

MCDERMOTT INTERNATIONAL INC
Form 10-Q
May 05, 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 March 31, 2016

OR

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

For the transition period from _____ to _____

Commission File No. 001-08430

MCDERMOTT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

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

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

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

77079

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Accelerated filer

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

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

The number of shares of the registrant’s common stock outstanding at May 3, 2016 was 240,357,706.

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 (Loss)</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>	23
<u>Item 3—Quantitative and Qualitative Disclosures about Market Risk</u>	33
<u>Item 4—Controls and Procedures</u>	35
<u>PART II—OTHER INFORMATION</u>	36
<u>Item 1—Legal Proceedings</u>	36
<u>Item 6—Exhibits</u>	37
<u>SIGNATURES</u>	39

PART I—FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three Months Ended March 31,	
	2016	2015
	(In thousands, except share and per share amounts)	
Revenues	\$729,032	\$550,463
Costs and Expenses:		
Cost of operations	616,033	475,459
Selling, general and administrative expenses	38,328	51,676
Impairment loss	32,311	-
Gains on asset disposals	-	(367)
Restructuring expenses	6,367	10,389
Total costs and expenses	693,039	537,157
Operating income	35,993	13,306
Other income (expense):		
Interest expense, net	(11,238)	(12,179)
Loss on foreign currency, net	(3,183)	(1,468)
Other expense, net	(208)	(97)
Total other expense	(14,629)	(13,744)
Income (loss) before provision for income taxes	21,364	(438)
Provision for income taxes	19,330	4,869
Income (loss) before loss from investments in unconsolidated affiliates	2,034	(5,307)
Loss from investments in unconsolidated affiliates	(4,478)	(6,741)
Net loss	(2,444)	(12,048)
Less: Net income (loss) attributable to noncontrolling interest	(272)	2,459
Net loss attributable to McDermott International, Inc.	\$(2,172)	\$(14,507)

Loss per share		
Net loss attributable to McDermott International, Inc.		
Basic:	(0.01)	(0.06)
Diluted:	(0.01)	(0.06)
Shares used in the computation of loss per share:		
Basic:	239,137,912	237,504,719
Diluted:	239,137,912	237,504,719

See accompanying Notes to the Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2016	2015
	(in thousands)	
Net loss	\$(2,444)	\$(12,048)
Other comprehensive income (loss), net of tax:		
Unrealized gain on investments	5	12
Gain (loss) on derivatives	30,791	(16,885)
Foreign currency translation	(3,343)	(2,042)
Other comprehensive income (loss), net of tax	27,453	(18,915)
Total comprehensive income (loss)	\$25,009	\$(30,963)
Less: Comprehensive income (loss) attributable to non-controlling interests	(285)	2,426
Comprehensive income (loss) attributable to McDermott International, Inc.	\$25,294	\$(33,389)

See accompanying Notes to the Consolidated Financial Statements.

MCDERMOTT INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS

	March 31,	December 31,
	2016	2015
	(In thousands, except share and per share amounts)	
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 696,103	\$ 664,844
Restricted cash and cash equivalents	101,726	116,801
Accounts receivable—trade, net	271,713	208,474
Accounts receivable—other	55,350	66,689
Contracts in progress	358,501	435,829
Other current assets	46,716	34,641
Total current assets	1,530,109	1,527,278
Property, plant and equipment	2,432,169	2,467,352
Less accumulated depreciation	(838,050)	(856,493)
Net property, plant and equipment	1,594,119	1,610,859
Accounts receivable – long-term retainages	160,515	155,061
Investments in unconsolidated affiliates	26,844	26,551
Deferred income taxes	13,657	18,822
Other assets	46,314	48,505
Total assets	\$ 3,371,558	\$ 3,387,076
Liabilities and Equity		
Current liabilities:		
Notes payable and current maturities of long-term debt	\$ 25,298	\$ 24,882
Accounts payable	298,297	279,821
Accrued liabilities	299,277	330,943
Advance billings on contracts	138,272	164,773
Income taxes payable	21,541	23,787
Total current liabilities	782,685	824,206
Long-term debt	815,641	819,001
Self-insurance	19,363	18,653
Pension liability	24,025	24,066
Non-current income taxes	55,121	52,559
Other liabilities	104,735	101,870
Commitments and contingencies		
Stockholders' Equity:		
Common stock, par value \$1.00 per share, authorized 400,000,000 shares; issued 248,374,567 and 246,841,128 shares, respectively	248,374	246,841
Capital in excess of par value (including prepaid common stock purchase	1,685,061	1,687,059

contracts)		
Accumulated deficit	(263,056)	(260,884)
Treasury stock, at cost: 8,020,427 and 7,824,204 shares, respectively	(93,539)	(92,262)
Accumulated other comprehensive loss	(66,489)	(93,955)
Stockholders' Equity—McDermott International, Inc.	1,510,351	1,486,799
Noncontrolling interest	59,637	59,922
Total Equity	1,569,988	1,546,721
Total Liabilities and Equity	\$3,371,558	\$3,387,076

See accompanying Notes to the Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net loss	\$(2,444)	\$(12,048)
Non-cash items included in net loss:		
Depreciation and amortization	20,602	25,327
Impairment loss	32,311	-
Drydock amortization	3,940	5,272
Stock-based compensation charges	1,484	4,278
Loss from investments in unconsolidated affiliates	4,478	6,741
Restructuring expense	-	4,169
Deferred income taxes	5,164	(5,341)
Other non-cash items	(2,698)	(1,839)
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable	(61,248)	(69,214)
Contracts in progress net of advance billings on contracts	50,839	(61,021)
Accounts payable	16,762	110,785
Accrued and other current liabilities	(16,112)	(5,723)
Pension liability	(375)	(555)
Other assets and liabilities	6,577	(19,370)
Total cash provided by (used in) operating activities	59,280	(18,539)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(31,900)	(23,972)
(Increase) decrease in restricted cash and cash equivalents	15,075	(12,179)
Sales and maturities of available-for-sale securities	-	1,775
Investments in unconsolidated affiliates	(4,105)	(4,696)
Other investing activities	-	76
Total cash used in investing activities	(20,930)	(38,996)
Cash flows from financing activities:		
Repayment of debt	(4,752)	(4,706)
Repurchase of common stock	(2,200)	(1,003)
Other	-	(320)
Total cash used in financing activities	(6,952)	(6,029)
Effects of exchange rate changes on cash and cash equivalents	(139)	(1,109)
Net increase (decrease) in cash and cash equivalents	31,259	(64,673)
Cash and cash equivalents at beginning of period	664,844	665,309
Cash and cash equivalents at end of period	\$696,103	\$600,636

See accompanying Notes to the Consolidated Financial Statements.

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

	Par Value	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholders' Equity	Noncontrolling Interest ("NCI")	Total Equity
	(in thousands)							
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 loss	-	-	(2,172)	-	-	(2,172)	(272)	(2,444)
Other comprehensive income (loss) net of tax	-	-	-	27,466	-	27,466	(13)	27,453
Common stock issued	1,907	(1,907)	-	-	-	-	-	-
Stock-based compensation charges	-	458	-	-	-	458	-	458
Purchase of treasury shares	-	-	-	-	(2,200)	(2,200)	-	(2,200)
Retirement of common stock	(374)	(549)	-	-	923	-	-	-
Balance at March 31, 2016	\$248,374	\$1,685,061	\$(263,056)	\$(66,489)	\$(93,539)	\$1,510,351	\$59,637	\$1,569,988

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>	11
<u>Note 5—Accounts Receivable</u>	13
<u>Note 6—Contracts in Progress and Advance Billings on Contracts</u>	13
<u>Note 7—Debt</u>	14
<u>Note 8—Pension and Postretirement Benefits</u>	16
<u>Note 9—Derivative Financial Instruments</u>	16
<u>Note 10—Fair Value Measurements</u>	17
<u>Note 11—Stockholders' Equity</u>	18
<u>Note 12—Earnings Per Share</u>	19
<u>Note 13—Commitments and Contingencies</u>	20
<u>Note 14—Segment Reporting</u>	20

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 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

Income Tax—In November 2015, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“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 material impact on the presentation of our Consolidated Financial Statements. All comparable periods presented have been revised to reflect this change.

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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 material impact on the accompanying Consolidated Financial Statements.

Accounting Guidance Issued But Not Adopted as of March 31, 2016

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, and classification in the statement of cash flows. The amendments in this ASU are 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 future Consolidated Financial Statements and related disclosures.

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

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

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

Financial Assets and Liabilities—In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Under this new guidance, entities will be required to measure all investments in equity securities that are not subject to equity method or consolidation accounting at fair value, with changes recognized in net income. Fair value changes related to instrument-specific credit risk in financial liabilities accounted for under the fair value option in Accounting Standards Codification 825 must be recorded in other comprehensive income instead of earnings. ASU 2016-01 also changes presentation and disclosure requirements for financial assets and liabilities. ASU 2016-01 is effective for interim and annual periods beginning after December 15, 2017, with early adoption not permitted except related to changes in fair value for financial liabilities. We are currently assessing the impact of these amendments on our future Consolidated Financial Statements and related

disclosures.

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

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

8

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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.

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 March 31, 2016, total unapproved change orders included in our estimates at completion aggregated approximately \$122 million, of which approximately \$20 million was included in backlog. As of March 31, 2015, total unapproved change orders included in our estimates at completion aggregated approximately \$240 million, of which approximately \$73 million was included in backlog.

Claims Revenue

The amount of revenues and costs included in our estimates at completion (i.e., contract values) associated with claims was \$16 million and \$7 million as of March 31, 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 March 31, 2016 and 2015.

None of the claims included in our estimates at completion at March 31, 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 March 31, 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 any fiscal quarter or year. For all contracts, if a current estimate of total contract cost indicates a loss, the projected loss is recognized in full when determined.

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

As of March 31, 2016, one significant active project, the Agile vessel charter project in Brazil, was in a loss position and, as a result, future revenues were expected to equal costs when recognized. The customer recently notified us that they would be terminating the contract in May 2016. As of March 31, 2016, the related backlog for the loss project was approximately \$5 million.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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 March 31, 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 months ended March 31, 2016 and 2015.

Three months ended March 31, 2016

Operating income for the three months ended March 31, 2016 was positively impacted by net favorable changes in cost estimates totaling approximately \$40 million across all segments.

Americas, Europe and Africa Segment (“AEA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$16 million, primarily attributable to successful execution and close-out improvements on two significant projects, PB Litoral and Exxon Julia Subsea Tieback, in the first quarter of 2016. Included in the change was a reversal of a \$7 million provision for liquidated damages due to an agreed extension of the PB Litoral project completion date. Miscellaneous other projects also experienced net positive changes in estimate, which were individually not material.

Middle East Segment (“MEA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$7 million, primarily due to productivity improvements and associated cost savings related to the DB 27 vessel on a Saudi Aramco project and cost savings on miscellaneous other projects.

Asia Segment (“ASA”)—This segment had net favorable changes in estimates aggregating approximately \$17 million driven by improved productivity and project execution cost savings on the Inpex Ichthys project, agreement on outstanding change orders on the Brunei Shell Petroleum pipeline replacement project and agreement on outstanding change orders and cost savings on miscellaneous other projects.

Three months ended March 31, 2015

Operating income for the three months ended March 31, 2015 was positively impacted by net favorable changes in cost estimates totaling approximately \$22 million across all segments.

AEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$7 million, primarily due to \$4 million in reduced cost estimates attributable to a revised demobilization plan for one of our vessels, the North Ocean 105 (the “NO 105”), which is currently working on a subsea project in Brazil.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$9 million. Two EPCI projects in Saudi Arabia were positively impacted by \$7 million of changes in revenue recovery and cost savings based on constructive discussions with the customer on design optimization and by \$6 million for improvement in revenue recovery estimates and due to the favorable outcome of our discussions with the customer on compensation for vessel downtime due to weather and standby delays. These favorable changes were partially offset by the \$5 million negative impact on an EPCI project in Saudi Arabia, primarily due to changes in cost estimates as a result of a change in marine execution plans.

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately \$6 million, driven by multiple projects, none of the individual results of which were material.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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 remaining activities for MPI are still progressing, and we expect to substantially complete the move from Singapore to Kuala Lumpur, along with additional sourcing initiatives, in the second quarter 2016.

We continued our efforts to improve our cost structure by initiating the Additional Overhead Reduction program (“AOR”) during fourth quarter 2015. AOR actions have included personnel reductions affecting direct operating expense and SG&A, and with additional opportunities for cost reductions identified in the first quarter of 2016, is now expected to be complete in the third quarter of 2016.

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

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 months ended March 31, 2016 and 2015, as well as amounts incurred from the inception of our restructuring efforts up to March 31, 2016 and amounts expected to be incurred in the future, by major type of cost and by segment.

	Incurred in the three months ended March 31, 2016 2015 (in thousands)		Incurred from inception to March 31, 2016	Estimate of remaining amounts to be incurred	Total
Americas Restructuring					
Impairments and write offs	\$-	\$-	\$ 12,923	\$ -	\$12,923
Severance and other personnel-related costs	-	881	13,981	-	13,981
Morgan City environmental reserve	-	-	5,925	-	5,925
Morgan City yard-related expenses	-	914	12,557	-	12,557
Other	-	-	158	-	158
	-	1,795	45,544	-	45,544
Corporate Restructuring	-	-	6,601	-	6,601
MPI					
Severance and other personnel-related costs					
AEA	-	1,252	6,646	-	6,646
MEA	-	607	856	-	856
ASA	433	1,800	6,537	1,898	8,435
Corporate and other	-	719	1,611	-	1,611
Asset impairment and disposal					
ASA	-	4,168	7,471	-	7,471
Legal and other advisor fees					
ASA	-	-	-	390	390
Corporate	173	48	11,590	-	11,590
Other	-	-	-	-	-
AEA	-	-	692	-	692
ASA	895	-	6,829	2,327	9,156
Corporate and other	-	-	983	-	983
	1,501	8,594	43,215	4,615	47,830
AOR					
Severance and other personnel-related costs					
AEA	2,186	-	2,186	795	2,981
ASA	-	-	-	400	400
Corporate	785	-	785	472	1,257
Legal and other advisor fees					
Corporate	1,728	-	2,528	-	2,528
Other	-	-	-	-	-

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AEA	150	-	150	-	150
MEA	17	-	17	-	17
Corporate	-	-	-	2,469	2,469
	4,866	-	5,666	4,136	9,802
Total	\$6,367	\$10,389	\$ 101,026	\$ 8,751	\$109,777
By segment					
AEA	\$2,336	\$3,047	\$ 55,218	\$ 795	\$56,013
MEA	17	607	873	-	873
ASA	1,328	5,968	20,837	5,015	25,852
Corporate	2,686	767	24,098	2,941	27,039
Total	\$6,367	\$10,389	\$ 101,026	\$ 8,751	\$109,777

12

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:

	March 31, 2016	December 31, 2015
	(in thousands)	
Contract receivables:		
Contracts in progress	\$228,929	164,898
Completed contracts	45,235	35,702
Retainages	7,587	17,896
Unbilled	4,303	4,303
Less allowances	(14,341)	(14,325)
Accounts receivable—trade, net	\$271,713	\$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:

	March 31, 2016	December 31, 2015
	(in thousands)	
Retainages expected to be collected within one year	\$7,587	\$17,896
Retainages expected to be collected after one year	160,515	155,061
Total retainages	\$168,102	\$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:

March 31, 2016	December 31, 2015
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	(In thousands)	
Costs incurred less costs of revenues recognized	\$ 119,879	\$ 112,819
Revenues recognized less billings to customers	238,622	323,010
Contracts in Progress	\$ 358,501	\$ 435,829
Billings to customers less revenues recognized	106,249	265,618
Costs incurred less costs of revenue recognized	32,023	(100,845)
Advance Billings on Contracts	\$ 138,272	\$ 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 \$18 million and \$20 million as of March 31, 2016 and December 31, 2015, respectively, are as follows:

	March 31, 2016	December 31, 2015
	(In thousands)	
Senior Notes	\$492,306	\$491,890
Term Loan	289,771	289,979
North Ocean 105 Construction Financing	38,399	38,263
Amortizing Notes	18,005	21,205
Capital lease obligation	2,458	2,546
	840,939	843,883
Less: Amounts due within one year	25,298	24,882
Total long-term debt	\$815,641	\$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”), which is scheduled to mature in 2017, and a \$300 million first-lien, second-out five-year term loan (the “Term Loan”), which is 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;

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

· 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 expenditure 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.

This change to our financial covenants was effective for the covenants tested as of March 31, 2016, and we were in compliance with these requirements, as shown below:

Ratios	Requirement	Actual
Minimum fixed charge coverage ratio	1.15x	2.75x
Maximum total leverage ratio	4.5x	2.50x
Maximum secured leverage ratio	2x	0.94x

As of March 31, 2016 and December 31, 2015, the aggregate face amount of letters of credit issued under the LC Facility was \$467 million and \$384 million, respectively. No financial letters of credit have been issued under the LC Facility.

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 March 31, 2016 and December 31, 2015, we had an aggregate face amount of approximately \$100 million and \$102 million of such letters of credit outstanding supported by cash collateral, including financial letters of credit of \$43 million and \$45 million, respectfully. We have included the supporting cash collateral in restricted cash and cash equivalents in the accompanying Consolidated Balance Sheets.

Also, in April 2016, we entered into an unsecured and uncommitted bilateral letter of credit arrangement for approximately \$100 million with a Middle Eastern bank. The newly issued bilateral letter of credit arrangement is anticipated to support our Middle Eastern business.

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 LC Facility, 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.

Bank Guarantees

In 2015, MDR executed a reimbursement agreement with a Middle East based bank which provides an uncommitted line of credit in support of our contracting activities in the Middle East. There are no administrative or commitment fees associated with the agreement. As of March 31, 2016, bank guarantees issued under that agreement were \$28 million. Bank guarantees issued under other general reimbursement arrangements totaled \$101 million and \$100 million, as of March 31, 2016 and December 31, 2015, respectively.

Surety Bonds

As of March 31, 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 \$73 million and \$54 million, respectively.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

NOTE 8—PENSION AND POSTRETIREMENT BENEFITS

Net periodic benefit gain 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		TCN Plan	
	Three Months Ended March 31,			
	2016	2015	2016	2015
	(In thousands)			
Interest cost	\$5,259	\$5,382	\$338	\$407
Expected return on plan assets	(5,003)	(6,677)	(397)	(710)
Net periodic (benefit) cost	\$256	\$(1,295)	\$(59)	\$(303)

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 March 31, 2016, the majority of our foreign currency forward contracts were designated as cash flow hedging instruments. In addition, we deferred approximately \$33 million of net losses on those derivative financial instruments in AOCI, and we expect to reclassify approximately \$24 million of deferred losses out of AOCI by March 31, 2017, as hedged items are recognized. The notional value of our outstanding derivative contracts totaled \$536 million at March 31, 2016, with maturities extending through December 2017. Of this amount, approximately \$286 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 March 31, 2016, the fair value of these contracts was in a net liability position totaling approximately \$3 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.

The following tables summarize our derivative financial instruments:

Asset and Liability Derivatives

	March	
	31, 2016	December 31, 2015
	(In thousands)	
Derivatives Designated as Hedges:		
Location:		
Accounts receivable—other	\$7,686	\$ 1,668
Other assets	154	215
Total asset derivatives	\$7,840	\$ 1,883
Accounts payable	\$8,330	\$ 26,649
Other liabilities	2,080	4,018
Total liability derivatives	\$10,410	\$ 30,667

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

The Effects of Derivative Instruments on our Financial Statements

	March 31,	
	2016	2015
	(In thousands)	
Derivatives Designated as Hedges:		
Amount of loss recognized in other comprehensive income (loss)	\$20,534	\$36,690
Income reclassified from AOCI into income: effective portion		
Location: Cost of operations	9,679	19,854
Gain(loss) recognized in income (loss): ineffective portion and amount excluded from effectiveness testing		
Location: Gain (loss) on foreign currency—net	(1,205)	1,817

NOTE 10—FAIR VALUE MEASUREMENTS

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

	March 31, 2016				
	Carrying				
	Amount	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Recurring					
Forward contracts	\$(2,570)	\$(2,570)	\$-	\$(2,570)	\$-
Non-recurring					
Cash and cash equivalents	696,103	696,103	696,103	-	-
Restricted cash and cash equivalents	101,726	101,726	101,726	-	-
Debt	(840,939)	(733,743)	-	(667,540)	(66,203)
	December 31, 2015				
	Carrying				
	Amount	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Recurring					
Forward contracts	\$(28,784)	\$(28,784)	\$-	\$(28,784)	\$-
Non-recurring					
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 Amortizing Notes and NO 105 Construction 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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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 first quarter of 2016, we impaired our Agile vessel upon termination of its current charter in May 2016 and 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 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.

NOTE 11—STOCKHOLDERS' EQUITY

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

	Three Months Ended March 31,	
	2016	2015
Ordinary shares outstanding		
Beginning balance	239,016,924	237,809,823
Common stock issued	1,907,215	990,039
Purchase of common stock	(569,999)	(300,553)
Ending balance	240,354,140	238,499,309
Ordinary shares held as Treasury shares		
Beginning balance	7,824,204	7,400,027
Purchase of common stock	569,999	300,553
Retirement of common stock	(373,776)	-
Ending balance	8,020,427	7,700,580
Ordinary shares issued at the end of the period	248,374,567	246,199,889

Accumulated Other Comprehensive Income (Loss) (AOCI)

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

	March 31, 2016	December 31, 2015
	(In thousands)	
Foreign currency translation adjustments (“FCTA”)	\$(33,268)	\$(29,925)
Net unrealized gain on investments	252	247
Net loss on derivative financial instruments	(33,473)	(64,277)
Accumulated other comprehensive loss	\$(66,489)	\$(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.

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:

	Foreign currency translation adjustments (In thousands)	Unrealized holding gain (loss) on investments	Gain (loss) on derivative ⁽¹⁾	TOTAL
Balance, January 1, 2015	\$(15,212)	\$ 241	\$ (82,837)	\$(97,808)
Other comprehensive income (loss) before reclassification	(2,042)			