MCDERMOTT INTERNATIONAL INC
Form 10-Q
July 26, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File No. 001-08430

McDERMOTT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

REPUBLIC OF PANAMA	72-0593134
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
757 N. ELDRIDGE PKWY	
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 þ 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 þ 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 þ	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 þ

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

McDERMOTT INTERNATIONAL, INC.

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PART I—FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

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

Income (loss) per share				
Net income (loss) attributable to McDermott International, Inc.				
Basic:	0.09	0.05	0.08	(0.01)
Diluted:	0.07	0.04	0.07	(0.01)
Shares used in the computation of income (loss) per share:				
Basic:	240,338,540	238,332,012	239,739,204	237,918,366
Diluted:	284,909,414	289,689,981	283,132,238	237,918,366

See accompanying Notes to the Consolidated Financial Statements.

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

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

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS

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

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

See accompanying Notes to the Consolidated Financial Statements.

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

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

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

See accompanying Notes to the Consolidated Financial Statements.

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

	Common Stock 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 income	-	-	18,485	-	-	18,485	876	19,361
Other comprehensive income (loss), net of tax	-	-	-	28,080	-	28,080	(21)	28,059
Common stock issued	2,206	(2,206)	-	-	-	-	-	-
Stock-based compensation charges	-	4,891	-	-	-	4,891	-	4,891
Purchase of treasury shares	-	-	-	-	(2,572)	(2,572)	-	(2,572)
Retirement of common stock	(401)	(641)	-	-	1,042	-	-	-
Balance at June 30, 2016	$248,646	$1,689,103	$(242,399)	$(65,875)	$(93,792)	$1,535,683	$60,777	$1,596,460

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

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McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

NOTE 1—BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

Basis of Presentation

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

Classification

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

Recently Issued and Adopted Accounting Guidance

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

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

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

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

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

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

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

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

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

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

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

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

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

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

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

NOTE 2—REVENUE RECOGNITION

Unapproved Change Orders

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

Claims Revenue

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

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

Loss Recognition

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

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

NOTE 3—USE OF ESTIMATES

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

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

Three months ended June 30, 2016

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

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

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

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

Six months ended June 30, 2016

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

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

Three months ended June 30, 2015

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

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

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

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

Six months ended June 30, 2015

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

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

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

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

NOTE 4—RESTRUCTURING

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

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

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

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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:

	June 30, 2016	December 31, 2015
	(in thousands)	
Contract receivables:		
Contracts in progress	$201,505	164,898
Completed contracts	33,725	35,702
Retainages	48,410	17,896
Unbilled	4,303	4,303
Less allowances	(14,318)	(14,325)
Accounts receivable—trade, net	$273,625	$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:

	June 30, 2016	December 31, 2015
	(in thousands)	
Retainages expected to be collected within one year	$48,410	$17,896
Retainages expected to be collected after one year	128,190	155,061
Total retainages	$176,600	$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:

	June 30, 2016	December 31, 2015

	(In thousands)	
Costs incurred less costs of revenue recognized	$93,047	$112,819
Revenues recognized less billings to customers	211,743	323,010
Contracts in Progress	$304,790	$435,829
Billings to customers less revenue recognized	30,484	265,618
Costs incurred less costs of revenue recognized	70,937	(100,845)
Advance Billings on Contracts	$101,421	$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 June 30, 2016 and December 31, 2015, respectively, are as follows:

	June 30, 2016	December 31, 2015
	(In thousands)	
Senior Notes	$492,690	$491,890
Term Loan	212,364	289,979
North Ocean 105 Construction Financing	34,760	38,263
Amortizing Notes	14,726	21,205
Capital lease obligation	2,370	2,546
	756,910	843,883
Less: Amounts due within one year	52,802	24,882
Total long-term debt	$704,108	$819,001

Credit Agreement, Senior Notes and Amortizing Notes

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

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

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

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

- replaced the existing EBITDA covenant with new ratios (as defined in Amendment No. 3) as follows:
- a minimum fixed charge coverage ratio of 1.15x for the fiscal quarter ended March 31, 2016 and each fiscal quarter thereafter;
- a maximum total leverage ratio of 4.5x for the fiscal quarter ended March 31, 2016 and each subsequent fiscal quarter through June 30, 2017, 4.0x for the fiscal quarters ending September 30, 2017 and December 31, 2017, and 3.5x for each fiscal quarter thereafter; and
- a maximum secured leverage ratio of 2.0x for the fiscal quarter ended March 31, 2016 and each subsequent fiscal quarter through December 31, 2017, and 1.5x for each fiscal quarter thereafter; and

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

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

- change the existing letter of credit capacity of $520 million to $450 million;
- extend the deadline for mortgaging the DLV 2000 to one year after taking delivery thereof, and give McDermott the option to consider potential financing options for the DLV 2000 during that period;
- increase the basket for purchase money indebtedness from $20 million to $150 million;
- modify the covenant limiting acquisitions to permit up to $150 million of acquisitions; and
- modify the covenant limiting the prepayment or purchase of junior priority debt to permit up to $100 million of such prepayments or purchases.

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

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

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

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

Ratios	Requirement	Actual
Minimum fixed charge coverage ratio	1.15x	2.58x
Maximum total leverage ratio	4.5x	2.41x
Maximum secured leverage ratio	2x	0.79x

As of June 30, 2016 and December 31, 2015, the aggregate face amount of letters of credit issued under the LC Facility was $397 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 June 30, 2016 and December 31, 2015, we had an aggregate face amount of approximately $113 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, respectively. We have included the supporting cash collateral in restricted cash and cash equivalents in the accompanying Consolidated Balance Sheets.

North Ocean Financing

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

Unsecured Bilateral Lines of Credit

MDR has reimbursement agreements in place with Middle Eastern banks which provide uncommitted lines of credit in support of our contracting activities in the Middle East. There are no administrative or commitment fees associated with these agreements. Bank guarantees issued under these agreements were $191 million and $118 million, as of June 30, 2016 and December 31, 2015, respectively. In April 2016, we entered into an unsecured and uncommitted bilateral letter of credit arrangement for approximately $100 million with a Middle Eastern bank to support our business in the region. As of June 30, 2016, we had an aggregate face amount of approximately $80 million of letters of credit outstanding under that arrangement.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

Surety Bonds

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

NOTE 8—PENSION AND POSTRETIREMENT BENEFITS

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

	Domestic Plans			
	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Interest cost	$5,293	$5,425	$10,552	$10,807
Expected return on plan assets	(5,001)	(6,677)	(10,004)	(13,354)
Net periodic (benefit) cost	$292	$(1,252)	$548	$(2,547)

	TCN Plan			
	Three months ended June 30,		Six months ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Interest cost	$338	$406	$676	$813
Expected return on plan assets	(397)	(710)	(794)	(1,420)
Net periodic benefit	$(59)	$(304)	$(118)	$(607)

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 June 30, 2016, the majority of our foreign currency forward contracts were designated as cash flow hedging instruments. In addition, we deferred approximately $29 million of net losses on those derivative financial instruments in AOCI, and we expect to reclassify approximately $18 million of deferred losses out of AOCI by June 30, 2017, as hedged items are recognized. The notional value of our outstanding derivative contracts totaled $357 million at June 30, 2016, with maturities extending through 2017. Of this amount, approximately $214 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 June 30, 2016, the fair value of these contracts was in a net liability position totaling approximately $8 million. The fair value of outstanding derivative instruments is determined using observable financial market inputs, such as quoted market prices, and is classified as Level 2 in nature.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

The following tables summarize our derivative financial instruments:

Asset and Liability Derivatives

	June 30, 2016	December 31, 2015
	(In thousands)	
Derivatives Designated as Hedges:		
Location:		
Accounts receivable-other	$1,911	$ 1,668
Other assets	-	215
Total asset derivatives	$1,911	$ 1,883
Accounts payable	$8,735	$ 26,649
Other liabilities	1,281	4,018
Total liability derivatives	$10,016	$ 30,667

The Effects of Derivative Instruments on our Financial Statements

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Derivatives Designated as Hedges:				
Amount of gain (loss) recognized in other comprehensive income (loss)	$(10,304)	$8,034	$10,230	$(28,656)
Income reclassified from AOCI into income (loss): effective portion				
Location: Cost of operations	14,932	19,572	24,611	39,426
Gain (loss) recognized in income (loss): ineffective portion and amount excluded from effectiveness testing				
Location : Gain (loss) on foreign currency—net	(344)	2,047	(1,549)	3,864

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

NOTE 10—FAIR VALUE MEASUREMENTS

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

	June 30, 2016				
	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Recurring					
Forward contracts	$(8,105)	$(8,105)	$-	$(8,105)	$-
Non-recurring					
Cash and cash equivalents	470,023	470,023	470,023	-	-
Restricted cash and cash equivalents	112,792	112,792	112,792	-	-
Debt	(756,910)	(702,835)	-	(645,524)	(57,311)

	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 the amortizing notes included within the TEUs or the NO 105 financing. The income approach was used to value these instruments based on the present value of future cash flows discounted at estimated borrowing rates for similar debt instruments or on estimated prices based on current yields for debt issues of similar quality and terms. These instruments are classified as Level 3 within the fair value hierarchy.

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

Fair Value Disclosure of Non-financial Assets

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

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

NOTE 11—STOCKHOLDERS' EQUITY

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

	Six Months Ended June 30, 2016	2015
Shares outstanding		
Beginning balance	239,016,924	237,809,823
Common stock issued	2,206,027	1,472,897
Purchase of common stock	(651,291)	(401,986)
Ending balance	240,571,660	238,880,734
Shares held as Treasury shares		
Beginning balance	7,824,204	7,400,027
Purchase of common stock	651,291	401,986
Retirement of common stock	(400,701)	-
Ending balance	8,074,794	7,802,013
Ordinary shares issued at the end of the period	248,646,454	246,682,747

Accumulated Other Comprehensive Income (Loss) (AOCI)

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

	June 30, 2016	December 31, 2015
	(In thousands)	
Foreign currency translation adjustments ("FCTA")	$(37,295)	$(29,925)
Net unrealized gain on investments	264	247
Net loss on derivative financial instruments	(28,844)	(64,277)
Accumulated other comprehensive loss	$(65,875)	$(93,955)

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

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

2016 Period

For the three months ended June 30, 2016	Foreign currency translation adjustments	Unrealized holding gain (loss) on investments	Gain (loss) on derivative [1]		TOTAL
	(In thousands)				
Balance, March 31, 2016	$ (33,268)	$ 252	$ (33,473)		$ (66,489)
Other comprehensive income (loss) before reclassification	(4,027)	12	(10,304)		(14,319)
Amounts reclassified from AOCI	-	-	14,933	[2]	14,933
Net current period other comprehensive income (loss)	(4,027)	12	4,629		614
Balance, June 30, 2016	$ (37,295)	$ 264	$ (28,844)		$ (65,875)

For the six months ended June 30, 2016	Foreign currency translation adjustments	Unrealized holding gain (loss) on investments	Gain (loss) on derivatives [1]		TOTAL
	(In thousands)				
Balance, January 1, 2016	$ (29,925)	$ 247	$ (64,277)		$ (93,955)
Other comprehensive income (loss) before reclassification	(7,370)	17	10,230		2,877
Amounts reclassified from AOCI	-	-	25,203	[2]	25,203
Net current period other comprehensive income (loss)	(7,370)	17	35,433		28,080
Balance, June 30, 2016	$ (37,295)	$ 264	$ (28,844)		$ (65,875)

2015 Period

For the three months ended June 30, 2015	Foreign currency translation adjustments	Unrealized holding gain (loss) on investments	Gain (loss) on derivative(1)		TOTAL
	(In thousands)				
Balance, March 31, 2015	$ (17,254)	$ 253	$ (99,689)		$ (116,690)
Other comprehensive income (loss) before reclassification	(2,701)	4	8,034		5,337
Amounts reclassified from AOCI	(2,243)	-	19,572	[2]	17,329
Net current period other comprehensive income (loss)	(4,944)	4	27,606		22,666
Balance, June 30, 2015	$ (22,198)	$ 257	$ (72,083)		$ (94,024)

For the six months ended June 30, 2015	Foreign currency translation adjustments	Unrealized holding gain (loss) on investments	Gain (loss) on derivative(1)		TOTAL
	(In thousands)				
Balance, January 1, 2015	$ (15,212)	$ 241	$ (82,837)		$ (97,808)
Other comprehensive income (loss) before reclassification	(4,743)	16	(28,656)		(33,383)
Amounts reclassified from AOCI	(2,243)	-	39,410	[2]	37,167
Net current period other comprehensive income (loss)	(6,986)	16	10,754		3,784

Balance, June 30, 2015	$(22,198)	$ 257	$ (72,083)	$(94,024)

(1) Refer to Note 9 for additional details.
(2) Reclassified to Cost of operations and Gain on foreign currency, net.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

NOTE 12—EARNINGS PER SHARE

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

	Three Months Ended June 30, 2016	Three Months Ended June 30, 2015	Six Months Ended June 30, 2016	Six Months Ended June 30, 2015
	(In thousands, except share and per share amounts)			
Net income (loss) attributable to McDermott International, Inc.	$20,657	$11,526	$18,485	$(2,981)
Weighted average common shares (basic)	240,338,540	238,332,012	239,739,204	237,918,366
Effect of dilutive securities:				
Tangible equity units	40,896,300	40,896,300	40,896,300	-
Stock options, restricted stock and restricted stock units	3,674,574	10,461,669	2,496,734	-
Adjusted weighted average common shares and assumed exercises of stock options and vesting of stock awards (diluted)	284,909,414	289,689,981	283,132,238	237,918,366
Income (loss) per share				
Net income (loss) attributable to McDermott International, Inc.				
Basic:	0.09	0.05	0.08	(0.01)
Diluted:	0.07	0.04	0.07	(0.01)

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

Potential dilutive common shares for the settlement of the common stock purchase contracts totaling 40.9 million shares were considered in the calculation of diluted weighted-average shares for the six months ended June 30, 2015, however, due to our net loss position in that period, they have not been reflected above because they would be anti-dilutive.

NOTE 13—COMMITMENTS AND CONTINGENCIES

Litigation

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

- performance or warranty-related matters under our customer and supplier contracts and other business arrangements; and
- workers’ compensation claims, Jones Act claims, occupational hazard claims, including asbestos-exposure claims, premises liability claims and other claims.

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

Environmental Matters

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

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

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

Contracts Containing Liquidated Damages Provisions

Some of our contracts contain provisions that require us to pay liquidated damages if we are responsible for the failure to meet specified contractual milestone dates and the applicable customer asserts a claim under those provisions. Those contracts define the conditions under which our customers may make claims against us for liquidated damages. In many cases in which we have historically had potential exposure for liquidated damages, such damages ultimately were not asserted by our customers. As of June 30, 2016, we had approximately $10 million of potential liquidated damages liability, for which no liability is recorded in our Consolidated Financial Statements. We believe we will be successful in obtaining schedule extensions or other customer-agreed changes that should resolve the potential for unaccrued liquidated damages. Accordingly, we believe that no amounts for these unaccrued liquidated damages are probable of being paid by us. However, we may not achieve relief on some or all of the issues involved and, as a result, could be subject to higher damage amounts.

NOTE 14—SEGMENT REPORTING

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

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

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

Summarized financial information is shown in the following tables:
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	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Revenues[(1)]:				
AEA	$86,810	$104,701	$149,435	$248,014
MEA	317,834	420,221	588,089	574,021
ASA	301,983	521,615	698,135	774,965
Total revenues	$706,627	$1,046,537	$1,435,659	$1,597,000
Operating income (loss)[(2)]:				
AEA	$3,168	$6,176	$(21,753)	$22,433
MEA	41,959	30,823	80,426	36,065
ASA	12,274	17,157	37,407	9,731
Corporate	(413)	(5,043)	(3,099)	(5,810)
Total operating income	$56,988	$49,113	$92,981	$62,419
Capital expenditures[(3)]:				
AEA	$941	$516	$3,526	$3,429
MEA	2,469	4,828	4,703	14,942
ASA	134,567	18,669	161,575	29,493
Corporate and Other	797	-	870	121
Total capital expenditures	$138,774	$24,013	$170,674	$47,985
Depreciation and amortization:				
AEA	$7,172	$10,464	$14,315	$23,287
MEA	6,033	9,019	10,844	14,757
ASA	6,060	3,862	12,449	7,778
Corporate and Other	2,130	2,699	4,389	5,549
Total depreciation and amortization				