MCDERMOTT INTERNATIONAL INC
Form 10-Q
April 29, 2019

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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, 2019

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	72-0593134 (I.R.S. Employer
Incorporation or Organization)	Identification No.)
757 N. Eldridge Parkway	
HOUSTON, TEXAS	77079

(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 every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 25, 2019 was 181,658,808.

TABLE OF CONTENTS

McDERMOTT INTERNATIONAL, INC.

INDEX—FORM 10-Q

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

PART I: FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

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

	Three months ended March 31,	
	2019	2018
	(In millions, except per share amounts)	
Revenues	$2,211	$608
Costs and Expenses:		
Cost of operations	2,018	476
Project intangibles and inventory-related amortization	10	-
Total cost of operations	2,028	476
Research and development expenses	8	-
Selling, general and administrative expenses	72	48
Other intangibles amortization	22	-
Transaction costs	4	3
Restructuring and integration costs	69	12
Other operating expense, net	1	-
Total expenses	2,204	539
Income (loss) from investments in unconsolidated affiliates	9	(4)
Investment in unconsolidated affiliates-related amortization	(3)	-
Operating income	13	65
Other expense:		
Interest expense, net	(92)	(12)
Other non-operating income, net	1	2
Total other expense, net	(91)	(10)
(Loss) income before provision for income taxes	(78)	55
Income tax (benefit) expense	(21)	21
Net (loss) income	(57)	34
Less: Net loss attributable to noncontrolling interests	(1)	(1)
Net (loss) income attributable to McDermott	$(56)	$35

Dividends on redeemable preferred stock	(10)	-
Accretion of redeemable preferred stock	(4)	-
Net (loss) income attributable to common stockholders	$(70)	$35
Net (loss) income per share attributable to common stockholders		
Basic	$(0.39)	$0.37
Diluted	$(0.39)	$0.37
Shares used in the computation of net (loss) income per share		
Basic	181	95
Diluted	181	95

See accompanying Notes to these Condensed Consolidated Financial Statements.

1

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Three months ended March 31,	
	2019	2018
	(In millions)	
Net (loss) income	$(57)	$ 34
Other comprehensive (loss) income, net of tax:		
(Loss) gain on derivatives	(19)	-
Foreign currency translation	(39)	(1)
Total comprehensive (loss) income	(115)	33
Less: Comprehensive loss attributable to noncontrolling interests	(1)	(1)
Comprehensive (loss) income attributable to McDermott	$(114)	$ 34

See accompanying Notes to these Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2019	December 31, 2018
	(In millions, except per share amounts)	
Assets	(Unaudited)	
Current assets:		
Cash and cash equivalents ($142 and $146 related to variable interest entities ("VIEs"))	$413	$ 520
Restricted cash and cash equivalents	326	325
Accounts receivable—trade, net ($15 and $29 related to VIEs)	977	932
Accounts receivable—other ($49 and $57 related to VIEs)	149	175
Contracts in progress ($245 and $144 related to VIEs)	1,006	704
Project-related intangible assets, net	114	137
Inventory	106	101
Other current assets ($29 and $24 related to VIEs)	148	139
Total current assets	3,239	3,033
Property, plant and equipment, net	2,051	2,067
Operating lease right-of-use assets	401	-
Accounts receivable—long-term retainages	69	62
Investments in unconsolidated affiliates	453	452
Goodwill	2,681	2,654
Other intangibles, net	979	1,009
Other non-current assets	156	163
Total assets	$10,029	$ 9,440
Liabilities, Mezzanine Equity and Stockholders' Equity		
Current liabilities:		
Revolving credit facility	$178	$ -
Current maturities of long-term debt	30	30
Current portion of long-term lease obligations	97	8
Accounts payable ($326 and $277 related to VIEs)	949	595
Advance billings on contracts ($541 and $717 related to VIEs)	1,618	1,954
Project-related intangible liabilities, net	52	66
Accrued liabilities ($94 and $136 related to VIEs)	1,694	1,564
Total current liabilities	4,618	4,217
Long-term debt	3,393	3,393
Long-term lease obligations	394	66
Deferred income taxes	47	47
Other non-current liabilities	659	664
Total liabilities	9,111	8,387
Commitments and contingencies		
Mezzanine equity:		

Redeemable preferred stock	243	230
Stockholders' equity:		
Common stock, par value $1.00 per share, authorized 255 shares; issued 184 and 183 shares, respectively	184	183
Capital in excess of par value	3,545	3,539
Accumulated deficit	(2,789)	(2,719)
Accumulated other comprehensive loss	(165)	(107)
Treasury stock, at cost: 3 and 3 shares, respectively	(96)	(96)
Total McDermott Stockholders' Equity	679	800
Noncontrolling interest	(4)	23
Total stockholders' equity	675	823
Total liabilities and stockholders' equity	$ 10,029	$ 9,440

See accompanying Notes to these Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Three months ended March 31,	
	2019	2018
	(In millions)	
Cash flows from operating activities:		
Net (loss) income	$(57)	$34
Non-cash items included in net (loss) income:		
Depreciation and amortization	76	23
Debt issuance cost amortization	11	2
Stock-based compensation charges	6	3
Deferred taxes	-	1
Changes in operating assets and liabilities, net of effects of businesses acquired:		
Accounts receivable	(87)	(68)
Contracts in progress, net of advance billings on contracts	(638)	143
Accounts payable	357	(90)
Other current and non-current assets	12	(20)
Investments in unconsolidated affiliates	(4)	4
Other current and non-current liabilities	80	6
Total cash (used in) provided by operating activities	(244)	38
Cash flows from investing activities:		
Purchases of property, plant and equipment	(18)	(18)
Advances related to proportionately consolidated consortiums	(114)	-
Investments in unconsolidated affiliates	(1)	(2)
Total cash used in investing activities	(133)	(20)
Cash flows from financing activities:		
Revolving credit facility borrowings	483	-
Revolving credit facility repayments	(305)	-
Repayment of debt and finance lease obligations	(8)	-
Advances related to equity method joint ventures and proportionately consolidated consortiums	116	-
Repurchase of common stock	(4)	(7)
Distribution to joint venture member	(5)	-
Total cash provided by (used in) financing activities	277	(7)
Effects of exchange rate changes on cash, cash equivalents and restricted cash	(6)	-
Net (decrease) increase in cash, cash equivalents and restricted cash	(106)	11
Cash, cash equivalents and restricted cash at beginning of period	845	408
Cash, cash equivalents and restricted cash at end of period	$739	$419

See accompanying Notes to these Condensed Consolidated Financial Statements.

CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

	Common Stock Par Value	Capital in Excess of Par Value	Retained Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Loss ("AOCI")	Treasury Stock	Stockholders' Equity	Noncontrolling Interest ("NCI")	Total Equity
	(In millions)							
Balance at December 31, 2017	$$$$ 293	$1,663	$ (48)	$ (50)	$ (96)	$ 1,762	$ 28	$1,790
Adoption of ASC 606	-	-	20	-	-	20	-	20
Balance at January 1, 2018	293	1,663	(28)	(50)	(96)	1,782	28	1,810
Net income (loss)	-	-	35	-	-	35	(1)	34
Other comprehensive loss, net of tax	-	-	-	(1)	-	(1)	-	(1)
Common stock issued	3	(3)	-	-	-	-	-	-
Stock-based compensation charges	-	3	-	-	-	3	-	3
Purchase of treasury shares	-	-	-	-	(7)	(7)	-	(7)
Retirement of common stock	(1)	(6)	-	-	7	-	-	-
Balance at March 31, 2018	295	1,657	7	(51)	(96)	1,812	27	1,839
Balance at December 31, 2018	183	3,539	(2,719)	(107)	(96)	800	23	823
Net loss	-	-	(56)	-	-	(56)	(1)	(57)
Other comprehensive loss, net of tax	-	-	-	(58)	-	(58)	-	(58)
Common stock issued	2	(2)	-	-	-	-	-	-
Stock-based compensation charges	-	6	-	-	-	6	-	6
Accretion and dividends on redeemable preferred stock	-	-	(14)	-	-	(14)	-	(14)
Conversion of noncontrolling interest	-	2	-	-	-	2	(26)	(24)
Purchase of treasury shares	-	-	-	-	(4)	(4)	-	(4)
Retirement of common stock	(1)	(3)			4	-	-	-
Other	-	3	-	-	-	3	-	3

Balance at March 31, 2019	$ 184	$3,545	$ (2,789)	$ (165)	$ (96)	$ 679	$ (4)	$675

See accompanying Notes to these Condensed Consolidated Financial Statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

TABLE OF CONTENTS

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—NATURE OF OPERATIONS AND ORGANIZATION

Nature of Operations

McDermott International, Inc. (“McDermott,” “we” or “us”), a corporation incorporated under the laws of the Republic of Panama in 1959, is a fully integrated provider of engineering, procurement, construction and installation (“EPCI”) and technology solutions to the energy industry. We design and build end-to-end infrastructure and technology solutions to transport and transform oil and gas into a variety of products. Our proprietary technologies, integrated expertise and comprehensive solutions are utilized for offshore, subsea, power, liquefied natural gas (“LNG”) and downstream energy projects around the world. Our customers include national, major integrated and other oil and gas companies as well as producers of petrochemicals and electric power, and we operate in most major energy 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.

Organization

Our business is organized into five operating groups, which represent our reportable segments consisting of: North, Central and South America (“NCSA”); Europe, Africa, Russia and Caspian (“EARC”); the Middle East and North Africa (“MENA”); Asia Pacific (“APAC”); and Technology. See Note 22, *Segment Reporting,* for further discussion.

NOTE 2—BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying Condensed Consolidated Financial Statements (the “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 and are not necessarily indicative of results of operations for a full year. Therefore, they should be read in conjunction with the Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2018 (the “2018 Form 10-K”).

The Financial Statements reflect all wholly owned subsidiaries and those entities we are required to consolidate. See the “Joint Venture and Consortium Arrangements” section of “Note 2—Basis of Presentation and Significant Accounting Policies” in the 2018 Form 10-K for further discussion of our consolidation policy for those entities that are not wholly owned. In the opinion of our management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. Intercompany balances and transactions are eliminated in consolidation. Values presented within tables (excluding per share data) are in millions and may not sum due to rounding.

On May 10, 2018, we completed our combination with Chicago Bridge & Iron Co. N.V. (“CB&I”) through a series of transactions (the “Combination”). See Note 3, *Business Combination,* for further discussion.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Reclassifications

Bidding and Proposal Costs—We began classifying bid and proposal costs in Cost of operations in our Condensed Consolidated Statements of Operations (the "Statement of Operations") in the second quarter of 2018 as a result of our realignment of commercial personnel within our operating groups in conjunction with the Combination. For the first quarter of 2018, bid and proposal costs were included in Selling, general and administrative expenses ("SG&A") and totaled $10 million. Our Cost of operations for the first quarter of 2019 includes $26 million of bid and proposal costs.

Beginning in the second quarter of 2018, we made certain classification changes, as well as reclassifications to our historical financial statements to align with our current presentation, as follows:

- *Income (Loss) from Investments in Unconsolidated Affiliates*—Our Statements of Operations for the three months ended March 31, 2018 reflects the reclassification of a $4 million loss from investments in unconsolidated affiliates associated with our ongoing io Oil and Gas and Qingdao McDermott Wuchuan Offshore Engineering Company Ltd. joint ventures to Operating income to conform to our current presentation. Previously, results from these unconsolidated joint ventures were presented below Operating income, as we did not consider the activities of the unconsolidated joint ventures to be integral to our operations. Based on an expected expansion in activity of these unconsolidated joint ventures in 2018 and in the future, we now believe the activities of these unconsolidated joint ventures are integral to our ongoing operations and are most appropriately reflected in Operating income. Income (loss) from investments in unconsolidated affiliates that are not integral to our operations will continue to be presented below Operating income. See Note 9, *Joint Venture and Consortium Arrangements,* for further discussion of our unconsolidated joint ventures.
- *Reverse Common Stock Split*—We amended our Amended and Restated Articles of Incorporation during the second quarter of 2018 to effect a three-to-one reverse stock split of McDermott common stock, effective May 9, 2018. Common stock, capital in excess of par, share and per share (except par value per share, which was not affected) information presented for the first quarter of 2018 has been recast in the Financial Statements and accompanying Notes to reflect the reverse stock split.
- *Restructuring and Integration Costs and Transaction Costs*—Approximately $12 million of restructuring and integration costs and $3 million of transaction costs related to the Combination, which were previously recorded within Other operating (income) expenses, net during the three months ended March 31, 2018, were reclassified to (i) Restructuring and integration costs and (ii) Transaction costs, respectively, in our Statements of Operations. See Note 10, *Restructuring and Integration Costs and Transaction Costs,* for further discussion.

Use of Estimates and Judgments

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosures of contingent assets and liabilities. We believe the most significant estimates and judgments are associated with:

- revenue recognition for our contracts, including estimating costs to complete each contract and the recognition of incentive fees and unapproved change orders and claims;
- determination of fair value with respect to acquired assets and liabilities;
- fair value and recoverability assessments that must be periodically performed with respect to long-lived tangible assets, goodwill and other intangible assets;
- valuation of deferred tax assets and financial instruments;
- the determination of liabilities related to loss contingencies, self-insurance programs and income taxes;
- the determination of pension-related obligations; and

- consolidation determinations with respect to our joint venture and consortium arrangements.

If the underlying estimates and assumptions upon which the Financial Statements are based change in the future, actual amounts may differ from those included in the Financial Statements.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Recently Adopted Accounting Guidance

Leases—In February 2016, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2016-02, Leases (Topic 842). This ASU requires 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. We adopted this ASU effective January 1, 2019 using the modified retrospective application, applying the new standard to leases in place as of the adoption date. Prior periods have not been adjusted.

We elected to apply certain practical expedients allowed upon the adoption of this ASU, which, among other things, allowed us to: not reassess whether any expired or existing contracts contain leases; carry forward the historical lease classification; and not have to reassess any initial direct cost of any expired or existing leases. Adoption of the new standard resulted in the recording of Operating lease right-of-use assets, Current portion of long-term lease obligations and Long-term lease obligations of approximately \$424 million, \$101 million and \$342 million, respectively, as of January 1, 2019. The adoption of this ASU did not have a material impact on our Statement of Operations, Condensed Consolidated Statement of Cash Flows ("Statement of Cash Flows") or the determination of compliance with financial covenants under our current debt agreements. See Note 12, *Lease Obligations*, for further discussion.

Income Taxes—In January 2018, the FASB issued ASU 2018-02, Reporting Comprehensive Income (Topic 220). This ASU gives entities the option to reclassify to retained earnings the tax effects resulting from the U.S. Tax Cuts and Jobs Act related to items in accumulated other comprehensive income (loss) ("AOCI") that the FASB refers to as having been stranded in AOCI. We adopted this ASU effective January 1, 2019. The adoption of this ASU did not have a material impact on the Financial Statements and related disclosures.

Derivatives—In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815). This ASU includes financial reporting improvements related to hedging relationships to better report the economic results of an entity's risk management activities in its financial statements. Additionally, this ASU makes certain improvements to simplify the application of the hedge accounting guidance. We adopted this ASU effective January 1, 2019. The adoption of this ASU did not have a material impact on the Financial Statements. See Note 16, Derivative Financial Instruments, for related disclosures.

In October 2018, the FASB issued ASU No. 2018-16, *Derivatives and Hedging: Inclusion of the Secured Overnight Financing Rate (SOFR) Overnight Index Swap (OIS) Rate as a Benchmark Interest Rate for Hedge Accounting Purposes*, which expands the list of benchmark interest rates permitted in the application of hedge accounting. This ASU permits the use of an OIS rate based on the SOFR as a U.S. benchmark interest rate for hedge accounting purposes. We adopted this ASU effective January 1, 2019. The adoption of this ASU did not have a material impact on the Financial Statements and related disclosures. See Note 16, *Derivative Financial Instruments*.

Significant Accounting Policies

Our significant accounting policies are detailed in "Note 2—Basis of Presentation and Significant Accounting Policies" in the 2018 Form 10-K. The following is an update to those significant accounting policies due to recently adopted accounting guidance.

Leases—We classify an arrangement as a lease at inception if we have the right to control the use of an identified asset we do not legally own for a period of time in exchange for consideration. In general, leases with an initial term of 12 months or less are not recorded on our Balance Sheet unless it is reasonably certain we will renew the lease. All leases with an initial term of more than 12 months, whether classified as operating or finance, are recorded to our Balance Sheet based on the present value of lease payments over the lease term, determined at lease commencement. Determination of the present value of lease payments requires a discount rate. We use the implicit rate in the lease agreement when available. Most of our leases do not provide an implicit interest rate; therefore, we use an incremental borrowing rate based on information available at the commencement date.

Our lease terms may include options to extend or terminate the lease when it is reasonably certain we will exercise that option. Lease expense for operating leases and the amortization of the right-of-use asset for finance leases are recognized on a straight-line basis over the lease term.

We have lease agreements with lease and non-lease components, which are generally accounted for separately for all leases other than leases at our construction project sites. Non-lease components included in assets and obligations under operating leases are not material to our financial statements.

For our joint ventures, consortiums and other collaborative arrangements (referred to as “joint ventures” and “consortiums”), the right-of-use asset and lease obligations are generally recognized by the party that enters into the lease agreement, which could be the joint venture directly, one of our joint venture partners or us. We have recognized our proportionate share of leases entered into by our joint ventures, where the joint venture has the right to control the use of an identified asset.

Derivative Financial Instruments—We utilize derivative financial instruments in certain circumstances to mitigate the effects of changes in foreign currency exchange rates and interest rates, as described below.

- *Foreign Currency Rate Derivatives*—We do not engage in currency speculation. However, we utilize foreign currency exchange rate derivatives on an ongoing basis to hedge against certain foreign currency related operating exposures. We generally apply hedge accounting treatment for contracts used to hedge operating exposures and designate them as cash flow hedges. Therefore, gains and losses are included in AOCI until the associated underlying operating exposure impacts our earnings, at which time the impact of the hedge is recorded within the income statement line item associated with the underlying exposure. Changes in the fair value of instruments that we do not designate as cash flow hedges are recognized in the income statement line item associated with the underlying exposure.
- *Interest Rate Derivatives*—Our interest rate derivatives are limited to a swap arrangement entered into on May 8, 2018, to hedge against interest rate variability associated with $1.94 billion of the $2.26 billion Term Facility described in Note 11, *Debt*. The swap arrangement has been designated as a cash flow hedge, as its critical terms matched those of the Term Facility at inception and through March 31, 2019. Accordingly, changes in the fair value of the swap arrangement are included in AOCI until the associated underlying exposure impacts our interest expense.

See Note 15, *Fair Value Measurements*, and Note 16, *Derivative Financial Instruments,* for further discussion.

Accounting Guidance Issued but Not Adopted as of March 31, 2019

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 ASU on our future consolidated financial statements and related disclosures.

Defined Benefit Pension Plans—In August 2018, the FASB issued ASU No. 2018-14, Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20). This ASU eliminates, modifies and adds disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. This ASU is effective for fiscal years ending after December 15, 2020, with early adoption permitted. We are evaluating the impact of the new guidance on our future disclosures.

Consolidation—In October 2018, the FASB issued ASU No. 2018-17, Consolidation: Targeted Improvements to Related Party Guidance for Variable Interest Entities (“VIE”). This ASU amends the guidance for determining whether a decision-making fee is a variable interest, which requires companies to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety. The ASU is effective for annual and interim periods beginning after December 15, 2019. We are currently assessing the impact of this ASU on our future consolidated financial statements and related disclosures.

Collaborative Arrangements—In November 2018, the FASB issued ASU No. 2018-18, Collaborative Arrangements: Clarifying the Interaction between Topic 808 and Topic 606. This ASU clarifies that certain transactions between collaborative arrangement participants should be accounted for as revenue under Topic 606 when the collaborative arrangement participant is a customer in the context of a unit of account. In addition, unit-of-account guidance in Topic 808 was aligned with the guidance in Topic 606 (that is, a distinct good or service) when assessing whether the collaborative arrangement or a part of the arrangement is within the scope of Topic 606. This ASU is effective for interim and annual periods beginning after December 15, 2019. Early adoption is permitted. We are currently assessing the impact of this ASU on our future consolidated financial statements and related disclosures.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 3—BUSINESS COMBINATION

General On December 18, 2017, we entered into an agreement to combine our business with CB&I, an established downstream provider of industry-leading petrochemical, refining, power, gasification and gas processing technologies and solutions. On May 10, 2018 (the "Combination Date") we completed the Combination.

Transaction Overview—On the Combination Date, we acquired the equity of certain U.S. and non-U.S. CB&I subsidiaries that owned CB&I's technology business, as well as certain intellectual property rights, for $2.87 billion in cash consideration that was funded using debt financing, as discussed further in Note 11, Debt, and existing cash. Also, on the Combination Date, CB&I shareholders received 0.82407 shares of McDermott common stock for each share of CB&I common stock tendered in the exchange offer. Each remaining share of CB&I common stock held by CB&I shareholders not acquired by McDermott in the exchange offer was effectively converted into the right to receive the same 0.82407 shares of McDermott common stock that was paid in the exchange offer, together with cash in lieu of any fractional shares of McDermott common stock, less any applicable withholding taxes. Stock-settled equity-based awards relating to shares of CB&I's common stock were either canceled and converted into the right to receive cash or were converted into comparable McDermott awards on generally the same terms and conditions as prior to the Combination Date. We issued 84.5 million shares of McDermott common stock to the former CB&I shareholders and converted CB&I stock-settled equity awards into McDermott stock-settled equity-based awards to be settled in approximately 2.2 million shares of McDermott common stock.

Transaction Accounting—The Combination is accounted for using the acquisition method of accounting in accordance with ASC Topic 805, Business Combinations. McDermott is considered the acquirer for accounting purposes based on the following facts at the Combination Date: (1) McDermott's stockholders owned approximately 53 percent of the combined business on a fully diluted basis; (2) a group of McDermott's directors, including the Chairman of the Board, constituted a majority of the Board of Directors; and (3) McDermott's President and Chief Executive Officer and Executive Vice President and Chief Financial Officer continue in those roles. The series of transactions resulting in McDermott's acquisition of CB&I's entire business is being accounted for as a single accounting transaction, as such transactions were entered into at the same time in contemplation of one another and were collectively designed to achieve an overall commercial effect.

Purchase Consideration We completed the Combination for a gross purchase price of approximately $4.6 billion ($4.1 billion net of cash acquired), detailed as follows (in millions, except per share amounts):

	(In millions, except per share amounts)
CB&I shares for Combination consideration	103
Conversion Ratio: 1 CB&I share = 0.82407 McDermott shares	85
McDermott stock price on May 10, 2018	19.92
Equity Combination consideration transferred	$1,684
Fair value of converted awards earned prior to the Combination	9
Total equity Combination consideration transferred	1,693
Cash consideration transferred	2,872
Total Combination consideration transferred	4,565
Less: Cash acquired	(498)

Total Combination consideration transferred, net of cash acquired	$4,067

Preliminary Purchase Price Allocation—The aggregate purchase price noted above was allocated to the major categories of assets and liabilities acquired based upon their estimated fair values at the Combination Date, which were based, in part, upon external preliminary appraisal and valuation of certain assets, including specifically identified intangible assets and property and equipment. The excess of the purchase price over the preliminary estimated fair value of the net tangible and identifiable intangible assets acquired, totaling $4.9 billion, was recorded as goodwill.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The following summarizes our preliminary purchase price allocation at the Combination Date (in millions):

	May 10, 2018
Net tangible assets:	
Cash	$498
Accounts receivable	844
Inventory	111
Contracts in progress	273
Assets held for sale [(1)]	70
Other current assets	272
Investments in unconsolidated affiliates [(2)]	426
Property, plant and equipment	385
Other non-current assets	127
Accounts payable	(469)
Advance billings on contracts [(3)]	(2,410)
Deferred tax liabilities	(16)
Other current liabilities	(1,211)
Other non-current liabilities	(453)
Noncontrolling interest	14
Total net tangible liabilities	(1,539)
Project-related intangible assets/liabilities, net [(4)]	150
Other intangible assets [(5)]	1,071
Net identifiable liabilities	(318)
Goodwill [(6)]	4,883
Total Combination consideration transferred	4,565
Less: Cash acquired	(498)
Total Combination consideration transferred, net of cash acquired	$4,067

(1) Assets held for sale includes CB&I's former administrative headquarters within Corporate and various fabrication facilities within NCSA. During the third quarter of 2018, we completed the sale of CB&I's former administrative headquarters for proceeds of $52 million.

(2) Investments in unconsolidated affiliates includes a fair value adjustment of $215 million associated with the Combination. Approximately $146 million of the fair value adjustment is attributable to the basis difference between McDermott's investment and the underlying equity in identifiable assets of unconsolidated affiliates and will be amortized to Investment in unconsolidated affiliates-related amortization over a range of two to 30 years based on the life of assets to which the basis difference is attributed.

(3) Advance billings on contracts includes accrued provisions for estimated losses on projects of $374 million, primarily associated with the Cameron LNG and Freeport LNG Trains 1 and 2, the now-substantially completed gas power project for a unit of Calpine Corporation ("Calpine") and the now-completed gas power project for Indianapolis Power & Light Company.

(4) Project-related intangible assets/liabilities, net includes intangible asset and liabilities of $259 million and $109 million, respectively. The balances represent the fair value of acquired remaining performance obligations ("RPOs") and normalized profit margin fair value associated with acquired long-term contracts that were deemed to be lower than fair value (excluding amounts recorded in Advance billings on contracts and Contracts in progress) as of the Combination Date. The project-related intangible assets and liabilities will be amortized as the applicable projects progress over a range of two to six years within Project-related intangibles amortization in our Statements of Operations.

(5) Other intangible assets are reflected in the table below and recorded at estimated fair value, as determined by our management, based on available information, which includes preliminary valuations prepared by external experts. The estimated useful lives for intangible assets were determined based upon the remaining useful economic lives of the intangible assets that are expected to contribute directly or indirectly to future cash flows.

	May 10, 2018 Fair value (In millions)	Useful Life Range	Weighted Average Useful Life
Process technologies	$ 514	10-30	27
Trade names	401	10-20	12
Customer relationships	129	4-11	10
Trademarks	27	10	10
Total	$ 1,071		

(6) Goodwill resulted from the acquired established workforce, which does not qualify for separate recognition, as well as expected future cost savings and revenue synergies associated with the combined operations. Of the $4.9 billion of estimated goodwill recorded in conjunction with the Combination, $2.6 billion, $461 million, $50 million, $52 million and $1.7 billion, was allocated to our NCSA, EARC, MENA, APAC and Technology reporting segments, respectively. Approximately $1.7 billion of the opening goodwill balance is deductible for tax purposes.

Changes in our preliminary purchase price allocation of approximately $61 million since our previous estimates as of December 31, 2018 primarily related to fair value adjustments to accounts receivable on acquired contracts, leasehold improvements, property and equipment and estimated liabilities associated with litigation.

The preliminary purchase price allocation described above is subject to further change when additional information is obtained. We have not finalized our assessment of the fair values of purchased receivables, intangible assets and liabilities, inventory, property and equipment, joint venture and consortium arrangements, tax balances, contingent liabilities, long-term leases or acquired contracts. Our final purchase price allocation, to be completed in the second quarter of 2019, may result in additional adjustments to various other assets and liabilities, including the residual amount allocated to goodwill during the measurement period.

Impact on RPOs—CB&I RPOs totaled approximately $8.3 billion at the Combination Date,

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Supplemental Pro Forma Information (Unaudited)—The following unaudited pro forma financial information reflects the Combination and the related events as if they occurred on January 1, 2018 and gives effect to pro forma events that are directly attributable to the Combination, factually supportable, and expected to have a continuing impact on our combined results, following the Combination. The pro forma financial information includes adjustments to: (1) include additional intangibles amortization, investment in unconsolidated affiliates-related amortization, depreciation of property, plant and equipment and net interest expense associated with the Combination and (2) exclude restructuring, integration and transaction costs that were included in McDermott and CB&I's historical results and are expected to be non-recurring. This pro forma financial information is presented for illustrative purposes only and is not necessarily indicative of the operating results that would have been achieved had the pro forma events taken place on the date indicated. Further, the pro forma financial information does not purport to project the future operating results of the combined business operations following the Combination.

	Three Months Ended March 31, 2018 [1]
Pro forma revenue	$ 2,353
Pro forma net income attributable to common stockholders	39
Pro forma net income per share attributable to common stockholders	
Basic	0.22
Diluted	0.21
Shares used in the computation of net income per share [2]	
Basic	181
Diluted	188

[1] Adjustments, net of tax, included in the pro forma net income above that were of a non-recurring nature totaled $15 million. The adjustments reflect the elimination of (1) restructuring and integration costs ($13 million); and (2) transaction costs ($2 million). These pro forma results exclude the effect of adjustments to the opening balance sheet associated with fair value purchase accounting estimates.

[2] Pro forma net income per share was calculated using weighted average basic shares outstanding during the three months ended March 31, 2019. Due to the net loss for the three months ended March 31, 2019, the effects of restricted stock, warrants and redeemable preferred stock were not included in the calculation of diluted earnings per share. For the presentation of the pro forma net income for the three months ended March 31, 2018, diluted shares includes the impact of restricted stock and warrants but does not include the impact of the redeemable preferred stock, as those shares were antidilutive.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 4—REVENUE RECOGNITION

RPOs

Our RPOs by segment were as follows:

	March 31, 2019		December 31, 2018	
	(Dollars in millions)			
NCSA	$8,581	56 %	$5,649	52 %
EARC	1,914	12 %	1,378	12 %
MENA	2,879	19 %	1,834	17 %
APAC	1,401	9 %	1,420	13 %
Technology	601	4 %	632	6 %
Total	$15,376	100%	$10,913	100%

Of the March 31, 2019 RPOs, we expect to recognize revenues as follows:

	2019	2020	Thereafter
	(In millions)		
Total RPOs	$6,189	$5,119	$ 4,068

Revenue Disaggregation

Our revenue by product offering, contract types and revenue recognition methodology was as follows:

	Three Months Ended March 31,	
	2019 (2)	2018 (2)
	(In millions)	
Revenue by product offering:		
Offshore and subsea	$605	$608
LNG	421	-
Downstream (1)	862	-
Power	323	-
	$2,211	$608

Revenue by contract type:		
Fixed price	$1,726	$583
Reimbursable	303	-
Hybrid	110	-
Unit-basis and other	72	25
	$2,211	$608
Revenue by recognition methodology:		
Over time	$2,160	$608
At a point in time	51	-
	$2,211	$608

(1) Includes the results of our Technology operating group.
(2) Intercompany amounts have been eliminated in consolidation.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Other

For the three months ended March 31, 2019, we recognized approximately $22 million of revenues resulting from changes in transaction prices associated with performance obligations satisfied in prior periods, primarily in our NCSA segment. For the three months ended March 31, 2018, we recognized approximately $66 million of revenues due to changes in transaction price associated with performance obligations satisfied in prior periods, primarily in our APAC segment. The changes in transaction prices primarily related to reimbursement of costs incurred in prior periods.

Revenues recognized during the three months ended March 31, 2019, with respect to amounts included in our Advance billings on contracts balance as of December 31, 2018, were approximately $768 million.

Unapproved Change Orders, Claims and Incentives

Unapproved Change Orders and Claims—As of March 31, 2019, we had unapproved change orders and claims included in transaction prices for our projects aggregating to approximately $297 million, of which approximately $93 million was included in our RPO balance. As of December 31, 2018, we had unapproved change orders and claims included in transaction prices for our projects aggregating to approximately $428 million, of which approximately $130 million was included in our RPO balance.

Incentives—As of March 31, 2019, we had incentives included in transaction prices for our projects aggregating to approximately $16 million, of which approximately $1 million was included in our RPO balance. As of December 31, 2018, we did not have any material incentives included in transaction prices for our projects.

The amounts recorded in contract prices and recognized as revenues reflect our best estimates of recovery; however, the ultimate resolution and amounts received could differ from these estimates and could have a material adverse effect on our results of operations, financial position and cash flow.

Loss Projects

Our accrual of provisions for estimated losses on active uncompleted contracts as of March 31, 2019 was $190 million and primarily related to the Cameron LNG project and the Freeport LNG Trains 1 & 2 projects. Our accrual of provisions for estimated losses on active uncompleted contracts as of December 31, 2018 was $266 million and primarily related to the Cameron LNG, Freeport LNG Trains 1 & 2, Calpine and Abkatun-A2 projects. Our Freeport LNG Train 3 project is not anticipated to be in a loss position.

Summary information for our significant ongoing loss projects as of March 31, 2019 is as follows:

Cameron LNG At March 31, 2019, our U.S. LNG export facility project in Hackberry, Louisiana for Cameron LNG (within our NCSA operating group) was approximately 65% complete on a post-Combination basis (approximately 90% on a pre-Combination basis) and had an accrued provision for estimated losses of approximately $128 million. For these purposes (and for purposes of the discussion below), when we refer to a percentage of completion on a pre-Combination basis, we are referring to the cumulative percentage of completion, which includes progress made prior to the Combination Date. In accordance with U.S. GAAP, as of the Combination Date, we reset the progress to completion for all of CB&I’s projects then in progress to 0% for accounting purposes based on the remaining costs to be incurred as of that date.

Freeport LNG At March 31, 2019, Trains 1 & 2 of our U.S. LNG export facility project in Freeport, Texas for Freeport LNG (within our NCSA operating group) were approximately 80% complete on a post-Combination basis (approximately 95% on a pre-Combination basis) and had an accrued provision for estimated losses of approximately $19 million. During the three months ended March 31, 2019, the project was negatively impacted by $27 million due to changes in cost estimates resulting from increases in construction and subcontractor costs. These cost estimate increases were partially offset by the recording of approximately $11 million of incentive revenues. Additionally, Freeport LNG Train 3 was positively impacted by $16 million of changes in cost estimates at completion due to increased productivity and savings in indirect costs, resulting in an overall net immaterial impact on operating margin at completion for the Freeport LNG project taken as a whole.

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Summary information for our significant loss projects previously reported in the 2018 Form 10-K that are substantially complete as of March 31, 2019 is as follows:

Calpine Power Project At March 31, 2019, our U.S. gas turbine power project for Calpine (within our NCSA operating group) was approximately 95% complete on a post-Combination basis (approximately 99% on a pre-Combination basis), and the remaining accrued provision for estimated losses was not significant.

Abkatun-A2 Project At March 31, 2019, our Abkatun-A2 platform project in Mexico for Pemex (within our NCSA operating group) was approximately 95% complete, and the remaining accrued provision for estimated losses was not significant.

NOTE 5—PROJECT CHANGES IN ESTIMATES

Our RPOs for each of our operating groups generally consist of several hundred contracts, and our results may be impacted by changes in estimated margins. The following is a discussion of our most significant changes in cost estimates that impacted segment operating income for the three months ended March 31, 2019 and 2018. For discussion of significant changes in estimates resulting from changes in transaction prices, see Note 4, *Revenue Recognition*.

Three months ended March 31, 2019

Segment operating income for the three months ended March 31, 2019 was impacted by net favorable changes in estimates totaling approximately $19 million, primarily in our NCSA, EARC, MENA and APAC segments.

NCSA—Our segment results for the three months ended March 31, 2019 were negatively impacted by net unfavorable changes in estimates aggregating approximately $24 million. The net unfavorable changes were due to cost increases on the Freeport LNG Trains 1 & 2 project and a

Revenue

Recognition, for further discussion of our Freeport LNG Trains 1 & 2 and Train 3 projects.

EARC—Our segment results for the three months ended March 31, 2019 were positively impacted by net favorable changes in estimates aggregating approximately $4 million.

MENA—Our segment results for the three months ended March 31, 2019 were positively impacted by net favorable changes in estimates aggregating approximately $33 million. The net favorable changes were primarily due to reductions in costs on various projects in the Middle East.

APAC—Our segment results for the three months ended March 31, 2019 were positively impacted by net favorable changes in estimates aggregating approximately $6 million. The net favorable changes were due to reductions in cost to complete several projects, partially offset by cost increases and weather downtime on various projects.

Three months ended March 31, 2018

Segment operating income for the three months ended March 31, 2018 was positively impacted by net favorable changes in estimates totaling approximately $37 million, primarily in our MENA (approximately $30 million) and APAC (approximately $9 million) segments.

17

NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 6—CASH, CASH EQUIVALENTS AND RESTRICTED CASH

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported within the Balance Sheets that sum to the totals of such amounts shown in the Statements of Cash Flows as of March 31, 2019 and December 31, 2018:

	March 31, 2019	December 31, 2018
	(In millions)	
Cash and cash equivalents	$ 413	$ 520
Restricted cash and cash equivalents [1]	326	325
Total cash, cash equivalents and restricted cash shown in the Consolidated Statements of Cash Flows	$ 739	$ 845

[1] Our restricted cash balances primarily serve as cash collateral deposits for our letter of credit facilities. See Note 11, *Debt*, for further discussion.

NOTE 7—ACCOUNTS RECEIVABLE

Accounts Receivable—Trade, Net Our trade receivable balances at March 31, 2019 and December 31, 2018 included the following:

	March 31, 2019	December 31, 2018
	(In millions)	
Contract receivables [1]	$ 838	$ 794
Retainages [2]	156	155
Less allowances	(17)	(17)
Accounts receivable—trade, net	$ 977	$ 932

[1] Unbilled receivables for our performance obligations recognized at a point in time are recorded within Accounts receivable-trade, net and were approximately $44 million and $31 million as of March 31, 2019 and December 31, 2018, respectively.

[2] Retainages classified within Accounts receivable-trade, net are amounts anticipated to be collected within one year and as to which we have an unconditional right to collect from the customer, subject only to the passage of time. Retainages anticipated to be collected beyond one year are classified as Accounts receivable long-term retainages on our Balance Sheet.

NOTE 8—GOODWILL AND OTHER INTANGIBLE ASSETS

Goodwill

Our goodwill balance is attributable to the excess of the purchase price over the fair value of net assets acquired in connection with the Combination. The changes in the carrying amount of goodwill during the three months ended March 31, 2019 are as follows: