock, at cost: 8,289,375 and 7,824,204 shares, respectively	(94,892 )	(92,262 )
Stockholders' Equity—McDermott International, Inc.	1,553,032	1,486,799
Noncontrolling interest	43,271	59,922
Total Equity	1,596,303	1,546,721
Total Liabilities and Equity	\$3,138,372	\$3,387,076

See accompanying Notes to the Consolidated Financial Statements.



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

	Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
<b>Cash flows from operating activities:</b>		
Net income	\$35,753	\$9,176
<b>Non-cash items included in net income:</b>		
Depreciation and amortization	66,892	75,982
Drydock amortization	9,863	13,910
Impairment loss	44,069	6,808
Stock-based compensation charges	14,011	12,991
Loss from investments in unconsolidated affiliates	2,844	18,748
Loss (gain) on asset disposals	(950 )	1,443
Restructuring (gain) expense	(1,500 )	11,954
Deferred income taxes	11,889	2,315
Other non-cash items	(1,657 )	3,164
<b>Changes in operating assets and liabilities that provided (used) cash:</b>		
Accounts receivable	(29,661 )	11,294
Contracts in progress, net of Advance billings on contracts	53,608	(260,317)
Accounts payable	(110,196)	98,552
Accrued and other current liabilities	(13,426 )	(7,269 )
Pension liability	(1,209 )	(1,319 )
Income taxes	10,453	(10,360 )
Other assets and liabilities, net	34,816	7,582
<b>Total cash provided by (used in) operating activities</b>	<b>125,599</b>	<b>(5,346 )</b>
<b>Cash flows from investing activities:</b>		
Purchases of property, plant and equipment	(197,393)	(66,118 )
Decrease in restricted cash and cash equivalents	17,169	51,769
Investments in unconsolidated affiliates	(4,105 )	(6,960 )
Proceeds from asset dispositions	1,123	10,669
Sales and maturities of available-for-sale securities	-	3,175
Other, net	-	417
<b>Total cash used in investing activities</b>	<b>(183,206)</b>	<b>(7,048 )</b>
<b>Cash flows from financing activities:</b>		
Repayment of debt	(93,755 )	(18,004 )
Repurchase of common stock	(3,909 )	-
Payment of debt issuance costs	(8,256 )	-
Distribution to noncontrolling interest	-	(24 )
Other, net	-	(928 )
<b>Total cash used in financing activities</b>	<b>(105,920)</b>	<b>(18,956 )</b>
Effects of exchange rate changes on cash and cash equivalents	(861 )	(2,574 )

Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

Net decrease in cash and cash equivalents	(164,388)	(33,924 )
Cash and cash equivalents at beginning of period	664,844	665,309
Cash and cash equivalents at end of period	\$500,456	\$631,385

See accompanying Notes to the Consolidated Financial Statements.

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

	Common Stock Value (in thousands)	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholder's Equity	Noncontrolling Interest ("NCI")	Total Equity
Balance at January 1, 2016	\$ 246,841	\$ 1,687,059	\$(260,884 )	\$(93,955 )	\$(92,262)	\$ 1,486,799	\$ 59,922	\$ 1,546,721
Net income	-	-	34,593	-	-	34,593	1,160	35,753
Other comprehensive income (loss), net of tax	-	-	-	26,623	-	26,623	(32 )	26,591
Common stock issued	3,235	(3,235 )	-	-	-	-	-	-
Stock-based compensation charges	-	8,329	-	-	-	8,329	-	8,329
Purchase of treasury shares	-	-	-	-	(3,909 )	(3,909 )	-	(3,909 )
Retirement of common stock	(447 )	(832 )	-	-	1,279	-	-	-
Purchase of shares from NCI	-	597	-	-	-	597	(17,779 )	(17,182 )
Balance at September 30, 2016	\$ 249,629	\$ 1,691,918	\$(226,291 )	\$(67,332 )	\$(94,892)	\$ 1,553,032	\$ 43,271	\$ 1,596,303

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

TABLE OF CONTENTS

	PAGE
<u>Note 1—Basis of Presentation and Significant Accounting Policies</u>	7
<u>Note 2—Revenue Recognition</u>	9
<u>Note 3—Use of Estimates</u>	10
<u>Note 4—Restructuring</u>	12
<u>Note 5—Accounts Receivable</u>	14
<u>Note 6—Contracts in Progress and Advance Billings on Contracts</u>	14
<u>Note 7—Debt</u>	15
<u>Note 8—Pension and Postretirement Benefits</u>	17
<u>Note 9—Derivative Financial Instruments</u>	17
<u>Note 10—Fair Value Measurements</u>	19
<u>Note 11—Stockholders' Equity</u>	20
<u>Note 12—Earnings Per Share</u>	22
<u>Note 13—Commitments and Contingencies</u>	22
<u>Note 14—Segment Reporting</u>	23

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

Statement of Cash Flows—In August 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU clarifies how entities should classify certain cash receipts and cash payments in their

statements of cash flows. The new guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. We adopted this ASU in the third quarter of 2016. Our retrospective adoption did not have a material impact on the presentation of our Consolidated Financial Statements.

**Stock Compensation**—In March 2016, the FASB issued 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.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

**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 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.

**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. Under this ASU, we are 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 our management's plan to alleviate any such substantial doubt. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter with early adoption permitted. We adopted this ASU in the third quarter of 2016. Except for the disclosures set forth in this paragraph, our adoption of the ASU did not impact the presentation of our Consolidated Financial Statements or the disclosures in the Consolidated Financial Statements.

Accounting Guidance Issued But Not Adopted as of September 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



McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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.

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 September 30, 2016, total unapproved change orders included in our estimates at completion aggregated approximately \$139 million, of which approximately \$21 million was included in backlog. As of September 30, 2015, total unapproved change orders included in our estimates at completion aggregated approximately \$146 million, of which approximately \$23 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 \$10 million as of September 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 September 30, 2016 and 2015.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

None of the claims included in our estimates at completion at September 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

As of September 30, 2016, we have provided for our estimated costs to complete for 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 immediately in cost of operations in the Consolidated Statements of Operations.

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. The provision for estimated losses on all active uncompleted projects is a component of "Advance billings on contracts" in our Consolidated Balance Sheets.

As of September 30, 2016 and December 31, 2015 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 September 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 nine months ended September 30, 2016 and 2015.

Three months ended September 30, 2016

Operating income for the three months ended September 30, 2016 was positively impacted by net favorable changes in estimates totaling approximately \$34 million across all segments.

Americas, Europe and Africa Segment (“AEA”)—This segment was positively impacted by net favorable changes in estimates, aggregating approximately \$6 million, none of which individually were material.

Middle East Segment (“MEA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$12 million, including changes due to productivity improvements and associated cost savings related to a Saudi Aramco project. The remaining changes attributable to other miscellaneous projects were not individually material.

Asia Segment (“ASA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$16 million, which were primarily driven by cost savings associated with our vessel productivity improvements, as well as favorable changes in estimates at completion on several active projects. Those changes were partially offset by net unfavorable changes on an active project, which was not material.

10

---

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

Nine months ended September 30, 2016

Operating income for the nine months ended September 30, 2016 was positively impacted by net favorable changes in estimates totaling approximately \$101 million across all segments.

AEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$29 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 improvements 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 additional extension of the PB Litoral project completion date. Those changes were partially offset by net unfavorable changes on multiple projects, none of which were individually material.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$29 million, primarily due to productivity improvements and associated cost savings related to the DB 27 and the Intermac 406 vessels, both associated with Saudi Aramco projects, due to improved execution. Those favorable changes in estimates were partially offset by marine equipment downtime due to weather on a project in Qatar.

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$43 million, primarily driven by cost savings associated with productivity improvements on our CSV 108 vessel activities and favorable agreement on outstanding change orders on active and completed projects during the 2016 period. Those changes were partially offset by net unfavorable changes on multiple projects, none of which were individually material.

Three months ended September 30, 2015

Operating income for the three months ended September 30, 2015 was impacted by net unfavorable changes in cost estimates totaling approximately \$8 million.

AEA—This segment had net unfavorable changes in estimates aggregating approximately \$11 million. Results for the third quarter of 2015 included \$6 million due to changes in the marine campaign execution plan on the PB Litoral EPCI project in Mexico and charges associated with a legal settlement. The changes in the PB Litoral marine campaign execution plan were due to carryover of offshore scope and revised cost estimates for hookup campaign. These changes were partially offset by the extension of the project completion date on the PB Litoral project, which resulted in a \$13 million provision reversal for liquidated damages.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$6 million. Projects in Saudi Arabia were positively impacted by: (1) a \$6 million favorable change order for vessel downtime; (2) productivity improvements and associated cost savings on a cable-lay project in Saudi Arabia totaling approximately \$3 million; and (3) \$1 million in net positive changes in estimates on multiple projects, which were not individually material. These favorable changes were partially offset by a \$4 million increase in pipelay cost estimates on a U.A.E. project, primarily due to changes in execution plan as a result of needing to substitute with a third-party vessel and hookup associated issues.

ASA—This segment had net unfavorable changes in estimates aggregating approximately \$3 million. The deterioration was primarily due to \$8 million of cost overruns and weather downtime on an installation project in Brunei, partially offset by \$5 million of net positive changes in estimates on multiple projects, which were not individually material.

Nine months ended September 30, 2015

Operating income for the nine months ended September 30, 2015 was positively impacted by net favorable changes in estimates totaling approximately \$21 million across all segments.

AEA—This segment had net unfavorable changes in estimates aggregating approximately \$1 million. For the nine months ended September 30, 2015, the AEA segment was positively impacted by: (1) \$13 million provision reversal for liquidated damages due to the extension of the PB Litoral project completion date; (2) \$4 million due to productivity improvements on the Agile charter; and (3) \$3 million each attributable to the Papa Terra project due to reduced cost estimates and to the North Ocean 105 vessel (the “NO 105”) due to reduced demobilization cost resulting from revised project plans. Those changes were partially offset by \$6 million due to changes in the marine campaign execution on the PB Litoral project discussed above and charges associated with a legal settlement. Other multiple projects experience net positive changes in estimates of \$1 million, which were not individually material.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$16 million. The following four projects, in Saudi Arabia, were positively impacted: (1) \$11 million of changes in estimates mostly due to productivity improvements and associated cost savings on the Intermac 406, which was working on a cable lay project; (2) \$5 million of cost savings associated with revised cable lay scope; (3) \$5 million as a result of an agreement with the customer on compensation for vessel downtime due to weather and standby delays; and (4) \$4 million related to marine hook-up campaign savings. The KJO Hout project in the Neutral Zone was positively impacted by \$7 million due to changes in revenue recovery and cost savings resulting from customer-approved design optimization. Those favorable changes were partially offset by: (1) \$9 million increase in pipelay cost estimates on a U.A.E. project as a result of changes in our execution plan; (2) \$5 million negative impact on another EPCI project in Saudi Arabia due to an increase in cost estimates on onshore scope; and (3) \$2 million of unfavorable changes in estimates on multiple projects, none of which were individually material.

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$6 million. Improvements were driven by \$4 million of productivity gains and improvements in cost estimates realized on the Gorgon MRU fabrication project, as well as \$10 million net improvements on multiple projects that were not individually material. Those improvements were partially offset by \$8 million in cost overruns resulting from weather downtime on an installation project in Brunei.

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 completed the MPI restructuring during third quarter of 2016.

We continued our efforts to improve our cost structure by initiating the Additional Overhead Reduction program (“AOR”) during the fourth quarter of 2015. AOR actions, which have included personnel reductions affecting direct operating and selling, general and administrative expenses, were substantially complete as of September 30, 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.

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.





McDERMOTT INTERNATIONAL, INC.

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

The following table presents amounts incurred during the three and nine months ended September 30, 2016 and 2015, as well as amounts incurred from the inception of our restructuring efforts up to September 30, 2016. Amounts expected to be incurred in the fourth quarter of 2016 are not material.

	Incurred in the three months ended September 30,		Incurred in the nine months ended September 30,		Incurred from inception to September 30, 2016
	2016	2015	2016	2015	
	(in thousands)				
Americas Restructuring	\$-	\$(27 )	\$(1,500 )	\$2,308	\$ 44,044
Corporate Restructuring	-	-	-	-	6,601
<b>MPI</b>					
Severance and other personnel-related costs					
AEA	-	2,360	-	6,411	6,646
MEA	-	71	-	982	856
ASA	1,165	387	2,590	3,973	8,694
Corporate and other	-	-	-	1,119	1,611
Asset impairment and disposal					
ASA	-	-	-	7,471	7,471
Legal and other advisor fees					
ASA	-	-	-	-	-
Corporate and other	-	3,555	222	6,335	11,639
Other					
AEA	-	-	-	-	692
ASA	-	-	2,436	3,527	8,370
Corporate and other	-	-	-	-	983
	1,165	6,373	5,248	29,818	46,962
<b>AOR</b>					
Severance and other personnel-related costs					
AEA	321	-	3,529	-	3,529
ASA	235	-	235	-	235
Corporate and other	-	-	836	-	836
Legal and other advisor fees					
Corporate	-	-	1,968	-	2,768
Other					
AEA	-	-	166	-	166
MEA	-	-	17	-	17
Corporate and other	115	-	188	-	188
	671	-	6,939	-	7,739

Total	\$1,836	\$6,346	\$10,687	\$32,126	\$ 105,346
By segment					
AEA	\$321	\$2,333	\$2,195	\$8,719	\$ 55,077
MEA	-	71	17	982	873
ASA	1,400	387	5,261	14,971	24,770
Corporate and other	115	3,555	3,214	7,454	24,626
Total	\$1,836	\$6,346	\$10,687	\$32,126	\$ 105,346

MCDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

## NOTE 5—ACCOUNTS RECEIVABLE

Accounts Receivable—Trade, Net

A summary of contract receivables is as follows:

	September 30, 2016	December 31, 2015
	(in thousands)	
Contract receivables:		
Contracts in progress	\$ 181,401	\$ 164,898
Completed contracts	51,277	35,702
Retainages	52,031	17,896
Unbilled	4,303	4,303
Less allowances	(14,312 )	(14,325 )
Accounts receivable—trade, net	\$ 274,700	\$ 208,474

Contract retainages generally represent amounts withheld by our customers until project completion, in accordance with the terms of the applicable contracts. The following is a summary of retainages on our contracts:

	September 30, 2016	December 31, 2015
	(in thousands)	
Retainages expected to be collected within one year	\$ 52,031	\$ 17,896
Retainages expected to be collected after one year	125,941	155,061
Total retainages	\$ 177,972	\$ 172,957

## NOTE 6—CONTRACTS IN PROGRESS AND ADVANCE BILLINGS ON CONTRACTS

A detail of the components of contracts in progress and advance billings on contracts is as follows:

	September 30, 2016	December 31, 2015
	(In thousands)	
Costs incurred less costs of revenue recognized	\$ 108,043	\$ 112,819

Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

Revenues recognized less billings to customers	193,693	323,010
Contracts in Progress	\$301,736	\$435,829
Billings to customers less revenue recognized	20,532	265,618
Costs incurred less costs of revenue recognized	63,748	(100,845)
Advance Billings on Contracts	\$84,280	\$164,773

McDERMOTT INTERNATIONAL, INC.

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

## NOTE 7—DEBT

The carrying values of our long-term debt obligations, net of debt issuance costs of \$16 million and \$20 million as of September 30, 2016 and December 31, 2015, respectively, are as follows:

	September 30, 2016	December 31, 2015
	(In thousands)	
Senior Notes	\$493,076	\$491,890
Term Loan	212,217	289,979
North Ocean 105 Construction Financing	35,361	38,263
Amortizing Notes	11,368	21,205
Capital lease obligation	2,370	2,546
	754,392	843,883
Less: Amounts due within one year	50,046	24,882
Total long-term debt	\$704,346	\$819,001

## Credit Agreement, Senior Notes and Amortizing Notes

In April 2014 we entered into a credit agreement (the “Credit Agreement”), which initially provided for a \$400 million first-lien, first-out three-year letter of credit facility (the “LC Facility”), scheduled to mature in 2017, and a \$300 million first-lien, second-out five-year term loan (the “Term Loan”), scheduled to mature in 2019. We also completed the issuance of (a) \$500 million of second-lien, seven-year, senior secured notes; and (b) \$288 million of tangible equity units (“TEUs”) composed of (1) three-year amortizing, senior unsecured notes, in an aggregate principal amount of \$48 million, and (2) prepaid common stock purchase contracts.

In October 2015, we entered into an Amendment No. 1, which amended the Credit Agreement primarily to increase the existing LC Facility from \$400 million to \$520 million.

In February 2016, we entered into an Amendment No. 2 to the Credit Agreement, which amended the Credit Agreement to permit us to add to Covenant EBITDA certain cash restructuring expenses related to the conclusion of MPI or implementation of AOR for the quarters ending on or after March 31, 2016 but before April 16, 2017, in an aggregate amount not to exceed \$25 million (as of any date of determination).

On April 18, 2016, we entered into an Amendment No. 3 to the Credit Agreement, which, among other things:

- replaced the existing EBITDA covenant with new ratios (as defined in Amendment No. 3) as follows:
  - a minimum fixed charge coverage ratio of 1.15x for the fiscal quarter ended March 31, 2016 and each fiscal quarter thereafter;
  - a maximum total leverage ratio of 4.5x for the fiscal quarter ended March 31, 2016 and each subsequent fiscal quarter through June 30, 2017, 4.0x for the fiscal quarters ending September 30, 2017 and December 31, 2017, and 3.5x for each fiscal quarter thereafter; and

a maximum secured leverage ratio of 2.0x for the fiscal quarter ended March 31, 2016 and each subsequent fiscal quarter through December 31, 2017, and 1.5x for each fiscal quarter thereafter; and

amended the maximum capital expenditure covenant to limit capital expenditures in 2016 and thereafter to \$250 million each fiscal year, with any prior fiscal year unused capital expenditures up to \$125 million able to be carried forward and added to the next year's capital expenditure capacity, for a total of \$375 million.

In addition, upon the May 13, 2016 satisfaction of certain conditions set forth in Amendment 3, including the receipt of requisite consents from term lenders under the Credit Agreement, Amendment 3 also amended the Credit Agreement to, among other things:

extend the maturity date of the LC Facility commitments to April 22, 2019, unless the Term Loan has not been repaid or refinanced by January 15, 2019, in which case the LC Facility commitments will expire on January 15, 2019;

change the existing letter of credit capacity of \$520 million to \$450 million;

15

---

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

extend the deadline for mortgaging the DLV 2000 to one year after taking delivery thereof, and give McDermott the option to consider potential financing options for the DLV 2000 during that period;  
 increase the basket for purchase money indebtedness from \$20 million to \$150 million;  
 modify the covenant limiting acquisitions to permit up to \$150 million of acquisitions; and  
 modify the covenant limiting the prepayment or purchase of junior priority debt to permit up to \$100 million of such prepayments or purchases.

On May 12, 2016, we entered into an Amendment No. 4 to the Credit Agreement which, among other things:

increased the applicable margin payable on the Term Loan by 3.0% per annum; and  
 required that the net cash proceeds of any sale (including a sale and leaseback) of the DLV 2000 be applied as a mandatory prepayment of the Term Loan.

On May 13, 2016, McDermott voluntarily prepaid \$75 million of the Term Loan and satisfied the other conditions to the “effective date” set forth in Amendment No. 4.

We were in compliance with our financial covenants as of September 30, 2016, as shown below:

Ratios	Requirement	Actual
Minimum fixed charge coverage ratio	1.15x	2.86x
Maximum total leverage ratio	4.5x	2.15x
Maximum secured leverage ratio	2x	0.66x

As of September 30, 2016 and December 31, 2015, the aggregate face amount of letters of credit issued under the LC Facility was \$355 million and \$384 million, respectively.

The LC Facility permits us to deposit up to \$300 million with letter of credit issuers to cash collateralize letters of credit issued on a bilateral basis outside the credit facility. As of September 30, 2016 and December 31, 2015, we had an aggregate face amount of approximately \$99 million and \$102 million of such letters of credit outstanding supported by cash collateral, including financial letters of credit of \$21 million and \$45 million, respectively. We have included the supporting cash collateral in restricted cash and cash equivalents in the accompanying Consolidated Balance Sheets.

#### North Ocean Financing

NO 105 On September 30, 2010, MDR, as guarantor, and North Ocean 105 AS, in which we have a 75% ownership interest, as borrower, entered into a financing agreement to finance a portion of the construction costs of the NO 105. Borrowings under the agreement are secured by, among other things, a pledge of all of the equity of North Ocean 105 AS, a mortgage on the NO 105, and a lien on substantially all of the other assets of North Ocean 105 AS. MDR unconditionally guaranteed all amounts to be borrowed under the agreement. Under the current Credit Agreement, we are required to exercise our option under the North Ocean 105 AS joint venture agreement to purchase Oceanteam ASA’s 25% ownership interest in the vessel-owning company and repay the outstanding NO 105 debt by April 2017.

Unsecured Bilateral Lines of Credit

MDR has reimbursement agreements in place with Middle Eastern banks which provide uncommitted lines of credit in support of our contracting activities in the Middle East. There are no administrative or commitment fees associated with these agreements. Bank guarantees issued under these agreements were \$248 million and \$118 million, as of September 30, 2016 and December 31, 2015, respectively. In April 2016, we entered into an unsecured and uncommitted bilateral letter of credit arrangement for approximately \$100 million with a Middle Eastern bank to support our business in the region. As of September 30, 2016, we had an aggregate face amount of approximately \$83 million of letters of credit outstanding under that arrangement.



MCDERMOTT INTERNATIONAL, INC.

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

## Surety Bonds

As of September 30, 2016 and December 31, 2015, surety bonds issued under general agreements of indemnity in favor of surety underwriters in support of contracting activities of our subsidiaries J. Ray McDermott de México, S.A. de C.V. and McDermott, Inc. totaled \$85 million and \$54 million, respectively.

## NOTE 8—PENSION AND POSTRETIREMENT BENEFITS

Net periodic cost (benefit) for our non-contributory qualified defined benefit pension plan and several of our non-qualified supplemental defined benefit pension plans (the “Domestic Plans”) and our J. Ray McDermott, S.A. Third Country National Employees Pension Plan (the “TCN Plan”) includes the following components:

	Domestic Plans			
	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Interest cost	\$5,276	\$5,403	\$15,828	\$16,210
Expected return on plan assets	(5,002)	(6,676)	(15,006)	(20,030)
Net periodic cost (benefit)	\$274	\$(1,273)	\$822	\$(3,820)

  

	TCN Plan			
	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
	(In thousands)			
Interest cost	\$338	\$407	\$1,014	\$1,220
Expected return on plan assets	(397 )	(710 )	(1,191 )	(2,130 )
Net periodic benefit	\$(59 )	\$(303 )	\$(177 )	\$(910 )

## NOTE 9—DERIVATIVE FINANCIAL INSTRUMENTS

We enter into derivative financial instruments primarily to hedge certain firm purchase commitments and forecasted transactions denominated in foreign currencies. We record these contracts at fair value on our Consolidated Balance

Sheets. Depending on the hedge designation at the inception of the contract, the related gains and losses on these contracts are either: (1) deferred as a component of Accumulated Other Comprehensive Income (“AOCI”) until the hedged item is recognized in earnings; (2) offset against the change in fair value of the hedged firm commitment through earnings; or (3) recognized immediately in earnings. At inception and on an ongoing basis, we assess the hedging relationship to determine its effectiveness in offsetting changes in cash flows or fair value attributable to the hedged risk. We exclude from our assessment of effectiveness the portion of the fair value of the forward contracts attributable to the difference between spot exchange rates and forward exchange rates. The ineffective portion of a derivative’s change in fair value and any portion excluded from the assessment of effectiveness are immediately recognized in earnings. Gains and losses on derivative financial instruments that are immediately recognized in earnings are included as a component of gain (loss) on foreign currency—net in our Consolidated Statements of Operations.

As of September 30, 2016, the majority of our foreign currency forward contracts were designated as cash flow hedging instruments. In addition, we deferred approximately \$25 million of net losses on those derivative financial instruments in AOCI, and we expect to reclassify approximately \$14 million of deferred losses out of AOCI by September 30, 2017, as hedged items are recognized. The notional value of our outstanding derivative contracts totaled \$325 million at September 30, 2016, with maturities extending through 2017. Of this amount, approximately \$194 million is associated with various foreign currency expenditures we expect to incur on one of our ASA segment EPCI projects. These instruments consist of contracts to purchase or sell foreign-denominated currencies. As of September 30, 2016, the fair value of these contracts was in a net liability position totaling approximately \$5 million. The fair value of outstanding derivative instruments is determined using observable financial market inputs, such as quoted market prices, and is classified as Level 2 in nature.

McDERMOTT INTERNATIONAL, INC.

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

The following tables summarize our derivative financial instruments:

## Asset and Liability Derivatives

	September 30, December 2016 31, 2015 (In thousands)	
<b>Derivatives Designated as Hedges:</b>		
<b>Location:</b>		
Accounts receivable-other	\$1,156	\$1,668
Other assets	73	215
<b>Total asset derivatives</b>	<b>\$1,229</b>	<b>\$1,883</b>
Accounts payable	\$5,994	\$26,649
Other liabilities	261	4,018
<b>Total liability derivatives</b>	<b>\$6,255</b>	<b>\$30,667</b>

## The Effects of Derivative Instruments on our Financial Statements

	Three Months Ended September 30, 2016 2015 (in thousands)		Nine Months Ended September 30, 2016 2015	
<b>Derivatives Designated as Hedges:</b>				
Amount of gain (loss) recognized in other comprehensive income (loss)	\$4,228	\$(28,248)	\$14,458	\$(56,904)
<b>Income reclassified from AOCI into income (loss): effective portion</b>				
Location: Cost of operations	(679 )	27,547	23,932	66,973
<b>Gain(loss) recognized in income (loss): ineffective portion and amount excluded from effectiveness testing</b>				
Location: Gain (loss) on foreign currency—net	1,830	(1,329 )	281	2,535

McDERMOTT INTERNATIONAL, INC.

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

## NOTE 10—FAIR VALUE MEASUREMENTS

The following table presents the financial instruments outstanding as of September 30, 2016 and December 31, 2015 that are measured at fair value on a recurring basis and financial instruments that are not measured at fair value on a recurring basis.

	September 30, 2016 Carrying				
	Amount	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
<b>Recurring</b>					
Forward contracts	\$(5,026 )	\$(5,026 )	\$-	\$(5,026 )	\$-
<b>Non-recurring</b>					
Cash and cash equivalents	500,456	500,456	500,456	-	-
Restricted cash and cash equivalents	99,632	99,632	99,632	-	-
Debt	(754,392)	(746,820)	-	(693,716)	(53,104)
	December 31, 2015 Carrying				
	Amount	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
<b>Recurring</b>					
Forward contracts	\$(28,784 )	\$(28,784 )	\$-	\$(28,784 )	\$-
<b>Non-recurring</b>					
Cash and cash equivalents	664,844	664,844	664,844	-	-
Restricted cash and cash equivalents	116,801	116,801	116,801	-	-
Debt	(843,883)	(777,634)	-	(707,492)	(70,142)

We used the following methods and assumptions in estimating our fair value disclosures for our other financial instruments:

Cash and cash equivalents and restricted cash and cash equivalents—The carrying amounts that we have reported in the accompanying consolidated balance sheets for cash, cash equivalents and restricted cash and cash equivalents approximate their fair values and are classified as Level 1 within the fair value hierarchy.

Short-term and long-term debt—The fair value of debt instruments valued using a market approach based on quoted prices for similar instruments traded in active markets is classified as Level 2 within the fair value hierarchy.

Quoted prices are not available for the amortizing notes included within the TEUs or the NO 105 financing. The income approach was used to value these instruments based on the present value of future cash flows discounted at

estimated borrowing rates for similar debt instruments or on estimated prices based on current yields for debt issues of similar quality and terms. These instruments are classified as Level 3 within the fair value hierarchy.

Forward contracts. The fair value of forward contracts is classified as Level 2 within the fair value hierarchy and is valued using observable market parameters for similar instruments traded in active markets. Where quoted prices are not available, the income approach is used to value forward contracts, which discounts future cash flows based on current market expectations and credit risk.

#### Fair Value Disclosure of Non-financial Assets

During the third quarter of 2016, our management reevaluated our operational plans for certain underutilized marine assets. As a result of this exercise, we identified certain marine assets that would not be used in a manner consistent with management's original intent. Based on this determination, we tested the carrying value of these assets for recoverability by comparing the undiscounted future cash flows to the assets' respective carrying values. As the carrying value of those assets exceeded the undiscounted future cash flows, an impairment was recorded. The impairment was calculated as the difference between the \$22 million carrying value of the assets and the \$10 million estimated fair value of the assets, resulting in a \$12 million non-cash impairment charge in our ASA segment. We utilized both a market approach and income approach to estimate the fair value of the assets. Inputs included market sales data for comparable assets, forecasted cash flows and discount rates believed to be consistent with those used by principal market participants. The fair value measurement is based on inputs that are not observable in the market and thus represent level 3 inputs.

McDERMOTT INTERNATIONAL, INC.

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

During the first quarter of 2016, we impaired our Agile vessel upon termination of its current charter in May 2016, given the lack of opportunities for this type of vessel. In connection with that decision, we recognized a non-cash impairment charge of \$32 million during the first quarter of 2016, which equaled the vessel's carrying value, in accordance with ASC 360-10, Property, Plant and Equipment.

Another vessel, the DB101, which was held and used in our ASA segment, was written down to a fair value of \$14 million, resulting in a non-cash impairment charge of \$4 million in the first quarter of 2015, and was disposed of in the second quarter of 2015. An impairment loss of \$3 million was recognized in the second quarter of 2015 and was included in restructuring expenses.

In the second quarter of 2015, we abandoned a marine pipelay welding system project and recognized a \$7 million non-cash impairment charge, which equaled the carrying value of that asset.

## NOTE 11—STOCKHOLDERS' EQUITY

The changes in the number of shares outstanding and treasury shares held by the Company are as follows:

	Nine Months Ended September 30,	
	2016	2015
<b>Shares outstanding</b>		
Beginning balance	239,016,924	237,809,823
Common stock issued	3,234,994	1,564,317
Purchase of common stock	(912,344 )	(410,019 )
Ending balance	241,339,574	238,964,121
<b>Shares held as Treasury shares</b>		
Beginning balance	7,824,204	7,400,027
Purchase of common stock	912,344	410,019
Retirement of common stock	(447,173 )	-
Ending balance	8,289,375	7,810,046
<b>Ordinary shares issued at the end of the period</b>	<b>249,628,949</b>	<b>246,774,167</b>

## Accumulated Other Comprehensive Income (Loss) (AOCI)

The components of AOCI included in stockholders' equity are as follows:

	September 30, 2016	December 31, 2015
	(In thousands)	
Foreign currency translation adjustments ("FCTA")	\$(42,326)	\$(29,925 )
Net gain on investments	261	247
Net loss on derivative financial instruments	(25,267)	(64,277 )
Accumulated other comprehensive loss	\$(67,332)	\$(93,955 )

During the first quarter of 2016, we recorded a \$7 million adjustment decreasing FCTA, with an offsetting reduction of Loss on foreign currency, net, to correct amounts accounted for inappropriately in a previous period.

In the second quarter of 2016, foreign currency instruments associated with construction of our DLV 2000 vessel were settled upon the final payment to the shipyard. These instruments were designated as cash flow hedges and, as such, \$20 million of cumulative loss is recorded in AOCI and will be amortized consistent with the depreciation of the vessel.

McDERMOTT INTERNATIONAL, INC.

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

The following table presents the components of AOCI and the amounts that were reclassified during the periods indicated:

## 2016 Period

	Foreign currency translation adjustments (In thousands)	Unrealized holding gain (loss) on investments	Gain (loss) on derivative (1)	TOTAL
For the three months ended September 30, 2016				
Balance, June 30, 2016	\$(37,295)	\$ 264	\$ (28,844 )	\$(65,875 )
Other comprehensive income (loss) before reclassification	(5,031 )	(3 )	4,228	(806 )
Amounts reclassified from AOCI	-	-	(651 )	(651 )
Net current period other comprehensive income (loss)	(5,031 )	(3 )	3,577	(1,457 )
Balance, September 30, 2016	\$(42,326)	\$ 261	\$ (25,267 )	\$(67,332 )

	Foreign currency translation adjustments (In thousands)	Unrealized holding gain (loss) on investments	Gain (loss) on derivatives (1)	TOTAL
For the nine months ended September 30, 2016				
Balance, January 1, 2016	\$(29,925)	\$ 247	\$ (64,277 )	\$(93,955 )
Other comprehensive income (loss) before reclassification	(12,401)	14	14,458	2,071
Amounts reclassified from AOCI	-	-	24,552	24,552
Net current period other comprehensive income (loss)	(12,401)	14	39,010	26,623
Balance, September 30, 2016	\$(42,326)	\$ 261	\$ (25,267 )	\$(67,332 )

## 2015 Period

	Foreign currency translation adjustments (In thousands)	Unrealized holding gain (loss) on investments	Gain (loss) on derivative(1)	TOTAL
For the three months ended September 30, 2015				
Balance, June 30, 2015	\$(22,198)	\$ 257	\$ (72,083 )	\$(94,024 )
Other comprehensive income (loss) before reclassification	(9,333 )	(27 )	(28,249 )	(37,609 )
Amounts reclassified from AOCI	-	-	27,548	27,548
Net current period other comprehensive income (loss)	(9,333 )	(27 )	(701 )	(10,061 )
Balance, September 30, 2015	\$(31,531)	\$ 230	\$ (72,784 )	\$(104,085)

	Foreign currency translation adjustments (In thousands)	Unrealized holding gain (loss) on investments	Gain (loss) on derivative(1)	TOTAL
For the nine months ended September 30, 2015				



Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

Balance, January 1, 2015	\$ (15,212)	\$ 241	\$ (82,837 )	\$ (97,808 )
Other comprehensive income (loss) before reclassification	(14,076)	(11 )	(56,905 )	(70,992 )
Amounts reclassified from AOCI	(2,243 )	-	66,958	<sup>(2)</sup> 64,715
Net current period other comprehensive income (loss)	(16,319)	(11 )	10,053	(6,277 )
Balance, September 30, 2015	\$ (31,531)	\$ 230	\$ (72,784 )	\$ (104,085)

<sup>(1)</sup>Refer to Note 9 for additional details.

<sup>(2)</sup>Reclassified to Cost of operations and Gain on foreign currency, net.

#### Noncontrolling Interest

In 2013, we entered into certain joint ventures with TH Heavy Engineering Berhad (“THHE”), whereby we acquired a 30% interest in THHE Fabricators Sdn. Bhd. (“THF”), a subsidiary of THHE, and THHE acquired a 30% interest in our Malaysian subsidiary, Berlian McDermott Sdn. Bhd (“BMD”). In the third quarter of 2016, we reacquired the 30% of noncontrolling interest in BMD from THHE in exchange for our 30% equity interest in THF. We determined the fair value of the asset surrendered to be \$17 million. As of and for

McDERMOTT INTERNATIONAL, INC.

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

the periods ended September 30, 2016, in connection with the acquisition of the BMD noncontrolling interest, we recorded an \$18 million decrease in Noncontrolling interest, and, in connection with the sale of our investment in THF, we recorded a \$12 million decrease in Investments in unconsolidated affiliates and a \$5 million gain in Other income (expense), net in our Consolidated Financial Statements.

## NOTE 12—EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per common share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands, except share and per share amounts)			
Net income attributable to McDermott International, Inc.	\$16,108	\$3,666	\$34,593	\$685
Weighted average common shares (basic)	240,899,888	238,594,178	240,093,169	238,128,962
Effect of dilutive securities:				
Tangible equity units	40,896,300	40,896,300	40,896,300	40,896,300
Stock options, restricted stock and restricted stock units	2,111,165	1,306,677	2,143,451	-
Adjusted weighted average common shares and assumed exercises of stock options and vesting of stock awards (diluted)	283,907,353	280,797,155	283,132,920	279,025,262
Net income per share				
Net income attributable to McDermott International, Inc.				
Basic:	\$0.07	\$0.02	\$0.14	\$-
Diluted:	\$0.06	\$0.01	\$0.12	\$-

Approximately 2 million shares underlying outstanding stock-based awards were excluded from the computation of diluted earnings per share because they were anti-dilutive for the three and nine months ended September 30, 2016. Approximately 3 million and 11 million shares underlying outstanding stock-based awards were excluded from the computation of diluted earnings per share because they were anti-dilutive for the three and nine months ended September 30, 2015.

NOTE 13—COMMITMENTS AND CONTINGENCIES

Litigation

Due to the nature of our business, we and our affiliates are, from time to time, involved in litigation or subject to disputes or claims related to our business activities, including, among other things:

- performance or warranty-related matters under our customer and supplier contracts and other business arrangements; and

- workers' compensation claims, Jones Act claims, occupational hazard claims, including asbestos-exposure claims, premises liability claims and other claims.

Based upon our prior experience, we do not expect that any of these other litigation proceedings, disputes and claims will have a material adverse effect on our consolidated financial condition, results of operations or cash flows; however, because of the inherent uncertainty of litigation and other dispute resolution proceedings and, in some cases, the availability and amount of potentially applicable insurance, we can provide no assurance that the resolution of any particular claim or proceeding to which we are a party will not have a material effect on our consolidated financial condition, results of operations or cash flows for the fiscal period in which that resolution occurs.

Environmental Matters

We have been identified as a potentially responsible party at various cleanup sites under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended ("CERCLA"). CERCLA and other environmental laws can impose liability for the entire cost of cleanup on any of the potentially responsible parties, regardless of fault or the lawfulness of the original conduct. Generally, however, where there are multiple responsible parties, a final allocation of costs is made based on the amount and type of

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

wastes disposed of by each party and the number of financially viable parties, although this may not be the case with respect to any particular site. We have not been determined to be a major contributor of wastes to any of these sites. On the basis of our relative contribution of waste to each site, we expect our share of the ultimate liability for the various sites will not have a material adverse effect on our consolidated financial condition, results of operations or cash flows in any given year.

In 2013, we established a \$6 million environmental reserve in connection with our plan to discontinue the utilization of our Morgan City fabrication facility. For this site, up to June 30, 2016, we incurred approximately \$4 million. During the second quarter of 2016 we received a notice from the State of Louisiana stating that our environmental remediation obligations related to the closure of our Morgan City fabrication facility had been fulfilled. Pursuant to the notice received from the State of Louisiana, as well as our internal assessment, we believe no environmental remediation liability exists with respect to the Morgan City site. As a result, during the second quarter we reversed the remaining \$2 million of accrual.

#### Contracts Containing Liquidated Damages Provisions

Some of our contracts contain provisions that require us to pay liquidated damages if we are responsible for the failure to meet specified contractual milestone dates and the applicable customer asserts a claim under those provisions. Those contracts define the conditions under which our customers may make claims against us for liquidated damages. In many cases in which we have historically had potential exposure for liquidated damages, such damages ultimately were not asserted by our customers. As of September 30, 2016, we had approximately \$11 million of potential liquidated damages exposure, however no liability is recorded in our Consolidated Financial Statements. We believe we will be successful in obtaining schedule extensions or other customer-agreed changes that should resolve the potential for unaccrued liquidated damages. Accordingly, we believe that no amounts for these unaccrued liquidated damages are probable of being paid by us. However, we may not achieve relief on some or all of the issues involved and, as a result, could be subject to some liquidated damage amounts.

#### NOTE 14—SEGMENT REPORTING

We disclose the results of each of our operating segments in accordance with ASC 280, Segment Reporting. Each of the operating segments is separately managed by a senior executive who is a member of our Executive Committee (“EXCOM”). EXCOM is led by our Chief Executive Officer, who is the chief operating decision maker. Discrete financial information is available for each of the segments, and the EXCOM uses the operating results of each of the operating segments for performance evaluation and resource allocation.

We manage operating segments along geographic lines consisting of AEA, MEA and ASA. We also report certain corporate and other non-operating activities under the heading “Corporate and Other.” Corporate and Other primarily reflects corporate personnel and activities, incentive compensation programs and other costs, which are generally allocated to our operating segments. The only corporate costs currently not being allocated to our operating segments are the restructuring costs associated with our corporate reorganization.

We account for intersegment sales at prices that we generally establish by reference to similar transactions with unaffiliated customers. Reporting segments are measured based on operating income, which is defined as revenues reduced by total costs and expenses and equity in loss of unconsolidated affiliates.

McDERMOTT INTERNATIONAL, INC.

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

Summarized financial information is shown in the following tables:

	Three Months Ended		Nine Months Ended	
	September 30, 2016	2015	September 30, 2016	2015
(in thousands)				
<b>Revenues<sup>(1)</sup>:</b>				
AEA	\$69,699	\$96,371	\$219,134	\$344,385
MEA	334,731	318,346	922,820	892,367
ASA	154,113	391,140	852,248	1,166,105
<b>Total revenues</b>	<b>\$558,543</b>	<b>\$805,857</b>	<b>\$1,994,202</b>	<b>\$2,402,857</b>
<b>Operating income (loss)<sup>(2)</sup>:</b>				
AEA	\$(4,884 )	\$(15,753 )	\$(26,637 )	\$6,680
MEA	48,629	38,981	129,055	75,046
ASA	(575 )	16,336	36,832	26,067
Corporate and other	(115 )	(5,578 )	(3,214 )	(11,388 )
<b>Total operating income</b>	<b>\$43,055</b>	<b>\$33,986</b>	<b>\$136,036</b>	<b>\$96,405</b>
<b>Capital expenditures<sup>(3)</sup>:</b>				
AEA	\$269	\$3,286	\$3,795	\$6,715
MEA	8,318	2,735	13,021	17,677
ASA	16,603	11,648	178,178	41,141
Corporate and Other	1,529	464	2,399	585
<b>Total capital expenditures</b>	<b>\$26,719</b>	<b>\$18,133</b>	<b>\$197,393</b>	<b>\$66,118</b>
<b>Depreciation and amortization:</b>				
AEA	\$6,744	\$9,832	\$21,059	\$33,119
MEA	7,269	8,393	18,113	23,150
ASA	8,742	4,191	21,191	11,969
Corporate and Other	2,140	2,195	6,529	7,744
<b>Total depreciation and amortization</b>	<b>\$24,895</b>	<b>\$24,611</b>	<b>\$66,892</b>	<b>\$75,982</b>
<b>Drydock amortization:</b>				
AEA	\$2,248	\$3,133	\$7,658	\$9,377
MEA	455	443	1,519	1,606
ASA	228	676	686	2,927
<b>Total drydock amortization</b>	<b>\$2,931</b>	<b>\$4,252</b>	<b>\$9,863</b>	<b>\$13,910</b>

<sup>(1)</sup>Intersegment transactions included in revenues were not significant for either of the periods presented.

<sup>(2)</sup>The operating results for the nine months ended September 30, 2016 include: (1) a \$32 million impairment charge related to the Agile vessel in the AEA segment; and (2) a \$12 million impairment charge for certain underutilized

marine assets in the ASA segment. The ASA segment's operating results for the nine months ended September 30, 2015 included a \$4 million impairment charge for the DB 101 and \$3 million of loss on disposal of this asset.

---

McDERMOTT INTERNATIONAL, INC.

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

- (3) Total capital expenditures represent expenditures for which cash payments were made during the period. Capital expenditures for the three and nine months ended September 30, 2016 included \$2 million and \$0.1 million of cash payments for liabilities outstanding at the beginning of the respective periods. Capital expenditures for the three and nine months ended September 30, 2015 included \$1 million and \$10 million, respectively, of cash payments for accrued capital expenditures outstanding at the beginning of the respective periods.

	September 30, 2016	December 31, 2015
	(In thousands)	
Segment assets:		
AEA	\$731,872	\$896,822
MEA	973,018	971,170
ASA	853,771	774,365
Corporate and Other	579,711	744,719
	\$3,138,372	\$3,387,076



## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

In this quarterly report on Form 10-Q, unless the context otherwise indicates, "we," "us" and "our" mean McDermott International, Inc. and its consolidated subsidiaries.

### CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

We are including the following discussion to inform our existing and potential security holders generally of some of the risks and uncertainties that can affect our company and to take advantage of the "safe harbor" protection for forward-looking statements that applicable federal securities law affords. This information should be read in conjunction with the unaudited Consolidated Financial Statements and the Notes thereto included in Item 1 of this report and the audited Consolidated Financial Statements and the related Notes and Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in our Annual Report on Form 10-K for the year ended December 31, 2015.

From time to time, our management or persons acting on our behalf make forward-looking statements to inform existing and potential security holders about our company. These statements may include projections and estimates concerning the scope, execution, timing and success of specific projects and our future backlog, revenues, income and capital spending. Forward-looking statements are generally accompanied by words such as "estimate," "project," "predict," "forecast," "believe," "expect," "anticipate," "plan," "seek," "goal," "could," "may," or "should" or other words that convey the nature of future events or outcomes. Sometimes we will specifically describe a statement as being a forward-looking statement and refer to this cautionary statement.

These forward-looking statements include, but are not limited to, statements that relate to, or statements that are subject to risks, contingencies or uncertainties that relate to:

- future levels of revenues, operating margins, income from operations, cash flows, net income or earnings per share;
- outcome of project awards and scope, execution and timing of specific projects, including timing to complete and cost to complete these projects;
- future project activities, including the commencement and subsequent timing of marine or installation campaigns on specific projects, and the ability of projects to generate sufficient revenues to cover our fixed costs;
- estimates of percentage of completion and contract profits or losses;
- anticipated levels of demand for our products and services;
- global demand for oil and gas and fundamentals of the oil and gas industry;
- expectations regarding offshore development of oil and gas;
- market outlook for the EPCI market;
- expectations regarding cash flows from operating activities;
- expectations regarding backlog;
- future levels of capital, environmental or maintenance expenditures;
- the success or timing of completion of ongoing or anticipated capital or maintenance projects;
- the adequacy of our sources of liquidity and capital resources;
- interest expense;
- the effectiveness of our derivative contracts in mitigating foreign currency risk;
- results of our capital investment program;
- expectations regarding the acquisition or divestiture of assets;
- our ability to dispose of assets held for sale in a timely manner or for a price at or above net realizable value;
- the potential effects of judicial or other proceedings on our business, financial condition, results of operations and cash flows;



the anticipated effects of actions of third parties such as competitors, or federal, foreign, state or local regulatory authorities, or plaintiffs in litigation; and  
the results and estimated cost of personnel reductions affecting direct operating expense and selling, general and administrative (“SG&A”) functions.

These forward-looking statements speak only as of the date of this report; we disclaim any obligation to update these statements unless required by securities law, and we caution you not to rely on them unduly. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. These risks, contingencies and uncertainties relate to, among other matters, the following:

- general economic and business conditions and industry trends;
- general developments in the industries in which we are involved;
- the volatility of oil and gas prices;
- decisions about offshore developments to be made by oil and gas companies;
- the highly competitive nature of our industry;
- our ability to appropriately bid, estimate and effectively perform projects on time, in accordance with the schedules established by the applicable contracts with customers;
- changes in project design or schedule;
- changes in scope or timing of work to be completed under contracts;
- cancellations of contracts, change orders and other modifications and related adjustments to backlog and the resulting impact from using backlog as an indicator of future revenues or earnings;
- the collectability of amounts reflected in change orders and claims relating to work previously performed on contracts;
- the capital investment required to construct new-build vessels and maintain and/or upgrade our existing fleet of vessels;
- the ability of our suppliers and subcontractors to deliver raw materials in sufficient quantities and/or perform in a timely manner;
- volatility and uncertainty of the credit markets;
- our ability to comply with covenants in our credit agreement, indentures and other debt instruments and availability, terms and deployment of capital;
- the unfunded liabilities of our pension plans, which may negatively impact our liquidity and, depending upon future operations, may impact our ability to fund our pension obligations;
- the continued availability of qualified personnel;
- the operating risks normally incident to our lines of business, including the potential impact of liquidated damages;
- natural or man-caused disruptive events that could damage our facilities, equipment or our work-in-progress and cause us to incur losses and/or liabilities;
- equipment failure;
- changes in, or our failure or inability to comply with, government regulations;
- adverse outcomes from legal and regulatory proceedings;
- impact of potential regional, national and/or global requirements to significantly limit or reduce greenhouse gas and other emissions in the future;
- changes in, and liabilities relating to, existing or future environmental regulatory matters;
- changes in tax laws;
- rapid technological changes;

- the consequences of significant changes in interest rates and currency exchange rates;
- difficulties we may encounter in obtaining regulatory or other necessary approvals of any strategic transactions;
- the risks associated with integrating acquired businesses and making joint ventures operational;
- the risk we may not be successful in updating and replacing current information technology and the risks associated with information technology systems interruptions and cybersecurity threats;
- social, political and economic situations in countries where we do business;
- the risks associated with our international operations, including local content or similar requirements;
- interference from adverse weather or sea conditions;
- the possibilities of war, other armed conflicts or terrorist attacks;
- the effects of asserted and unasserted claims and the extent of available insurance coverages;
- our ability to obtain surety bonds, letters of credit and financing;
- our ability to maintain builder's risk, liability, property and other insurance in amounts and on terms we consider adequate and at rates that we consider economical;
- the aggregated risks retained in our captive insurance subsidiary; and
- the impact of the loss of insurance rights as part of the Chapter 11 Bankruptcy settlement concluded in 2006 involving several of our former subsidiaries.

We believe the items we have outlined above are important factors that could cause estimates in our financial statements to differ materially from actual results and those expressed in a forward-looking statement made in this quarterly report or elsewhere by us or on our behalf. We have discussed many of these factors in more detail elsewhere in this report and in our Annual Report on Form 10-K for the year ended December 31, 2015. These factors are not necessarily all the factors that could affect us. Unpredictable or unanticipated factors we have not discussed in this report could also have material adverse effects on actual results of matters that are the subject of our forward-looking statements. We do not intend to update our description of important factors each time a potential important factor arises, except as required by applicable securities laws and regulations. We advise our security holders that they should (1) be aware that factors not referred to above could affect the accuracy of our forward-looking statements and (2) use caution and common sense when considering our forward-looking statements.

## Business Segments and Results of Operations

### Business Segments

We report financial results under three reporting segments consisting of (1) the Americas, Europe and Africa (“AEA”), (2) the Middle East (“MEA”) and (3) Asia (“ASA”). We also report certain corporate and other non-operating activities under the heading “Corporate and Other.” Corporate and Other primarily reflects corporate personnel and activities, incentive compensation programs and other costs that are generally fully allocated to our operating segments. For financial information about our segments, see Note 14, Segment Reporting, to our Consolidated Financial Statements.

### AEA Segment

Through our AEA segment, which includes the Americas, Europe and Africa, we serve the needs of customers primarily in the United States, Brazil, Mexico, Trinidad, the North Sea, West Africa and East Africa. Project focus in this segment includes the fabrication and offshore installation of fixed and floating structures and the installation of pipelines and subsea systems. Engineering and procurement services are supported by engineering resources in Chennai, India, Dubai, U.A.E., London, the United Kingdom, Mexico City, Mexico and Houston, Texas. Our primary facilities for this segment are our fabrication facility in Altamira, Mexico and our spoolbase facility in Gulfport,

Mississippi.

28

---

### MEA Segment

Through our MEA segment, which includes the Caspian region, we serve the needs of customers in Saudi Arabia, the U.A.E., Qatar, Kuwait, Azerbaijan and Russia. Project focus in this segment relates primarily to the fabrication and offshore installation of fixed and floating structures and the installation of pipelines and subsea systems. The majority of our projects in this segment are performed on an EPCI basis. Engineering and procurement services are provided by our Dubai, U.A.E., Chennai, India and Al Khobar, Saudi Arabia offices and are supported by additional resources from our Houston, Texas office. The primary fabrication facility for this segment is located in Dubai, U.A.E.

### ASA Segment

Through our ASA segment, we serve the needs of customers primarily in Australia, Indonesia, Brunei, India, Malaysia, Vietnam and Thailand. Project focus in this segment includes the fabrication and offshore installation of fixed and floating structures and the installation of pipelines and subsea systems. The majority of our projects in this segment are performed on an EPCI basis. Engineering and procurement services are provided by our Kuala Lumpur office in Malaysia and are supported by additional resources located in Chennai, India, Dubai, U.A.E. and Houston, Texas. The primary fabrication facility for this segment is located on Batam Island, Indonesia. Additionally, through our equity ownership interest in a joint venture, we have access to additional fabrication capacity in China.

The above-mentioned fabrication facilities in each segment are equipped with a wide variety of heavy-duty construction and fabrication equipment, including cranes, welding equipment, machine tools and robotic and other automated equipment. Project installation is performed by major construction vessels, which we own or lease and are stationed throughout the various regions and provide structural lifting/lowering and pipelay services. These major construction vessels are supported by our multi-function vessels and chartered vessels from third parties to perform a wide array of installation activities that include anchor handling, pipelay, cable/umbilical lay, dive support and hookup/commissioning.

## Results of Operations

## Selected Financial Data:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(In thousands)			
<b>Revenues:</b>				
AEA	\$69,699	\$96,371	\$219,134	\$344,385
MEA	334,731	318,346	922,820	892,367
ASA	154,113	391,140	852,248	1,166,105
Total revenues	558,543	805,857	1,994,202	2,402,857
<b>Costs and Expenses:</b>				
Cost of operations	455,499	720,961	1,666,974	2,121,942
Selling, general and administrative expenses	46,983	44,664	137,386	144,133
Impairment loss	11,758	-	44,069	6,808
Loss (gain) on asset disposals	(588 )	(100 )	(950 )	1,443
Restructuring expenses	1,836	6,346	10,687	32,126
Total costs and expenses	515,488	771,871	1,858,166	2,306,452
<b>Operating income (loss):</b>				
AEA	(4,884 )	(15,753 )	(26,637 )	6,680
MEA	48,629	38,981	129,055	75,046
ASA	(575 )	16,336	36,832	26,067
Corporate and other	(115 )	(5,578 )	(3,214 )	(11,388 )
Total operating income	43,055	33,986	136,036	96,405
<b>Other income (expense):</b>				
Interest expense, net	(17,431 )	(13,015 )	(41,324 )	(38,179 )
Gain (loss) on foreign currency, net	376	(1,373 )	(4,781 )	(898 )
Other income, net	4,861	1,556	3,776	1,100
Total other expense	(12,194 )	(12,832 )	(42,329 )	(37,977 )
Income before provision for income taxes	30,861	21,154	93,707	58,428
Provision for income taxes	15,976	9,094	55,110	30,504
Income before income (loss) from Investments in Unconsolidated Affiliates	14,885	12,060	38,597	27,924
Income (loss) from Investments in Unconsolidated Affiliates	1,507	(4,526 )	(2,844 )	(18,748 )
Net income	16,392	7,534	35,753	9,176

Edgar Filing: MCDERMOTT INTERNATIONAL INC - Form 10-Q

Less: Net income attributable to noncontrolling interest	284	3,868	1,160	8,491
Net income attributable to McDermott International, Inc.	\$16,108	\$3,666	\$34,593	\$685

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

Revenues

Revenues decreased by 31%, or \$247 million, in the third quarter of 2016 compared to the third quarter of 2015.

30

---



AEA—Revenues in our AEA segment decreased by 28%, or \$26 million, in the third quarter of 2016 compared to the third quarter of 2015, primarily due to a reduction in active projects in 2016 compared to 2015.

In the third quarter of 2016, the following activities contributed to revenues: (1) transportation, installation and marine campaigns undertaken by our DB 50 and NO 105 vessels on the EOG Sercan project in Trinidad; (2) umbilical and flowline installation marine campaigns executed by our NO 102 and NO 105 vessels on the Caesar/Tonga field development project in the U.S. Gulf of Mexico; (3) engineering activities on the Abkatun-A2 project, a turnkey EPCI contract to build and commission an offshore platform, which was awarded in the second quarter of 2016; and (4) fabrication activity progress on the Ayatsil-C jacket replacement and deck installation project at our Altamira facility.

In the third quarter of 2015, the following activities contributed to revenues: (1) fabrication activity on the PB Litoral project, which was substantially complete in the first quarter of 2016; (2) fabrication work on the Exxon Julia subsea tieback project in the U.S. Gulf of Mexico, which was completed in the first quarter of 2016; and (3) the Agile charter marine campaign, which was terminated in the second quarter of 2016.

MEA—Revenues increased by 5%, or \$16 million, in the third quarter of 2016 compared to the third quarter of 2015.

In the third quarter of 2016, the following activities contributed to revenues: (1) engineering, fabrication and marine pipelay activities on a lump-sum EPCI project under the second Long-Term Agreement (“LTA-II”), fabrication and marine pipelay activities on the Marjan power system replacement project, and continued fabrication and marine installation progress on the 12 jackets supply project, all with Saudi Aramco; and (2) the marine campaign for installation of a pipeline, spool and risers on a flow assurance project in Qatar, awarded in the fourth quarter of 2015. The commencement in 2016 of a large pipeline-related project in the Middle East, as well as progress of the KJO Hout project to the fabrication phase, also contributed to third quarter 2016 revenues.

In the third quarter of 2015, the following activities contributed to revenues, all of which either were complete or were substantially complete in 2015: (1) Safaniya Phase 2, the Manifa project, involving an installation of observation platforms and jackets, hook-up activities on the Karan 45 project, each with Saudi Aramco; and (2) the ADMA 4 GI project in the U.A.E.

ASA—Revenues in our ASA segment decreased by 61%, or \$237 million, primarily due to reduced activity on: (1) the Ichthys EPCI project in Australia, as the project progressed through the marine transportation and installation phase; and (2) the Brunei Shell Petroleum (“BSP”) pipeline replacement project, which was substantially complete in 2015. Those decreases were partially offset by revenues from the commencement in 2016 of the Yamal module fabrication project, which was awarded in the third quarter of 2015.

#### Cost of Operations

Cost of operations decreased by 37%, or \$265 million, in the third quarter of 2016 compared to the third quarter of 2015.

AEA—Cost of operations in our AEA segment decreased by 35%, or \$34 million, in the third quarter of 2016 compared to the third quarter of 2015, primarily due to the reduction in active projects in the 2016 period compared to the 2015 period.

Cost of operations in the third quarter of 2016 included costs associated with the following projects: (1) transportation, installation and marine campaigns undertaken by our DB 50 and NO 105 vessels on the EOG Sercan project in Trinidad; (2) umbilical and flowline installation marine campaigns undertaken by our NO 102 and NO 105 vessels on the Caesar/Tonga field development project in the U.S. Gulf of Mexico; (3) engineering activities on the Abkatun-A2

project; and (4) fabrication activity progress on the Ayatsil-C jacket replacement and deck installation project at our Altamira facility.

Cost of operations in the third quarter of 2015 was primarily related to: (1) fabrication activity on the PB Litoral project, which was substantially complete in the first quarter of 2016; (2) fabrication work on the Exxon Julia subsea tieback project in the U. S. Gulf of Mexico, which was completed in the first quarter of 2016; and (3) the Agile charter marine campaign, which was terminated in the second quarter of 2016.

MEA—Cost of operations in our MEA segment increased by \$2 million in the third quarter of 2016 compared to the third quarter of 2015.

The third quarter of 2016 cost of operations included costs associated with: (1) engineering, fabrication and marine pipelay activities on a lump-sum EPCI project under the LTA-II, marine pipelay activities on the Marjan power system replacement project, each with Saudi Aramco; and (2) the marine campaign for installation of a pipeline, spool and risers on a flow assurance project in Qatar,

awarded in fourth quarter of 2015. The commencement in 2016 of a large pipeline-related project in the Middle East, as well as the KJO Hout project progressing to the fabrication phase, also contributed to the 2016 third quarter cost of operations.

The third quarter of 2015 cost of operations included costs associated with the following projects which were either complete or were substantially complete in 2015: Safaniya Phase 2, Manifa facilities and Karan 45, each with Saudi Aramco, and the ADMA 4 GI project, in the U.A.E.

ASA—Cost of operations in our ASA segment decreased by 65%, or \$233 million, in the third quarter of 2016 compared to the third quarter of 2015. The decrease was primarily due to: (1) lower activity on the Ichthys EPCI project in Australia, as the project progressed through the marine transportation and installation phase; and (2) completion of the BSP pipeline replacement project in 2015. Those decreases were partially offset by an increase from the commencement in 2016 of the Yamal module fabrication project, which was awarded in the third quarter of 2015.

### Operating Income

Operating income is frequently influenced by the resolution of change orders, project close-outs and settlements, which generally can cause operating margins to improve during the period in which these items are approved or finalized. While we expect change orders, close-outs and settlements to continue as part of our normal business activities, the period in which they are recognized is largely driven by the finalization of agreements with customers and suppliers and, as a result, is difficult to predict. Additionally, the future margin increases or decreases associated with these items are difficult to predict, due to, among other items, the difficulty of predicting the timing of recognition of change orders, close-outs and settlements and the timing of new project awards.

### Segment Analysis

Operating income for the three months ended September 30, 2016 and 2015 was \$43 million and \$34 million, respectively, an increase of \$9 million, primarily due to improvements in our AEA and MEA segments.

AEA—Operating losses were \$5 million and \$16 million in the third quarter of 2016 and 2015, respectively.

The AEA segment's third quarter 2016 operating loss was primarily driven by lower cost recovery associated with our fabrication facility at Altamira and our vessels due to a reduction in active projects.

Operating income during the third quarter of 2015 was negatively impacted by a \$17 million legal settlement charge, which was partially offset by a reversal of a \$13 million provision for liquidated damages due to an agreed extension of the PB Litoral project completion date, neither of which was repeated in the third quarter of 2016.

MEA—Operating income was \$49 million and \$39 million in the third quarter of 2016 and 2015, respectively.

In the third quarter of 2016, operating income was primarily driven by: (1) an increase in engineering, fabrication and marine pipelay activities on a lump-sum EPCI project under LTA-II with Saudi Aramco; (2) the commencement in 2016 of the large pipeline-related project in the Middle East, awarded in the fourth quarter of 2015 and a marine campaign for installation of pipeline, spool and risers on a flow assurance project, awarded in the fourth quarter of 2015, in Qatar.

In the third quarter of 2015, operating income included: (1) \$21 million of recovery associated with a vessel downtime change order; (2) \$13 million from an installation of observation platforms and jackets marine campaign; and (3) \$10 million from higher marine hookup activity and favorable change order settlements on several Saudi Arabian

projects.

ASA—Operating loss in the third quarter of 2016 was \$1 million compared to \$16 million of operating income in the third quarter of 2015. The decrease was primarily due to a \$12 million impairment charge recorded in the third quarter of 2016, discussed below.

The operating results for the third quarter of 2016, before the impairment charge, were primarily driven by marine transportation and installation activity, improved productivity, project execution cost savings and recognition of approved change orders on active projects, primarily the Ichthys project in Australia, and fabrication activity at our Batam facility.

Additionally, in connection with our review of long-lived assets for impairment during the third quarter of 2016, we determined that the carrying values of certain marine assets were not recoverable and exceeded their respective fair values. As a result, we recorded a \$12 million non-cash impairment charge in our ASA segment.

32

---

The completion of the BSP pipeline replacement and other active projects in 2015 also contributed to the operating loss.

#### Other Items in Operating Income

Restructuring expenses—Restructuring expenses included in operating income were \$2 million and \$6 million in the third quarter of 2016 and 2015, respectively. See Note 4, Restructuring, to the accompanying Consolidated Financial Statements.

#### Other income (expense)

Interest expense, net Interest expense, net was \$17 million and \$13 million in the third quarters of 2016 and 2015, respectively. Interest expense for both periods is associated with our long-term debt obligations discussed in Note 7, Debt, to the accompanying Consolidated Financial Statements.

#### Provision for Income Taxes

For the three months ended September 30, 2016, we recognized income before provision for income taxes of \$31 million, compared to an income of \$21 million in the three months ended September 30, 2015. The provision for income taxes was \$16 million and \$9 million for the three months ended September 30, 2016 and 2015, respectively. The increase in the provision for income taxes was driven by increased profits in certain taxable jurisdictions in which we operate. In addition, our tax provision for the three months ended September 30, 2015 was reduced by a net \$4 million reduction in uncertain tax positions associated with the settlement of prior year tax matters.

#### Income (loss) from investments in unconsolidated affiliates

We participate with third parties in the ownership of certain entities, which we sometimes refer to as “joint ventures,” for convenience of reference. Those entities are organized in various forms, including as corporations, limited liability companies and other companies with limited liability. By using the term “joint venture,” we are not implying that those entities constitute general partnerships. Some of those joint venture entities are not consolidated and are generally accounted for under the equity method of accounting. We refer to those entities as “unconsolidated affiliates.”

The income from investments in our unconsolidated affiliates in the third quarter of 2016 was \$2 million compared to a \$5 million loss in the third quarter of 2015. The improvement was primarily attributable to our joint venture in China.

#### Noncontrolling Interests

Net income attributable to noncontrolling interests was \$0.3 million and \$4 million in the third quarters of 2016 and 2015, respectively. The change was primarily due to lower profitability in our Indonesian joint venture and losses incurred by one of our Malaysian joint ventures, Berlian McDermott Sdn. Bhd.

#### Nine Months ended September 30, 2016 Compared to Nine Months ended September 30, 2015

##### Revenues

Revenues decreased by 17%, or \$409 million, in the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015, primarily due to decreases in our AEA and ASA segments, partially offset by a

small increase in our MEA segment.

AEA—Revenues decreased by 36%, or \$125 million, due to a reduction in active projects in the 2016 period compared to the 2015 period.

In 2016, the following activities contributed to revenues: (1) transportation, installation and marine campaigns executed by our DB 50 and NO 105 vessels on the EOG Sercan project in Trinidad; (2) fabrication/spooling and installation of jumpers and control umbilicals at the Jack St. Malo project in the Gulf of Mexico, which was completed in the third quarter of 2016; (3) hookup and commissioning activities associated with the PB Litoral project, which was completed in the first half of 2016; (4) fabrication activity progress on the Ayatsil-C jacket replacement and deck installation project at our Altamira facility; (5) completion of the LLOG Otis subsea tieback project in the U.S. Gulf of Mexico; (6) marine campaigns executed by our DB 50 vessel on the Exxon Julia Subsea Tieback project in the U.S. Gulf of Mexico, which was completed in the first quarter of 2016; (7) umbilical and

flowline installation marine campaigns by our NO 102 and NO 105 vessels for the Caesar/Tonga field development project in the U.S. Gulf of Mexico and (8) engineering work under the turnkey EPCI contract for the Abkatun-A2 platform.

In 2015, the following projects, which were complete or substantially complete in 2015, contributed to revenue: (1) the NO 102, NO 105 and Agile vessel charter campaigns in Brazil; (2) fabrication activity on the PB Litoral project in the Gulf of Mexico; (3) marine campaigns executed by our DB 50 vessel on the Exxon Julia subsea tieback project in the Gulf of Mexico; (4) work on Ayatsil-A, a transportation and installation (“T&I”) project; (5) a mobile drilling structure installation project executed by our DB 50 vessel in the Gulf of Mexico; and (6) project close-out payments associated with the Papa Terra project in Brazil.

MEA—Revenues increased by 3%, or \$30 million, in the 2016 period compared to the 2015 period.

In 2016, the following activities contributed to revenues: (1) engineering, fabrication and marine activities on the lump-sum EPCI project under the LTA-II, continued fabrication and marine installation progress on the 12 jackets supply project, and fabrication and marine pipelay activities on the Marjan power system replacement project, each with Saudi Aramco; and (2) engineering and fabrication activity on our KJO Hout project. The commencement in 2016 of: (1) the large pipeline-related project in the Middle East; (2) the marine campaign for installation of a pipeline, spool and risers on a flow assurance project in Qatar, awarded in the fourth quarter of 2015; and (3) offshore marine hookup campaign progress on a wellhead jacket and umbilical project also contributed to the 2016 revenue.

In 2015, activities on the following projects, which either were complete or were substantially complete in 2015, contributed to revenues: (1) the Safaniya phase 2, Karan 45, Abu Ali Cables, and Manifa facilities projects, each with Saudi Aramco; and (2) the ADMA 4 GI project in the U.A.E.

ASA—Revenues decreased 27%, or \$314 million, in the 2016 period compared to the 2015 period.

Reduced activity in the 2016 period on our Ichthys EPCI project in Australia also contributed to the decrease in revenues as the project progressed through the marine transportation and installation phase. However this decrease was partially offset by commencement in 2016 of the following projects: (1) the Yamal module fabrication project awarded in the third quarter of 2015; (2) the Bergading offshore installation project in Malaysia, which was completed in the second quarter of 2016; and (3) the EPCI project for Vashishta subsea field infrastructure development off India’s East coast.

In 2015 the following projects, which were either complete or were substantially complete in 2015, contributed to revenue: (1) the BSP pipeline replacement project; (2) the Gorgon MRU project; and (3) the Bukit-Tua platform/subsea spools installation project.

#### Cost of Operations

Cost of operations decreased by 21%, or \$455 million, in the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015.

AEA—Cost of operations decreased 38%, or \$111 million, in the 2016 period compared to the 2015 period.

In 2016, cost of operations was incurred on the following projects: (1) transportation, installation and marine campaigns executed by our DB 50 and NO 105 vessels on the EOG Sercan project in Trinidad; (2) fabrication/spooling and installation of jumpers and control umbilicals at the Jack St. Malo project in the Gulf of Mexico, which was completed in the second quarter of 2016; (3) fabrication activity progress on the Ayatsil-C jacket

replacement and deck installation project at our Altamira facility; (4) umbilical and flowline installation marine campaigns by our NO 102 and NO 105 vessels on the Caesar/Tonga field development project in the U.S. Gulf of Mexico; (5) completion of the LLOG Otis subsea tieback project in the Gulf of Mexico; and (6) engineering activities under the turnkey EPCI contract for the Abkatun-A2 platform.

In 2015, the following projects, which were complete or substantially complete in 2015 contributed to the cost of operations: (1) NO 102, NO 105 and Agile vessel charter campaigns in Brazil; (2) the PB Litoral project at our Altamira fabrication facility; (3) the Exxon Julia subsea tieback project in the Gulf of Mexico; (4) the Ayatsil-A, a T&I project; and (5) a mobile drilling structure installation project executed by our DB 50 vessel in the Gulf of Mexico.

MEA—Cost of operations decreased by \$25 million, in the 2016 period compared to the 2015 period.

In 2016, the following activities contributed to cost of operations: (1) engineering, fabrication and marine activities on the lump-sum EPCI project under the LTA-II, fabrication and marine installation progress on the 12 jackets supply project and fabrication and



marine pipelay activities on the Marjan power systems replacement project, each with Saudi Aramco; (2) the commencement in 2016 of the marine campaign for installation of pipeline, spool and risers on a flow assurance project in Qatar, awarded in the fourth quarter of 2015; and (3) work on a large pipeline-related project in the Middle East; and (4) offshore marine campaign hookup progress on a wellhead jacket and umbilical projects.

In the 2015 period, activities on the following projects, which were either complete or were substantially complete in 2015, contributed to cost of operations: (1) Safaniya Phase 2, Karan 45, Manifa facilities, and Abu Ali Cables, each with Saudi Aramco; and (2) the ADMA 4 GI project in the U.A.E.

ASA—Costs of operations decreased by 30%, or \$319 million in the 2016 period compared to the 2015 period.

Reduced activity in the 2016 period on the Ichthys EPCI project in Australia contributed to the decrease in cost of operations, as the project progressed through the marine transportation and installation phase. This decrease was partially offset by commencement of the following new projects in 2016: (1) the Yamal module fabrication project, awarded in the third quarter of 2015; (2) the Bergading installation project in Malaysia, which was completed in the second quarter of 2016; and (3) the EPCI project for the Vashishta subsea field infrastructure development offshore of India's East coast.

In the 2015 period, activities on the following projects, which either were complete or were substantially complete in 2015, contributed to cost of operations: (1) the BSP pipeline replacement project; (2) the Gorgon MRU project; and (3) the Bukit-Tua platform/subsea spools installation projects.

#### Operating Income

Operating income for the nine months ended September 30, 2016 increased by \$40 million over the corresponding period during the prior year, from \$96 million in 2015 to \$136 million of operating income in 2016, primarily due to improvements in our MEA and ASA segments.

#### Segment Analysis

AEA—Operating results decreased by \$33 million from operating income of \$7 million in the 2015 period to a \$26 million operating loss in the 2016 period.

In 2016, the AEA segment's operating loss was primarily driven by lower cost recovery associated with our fabrication facility at Altamira and our vessels due to a reduction in active projects, as well as a \$32 million non-cash impairment charge related to our Agile vessel, discussed below.

Those decreases were partially offset by net favorable changes in estimates aggregating approximately \$29 million, primarily due to successful execution and close-out improvements on two significant projects, the PB Litoral project and the Exxon Julia subsea tieback project, as well as 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 \$29 million of changes in project estimates was also a reversal of a \$7 million provision for liquidated damages due to an agreed extension of the PB Litoral project completion date.

We impaired our Agile vessel upon termination of its charter in May 2016, given the lack of opportunities for the vessel. In connection with that decision, we recognized a non-cash impairment charge of \$32 million during the first quarter of 2016, which equaled the vessel's carrying value.

In the 2015 period, operating income in the AEA segment was primarily provided by (1) marine charter activities in Brazil undertaken by the NO 102, NO 105 and Agile vessels; (2) the Intermac 600's marine campaign in the Gulf of Mexico; (3) \$11 million of benefit as a result of a favorable outcome in our discussions with the customer on compensation for weather delays related to the Papa Terra project; and (4) the reversal of a \$13 million provision for liquidated damages due to an agreed extension of the PB Litoral project completion date.

In addition, the 2015 period operating income was negatively impacted by a \$17 million legal settlement charge, which was not repeated in the 2016 period.

MEA—Operating income in the 2016 and 2015 periods was \$129 million and \$75 million, respectively, an increase of \$54 million.

The 2016 period operating income included benefits from: (1) the jacket fabrication and installation activity on the project to supply 12 jackets; (2) a benefit from increased engineering and marine activities on the power systems replacement project; and (3) engineering, fabrication and pipelay activity on the LTA-II project, each with Saudi Aramco. The commencement in the 2016 period of: (1) the large pipeline-related project in the Middle East; and (2) the marine installation activities for pipeline, spool and risers on a flow assurance project and offshore marine hookup campaign progress on a wellhead jacket and umbilical project in Qatar also contributed to our MEA segment operating income.

In the 2015 period, operating income included \$75 million of benefits from: (1) increased marine and hookup activities from improved marine vessel productivity and efficient demobilization on a cable-lay project; (2) improved productivity and lower demobilization costs on a jacket and deck installation project; (3) higher fabrication and marine campaign activity for an installation observation platforms and jackets project; and (4) the award of an EPCI change order on the KJO Hout project.

ASA—Operating income in the 2016 and 2015 periods was \$37 million and \$26 million, respectively, an increase of \$11 million. The increase was primarily attributable to (1) improved productivity and project execution cost savings and recognition of approved change orders on active projects; and (2) close-out improvements on our completed projects.

Additionally, in connection with a review of our long-lived assets for impairment during the third quarter of 2016, we determined that the carrying values of certain marine assets were not recoverable and exceeded their respective fair values. As a result, we recorded a \$12 million non-cash impairment charge in our ASA segment.

Operating income in the 2015 period also included a \$4 million impairment related to the DB 101 vessel and a \$3 million loss on disposal of an asset, which was not repeated in the 2016 period.

#### Other Items in Operating Income

Selling, general and administrative expenses (“SG&A”)—SG&A was \$137 million and \$144 million in the nine months ended September 30, 2016 and 2015, respectively. We continue our efforts to improve our cost structure, and the implementation of both our MPI and AOR programs contributed to lower SG&A expense in the nine months ended September 30, 2016 compared to the corresponding 2015 period.

Restructuring expenses—Restructuring expenses included in operating income were \$11 million and \$32 million in the nine months ended September 30, 2016 and 2015, respectively, a decrease of \$21 million. See Note 4, Restructuring, to the accompanying Consolidated Financial Statements. As a part of the restructuring, in the first quarter of 2015, one of our vessels, the DB 101, which was held and used in the ASA segment, was written down to a fair value of \$14 million, resulting in a non-cash impairment charge of \$4 million. In the second quarter of 2015, we disposed of the asset and recognized an additional loss of \$3 million.

#### Other Items

Interest expense, net Interest expense, net was \$41 million and \$38 million in the nine months ended September 30, 2016 and 2015, respectively. Interest expense for both periods is associated with our long-term debt obligations discussed in Note 7, Debt, to the accompanying Consolidated Financial Statements.

Loss (gain) on foreign currency, net Foreign currency losses were \$5 million in the nine months ended September 30, 2016. Losses related to foreign currency remeasurement were \$5 million and hedging activity losses were \$7 million, which were partially offset by a \$7 million correction as described in Note 11, Stockholders’ Equity. Foreign currency gain in the nine months ended September 30, 2015 was not material.

Provision for Income Taxes

For the nine months ended September 30, 2016, we recognized income before provision for income taxes of \$94 million, compared to an income of \$58 million in the nine months ended September 30, 2015. The provision for income taxes was \$55 million and \$31 million for the nine months ended September 30, 2016 and 2015, respectively. The increase in the provision for income taxes was driven by increased profits in certain taxable jurisdictions in which we operate. In addition, our tax provision for the nine months ended September 30, 2015 was reduced by a net \$4 million reduction in uncertain tax positions associated with the settlement of prior year tax matters.

### Losses from Investments in Unconsolidated Affiliates

The loss from investments in our unconsolidated affiliates was \$3 million and \$19 million in the first nine months of 2016 and 2015, respectively. The improvement was primarily attributable to our joint venture in China.

### Noncontrolling Interests

Net income attributable to noncontrolling interests decreased by \$7 million to \$1 million in the nine months ended September 30, 2016 from \$8 million in the nine months ended September 30, 2015, primarily due to lower profitability in our Indonesian joint venture and losses incurred by one of our Malaysian joint ventures, Berlian McDermott Sdn. Bhd.

### Critical Accounting Policies and Estimates

For a discussion of critical accounting policies and estimates we use in the preparation of our Consolidated Financial Statements, refer to Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the SEC on February 22, 2016. See Note 1 to our unaudited Consolidated Financial Statements included in this report for information on recently adopted accounting standards.

### Backlog

Backlog represents the dollar amount of revenues we expect to recognize in the future from contracts awarded and those that are in progress. These amounts are presented in U.S. dollars. Currency risk associated with backlog contracts that is not mitigated within the contract is generally mitigated with the use of foreign currency derivative (hedging) instruments, when deemed significant. However, these actions may not eliminate all currency risk exposure included within our long-term contracts. Backlog is not a measure defined by generally accepted accounting principles and is not a measure of contract profitability. Our methodology for determining backlog may not be comparable to methodologies used by other companies in determining their backlog amounts. The backlog values we disclose include anticipated revenues associated with: (1) the original contract amounts; (2) change orders for which we have received written confirmations from the applicable customers; (3) change orders for which we expect to receive confirmations in the ordinary course of business; and (4) claims that we have made against our customers. We do not include expected revenues of contracts related to unconsolidated joint ventures in our backlog, except to the extent of any contract awards we may receive from those joint ventures.

We include unapproved change orders for which we expect to receive confirmations in the ordinary course of business in backlog, generally to the extent of the lesser of the amounts we expect to recover or the associated costs incurred. Any revenue that would represent profit associated with unapproved change orders is generally excluded from backlog until written confirmation is obtained from the applicable customer. However, consideration is given to our history with the customer, as well as the contractual basis under which we may be operating. Accordingly, in certain cases based on our historical experience in resolving unapproved change orders with a customer, the associated profit may be included in backlog. At September 30, 2016 and December 31, 2015, the total unapproved change orders included in our estimates at completion aggregated approximately \$139 million and \$122 million, respectively, of which approximately \$21 million, as of both dates, was included in backlog. If an unapproved change order is disputed or rejected by the customer, the associated amount of revenue is treated as a claim.

We include claims in backlog only when we have a legal basis to do so, consider collection to be probable and believe we can reliably estimate the ultimate value. Claims revenue is included in backlog to the extent of the lesser of the amounts we expect to recover or associated costs incurred. Claims revenue in backlog at September 30, 2016 and December 31, 2015 was not material.

Backlog may not be indicative of future operating results, and projects in our backlog may be cancelled, modified or otherwise altered by customers. We can provide no assurance as to the profitability of our contracts reflected in backlog. It is possible that our estimates of profit could increase or decrease based on, among other things, changes in productivity, actual downtime and the resolution of change orders and claims with the customers.

The following table summarizes changes to our backlog (in thousands):

Backlog at December 31, 2015	\$4,231,447
Bookings from new awards	1,418,212
Additions and reductions on existing contracts	260,783
Less: Amounts recognized in revenues	1,994,202
Backlog at September 30, 2016 <sup>(1)</sup>	\$3,916,240

<sup>(1)</sup>At September 30, 2016, approximately 57% of this backlog revenue was attributable to Saudi Aramco. Our backlog by segment was as follows:

	September 30, 2016 (in approximate millions)	
AEA	\$566	14 %
MEA	2,530	65 %
ASA	820	21 %
Total Backlog	\$3,916	100%

Of the September 30, 2016 backlog, we expect to recognize revenues as follows:

	2016	2017	Thereafter
	(in approximate millions)		
Total backlog	\$535	\$2,420	\$ 961

## Liquidity and Capital Resources

Our primary internal source of liquidity is cash flow generated from operations and cash and cash equivalents on hand. Capacity under our existing credit arrangements is also available, if necessary, to provide letters of credit, bank guarantees and surety bonds. These letters of credit, bank guarantees and surety bonds are generally issued to customers in the ordinary course of business to support advance payments and performance guarantees, in lieu of retention on our contracts.

### Credit Agreement, Senior Notes and Amortizing Notes

In April 2014 we entered into a credit agreement (the "Credit Agreement"), which initially provided for a \$400 million first-lien, first-out three-year letter of credit facility (the "LC Facility"), scheduled to mature in 2017, and a \$300 million first-lien, second-out five-year term loan (the "Term Loan"), scheduled to mature in 2019. We also completed the

issuance of (a) \$500 million of second-lien, seven-year, senior secured notes; and (b) \$288 million of tangible equity units ("TEUs") composed of (1) three-year amortizing, senior unsecured notes, in an aggregate principal amount of \$48 million, and (2) prepaid common stock purchase contracts.

In October 2015, we entered into an Amendment No. 1, which amended the Credit Agreement primarily to increase the existing LC Facility from \$400 million to \$520 million.

In February 2016, we entered into an Amendment No. 2 to the Credit Agreement, which amended the Credit Agreement to permit us to add to Covenant EBITDA certain cash restructuring expenses related to the conclusion of MPI or implementation of AOR for the quarters ending on or after March 31, 2016 but before April 16, 2017, in an aggregate amount not to exceed \$25 million (as of any date of determination).



On April 18, 2016, we entered into an Amendment No. 3 to the Credit Agreement, which, among other things:

- replaced the existing EBITDA covenant with new ratios (as defined in Amendment No. 3) as follows:
  - a minimum fixed charge coverage ratio of 1.15x for the fiscal quarter ended March 31, 2016 and each fiscal quarter thereafter;
  - a maximum total leverage ratio of 4.5x for the fiscal quarter ended March 31, 2016 and each subsequent fiscal quarter through June 30, 2017, 4.0x for the fiscal quarters ending September 30, 2017 and December 31, 2017, and 3.5x for each fiscal quarter thereafter; and
  - a maximum secured leverage ratio of 2.0x for the fiscal quarter ended March 31, 2016 and each subsequent fiscal quarter through December 31, 2017, and 1.5x for each fiscal quarter thereafter; and
- amended the maximum capital expenditure covenant to limit capital expenditures in 2016 and thereafter to \$250 million each fiscal year, with any prior fiscal year unused capital expenditures up to \$125 million able to be carried forward and added to the next year's capital expenditure capacity, for a total of \$375 million.

In addition, upon the May 13, 2016 satisfaction of certain conditions set forth in Amendment 3, including the receipt of requisite consents from term lenders under the Credit Agreement, Amendment 3 also amended the Credit Agreement to, among other things:

- extend the maturity date of the LC Facility commitments to April 22, 2019, unless the Term Loan has not been repaid or refinanced by January 15, 2019, in which case the LC Facility commitments will expire on January 15, 2019;
- change the existing letter of credit capacity of \$520 million to \$450 million;
- extend the deadline for mortgaging the DLV 2000 to one year after taking delivery thereof, and give McDermott the option to consider potential financing options for the DLV 2000 during that period;
- increase the basket for purchase money indebtedness from \$20 million to \$150 million;
- modify the covenant limiting acquisitions to permit up to \$150 million of acquisitions; and
- modify the covenant limiting the prepayment or purchase of junior priority debt to permit up to \$100 million of such prepayments or purchases.

On May 12, 2016, we entered into an Amendment No. 4 to the Credit Agreement which, among other things:

- increased the applicable margin payable on the Term Loan by 3.0% per annum; and
- required that the net cash proceeds of any sale (including a sale and leaseback) of the DLV 2000 be applied as a mandatory prepayment of the Term Loan.

On May 13, 2016, McDermott voluntarily prepaid \$75 million of the Term Loan and satisfied the other conditions to the "effective date" set forth in Amendment No. 4.

We were in compliance with our financial covenants as of September 30, 2016, as shown below:

Ratios	Requirement	Actual
Minimum fixed charge coverage ratio	1.15x	2.86x
Maximum total leverage ratio	4.5x	2.15x
Maximum secured leverage ratio	2x	0.66x

Calculation of ratios under Credit Agreement, as amended, requires us to compute consolidated earnings before interest, taxes, depreciation and amortization, as adjusted (“Covenant EBITDA”). Covenant EBITDA is not a substitute for or superior to, operating income, net income, operating cash flow and other measures of financial performance prepared in accordance with the U.S GAAP. Covenant EBITDA has a specific definition per the Credit Agreement and will differ in the method of calculation from similarly titled measures used by other companies. The following reconciliation shows the calculation of Covenant EBITDA based on net income for each of the periods presented:

	Quarter ended September 30, 2016	Quarter ended June 30, 2016	Quarter ended March 31, 2016	Quarter ended December 31, 2015
(In millions)				
Net Income (loss) attributable to McDermott International, Inc.	\$16.1	\$20.7	\$(2.2)	\$(18.7)
Adjustments:				
Interest Expense (including interest capitalized)	18.0	13.2	11.6	12.1
Tax expense	16.0	19.8	19.3	21.5
Depreciation, drydock and amortization (excluding attributable to Nonguarantors)	26.7	23.4	23.4	27.3
Other items:				
Equity (income) loss	(1.5)	(0.1)	4.5	2.7
(Gain) loss on assets disposal	(0.6)	(0.4)	-	-
Impairment loss	11.8	-	32.3	-
Restructuring - other expense	1.8	2.5	6.4	8.7
Pension expense	0.2	0.3	0.3	24.5
Others	8.3	10.0	5.2	4.8
Total adjustments	\$80.7	\$68.7	\$103.0	\$101.6
Calculated Covenant EBITDA attributable to McDermott International, Inc.	\$96.8	\$89.4	\$100.8	\$82.9
Calculated Covenant EBITDA attributable to McDermott International, Inc. - Cumulative/TTM	\$369.9			

### Cash and Cash Equivalents

As of September 30, 2016, we had \$600 million of cash and cash equivalents and restricted cash compared to \$782 million as of December 31, 2015. At September 30, 2016, we had \$92 million of cash in jurisdictions outside the U.S., principally in the U.A.E., Mexico, Indonesia, Malaysia and Norway. Less than 3% of our outstanding cash balance is held in countries that have established government imposed currency restrictions that could impede the ability of our subsidiaries to transfer funds to us.

At September 30, 2016, we had restricted cash and cash equivalents totaling \$100 million compared to \$117 million as of December 31, 2015. The amounts as of September 30, 2016 and December 31, 2015 include \$99 million and \$102 million, respectively, of cash collateral for letters of credit that generally may be replaced with letters of credit under the LC Facility.

## Cash Flow Activities

Operating activities. Our net cash provided by operating activities was \$126 million in the nine months ended September 30, 2016, as compared to \$5 million used in the nine months ended September 30, 2015.

The cash provided (used) by operating activities primarily reflected our net income, adjusted for non-cash items and changes in components of our working capital—accounts receivable, contracts in progress net of advance billings on contracts, and accounts payable. Fluctuations in working capital are normal in our business. Working capital is impacted by the size of our projects and the achievement of billing milestones on backlog as we complete certain phases of the projects.

Investing activities. Our net cash used in investing activities was \$183 million in the nine months ended September 30, 2016, compared to cash used in investing activities of \$7 million in the nine months ended September 30, 2015. These cash uses, in both periods, primarily related to the capital expenditures discussed below.

Financing activities. Our net cash used in financing activities was \$106 million in the nine months ended September 30, 2016 as compared to net cash used in financing activities of \$19 million in the nine months ended September 30, 2015. The change was primarily attributable to the voluntary prepayment of \$75 million under the Term Loan discussed in Note 7, Debt, to the accompanying Consolidated Financial Statements, and \$12 million and \$4 million repayments related to the Amortizing Notes and North Ocean 105 Construction Financing, respectively.

We believe our cash on hand, anticipated future operating cash flows and capacity under our credit facilities will be sufficient to finance our capital expenditures, settle our commitments and contingencies and address our working capital and letter of credit needs at least for the next 12 months.

#### Capital Expenditures

As part of our strategic growth program, our management regularly evaluates our marine vessel fleet and our fabrication yard construction capacity to ensure our fleet and construction capabilities are adequately aligned with our overall growth strategy. These assessments may result in capital expenditures to construct, upgrade, acquire or operate vessels or acquire or upgrade fabrication yards that would enhance or grow our technical capabilities, or may involve engaging in discussions to dispose of certain marine vessels or fabrication yards.

Capital expenditures for the nine months ended September 30, 2016 were \$197 million, as compared to \$66 million for the nine months ended September 30, 2015. Capital expenditures for the nine months ended September 30, 2016 were primarily attributable to the construction of the DLV 2000, and were incurred as a result of the construction work reaching established milestones, including completion in the second quarter of 2016. Capital expenditures for the nine months ended September 30, 2015 were primarily attributable to the construction of the DLV 2000, as well as costs associated with upgrading the capabilities of other marine vessels. As of September 30, 2016, the total capitalized cost of the DLV 2000 in our Consolidated Financial Statements was \$433 million, including \$43 million of capitalized interest. Our remaining cash obligation for the vessel is \$15 million, all of which is payable in the fourth quarter of 2016.

#### Item 3. Quantitative and Qualitative Disclosures about Market Risk

In the normal course of business, our results of operations are exposed to certain market risks, primarily associated with fluctuations in currency exchange rates and interest rate risk. Our exposure to market risk from changes in interest rates relates primarily to the Term Loan, cash equivalents and our investment portfolio, which primarily consists of investments in commercial paper and other highly liquid money market instruments denominated in U.S. dollars. We are averse to principal loss and seek to ensure the safety and preservation of our invested funds by limiting default risk, market risk and reinvestment risk. All of our investments in debt securities are classified as available-for-sale.

We have operations in many locations around the world, and, as a result, our financial results could be significantly affected by factors such as changes in currency exchange rates or weak economic conditions in foreign markets. In order to manage the risks associated with currency exchange rate fluctuations, we attempt to hedge those risks with foreign currency derivative instruments. Historically, we have hedged those risks with foreign currency forward contracts. In certain cases, contracts with our customers may contain provisions under which payments from our customers are denominated in U.S. dollars and in a foreign currency. The payments denominated in a foreign currency are designed to compensate us for costs that we expect to incur in such foreign currency. In these cases, we may use

derivative instruments to reduce the risks associated with currency exchange rate fluctuations arising from differences in timing of our foreign currency cash inflows and outflows. Our operational cash flows and cash balances, though predominately held in U.S. dollars, may consist of different currencies at various points in time in order to execute our project contracts globally. Non-U.S. denominated asset and liability balances are subject to currency fluctuations when measured period to period for financial reporting purposes in U.S. dollars.

We have exposure to changes in interest rates under the Term Loan. As of September 30, 2016, we had no material future earnings or cash flow exposures from changes in interest rates on our other outstanding debt obligations, as substantially all of those obligations had fixed interest rates.

Our operational cash flows and cash balances, though predominately held in U.S. dollars, may consist of different currencies at various points in time in order to execute our project contracts globally. Non-U.S. denominated asset and liability balances are subject to currency fluctuations when measured period to period for financial reporting purposes in U.S. dollars.

## Interest Rate Sensitivity

The following tables provide information about our financial instruments that are sensitive to changes in interest rates. The table below presents principal cash flows and related weighted-average interest rates by expected maturity dates at September 30, 2016 (in thousands):

	Years Ending December 31,								Fair Value at September 30, 2016
	2016	2017	2018	2019	2020	Thereafter	Total		
Long-term Debt — fixed rate	\$8,556	\$41,769	\$436	\$1,346	\$ -	\$500,000	\$552,107	\$527,479	
Average Interest Rate	7.66 %	7.92 %	8.00 %	8.00 %	-	8.00 %			
Long-term Debt — floating rate	750	3,000	3,000	211,500	-	-	218,250	219,341	
Average Interest Rate	8.25 %	8.53 %	8.59 %	8.64 %					

## Currency Exchange Rate Sensitivity

The following table provides information about our foreign currency forward contracts outstanding at September 30, 2016 and presents such information in U.S. dollar equivalents. The table presents notional amounts and related weighted-average exchange rates by expected (contractual) maturity dates and constitutes a forward-looking statement. These notional amounts generally are used to calculate the contractual payments to be exchanged under the contract. The average contractual exchange rates are expressed using market convention, which is dependent on the currencies being bought and sold under the forward contract.

## Forward Contracts to Purchase or Sell Foreign Currencies in U.S. Dollars (in thousands)

Foreign Currency	Year Ending	Fair Value at	Average Contractual Exchange Rate
	December 31, 2016	September 30, 2016	
Australian Dollar	\$130,033	\$ (1,310 )	0.7742
Danish Krone	5,740	18	6.6220
Euros	50,929	48	1.1248
Indian Rupee	3,057	106	69.5058
Norwegian Kroner	32,187	84	8.0977
Pound Sterling	6,432	(277 )	1.3611
Singapore Dollar	84	-	1.3612
Swiss Frank	6,672	-	0.9701

  

Foreign Currency	Year Ending	Fair Value at	Average Contractual Exchange Rate
------------------	-------------	---------------	-----------------------------------

	December 31, 2017	September 30, 2016	Exchange Rate
Australian Dollar	19,632	\$ (3,059 )	0.9062
Brazilian Real	4,000	(294 )	3.4855
Euros	43,431	(81 )	1.1339
Indian Rupee	9,976	303	71.5669
Norwegian Kroner	1,699	57	8.2595
Pound Sterling	9,822	(613 )	1.3922
Swiss Frank	1,365	(8 )	0.9555

#### Item 4. Controls and Procedures

As of the end of the period covered by this quarterly report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) adopted by the SEC under the Securities Exchange Act of 1934, as amended (the “Exchange Act”). Our disclosure controls and procedures were developed through a process in which our management applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding the control objectives. You should note that the design of any system of disclosure controls and procedures is based in part upon various assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Based on the evaluation referred to above, our Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures are effective as of September 30, 2016 to provide

reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and such information is accumulated and communicated to management, including our principal executive and principal financial officers or persons performing similar functions, as appropriate to allow timely decisions regarding disclosure. There has been no change in our internal control over financial reporting during the quarter ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

For information regarding ongoing investigations and litigation, see Note 13 to our unaudited Consolidated Financial Statements in Part I of this report, which we incorporate by reference into this Item.

#### Item 1A. Risk factors

We are subject to various risks and uncertainties in the course of our business. A discussion of material risks and uncertainties may be found under Item 1A–Risk Factors in Part I of our annual report on Form 10-K for the year ended December 31, 2015. The updates to those risk factors provided under Item 1A–Risk Factors in Part II of our quarterly report on Form 10-Q for the quarter ended June 30, 2016 is incorporated by reference into this item. The following provides a further update to those disclosures:

##### Risk Factors Relating to our Business Operations

Our employees work on projects that are inherently dangerous. If we fail to maintain safe work sites, we can be exposed to significant financial losses and reputational harm.

Safety is a leading focus of our business, and our safety record is critical to our reputation and is of paramount importance to our employees, customers and shareholders. However, we often work on large-scale and complex projects which can place our employees and others near large mechanized equipment, moving vehicles, dangerous processes or highly-regulated materials and in challenging environments. Although we have a functional group whose primary purpose is to implement effective quality, health, safety, environmental and security procedures throughout our company, if we fail to implement effective safety procedures, our employees and others may become injured, disabled or lose their lives, our projects may be delayed and we may be exposed to litigation or investigations.

Unsafe conditions at project work sites also have the potential to increase employee turnover, increase project costs and raise our operating costs. Additionally, many of our customers require that we meet certain safety criteria to be eligible to bid for contracts and our failure to maintain adequate safety standards, could result in reduced profitability, or lost project awards or customers. Any of the foregoing could result in financial losses or reputational harm, which could have a material adverse impact on our business, financial condition, and results of operations.

Item 6. Exhibits

Exhibit

Number	Description
3.1*	McDermott International, Inc.'s Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to McDermott International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (File No. 1-08430)).
3.2*	McDermott International, Inc.'s Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to McDermott International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (File No. 1-08430)).
3.3*	Amended and Restated Certificate of Designation of Series D Participating Preferred Stock of McDermott International, Inc. (incorporated by reference to Exhibit 3.3 to McDermott International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 (File No. 1-08430)).
12.1	Ratio of Earnings to Fixed Charges.
31.1	Rule 13a-14(a)/15d-14(a) certification of Chief Executive Officer.
31.2	Rule 13a-14(a)/15d-14(a) certification of Chief Financial Officer.
32.1	Section 1350 certification of Chief Executive Officer.
32.2	Section 1350 certification of Chief Financial Officer.
101.INS XBRL	Instance Document
101.SCH XBRL	Taxonomy Extension Schema Document
101.CAL XBRL	Taxonomy Extension Calculation Linkbase Document
101.LAB XBRL	Taxonomy Extension Label Linkbase Document
101.PRE XBRL	Taxonomy Extension Presentation Linkbase Document
101.DEF XBRL	Taxonomy Extension Definition Linkbase Document

\*Incorporated by reference to the filing indicated.

45

---

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

October 25, 2016

McDERMOTT INTERNATIONAL, INC.

By: /s/ STUART SPENCE  
Stuart Spence

Executive Vice President and Chief Financial Officer

EXHIBIT INDEX

Exhibit

Number Description

3.1\* McDermott International, Inc.'s Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to McDermott International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (File No. 1-08430)).

3.2\* McDermott International, Inc.'s Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to McDermott International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 (File No. 1-08430)).

3.3\* Amended and Restated Certificate of Designation of Series D Participating Preferred Stock of McDermott International, Inc. (incorporated by reference to Exhibit 3.3 to McDermott International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 (File No. 1-08430)).

12.1 Ratio of Earnings to Fixed Charges.

31.1 Rule 13a-14(a)/15d-14(a) certification of Chief Executive Officer.

31.2 Rule 13a-14(a)/15d-14(a) certification of Chief Financial Officer.

32.1 Section 1350 certification of Chief Executive Officer.

32.2 Section 1350 certification of Chief Financial Officer.

101.INS  
XBRL Instance Document

101.SCH  
XBRL Taxonomy Extension Schema Document

101.CAL  
XBRL Taxonomy Extension Calculation Linkbase Document

101.LAB  
XBRL Taxonomy Extension Label Linkbase Document

101.PRE  
XBRL Taxonomy Extension Presentation Linkbase Document

101.DEF  
XBRL Taxonomy Extension Definition Linkbase Document

\*Incorporated by reference to the filing indicated.