

MCDERMOTT INTERNATIONAL INC  
Form 10-Q  
May 07, 2014  
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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, 2014**

**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)**

|   |  |
|---|--|
| <b>REPUBLIC OF PANAMA</b><br><b>(State or Other Jurisdiction of</b>       | <b>72-0593134</b><br><b>(I.R.S. Employer</b> |
| <b>Incorporation or Organization)</b>                                     | <b>Identification No.)</b>                   |
| <b>757 N. ELDRIDGE PKWY</b>   |  |
| <b>HOUSTON, TEXAS</b>   | <b>77079</b>                                 |
| <b>(Address of Principal Executive Offices)</b>                           | <b>(Zip Code)</b>                            |
| <b>Registrant's Telephone Number, Including Area Code: (281) 870-5000</b> |  |

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

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

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

Large accelerated filer  Accelerated filer

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

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

The number of shares of the registrant's common stock outstanding at May 1, 2014 was 237,544,687.

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## PART I FINANCIAL INFORMATION

## Item 1. Condensed Consolidated Financial Statements

**McDERMOTT INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

|  | <b>Three Months Ended<br/>March 31,</b>                       |             |
|--|---|-------------|
|  | <b>2014</b>   | <b>2013</b> |
|  | <b>(Unaudited)</b>  |             |
|  | <b>(In thousands, except share and per<br/>share amounts)</b> |             |
| Revenues   | \$ 603,811  | \$ 807,488  |
| Costs and Expenses:  |   |             |
| Cost of operations   | 591,493   | 712,814     |
| Selling, general and administrative expenses                                 | 55,397  | 52,226      |
| Gain on asset disposals  | (6,439)   | (14,716)    |
| Restructuring charges  | 6,125   |             |
| Total costs and expenses   | 646,576   | 750,324     |
| Equity in Earnings (Loss) of Unconsolidated Affiliates                       | 1,123   | (4,131)     |
| Operating Income (Loss)  | (41,642)  | 53,033      |
| Other Income (Expense):  |   |             |
| Interest income  | 61  | 342         |
| Loss on foreign currency net   | (4,082)   | (2,526)     |
| Other income (expense) net   | (265)   | 782         |
| Total other income (expense)   | (4,286)   | (1,402)     |
| Income (loss) before provision for income taxes and noncontrolling interests | (45,928)  | 51,631      |
| Provision for Income Taxes   | 3,489   | 27,313      |
| Net Income (Loss)  | (49,417)  | 24,318      |
| Less: Net Income Attributable to Noncontrolling Interests                    | 536   | 3,765       |
| Net Income (Loss) Attributable to McDermott International, Inc.              | \$ (49,953)   | \$ 20,553   |

Earnings per Common Share:

|   |             |             |
|---|-------------|-------------|
| Basic:  |             |             |
| Income (loss) from operations, less noncontrolling interests    | (0.21)      | 0.09        |
| Net income (loss) attributable to McDermott International, Inc. | (0.21)      | 0.09        |
| Diluted:  |             |             |
| Income (loss) from operations, less noncontrolling interests    | (0.21)      | 0.09        |
| Net income (loss) attributable to McDermott International, Inc. | (0.21)      | 0.09        |
| Shares used in the computation of earnings per share:           |             |             |
| Basic   | 236,961,158 | 235,941,185 |
| Diluted   | 236,961,158 | 239,199,881 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents**McDERMOTT INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

|   | <b>Three Months Ended<br/>March 31,<br/>2014                  2013<br/>(Unaudited)</b> |           |
|---|--|-----------|
|   | <b>(In thousands)</b>  |           |
| Net Income (Loss)   | \$ (49,417)  | \$ 24,318 |
| Other comprehensive income (loss), net of tax:                            |  |           |
| Amortization of benefit plan costs  | 3,171  | 3,655     |
| Unrealized gain on investments  | (24)   | 401       |
| Translation adjustments   | (320)  | 7,214     |
| Gain (loss) on derivatives  | 14,529   | (17,566)  |
| Other comprehensive income, net of tax <sup>(1)</sup>                     | 17,356   | (6,296)   |
| Total Comprehensive Income (Loss)   | \$ (32,061)  | \$ 18,022 |
| Less: Comprehensive Income Attributable to Noncontrolling Interests       | \$ 503   | 3,753     |
| Comprehensive Income (Loss) Attributable to McDermott International, Inc. | \$ (32,564)  | \$ 14,269 |

(1) The tax impacts on amounts presented in other comprehensive income are not significant.  
See accompanying notes to condensed consolidated financial statements.

**Table of Contents****MCDERMOTT INTERNATIONAL, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

|  | <b>March 31,<br/>2014</b>                                     | <b>December 31,<br/>2013</b> |
|--|---|------------------------------|
|  | <b>(Unaudited)</b>  |                              |
|  | <b>(In thousands, except share<br/>and per share amounts)</b> |                              |
| <b>Assets</b>  |   |                              |
| Current Assets:  |   |                              |
| Cash and cash equivalents                              | \$ 268,130  | \$ 118,702                   |
| Restricted cash and cash equivalents                   | 43,286  | 23,652                       |
| Accounts receivable trade, net                         | 332,062   | 381,858                      |
| Accounts receivable other                              | 109,330   | 89,273                       |
| Contracts in progress                                  | 431,893   | 425,986                      |
| Deferred income taxes                                  | 7,092   | 7,091                        |
| Investments  | 3,248   |                              |
| Assets held for sale                                   | 1,396   | 1,396                        |
| Other current assets                                   | 61,353  | 32,242                       |
| <b>Total Current Assets</b>                            | <b>1,257,790</b>  | <b>1,080,200</b>             |
| Property, Plant and Equipment                          | 2,397,254   | 2,367,686                    |
| Less accumulated depreciation                          | (913,650)   | (889,009)                    |
| <b>Net Property, Plant and Equipment</b>               | <b>1,483,604</b>  | <b>1,478,677</b>             |
| Investments  | 2,189   | 13,511                       |
| Investments in Unconsolidated Affiliates               | 48,897  | 50,536                       |
| Assets held for sale                                   | 10,121  | 12,243                       |
| Other Assets   | 221,328   | 172,204                      |
| <b>Total Assets</b>                                    | <b>\$ 3,023,929</b>   | <b>\$ 2,807,371</b>          |
| <b>Liabilities and Equity</b>                          |   |                              |
| Current Liabilities:                                   |   |                              |
| Notes payable and current maturities of long-term debt | \$ 258,417  | \$ 39,543                    |
| Accounts payable                                       | 423,166   | 398,739                      |
| Accrued liabilities                                    | 383,401   | 365,224                      |
| Advance billings on contracts                          | 278,881   | 278,929                      |
| Deferred income taxes                                  | 20,257  | 17,892                       |
| Income taxes payable                                   | 16,656  | 20,657                       |
| <b>Total Current Liabilities</b>                       | <b>1,380,778</b>  | <b>1,120,984</b>             |

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|  |              |              |
|--|--------------|--------------|
| Long-Term Debt   | 49,761       | 49,019       |
| Self-Insurance   | 21,715       | 20,531       |
| Pension Liability  | 15,516       | 15,681       |
| Non-current Income Taxes   | 55,455       | 56,042       |
| Other Liabilities  | 89,019       | 104,770      |
| Commitments and Contingencies  |              |              |
| Stockholders' Equity:  |              |              |
| Common stock, par value \$1.00 per share, authorized 400,000,000 shares; issued 244,739,400 and 244,271,365 shares at March 31, 2014 and December 31, 2013, respectively | 244,739      | 244,271      |
| Capital in excess of par value   | 1,417,374    | 1,414,457    |
| Retained earnings  | (121,110)    | (71,157)     |
| Treasury stock, at cost, 7,231,536 and 7,130,294 shares at March 31, 2014 and December 31, 2013, respectively  | (97,407)     | (97,926)     |
| Accumulated other comprehensive loss   | (122,742)    | (140,131)    |
| Stockholders' Equity McDermott International, Inc.   | 1,320,854    | 1,349,514    |
| Noncontrolling Interests   | 90,831       | 90,830       |
| Total Equity   | 1,411,685    | 1,440,344    |
| Total Liabilities and Equity   | \$ 3,023,929 | \$ 2,807,371 |

See accompanying notes to condensed consolidated financial statements.



Table of Contents**McDERMOTT INTERNATIONAL, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | <b>Three Months Ended</b> |                  |
|---|---------------------------|------------------|
|   | <b>March 31,</b>          | <b>2013</b>      |
|   | <b>2014</b>               | <b>2013</b>      |
|   | <b>(Unaudited)</b>        |                  |
|   | <b>(In thousands)</b>     |                  |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                           |                  |
| Net income (loss)   | \$ (49,417)               | \$ 24,318        |
| Non-cash items included in net income (loss):   |                           |                  |
| Depreciation and amortization   | 24,602                    | 20,222           |
| Drydock amortization  | 6,946                     | 5,550            |
| Restructuring charges   | 675                       |                  |
| Equity in (earnings) loss of unconsolidated affiliates                                | (1,123)                   | 4,131            |
| Gain on asset disposals   | (6,439)                   | (14,716)         |
| Benefit for deferred taxes  | (2,628)                   | 5,332            |
| Stock-based compensation charges  | 4,387                     | 3,923            |
| Net periodic pension benefit cost   | 2,854                     | 642              |
| Other non-cash items  | 2,331                     | 1,749            |
| Changes in assets and liabilities, net of effects from acquisitions and dispositions: |                           |                  |
| Accounts receivable   | 26,365                    | (6,573)          |
| Net contracts in progress and advance billings on contracts                           | (5,974)                   | (19,935)         |
| Accounts payable  | 32,727                    | (125,234)        |
| Accrued and other current liabilities   | 15,046                    | (20,774)         |
| Pension liability and accrued postretirement and employee benefits                    | 5,880                     | (19,657)         |
| Other assets and liabilities  | (78,560)                  | (46,093)         |
| <b>TOTAL CASH USED IN OPERATING ACTIVITIES</b>  | <b>(22,328)</b>           | <b>(187,115)</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                           |                  |
| Purchases of property, plant and equipment  | (37,893)                  | (37,649)         |
| Increase in restricted cash and cash equivalents                                      | (19,634)                  | (3,826)          |
| Purchases of available-for-sale securities  | (1,997)                   | (3,744)          |
| Sales and maturities of available-for-sale securities                                 | 10,055                    | 31,193           |
| Proceeds from the sale and disposal of assets   | 8,370                     | 35,621           |
| Other investing activities  | (1,950)                   | (4,596)          |
| <b>TOTAL CASH (USED IN) PROVIDED BY INVESTING ACTIVITIES</b>                          | <b>(43,049)</b>           | <b>16,999</b>    |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                           |                  |
| Proceeds from short term debt   | 250,000                   |                  |
| Payment of debt   | (31,373)                  | (1,494)          |

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|  |                   |                   |
|--|-------------------|-------------------|
| Distributions to noncontrolling interests                    | (502)             | (6,200)           |
| Debt issuance cost and other financing activities            | (3,356)           | (1,015)           |
| <b>TOTAL CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b> | <b>214,769</b>    | <b>(8,709)</b>    |
| <b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH</b>              | <b>36</b>         | <b>213</b>        |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>  | <b>149,428</b>    | <b>(178,612)</b>  |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>      | <b>118,702</b>    | <b>640,147</b>    |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>            | <b>\$ 268,130</b> | <b>\$ 461,535</b> |

**SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:**

Cash paid during the period for:

|                               |           |           |
|-------------------------------|-----------|-----------|
| Income taxes (net of refunds) | \$ 11,668 | \$ 25,916 |
|-------------------------------|-----------|-----------|

See accompanying notes to condensed consolidated financial statements.

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## MCDERMOTT INTERNATIONAL, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

|   | Common Stock                         |            | Capital In             | Retained    | Treasury    | Accumulated<br>Other<br>Comprehensive | Stockholders | Non-                     | Total        |
|---|--------------------------------------|------------|------------------------|-------------|-------------|---------------------------------------|--------------|--------------------------|--------------|
|   | Shares                               | Par Value  | Excess of<br>Par Value | Earnings    | Stock       | Income<br>(Loss)                      | Equity       | Controlling<br>Interests | Equity       |
|   | (Unaudited)                          |            |                        |             |             |                                       |              |                          |              |
|   | (In thousands, except share amounts) |            |                        |             |             |                                       |              |                          |              |
| Balance<br>December 31,<br>2012                 | 243,442,156                          | \$ 243,442 | \$ 1,391,271           | \$ 445,756  | \$ (98,725) | \$ (94,413)                           | \$ 1,887,331 | \$ 64,774                | \$ 1,952,105 |
| Net income                                      |                                      |            |                        | 20,553      |             |                                       | 20,553       | 3,765                    | 24,318       |
| Other<br>comprehensive<br>income, net of<br>tax |                                      |            |                        |             |             | (6,284)                               | (6,284)      | (12)                     | (6,296)      |
| Exercise of<br>stock options                    | 18,549                               | 18         | 54                     |             |             |                                       | 72           |                          | 72           |
| Share vesting                                   | 317,664                              | 318        | (318)                  |             |             |                                       |              |                          |              |
| Purchase of<br>treasury shares                  |                                      |            |                        |             | (1,034)     |                                       | (1,034)      |                          | (1,034)      |
| Stock-based<br>compensation<br>charges          |                                      |            | 3,852                  |             | 71          |                                       | 3,923        |                          | 3,923        |
| Distributions to<br>noncontrolling<br>interests |                                      |            |                        |             |             |                                       |              | (6,200)                  | (6,200)      |
| Balance<br>March 31, 2013                       | 243,778,369                          | \$ 243,778 | \$ 1,394,859           | \$ 466,309  | \$ (99,688) | \$ (100,697)                          | \$ 1,904,561 | \$ 62,327                | \$ 1,966,888 |
| Balance<br>December 31,<br>2013                 | 244,271,365                          | \$ 244,271 | \$ 1,414,457           | \$ (71,157) | \$ (97,926) | \$ (140,131)                          | \$ 1,349,514 | \$ 90,830                | \$ 1,440,344 |
| Net loss  |                                      |            |                        | (49,953)    |             |                                       | (49,953)     | 536                      | (49,417)     |
| Other<br>comprehensive<br>income, net of<br>tax |                                      |            |                        |             |             | 17,389                                | 17,389       | (33)                     | 17,356       |
| Exercise of<br>stock options                    | 118,410                              | 118        | 147                    |             |             |                                       | 265          |                          | 265          |
| Share vesting                                   | 349,625                              | 350        | (350)                  |             |             |                                       |              |                          |              |
|   |                                      |            |                        |             | (748)       |                                       | (748)        |                          | (748)        |

|   |             |            |              |              |             |              |              |           |              |
|---|-------------|------------|--------------|--------------|-------------|--------------|--------------|-----------|--------------|
| Purchase of treasury shares               |             |            |              |              |             |              |              |           |              |
| Stock-based compensation charges          |             |            | 3,120        |              | 1,267       |              | 4,387        |           | 4,387        |
| Distributions to noncontrolling interests |             |            |              |              |             |              |              | (502)     | (502)        |
| Balance                                   |             |            |              |              |             |              |              |           |              |
| March 31, 2014                            | 244,739,400 | \$ 244,739 | \$ 1,417,374 | \$ (121,110) | \$ (97,407) | \$ (122,742) | \$ 1,320,854 | \$ 90,831 | \$ 1,411,685 |

See accompanying notes to condensed consolidated financial statements.

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**MCDERMOTT INTERNATIONAL, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**NOTE 1 BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES**

***Nature of Operations***

McDermott International, Inc. ( MII ), a corporation incorporated under the laws of the Republic of Panama in 1959, is a leading engineering, procurement, construction and installation ( EPCI ) company focused on designing and executing complex offshore oil and gas projects worldwide. Providing fully integrated EPCI services, we deliver fixed and floating production facilities, pipeline installations and subsea systems from concept to commissioning. Operating in approximately 20 countries across the Americas, Middle East and Asia Pacific, our integrated resources include approximately 14,000 employees and 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 unaudited condensed consolidated financial statements, unless the context otherwise indicates, we, us and our mean MII and its consolidated subsidiaries.

***Basis of Presentation***

We have presented our unaudited condensed consolidated financial statements in U.S. Dollars, pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC ) applicable to interim reporting. Financial information and disclosures normally included in our financial statements prepared annually in accordance with accounting principles generally accepted in the United States ( GAAP ) have been condensed or omitted. Readers of these financial statements should, therefore, refer to the consolidated financial statements and the accompanying notes in our annual report on Form 10-K for the year ended December 31, 2013.

We have included all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation. These condensed consolidated financial statements include the accounts of McDermott International, Inc., its consolidated subsidiaries and controlled entities. We use the equity method to account for investments in entities that we do not control, but over which we have significant influence. We generally refer to these entities as unconsolidated affiliates or joint ventures. We have eliminated all intercompany transactions and accounts.

Certain 2013 amounts in the condensed consolidated balance sheet and statement of cash flows have been reclassified to conform to the 2014 presentation.

***Business Segments***

In March 2014, we changed our organizational structure to orient around our offshore and subsea business activities through four primary geographic regions. The four geographic regions, which we consider to be our operating segments, consist of Asia Pacific, Americas (previously Atlantic), Middle East and North Sea and Africa. The Caspian is no longer considered an operating segment and will continue to be aggregated in the Middle East reporting segment.

The North Sea and Africa operating segment is also aggregated into the Middle East reporting segment due to the proximity of regions and similarities in the nature of services provided, economic characteristics and oversight responsibilities. Accordingly, we continue to report financial results under reporting segments consisting of Asia Pacific, Americas and the Middle East. We also report certain corporate and other non-operating activities under the heading Corporate and other . Corporate and other primarily

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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. See Note 9 for summarized financial information on our segments.

***Revenue Recognition***

We determine the appropriate accounting method for each of our long-term contracts before work on the project begins. We generally recognize contract revenues and related costs on a percentage-of-completion method for individual contracts or combinations of contracts based on work performed, man hours, or a cost-to-cost method, as applicable to the activity involved. We include the amount of accumulated contract costs and estimated earnings that exceed billings to customers in contracts in progress. We include billings to customers that exceed accumulated contract costs and estimated earnings in advance billings on contracts. Most long-term contracts contain provisions for progress payments. We expect to invoice customers for and collect all unbilled revenues. Certain costs are generally excluded from the cost-to-cost method of measuring progress, such as significant procurement costs for materials and third-party subcontractors. Total estimated project costs, and resulting income, are affected by changes in the expected cost of materials and labor, productivity, vessel costs, scheduling and other factors. Additionally, external factors such as weather, customer requirements and other factors outside of our control may affect the progress and estimated cost of a project's completion and, therefore, the timing and amount of revenue and income recognition.

In addition, change orders, which are a normal and recurring part of our business, can increase (and sometimes substantially) the future scope and cost of a job. Therefore, change order awards (although frequently beneficial in the long term) can have the short-term effect of reducing the job percentage of completion and thus the revenues and profits recognized to date. We regularly review contract price and cost estimates as the work progresses and reflect adjustments in profit, proportionate to the job percentage of completion in the period when those estimates are revised. Revenue from unapproved change orders is generally recognized to the extent of the lesser of amounts management expects to recover or costs incurred. Additionally, to the extent that claims included in backlog, including those that arise from change orders which are under dispute or which have been previously rejected by the customer, are not resolved in our favor, there could be reductions in or reversals of previously reported, revenues and profits, and charges against current earnings, which could be material.

***Claims Revenue***

Claims revenue may relate to various factors, including the procurement of materials, equipment performance failures, change order disputes or schedule disruptions and other delays, including those associated with weather or sea conditions. Claims revenue, when recorded, is only recorded to the extent of the lesser of the amounts management expects to recover or the associated costs incurred in our consolidated financial statements. We include certain unapproved claims in the applicable contract values when we have a legal basis to do so, consider collection to be probable and believe we can reliably estimate the ultimate value. Amounts attributable to unapproved change orders are not included in claims. 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. Claims are generally negotiated over the course of the respective projects and many of our projects are long-term in nature. None of the claims as of March 31, 2014 were involved in litigation.

The amount of revenues and costs included in our estimates at completion (i.e., contract values) associated with such claims was \$6.5 million and \$225.8 million as of March 31, 2014 and March 31, 2013, respectively. All of those claim amounts at March 31, 2014 were related to our Middle East segment. For the three months ended March 31, 2014, no

revenues and costs pertaining to claims were included in our condensed consolidated financial statements. For the three months ended March 31, 2013, \$29.0 million of revenues and costs pertaining to claims were included in our condensed consolidated financial statements.



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Our unconsolidated joint ventures did not include any claims revenue or associated cost in their financial results for the period ended March 31, 2014. For the period ended March 31, 2013, our unconsolidated joint ventures included \$3.7 million of claims revenue and associated costs in their financial results.

### *Deferred Profit Recognition*

For contracts as to which we are unable to estimate the final profitability due to their uncommon nature, including first-of-a-kind projects, we recognize equal amounts of revenue and cost until the final results can be estimated more precisely. For these contracts, we only recognize gross margin when reliably estimable and the level of uncertainty has been significantly reduced, which we generally determine to be when the contract is at least 70% complete. We treat long-term construction contracts that contain such a level of risk and uncertainty that estimation of the final outcome is impractical as deferred profit recognition contracts. If, while being accounted for under our deferred profit recognition policy, a current estimate of total contract costs indicates a loss, the projected loss is recognized in full and the project is accounted for under our normal revenue recognition guidelines. At March 31, 2014, no projects were accounted for under our deferred profit recognition policy.

### *Completed Contract Method*

Under the completed contract method, revenue and gross profit is recognized only when a contract is completed or substantially complete. We generally do not enter into fixed-price contracts without an estimate of cost to complete that we believe to be accurate. However, it is possible that in the time between contract execution and the start of work on a project, we could lose the ability to forecast cost to complete based on intervening events, including, but not limited to, experience on similar projects, civil unrest, strikes and volatility in our expected costs. In such a situation, we would use the completed contract method of accounting for that project. We did not enter into any contracts that we accounted for under the completed contract method during the quarters ended March 31, 2014 and March 31, 2013.

### *Loss Recognition*

A risk associated with fixed-priced contracts is that revenue from customers may not cover increases in our costs. It is possible that current estimates could materially change for various reasons, including, but not limited to, fluctuations in forecasted labor and vessel productivity, vessel repair requirements, weather downtime, subcontractor or supplier performance, pipeline lay rates or steel and other raw material prices. Increases in costs associated with our fixed-price contracts could have a material adverse impact on our consolidated financial condition, results of operations and cash flows. Alternatively, reductions in overall contract costs at completion could materially improve our consolidated financial condition, results of operations and cash flows.

As of March 31, 2014, 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.

Of the March 31, 2014 backlog amount of \$4.4 billion, approximately \$550.7 million relates to nine active projects that are in loss positions, whereby future revenues are expected to equal costs when recognized. Included in this amount is \$191.6 million of backlog associated with an EPCI project in Altamira, which is expected to be completed in the third quarter of 2015, \$144.6 million pertaining to a five-year charter of the *Agile* in Brazil, which began in early 2012, and \$65.9 million relating to a subsea project in the U.S. Gulf of Mexico scheduled for completion during

2014, all of which are being conducted by our Americas segment. The amount also includes \$91.5 million of backlog relating to an EPCI project in Saudi Arabia, in our Middle East segment, which is expected to be completed by the end of 2015. These four projects represent approximately 90% of the backlog amount in a loss position. 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.

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### *Use of Estimates*

We use estimates and assumptions to prepare our financial statements in conformity with GAAP. These estimates and assumptions affect the amounts we report in our financial statements and accompanying notes. Our actual results could differ from these 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, unexpected changes in weather conditions, productivity, unanticipated vessel repair requirements, customer, subcontractor and supplier delays and other costs. We generally expect to experience a reasonable amount of unanticipated events, and some of these events can result in significant cost increases above cost amounts we previously estimated. As of March 31, 2014, 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.

The following is a discussion of our most significant changes in estimates that impacted operating income for the three months ended March 31, 2014 and 2013.

#### *2014 Period*

Operating income for the three months ended March 31, 2014 was impacted by changes in cost estimates relating to projects in each of our segments.

The Asia Pacific segment experienced an improvement of approximately \$20.6 million mostly due to changes in estimates on a subsea project in Malaysia during the quarter ended March 31, 2014, primarily due to productivity improvements on our marine vessels as well as offshore support activities.

The Middle East segment was negatively impacted by losses of approximately \$31.9 million, mostly due to changes in estimates on three projects in Saudi Arabia during the three months ended March 31, 2014. On two EPCI projects in Saudi Arabia, we increased our estimated cost at completion by approximately \$24.3 million, primarily as a result of vessel downtime due to weather and standby delays (which may be recoverable from the customer, but which were not recognizable at March 31, 2014), and reduced productivity on fabrication and engineering activities. Both projects remain in a profitable position at March 31, 2014. On another EPCI project in Saudi Arabia, we increased our estimated cost to complete by approximately \$7.6 million, primarily due to increases in our cost estimates for the completion of onshore activities on the project.

The Americas segment was negatively impacted by changes in estimates of approximately \$35.4 million on an EPCI project in Altamira during the quarter ended March 31, 2014. The estimated cost at completion on this project increased primarily due to expected delays in final project delivery, resulting in a revised execution plan, increased fabrication labor costs and recognition of liquidated damages.

#### *2013 Period*

Operating income for the three months ended March 31, 2013 was impacted by changes in cost estimates relating to projects in each of our segments.

The Middle East segment was impacted by changes in estimates on five projects. In total, those five projects recognized approximately \$7.7 million in project losses in the three months ended March 31, 2013, as a result of increases to the estimated costs to complete those projects of approximately \$38.0 million. On one of those projects,

we increased our estimated cost at completion by \$17.5 million, which resulted in the recognition of a \$5.4 million loss in the three months ended March 31, 2013, primarily due to changes in the project's execution plan, which resulted in additional third-party construction vessel usage and marine downtime, cost overruns on offshore hook-up activities, and additional costs for project management-related activities. This project remained in a profitable position at March 31, 2014.

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On three projects in the Middle East segment, we increased our estimated cost at completion by \$16.7 million, which resulted in the recognition of only \$1.8 million of project income in the three months ended March 31, 2013. The changes in estimated cost at completion were principally driven by cost overruns associated with marine equipment downtime, including productivity, hook-up and project management-related activities. Each of those projects was in a profitable position at March 31, 2013. One of those projects was completed in the third quarter of 2013, and the remaining two projects are expected to be completed during 2014. On the remaining project in the Middle East segment, we recognized incremental costs of \$4.1 million in the three months ended March 31, 2013, primarily due to cost overruns on marine installation activities. That project was in a loss position at March 31, 2013 and was completed in the second quarter of 2013.

The Americas segment was impacted by changes in estimates on two projects. On one of those projects, we recognized approximately \$6.9 million of incremental project losses in the three months ended March 31, 2013, primarily due to declines in fabrication productivity. That project remained in a loss position through its completion in the fourth quarter of 2013. The other project was completed in the first quarter of 2013 and recognized \$2.4 million of cost savings as a result of efficiencies associated with fabrication activities.

The Asia Pacific segment benefited from certain changes in estimates, which resulted in a reduction of estimated costs at completion in the three months ended March 31, 2013 of approximately \$14.0 million, primarily due to efficiencies associated with the marine campaigns on two of our EPCI projects, both of which were completed in 2013. These benefits were partially offset by project charges recognized in the three months ended March 31, 2013 of approximately \$4.1 million associated with cost overruns on support vessels on one of our subsea projects, which remains in a loss position and is expected to be completed in the second quarter of 2014.

## ***Loss Contingencies***

We record liabilities for loss contingencies when it is probable that a liability has been incurred and the amount of loss is reasonably estimable. We provide disclosure when there is a reasonable possibility that the ultimate loss will exceed the recorded provision or if such loss is not reasonably estimable. We are currently involved in litigation and other proceedings, as discussed in Note 10. We have accrued our estimates of the probable losses associated with these matters, and associated legal costs are generally recognized in selling, general and administrative expenses as incurred. However, our losses are typically resolved over long periods of time and are often difficult to estimate due to various factors, including the possibility of multiple actions by third parties. Therefore, it is possible future earnings could be affected by changes in our estimates related to these matters.

## ***Cash and Cash Equivalents***

Our cash and cash equivalents are highly liquid investments with maturities of three months or less when we purchase them. We record cash and cash equivalents as restricted when we are unable to freely use such cash and cash equivalents for our general operating purposes. At March 31, 2014, all of our restricted cash was held in restricted foreign-entity accounts.

## ***Investments***

We classify investments available for current operations as current assets in the accompanying balance sheets, and we classify investments held for long-term purposes as noncurrent assets. We adjust the amortized cost of debt securities for amortization of premiums and accretion of discounts to maturity. That amortization is included in interest income. We include realized gains and losses on our investments in other income (expense) net. The cost of securities sold is based on the specific identification method. We include interest earned on securities in interest income.



**Table of Contents*****Investments in Unconsolidated Affiliates***

We generally use the equity method of accounting for affiliates in which our investment ownership ranges from 20% to 50%, and in which we do not exercise control over the entity. Currently, most of our investments in affiliates that are not consolidated are recorded using the equity method.

***Accounts Receivable******Accounts Receivable Trade, Net***

A summary of contract receivables is as follows:

|                                       | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---------------------------------------|---------------------------|------------------------------|
|                                       | <b>(Unaudited)</b>        |                              |
|                                       | <b>(In thousands)</b>     |                              |
| <b>Contract receivables:</b>          |                           |                              |
| Contracts in progress                 | \$ 189,044                | \$ 192,745                   |
| Completed contracts                   | 55,880                    | 77,248                       |
| Retainages                            | 110,718                   | 127,698                      |
| Unbilled                              | 4,325                     | 14,571                       |
| Less allowances                       | (27,905)                  | (30,404)                     |
| <b>Accounts receivable trade, net</b> | <b>\$ 332,062</b>         | <b>\$ 381,858</b>            |

We expect to invoice our unbilled receivables once certain milestones or other metrics are reached, and we expect to collect all unbilled amounts. We believe that our provision for losses on uncollectible accounts receivable is adequate for our credit loss exposure.

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:

|   | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|---------------------------|------------------------------|
|   | <b>(Unaudited)</b>        |                              |
|   | <b>(In thousands)</b>     |                              |
| Retainages expected to be collected within one year | \$ 110,718                | \$ 127,698                   |
| Retainages expected to be collected after one year  | 107,315                   | 65,365                       |
| <b>Total retainages</b>                             | <b>\$ 218,033</b>         | <b>\$ 193,063</b>            |

We have included in accounts receivable trade, net, retainages expected to be collected within one year. Retainages expected to be collected after one year are included in other assets.

*Accounts Receivable Other*

Accounts receivable other was \$109.3 million and \$89.3 million at March 31, 2014 and December 31, 2013, respectively. The balance primarily relates to transactions with unconsolidated affiliates, receivables associated with our hedging activities, value-added tax, other items and employee receivables. Employee receivables were \$4.2 million and \$4.5 million as of March 31, 2014 and December 31, 2013, respectively. These amounts are expected to be collected within 12 months, and any allowance for doubtful accounts on our accounts receivable other is based on our estimate of the amount of probable losses due to the inability to collect these amounts (based on historical collection experience and other available information). As of March 31, 2014 and December 31, 2013, no such allowance for doubtful accounts was recorded.



**Table of Contents*****Contracts in Progress and Advance Billings on Contracts***

Contracts in progress were \$431.9 million and \$426.0 million at March 31, 2014 and December 31, 2013, respectively. Advance billings on contracts were \$278.9 million at both March 31, 2014 and December 31, 2013. A detail of the components of contracts in progress and advance billings on contracts is as follows:

|   | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|---------------------------|------------------------------|
|   | <b>(Unaudited)</b>        |                              |
|   | <b>(In thousands)</b>     |                              |
| Costs incurred less costs of revenue recognized | \$ 127,773                | \$ 65,113                    |
| Revenues recognized less billings to customers  | 304,120                   | 360,873                      |
| <b>Contracts in Progress</b>                    | <b>\$ 431,893</b>         | <b>\$ 425,986</b>            |

|   | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|---------------------------|------------------------------|
|   | <b>(Unaudited)</b>        |                              |
|   | <b>(In thousands)</b>     |                              |
| Billings to customers less revenue recognized   | \$ 496,040                | \$ 466,205                   |
| Costs incurred less costs of revenue recognized | (217,159)                 | (187,276)                    |
| <b>Advance Billings on Contracts</b>            | <b>\$ 278,881</b>         | <b>\$ 278,929</b>            |

***Fair Value of Financial Instruments***

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. An established hierarchy for inputs is used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors that market participants would use in valuing the asset or liability.

Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

Level 1 inputs are based upon quoted prices for identical instruments traded in active markets.

Level 2 inputs are based upon quoted prices for similar instruments in active markets, quoted prices for similar or identical instruments in inactive markets and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets and liabilities.

Level 3 inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models and similar valuation techniques.

The carrying amounts that we have reported for financial instruments, including cash and cash equivalents, accounts receivables and accounts payable approximate their fair values. See Note 6 for additional information regarding fair value measurements.

**Table of Contents*****Derivative Financial Instruments***

Our worldwide operations give rise to exposure to changes in certain market conditions, which may adversely impact our financial performance. When we deem it appropriate, we use derivatives as a risk management tool to mitigate the potential impacts of certain market risks. The primary market risk we manage through the use of derivative instruments is movement in foreign currency exchange rates. We use foreign currency derivative contracts to reduce the impact of changes in foreign currency exchange rates on our operating results. We use these instruments to hedge our exposure associated with revenues and/or costs on our long-term contracts and other cash flow exposures that are denominated in currencies other than our operating entities' functional currencies. We do not hold or issue financial instruments for trading or other speculative purposes.

In certain cases, contracts with our customers contain provisions under which some payments from our customers are denominated in U.S. Dollars and other payments are denominated in a foreign currency. In general, the payments denominated in a foreign currency are designed to compensate us for costs that we expect to incur in such foreign currency. In these cases, we may use derivative instruments to reduce the risks associated with foreign currency exchange rate fluctuations arising from differences in timing of our foreign currency cash inflows and outflows. See Note 5 for additional information regarding derivative financial instruments.

***Foreign Currency Translation***

We translate assets and liabilities of our foreign operations, other than operations in highly inflationary economies, into U.S. Dollars at period-end exchange rates, and we translate income statement items at average exchange rates for the periods presented. We record adjustments resulting from the translation of foreign currency financial statements as a component of accumulated other comprehensive income (loss) ( AOCI ), net of tax.

***Earnings per Share***

We have computed earnings per common share on the basis of the weighted average number of common shares, and, where dilutive, common share equivalents, outstanding during the indicated periods. See Note 8 for our earnings per share computations.

***Accumulated Other Comprehensive Loss***

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

|  | <b>March 31,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|--|---------------------------|------------------------------|
|  | <b>(Unaudited)</b>        |                              |
|  | <b>(In thousands)</b>     |                              |
| Foreign currency translation adjustments     | \$ (2,882)                | \$ (2,562)                   |
| Net gain on investments                      | 214                       | 238                          |
| Net loss on derivative financial instruments | (30,824)                  | (45,386)                     |
| Unrecognized losses on benefit obligations   | (89,250)                  | (92,421)                     |
| <b>Accumulated other comprehensive loss</b>  | <b>\$ (122,742)</b>       | <b>\$ (140,131)</b>          |



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The following tables present the components of AOCI and the amounts that were reclassified during the period:

|   | <b>Unrealized holding<br/>loss on<br/>investment derivatives<sup>(1)</sup></b> | <b>Deferred gain<br/>(loss) on<br/>derivatives<sup>(1)</sup></b> | <b>Foreign<br/>currency gain<br/>(loss)</b> | <b>Defined benefit<br/>pension plans loss<sup>(2)</sup></b> | <b>TOTAL</b> |
|---|--|--|---|---|--------------|
| <b>For the three months ended March 31, 2014</b>          | <b>(Unaudited)</b>   |  |   |   |              |
|   | <b>(In thousands)</b>  |  |   |   |              |
| Balance, December 31, 2013                                | \$ 238   | \$ (45,386)  | \$ (2,562)                                  | \$ (92,421)   | \$ (140,131) |
| Other comprehensive income (loss) before reclassification | (24)   | 12,358   | (320)                                       |   | 12,014       |
| Amounts reclassified from AOCI                            |  | 2,204 <sup>(3)</sup>   |   | 3,171 <sup>(4)</sup>  | 5,375        |
| Net current period other comprehensive income (loss)      | (24)   | 14,562   | (320)                                       | 3,171   | 17,389       |
| Balance, March 31, 2014                                   | \$ 214   | \$ (30,824)  | \$ (2,882)                                  | \$ (89,250)   | \$ (122,742) |

|  | <b>Unrealized holding<br/>loss on<br/>investment derivatives<sup>(1)</sup></b> | <b>Deferred gain<br/>(loss) on<br/>derivatives<sup>(1)</sup></b> | <b>Foreign<br/>currency gain<br/>(loss)</b> | <b>Defined benefit<br/>pension plans loss<sup>(2)</sup></b> | <b>TOTAL</b> |
|--|--|--|---|---|--------------|
| <b>For the three months ended March 31, 2013</b>   | <b>(Unaudited)</b>   |  |   |   |              |
|  | <b>(In thousands)</b>  |  |   |   |              |
| Balance, December 31, 2012                         | \$ (2,315)   | \$ 11,734  | \$ (3,366)                                  | \$ (100,466)  | \$ (94,413)  |
| Other comprehensive income before reclassification | 401  | (15,450)   | 7,214                                       |   | (7,835)      |
| Amounts reclassified from AOCI                     |  | (2,104) <sup>(3)</sup>   |   | 3,655 <sup>(4)</sup>  | 1,551        |
| Net current period other comprehensive income      | 401  | (17,554)   | 7,214                                       | 3,655   | (6,284)      |
| Balance, March 31, 2013                            | \$ (1,914)   | \$ (5,820)   | \$ 3,848                                    | \$ (96,811)   | \$ (100,697) |

(1) Refer to Note 5 for additional details.

(2) Refer to Note 4 for additional details.

(3) Reclassified to cost of operations and gain on foreign currency, net.

(4) Reclassified to selling, general and administrative expenses.

**Recently Issued Accounting Standards**

On July 18, 2013, the Financial Accounting Standards Board ( FASB ) issued an update to the topic *Income Taxes*. The update clarifies that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if settlement is required or expected in the event the uncertain tax position is

disallowed. In situations where these items are not available at the reporting date under the tax law of the applicable jurisdiction or the tax law of the applicable jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. The update is effective for reporting periods beginning after December 15, 2013, and the adoption of this update does not have a material impact on our condensed consolidated financial statements.

In February 2013, the FASB issued an update to the topic *Comprehensive Income*. The update requires companies to provide additional information about the nature and amount of certain reclassifications out of AOCI, which impact the income statement. While the amendment does not change current reporting

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requirements, companies are required to provide information about the amounts reclassified out of AOCI by the respective line item. The update is effective for reporting periods beginning after December 15, 2012, and the adoption of this update did not have a material impact on our condensed consolidated financial statements.

In January 2013, the FASB issued an update to the topic *Balance Sheet*. This update requires new disclosures presenting detailed information regarding both the gross and net basis of derivatives and other financial instruments that are eligible for offset in the balance sheet or that are subject to a master netting arrangement. The update is effective for the first quarter of 2013 and is to be applied retrospectively. As this new guidance relates to presentation only, the adoption of this update did not have a material impact on our condensed consolidated financial statements.

**NOTE 2 ACQUISITION AND DISPOSITIONS*****Acquisition***

During the quarter ended March 31, 2013, we entered into a share purchase agreement to acquire all of the issued and outstanding shares of capital stock of Deepsea Group Limited, a United Kingdom-based company that provides subsea and other engineering services to international energy companies, primarily through offices in the United Kingdom and the United States. Total consideration was approximately \$9.0 million, which includes cash (\$6.0 million) and the delivery of 313,580 restricted shares of MII common stock (out of treasury). The transaction is being accounted for using the acquisition method and, accordingly, assets acquired and liabilities assumed are recorded at their respective fair values.

During the quarter ended December 31, 2013, we entered into two joint ventures with TH Heavy Engineering Berhad ( THHE ), whereby we acquired a 30% interest in a subsidiary of THHE, THHE Fabricators Sdn. Bhd., and THHE acquired a 30% interest in our Malaysian subsidiary, Berlian McDermott Sdn. Bhd. Accounting for these transactions is preliminary at March 31, 2014 and is pending finalization of these transactions by mid-2014. As of March 31, 2014, we recorded an equity method investment of approximately \$25.5 million, a non-controlling interest of approximately \$20.9 million and an increase in capital in excess of par value of approximately \$4.6 million arising from these transactions.

***Non-Core Asset Sales***

We previously committed to a plan to sell four of our multi-function marine vessels, specifically the *Bold Endurance*, *DB 16*, *DB 26* and the *DLB KP1*. Assets classified as held for sale are no longer depreciated. During the quarter ended March 31, 2014, we completed the sale of the *DLB KP1* for aggregate cash proceeds of approximately \$8.4 million, resulting in a gain of approximately \$6.4 million recognized in our Middle East segment. During the quarter ended March 31, 2013, we completed the sale of the *Bold Endurance* and the *DB 26* for aggregate cash proceeds of approximately \$32.0 million, resulting in an aggregate gain of approximately \$12.5 million. We remain in active discussions with interested parties to sell the *DB 16*.

***Americas and Corporate Restructuring***

We commenced a restructuring of our Americas operations during the quarter ended June 30, 2013, which involves our Morgan City, Louisiana, Houston, Texas, New Orleans, Louisiana and Brazil locations. The restructuring involves, among other things, reductions of management, administrative, fabrication and engineering personnel, and a plan to discontinue utilization of the Morgan City facility (after the completion of existing backlog projects, which are currently forecasted to be completed in the third quarter of 2014). Future fabrication operations in the Americas segment are expected to be executed using the Altamira, Mexico facility. In addition, we have reached an agreement

to exit our joint venture operation in Brazil. Costs associated with our Americas restructuring activities primarily include severance and other personnel-related costs, costs associated



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with exiting the joint venture in Brazil, asset impairment and relocation costs, environmental reserves and future unutilized lease costs. The total costs are expected to range between \$55.0 and \$60.0 million in the aggregate. Of the total anticipated costs, we incurred approximately \$3.6 million during the quarter ended March 31, 2014 and had incurred an aggregate of \$37.7 million through March 31, 2014.

In October 2013, we announced certain executive management changes that became effective during the fourth quarter of 2013. In March 2014, we changed our organizational structure to orient around offshore and subsea business activities through four primary geographic regions. Costs associated with our corporate reorganization activities will primarily include severance, relocation and other personnel-related costs and costs for advisors. The total of these costs is expected to range between \$20.0 million and \$25.0 million and to be incurred by the end of 2014. Of the total anticipated costs, we incurred approximately \$2.5 million during the quarter ended March 31, 2014 and had incurred an aggregate of \$4.2 million as of March 31, 2014.

The following table presents total amounts incurred during the quarter ended March 31, 2014, as well as amounts incurred from inception of restructuring efforts up to March 31, 2014 and amounts expected to be incurred in the future by major type of cost and by segment.

|   | <b>Incurred for three restructuring<br/>months ended<br/>March 31, 2014</b> | <b>Incurred from<br/>inception to<br/>March 31, 2014</b> | <b>Remaining<br/>to be<br/>incurred</b> | <b>Total</b>     |
|---|---|--|---|------------------|
|   | <b>(In thousands)</b>   |  |   |                  |
| <b>Americas</b>                             |   |  |   |                  |
| Impairments and write offs                  | \$  | \$ 14,138  | \$ 112                                  | \$ 14,250        |
| Severance and other personnel-related costs | 2,029   | 11,676   | 1,324                                   | 13,000           |
| Morgan City environmental reserve (accrued) |   | 5,925  |   | 5,925            |
| Morgan City yard-related expenses           | 1,602   | 5,800  | 9,450                                   | 15,250           |
| Other                                       |   | 158  | 6,417                                   | 6,575            |
|   | \$ 3,631  | \$ 37,697  | \$ 17,303                               | \$ 55,000        |
| <b>Corporate</b>                            |   |  |   |                  |
| Severance and other personnel-related costs | \$ 908  | \$ 2,569   | \$ 6,931                                | \$ 9,500         |
| Legal and other advisor fees                | 1,586   | 1,586  | 8,914                                   | 10,500           |
|   | \$ 2,494  | \$ 4,155   | \$ 15,845                               | \$ 20,000        |
| <b>Total</b>                                | <b>\$ 6,125</b>   | <b>\$ 41,852</b>   | <b>\$ 33,148</b>                        | <b>\$ 75,000</b> |

Accrued liabilities associated with restructuring activities were approximately \$7.9 million and \$8.0 million as of March 31, 2014 and December 31, 2013, respectively.

**NOTE 3 LONG-TERM DEBT AND NOTES PAYABLE**

During April 2014, we refinanced our existing obligations, and replaced in its entirety, our then existing \$950.0 million credit agreement (the Former Credit Agreement ) with a new credit agreement (the New Credit Agreement ), which provides for:

a \$400.0 million first-lien, first-out three-year letter of credit facility (the LC Facility ); and

a \$300.0 million first-lien, second-out five-year term loan (the Term Loan ).

As of March 31, 2014 we had \$250.0 million of revolving credit borrowings outstanding and approximately \$376.0 million of letters of credit outstanding under the Former Credit Agreement.

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Additionally, during April 2014, we completed the following new financing transactions:

the issuance of \$500.0 million of second-lien seven-year senior secured notes (the *Notes* ).

the issuance of \$287.5 million of tangible equity units ( *Units* ) composed of (1) three-year amortizing, senior unsecured notes, in an aggregate principal amount of \$47.5 million, and (2) prepaid common stock purchase contracts.

With the completion of these financing transactions in April 2014, we terminated the bridge loan commitment we had obtained from an affiliate of Goldman, Sachs, & Co. ( *Goldman Sachs* ). As a result of the termination of the bridge loan commitment, the fee we previously paid to Goldman Sachs to obtain the bridge loan commitment will be recognized as interest expense in the second quarter of 2014. Due to the replacement of the Former Credit Agreement, the unamortized issuance fees related to the Former Credit Agreement will also be recognized as interest expense in the second quarter of 2014. The total additional interest expense related to these items is expected to be approximately \$28.0 million in the quarter ending June 30, 2014.

The Former Credit Agreement provided for revolving credit borrowings and issuances of letters of credit in an aggregate outstanding amount of up to \$950.0 million.

At March 31, 2014, there was \$250.0 million of revolving credit borrowings outstanding, and letters of credit issued under the Former Credit Agreement totaled approximately \$376.0 million, including letters of credit in the aggregate amount of \$109.0 million issued in February 2014 to replace the letters of credit issued by Australia and New Zealand Banking Group Limited discussed below. During the quarter ended March 31, 2014, our outstanding borrowings under the Former Credit Agreement did not exceed \$250.0 million, and we had average outstanding borrowings under the Former Credit Agreement of approximately \$165.0 million, with an average interest rate of 3.45%. At December 31, 2013, there were no borrowings outstanding, and letters of credit issued under the Former Credit Agreement totaled approximately \$214.3 million.

At March 31, 2014, the applicable margin for Eurodollar-rate loans was 2.00%, the applicable margin for base-rate loans was 1.00%, the letter of credit fee for financial letters of credit was 2.00%, the letter of credit fee for performance letters of credit was 1.00%, and the commitment fee for unused portions of the Former Credit Agreement was 0.3%. The Former Credit Agreement did not have a floor for the base rate or the Eurodollar rate.

Obligations under the Former Credit Agreement were secured on a first-lien basis by pledges of capital stock of certain of our subsidiaries and mortgages and other security interests covering (1) all of our personal property and substantially all of the personal property of our wholly owned subsidiaries, subject to exceptions for bank accounts, equipment and certain other assets, and (2) certain of our marine vessels.

***New Credit Facilities***

During April 2014 we entered into the New Credit Agreement, which provides for the LC Facility and the Term Loan.

The New Credit Agreement includes the \$400.0 million first-lien, first-out LC Facility, which is scheduled to mature on April 16, 2017, and the \$300.0 million first-lien, second-out Term Loan, which is scheduled to mature April 16, 2019. The indebtedness and other obligations under the New Credit Agreement are guaranteed by substantially all of our material, wholly owned subsidiaries, other than our captive insurance subsidiary (collectively, the *Guarantors* ).

In connection with the New Credit Agreement, we paid certain fees to the lenders thereunder, as well as certain arrangement fees to the arrangers and agents for the New Credit Facilities, which we intend to amortize to interest expense over the respective terms of the LC Facility and the Term Loan.

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### *LC Facility*

The LC Facility provides for an initial letter of credit capacity of \$400.0 million and allows for uncommitted increases in capacity of \$100.0 million through December 31, 2014 and an additional \$100.0 million thereafter, potentially increasing the total capacity to \$600.0 million through the term of the LC Facility. Letters of credit issuable under the LC Facility support the obligations of McDermott and its affiliates and joint ventures. The aggregate amount of the LC Facility available for financial letters of credit is capped at 25% of the total LC Facility.

The LC Facility is secured on a first-lien, first-out basis (with relative priority over the Term Loan) by pledges of the capital stock of all the Guarantors and mortgages on, or other security interests in, substantially all the tangible and intangible assets of our company and the Guarantors, subject to specific exceptions.

The LC Facility contains various customary affirmative covenants, as well as specific affirmative covenants, including specific reporting requirements and a requirement for ongoing periodic financial reviews by a financial advisor. The LC Facility also requires compliance with various negative covenants, including limitations with respect to the incurrence of other indebtedness and liens, restrictions on acquisitions, capital expenditures and other investments, restrictions on sale/leaseback transactions and restrictions on prepayments of other indebtedness.

The LC Facility requires us to meet a minimum EBITDA (as defined) covenant, which requires that we generate consolidated EBITDA of at least certain specified amounts for different periods over the term of the facility. The LC Facility also requires us to maintain a ratio of fair market value of vessel collateral to the sum of (1) the outstanding principal amount of the Term Loan, (2) the aggregate amount of undrawn financial letters of credit outstanding under the LC Facility, (3) all drawn but unreimbursed letters of credit under the LC Facility, and (4) mark-to-market foreign exchange exposure that is not cash secured of at least 1.20:1.00. The LC Facility also requires us to maintain at least \$200.0 million of minimum available cash, excluding restricted cash, at the end of each quarter.

The LC Facility provides for a commitment fee of 0.50% per year on the unused portion of the LC Facility and letter of credit fees at an annual rate of 2.25% for performance letters of credit and 4.50% for financial letters of credit, as well as customary issuance fees and other fees and expenses.

### *Term Loan*

The Term Loan is secured on a first-lien, second-out basis (with the LC Facility having relative priority over the Term Loan) by pledges of the capital stock of all the Guarantors and mortgages on, or other security interests in, substantially all tangible and intangible assets of our company and the Guarantors, subject to specific exceptions.

The Term Loan requires mandatory prepayments from: (1) the proceeds from the sale of assets, as well as insurance proceeds, in each case subject to certain exceptions, to the extent such proceeds are not reinvested in our business within 365 days of receipt; (2) net cash proceeds from the incurrence of indebtedness not otherwise permitted by the New Credit Facilities; and (3) 50% of amounts deemed to be excess cash flow, subject to specified adjustments. The Term Loan also requires quarterly amortization payments equal to \$750,000. The Term Loan also provides for a prepayment premium if we prepay or re-price the Term Loan prior to April 16, 2016.

The Term Loan requires compliance with various customary affirmative and negative covenants. We must also maintain a ratio of ownership adjusted fair market value of marine vessels to the sum of (1) the outstanding principal amount of the Term Loan and (2) the aggregate principal amount of unreimbursed drawings and advances under the LC Facility of at least 1.75:1.00.



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The Term Loan was incurred with 25 basis points of original issue discount and bears interest at a floating rate, which can be, at our option, either: (1) a LIBOR rate for a specified interest period (subject to a LIBOR floor of 1.00%) plus an applicable margin of 4.25%; or (2) an alternate base rate (subject to a base rate floor of 2.00%) plus an applicable margin of 3.25%.

*Senior Notes*

During April 2014 we issued \$500.0 million in aggregate principal amount of 8.000% senior secured notes due 2021 (the Notes) in a private placement in accordance with Rule 144A and Regulation S under the Securities Act of 1933, as amended. Interest on the Notes is payable semi-annually in arrears on May 1 and November 1 of each year, beginning on November 1, 2014, at an annual rate of 8%. The Notes are scheduled to mature on May 1, 2021.

The Notes are unconditionally guaranteed on a senior secured basis by the Guarantors, and the Notes are secured on a second lien basis by pledges of capital stock of certain of our subsidiaries and mortgages and other security interests covering (1) specified marine vessels owned by certain of the Guarantors and (2) substantially all the other tangible and intangible assets of our company and the Guarantors, subject to exceptions for certain assets.

At any time or from time to time on or after May 1, 2017, at our option, we may redeem the Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount of the Notes to be redeemed) set forth below, together with accrued and unpaid interest to the redemption date, if redeemed during the 12-month period beginning May 1 of the years indicated:

| Year                | Percentage |
|---------------------|------------|
| 2017                | 104%       |
| 2018                | 102%       |
| 2019 and thereafter | 100%       |

The Indenture governing the Notes contains covenants that, among other things, limit our ability and the ability of our restricted subsidiaries to: (1) incur or guarantee additional indebtedness or issue preferred stock; (2) make investments or certain other restricted payments; (3) pay dividends or distributions on capital stock or purchase or redeem subordinated indebtedness; (4) sell assets; (5) create restrictions on the ability of our restricted subsidiaries to pay dividends or make other payments to us; (6) create certain liens; (7) sell all or substantially all of our assets or merge or consolidate with or into other companies; (8) enter into transactions with affiliates; and (9) create unrestricted subsidiaries. Many of those covenants would become suspended if the Notes were to attain an investment grade rating from both Moody's Investors Service, Inc. and Standard and Poor's Ratings Services and no default has occurred. The covenants mentioned above are subject to a number of important exceptions and limitations.

*Units*

During April 2014, we issued 11,500,000 6.25% tangible equity units, each with a stated amount of \$25.00. Each Unit consists of (1) a prepaid common stock purchase contract and (2) a senior amortizing note due April 1, 2017 (each an Amortizing Note) that has an initial principal amount of \$4.1266 per Amortizing Note, bears interest at a rate of 7.75% per annum and has a final scheduled installment payment date of April 1, 2017. Each prepaid common stock purchase contract will automatically settle on April 1, 2017, unless settled earlier: (1) at the holder's option, upon which we will deliver shares of our common stock, based on the applicable settlement rate and applicable market value of our stock as determined under the purchase contract; or (2) at our option, upon which we will deliver shares of our common stock, based upon the stated maximum settlement rate of 3.5562 shares per unit, subject to adjustment.





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**Table of Contents*****North Ocean Financing******North Ocean 102***

In December 2009, J. Ray McDermott, S.A. ( JRMSA ), a wholly owned subsidiary of MII, entered into a vessel-owning joint venture transaction with Oceanteam ASA. JRMSA has guaranteed approximately 50% of this debt based on its ownership percentages in the vessel-owning companies. The outstanding debt bore interest at a rate equal to the three-month LIBOR (which was subject to reset every three months) plus a margin of 3.315%. JRMSA paid in full the approximately \$31.4 million notes payable balance upon maturity during January 2014. JRMSA expects to exercise its option to purchase Oceanteam ASA's 50% ownership interest in the vessel-owning companies in December 2014. As of December 31, 2013 we reported a consolidated notes payable of \$31.4 million on our consolidated balance sheet, all of which was classified as current notes payable.

***North Ocean 105***

On September 30, 2010, MII, 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 *North Ocean 105*. The agreement provides for borrowings of up to \$69.4 million, bearing interest at 2.76% per year, and requires principal repayment in 17 consecutive semi-annual installments, which commenced on October 1, 2012. 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 *North Ocean 105*, and a lien on substantially all of the other assets of North Ocean 105 AS. MII unconditionally guaranteed all amounts to be borrowed under the agreement. At March 31, 2014 and December 31, 2013, there was \$57.2 million in borrowings outstanding under this agreement, of which approximately \$8.2 million was classified as current notes payable.

***Unsecured Bilateral Letters of Credit and Bank Guarantees***

In 2012, McDermott Middle East, Inc, and MII executed a general reimbursement agreement in favor of a bank located in the UAE relating to issuances of bank guarantees in support of contracting activities in the Middle East and India. As of March 31, 2014 and December 31, 2013, bank guarantees issued under these arrangements totaled \$56.2 million and \$55.8 million, respectively. In 2007 and in 2012, JRMSA and MII executed general unsecured reimbursement agreements in favor of two institutions that were lenders under the Former Credit Agreement relating to issuances of letters of credit in support of contracting activities primarily in Asia and the Middle East. The letters of credit issued under these arrangements totaled \$23.3 million and \$26.0 million as of March 31, 2014 and December 31, 2013, respectively.

On April 20, 2012, McDermott and one of its wholly owned subsidiaries, McDermott Australia Pty. Ltd. ( McDermott Australia ), entered into a secured Letter of Credit Reimbursement Agreement (the Reimbursement Agreement ) with Australia and New Zealand Banking Group Limited ( ANZ ). In accordance with the terms of the Reimbursement Agreement, ANZ issued letters of credit in the aggregate amount of approximately \$109.0 million to support McDermott Australia's performance obligations under contractual arrangements relating to a field development project. The obligations of McDermott and McDermott Australia under the Reimbursement Agreement are secured by McDermott Australia's interest in the contractual arrangements and certain related assets. During February 2014, we replaced these letters of credit with letters of credit issued under the Former Credit Agreement and subsequently replaced those letters of credit with letters of credit under the LC Facility.

***Surety Bonds***

In 2012 and 2011, MII executed general agreements of indemnity in favor of surety underwriters based in Mexico relating to surety bonds issued in support of contracting activities of J. Ray McDermott de Mèxico, S.A. de C.V. and McDermott, Inc, both subsidiaries of MII. As of March 31, 2014 and December 31, 2013, bonds issued under these arrangements totaled \$42.1 million and \$43.5 million, respectively. In October 2013, MII

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executed general agreements of indemnity in favor of surety underwriters relating to surety bonds in support of vessels operating in Brazil. The bonds issued under these arrangements totaled \$111.2 million and \$106.3 million as of March 31, 2014 and December 31, 2013, respectively.

***Long-term debt and notes payable obligations***

A summary of our long-term debt obligations are as follows:

|   | March 31,<br>2014 | December 31,<br>2013 |
|---|-------------------|----------------------|
|   | (Unaudited)       |                      |
|   | (In thousands)    |                      |
| Long-term debt consists of:                   |                   |                      |
| Former Credit Agreement                       | \$ 250,000        | \$                   |
| <i>North Ocean 102</i> Construction Financing |                   | 31,373               |
| <i>North Ocean 105</i> Construction Financing | 57,189            | 57,189               |
| Other financing                               | 989               |                      |
|   | 308,178           | 88,562               |
| Less: Amounts due within one year             | 258,417           | 39,543               |
| Total long-term debt                          | \$ 49,761         | \$ 49,019            |

**NOTE 4 PENSION PLANS**

Although we currently provide retirement benefits for most of our U.S. employees through sponsorship of the McDermott Thrift Plan, some of our longer-term U.S. employees and former employees are entitled to retirement benefits under the McDermott (U.S.) Retirement Plan, a non-contributory qualified defined benefit pension plan (the McDermott Plan ), and several non-qualified supplemental defined benefit pension plans. The McDermott Plan and the non-qualified supplemental defined benefit pension plans are collectively referred to herein as the Domestic Plans. The McDermott Plan has been closed to new participants since 2006, and benefit accruals under the McDermott Plan were frozen completely in 2010.

We also sponsor a defined benefit pension plan established under the laws of the Commonwealth of the Bahamas, the J. Ray McDermott, S.A. Third Country National Employees Pension Plan (the TCN Plan ), which provides retirement benefits for certain of our current and former foreign employees. Effective August 1, 2011, new entry into the TCN Plan was closed, and effective December 31, 2011, benefit accruals under the TCN Plan were frozen. Effective January 1, 2012, we established a new global defined contribution plan to provide retirement benefits to non-U.S. expatriate employees who may have otherwise obtained benefits under the TCN Plan.

Retirement benefits under the McDermott Plan and the TCN Plan are generally based on final average compensation and years of service, subject to the applicable freeze in benefit accruals under the plans. Our funding policy is to fund the plans as recommended by the respective plan actuaries and in accordance with the Employee Retirement Income Security Act of 1974, as amended ( ERISA ), or other applicable law. The Pension Protection Act of 2006 ( PPA ) amended ERISA and modified the funding requirements for certain defined benefit pension plans including the McDermott Plan. Funding provisions under the PPA accelerated funding requirements are applicable to the

McDermott Plan to ensure full funding of benefits accrued.

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Net periodic benefit cost for the Domestic Plans and the TCN Plan includes the following components:

|   | Domestic Plans               |         | TCN Plan |        |
|---|------------------------------|---------|----------|--------|
|   | Three Months Ended March 31, |         |          |        |
|   | 2014                         | 2013    | 2014     | 2013   |
|   | (Unaudited)                  |         |          |        |
|   | (In thousands)               |         |          |        |
| Interest cost                           | \$ 6,778                     | \$ 167  | \$ 475   | \$ 467 |
| Expected return on plan assets          | (6,875)                      | (3,000) | (740)    | (651)  |
| Recognized net actuarial loss and other | 3,290                        | 3,152   | (74)     | 507    |
| Net periodic benefit cost (gain)        | \$ 3,193                     | \$ 319  | \$ (339) | \$ 323 |

**NOTE 5 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 condensed 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 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 condensed consolidated statements of operations.

At March 31, 2014, the majority of our foreign currency forward contracts were designated as cash flow hedging instruments. In addition, we deferred approximately \$30.8 million of net losses on these derivative financial instruments in AOCI, and we expect to reclassify approximately \$22.0 million of deferred losses out of AOCI by March 31, 2015, as hedged items are recognized in earnings. The notional value of our outstanding derivative contracts totaled \$1.0 billion at March 31, 2014, with maturities extending through 2017. Of this amount, approximately \$635.3 million is associated with various foreign currency expenditures we expect to incur on one of our Asia Pacific segment EPCI projects. These instruments consist of contracts to purchase or sell foreign-denominated currencies. At March 31, 2014, the fair value of these contracts was in a net liability position totaling \$15.0 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.

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The following tables summarize our derivative financial instruments:

**Asset and Liability Derivatives**

|  | March 31,<br>2014 | December 31,<br>2013 |
|--|-------------------|----------------------|
|  | (Unaudited)       |                      |
|  | (In thousands)    |                      |
| <b>Derivatives Designated as Hedges:</b> |                   |                      |
| <b>Location</b>                          |                   |                      |
| Accounts receivable other                | \$ 8,258          | \$ 11,641            |
| Other assets                             | 964               | 1,647                |
| <b>Total asset derivatives</b>           | <b>\$ 9,222</b>   | <b>\$ 13,288</b>     |
| Accounts payable                         | \$ 11,781         | \$ 20,209            |
| Other liabilities                        | 12,436            | 21,846               |
| <b>Total liability derivatives</b>       | <b>\$ 24,217</b>  | <b>\$ 42,055</b>     |

**The Effects of Derivative Instruments on our Financial Statements**

|  | Three Months Ended<br>March 31, |             |
|--|---------------------------------|-------------|
|  | 2014                            | 2013        |
|  | (Unaudited)                     |             |
|  | (In thousands)                  |             |
| <b>Derivatives Designated as Hedges:</b>   |                                 |             |
| Amount of gain/ (loss) recognized in other comprehensive income                                      | \$ 12,358                       | \$ (15,450) |
| Income reclassified from AOCI into income: effective portion   |                                 |             |
| <b>Location</b>  |                                 |             |
| Cost of operations   | \$ 202                          | \$ 2,014    |
| Gain (loss) recognized in income: ineffective portion and amount excluded from effectiveness testing |                                 |             |
| <b>Location</b>  |                                 |             |
| Gain (loss) on foreign currency net  | \$ (847)                        | \$ (2,849)  |

**NOTE 6 FAIR VALUE MEASUREMENTS**

The following is a summary of our available-for-sale securities measured at fair value:

| Total<br>at | Level 1 | Level 2 | Level 3 |
|-------------|---------|---------|---------|
|-------------|---------|---------|---------|

March 31, 2014

(Unaudited)  
(In thousands)

|                             |                 |           |                 |           |
|-----------------------------|-----------------|-----------|-----------------|-----------|
| Mutual funds <sup>(1)</sup> | \$ 2,189        | \$        | \$ 2,189        | \$        |
| Commercial paper            | 3,248           |           | 3,248           |           |
| <b>Total</b>                | <b>\$ 5,437</b> | <b>\$</b> | <b>\$ 5,437</b> | <b>\$</b> |

**Total at**  
**December 31, 2013**

|  | Level 1 | Level 2 | Level 3 |
|--|---------|---------|---------|
|--|---------|---------|---------|

(In thousands)

|  |                  |           |                 |                 |
|--|------------------|-----------|-----------------|-----------------|
| Mutual funds <sup>(1)</sup>  | \$ 2,173         | \$        | \$ 2,173        | \$              |
| Commercial paper   | 3,699            |           | 3,699           |                 |
| Asset-backed securities and collateralized mortgage obligations <sup>(2)</sup> | 7,639            |           | 2,082           | 5,557           |
| <b>Total</b>   | <b>\$ 13,511</b> | <b>\$</b> | <b>\$ 7,954</b> | <b>\$ 5,557</b> |

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(1) Various U.S. equities and other investments managed under mutual funds

(2) Asset-backed and mortgage-backed securities with maturities of up to 26 years

Our Level 2 investments consist primarily of commercial paper, asset-backed commercial paper notes backed by a pool of mortgage-backed securities and mutual funds. The fair value of our Level 2 investments was determined using a market approach which is based on quoted prices and other information for similar or identical instruments.

Our Level 3 investment consists of asset-backed commercial paper notes backed by a pool of mortgage-backed securities. The fair value of this Level 3 investment was based on the calculation of an overall weighted-average valuation, using the prices of the underlying individual securities. Individual securities in the pool were valued based on market observed prices, where available. If market prices were not available, prices of similar securities backed by similar assets were used.

**Changes in Level 3 Instrument**

The following is a summary of the changes in our Level 3 instrument measured on a recurring basis for the three months ended March 31, 2014 and March 31, 2013:

|                                     | <b>Three Months Ended<br/>March 31,<br/>2014          2013<br/>(Unaudited)<br/>(In thousands)</b> |          |
|-------------------------------------|---|----------|
| Balance at beginning of period      | \$ 5,557  | \$ 6,343 |
| Total realized and unrealized gains | 1,248   | 210      |
| Sales/ principal repayments         | (6,805)   | (396)    |
| Balance at end of period            | \$  | \$ 6,157 |

**Unrealized Gains and Losses on Investments**

Our net unrealized gain on investments was \$0.2 million at March 31, 2014. During the year ended December 31, 2013, we recognized other than temporary impairment of \$1.6 million on the asset-backed securities and collateralized mortgage obligations. Our net unrealized gain on investments was \$0.2 million as of December 31, 2013. The amount of investments in an unrealized loss position for less than twelve months was not significant for either of the periods presented.

**Other Financial Instruments**

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 condensed 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 is classified as Level 2 within the fair value hierarchy and is valued using a market approach based on quoted prices for similar instruments traded in active markets. Where quoted prices are not available, the income approach is 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.

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*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.

The estimated fair values of certain of our financial instruments are as follows:

|                                      | March 31, 2014  |              | December 31, 2013 |             |
|--------------------------------------|-----------------|--------------|-------------------|-------------|
|                                      | Carrying Amount | Fair Value   | Carrying Amount   | Fair Value  |
|                                      | (Unaudited)     |              |                   |             |
|                                      | (In thousands)  |              |                   |             |
| <b>Balance Sheet Instruments</b>     |                 |              |                   |             |
| Cash and cash equivalents            | \$ 268,130      | \$ 268,130   | \$ 118,702        | \$ 118,702  |
| Restricted cash and cash equivalents | \$ 43,286       | \$ 43,286    | \$ 23,652         | \$ 23,652   |
| Investments                          | \$ 5,437        | \$ 5,437     | \$ 13,511         | \$ 13,511   |
| Debt                                 | \$ (308,178)    | \$ (309,430) | \$ (88,562)       | \$ (90,005) |
| Forward contracts                    | \$ (14,995)     | \$ (14,995)  | \$ (28,767)       | \$ (28,767) |

**NOTE 7 STOCK-BASED COMPENSATION**

Equity instruments are measured at fair value on the grant date. Stock-based compensation expense is generally recognized on a straight-line basis over the requisite service periods of the awards. Compensation expense is based on awards we expect to ultimately vest. Therefore, we have reduced compensation expense for estimated forfeitures based on our historical forfeiture rates. Our estimate of forfeitures is determined at the grant date and is revised if our actual forfeiture rate is materially different from our estimate.

We use a Black-Scholes model to determine the fair value of certain share-based awards, such as stock options. Additionally, we use a Monte Carlo model to determine the fair value of certain share-based awards that contain market and performance-based conditions. The use of these models requires highly subjective assumptions, such as assumptions about the expected life of the award, vesting probability, expected dividend yield and the volatility of our stock price.

Total stock-based compensation expense, net recognized for the three months ended March 31, 2014 and March 31, 2013 is as follows:

|                        | Three Months Ended |          |
|------------------------|--------------------|----------|
|                        | 2014               | 2013     |
|                        | (Unaudited)        |          |
|                        | (In thousands)     |          |
| Stock Options          | \$ 680             | \$ 1,030 |
| Restricted Stock Units | 3,379              | 1,737    |
| Performance Shares     | 328                | 1,156    |

|       |          |          |
|-------|----------|----------|
| Total | \$ 4,387 | \$ 3,923 |
|-------|----------|----------|

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

|  | <b>Three Months Ended<br/>March 31,</b>                       |             |
|--|---|-------------|
|  | <b>2014</b>   | <b>2013</b> |
|  | <b>(Unaudited)</b>  |             |
|  | <b>(In thousands, except share and<br/>per share amounts)</b> |             |
| Income from operations less noncontrolling interests   | \$ (49,953)   | \$ 20,553   |
| Net income attributable to McDermott International, Inc.   | \$ (49,953)   | \$ 20,553   |
| Weighted average common shares (basic)   | 236,961,158   | 235,941,185 |
| Effect of dilutive securities:   |   |             |
| Stock options, restricted stock and restricted stock units <sup>(1)</sup>  |   | 3,258,696   |
| Adjusted weighted average common shares and assumed exercises of stock options and vesting of stock awards (diluted) | 236,961,158   | 239,199,881 |
| <b>Basic earnings per share:</b>   |   |             |
| Income (loss) from operations less noncontrolling interests  | (0.21)  | 0.09        |
| Net income (loss) attributable to McDermott International, Inc.  | (0.21)  | 0.09        |
| <b>Diluted earnings per share:</b>   |   |             |
| Income (loss) from operations less noncontrolling interests  | (0.21)  | 0.09        |
| Net income (loss) attributable to McDermott International, Inc.  | (0.21)  | 0.09        |

(1) Approximately 3.0 million and 2.9 million shares underlying outstanding stock-based awards were excluded from the computation of diluted earnings per share because they were antidilutive for the three months ended March 31, 2014 and 2013, respectively.

**NOTE 9 SEGMENT REPORTING**

In March 2014, we changed our organizational structure to orient around our offshore and subsea business activities through four primary geographic regions. The four geographic regions, which we consider to be our operating segments, consist of Asia Pacific, Americas, Middle East, and North Sea and Africa. The Caspian is no longer considered an operating segment and will continue to be aggregated in the Middle East reporting segment. The North Sea and Africa operating segment is also aggregated into the Middle East reporting segment due to the proximity of regions and similarities in the nature of services provided, economic characteristics and oversight responsibilities. Accordingly, we continue to report financial results under reporting segments consisting of Asia Pacific, Americas and the Middle East. 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.



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Reporting segments are measured based on operating income, which is defined as revenues reduced by total costs and expenses and equity in income (loss) of unconsolidated affiliates. Summarized financial information is shown in the following tables:

|  | <b>Three Months Ended<br/>March 31,</b> |                   |
|--|---|-------------------|
|  | <b>2014</b>                             | <b>2013</b>       |
|  | <b>(Unaudited)</b>                      |                   |
|  | <b>(In thousands)</b>                   |                   |
| <b>Revenues<sup>(1)</sup>:</b>             |   |                   |
| Asia Pacific                               | \$ 161,825                              | \$ 326,062        |
| Americas                                   | 181,625                                 | 148,184           |
| Middle East                                | 260,361                                 | 333,242           |
| <b>Total revenues</b>                      | <b>\$ 603,811</b>                       | <b>\$ 807,488</b> |
| <b>Operating income:</b>                   |   |                   |
| Asia Pacific                               | \$ 2,091                                | \$ 87,952         |
| Americas                                   | (31,811)                                | (16,410)          |
| Middle East                                | (9,428)                                 | (18,509)          |
| Corporate                                  | (2,494)                                 |                   |
| <b>Total operating income</b>              | <b>\$ (41,642)</b>                      | <b>\$ 53,033</b>  |
| <b>Capital expenditures<sup>(2)</sup>:</b> |   |                   |
| Asia Pacific                               | \$ 4,068                                | \$ 3,755          |
| Americas                                   | 7,405                                   | 22,010            |
| Middle East                                | 22,579                                  | 10,552            |
| Corporate and other                        | 3,841                                   | 1,332             |
| <b>Total capital expenditures</b>          | <b>\$ 37,893</b>                        | <b>\$ 37,649</b>  |
| <b>Depreciation and amortization:</b>      |   |                   |
| Asia Pacific                               | \$ 5,032                                | \$ 5,030          |
| Americas                                   | 8,297                                   | 6,805             |
| Middle East                                | 9,575                                   | 6,510             |
| Corporate and Other                        | 1,698                                   | 1,877             |
| <b>Total depreciation and amortization</b> | <b>\$ 24,602</b>                        | <b>\$ 20,222</b>  |
| <b>Drydock amortization:</b>               |   |                   |
| Asia Pacific                               | \$ 1,955                                | \$ 2,961          |
| Americas                                   | 4,562                                   | 1,908             |
| Middle East                                | 429                                     | 681               |
| <b>Total drydock amortization</b>          | <b>\$ 6,946</b>                         | <b>\$ 5,550</b>   |

- (1) Intersegment transactions included in revenues were not significant for either of the periods presented.
- (2) Total capital expenditures presents expenditures for which cash payments were made during the period. Capital expenditures for the three months ended March 31, 2014 include \$8.3 million of cash payments for accrued capital expenditures outstanding as of December 31, 2013. Capital expenditures for the three months ended March 31, 2013 exclude approximately \$34.0 million in accrued liabilities related to capital expenditures.

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|                        | March 31,<br>2014 | December 31,<br>2013 |
|------------------------|-------------------|----------------------|
|                        | (Unaudited)       |                      |
|                        | (In thousands)    |                      |
| <b>Segment assets:</b> |                   |                      |
| Asia Pacific           | \$ 740,507        | \$ 1,030,823         |
| Americas               | 795,598           | 522,713              |
| Middle East            | 1,148,041         | 1,129,529            |
| Corporate and other    | 339,783           | 124,306              |
| <br>Total assets       | <br>\$ 3,023,929  | <br>\$ 2,807,371     |

**NOTE 10 COMMITMENTS AND CONTINGENCIES*****Investigations and Litigation***

On or about August 23, 2004, a declaratory judgment action entitled *Certain Underwriters at Lloyd's London, et al. v. J. Ray McDermott, Inc. et al.*, was filed by certain underwriters at Lloyd's, London and Threadneedle Insurance Company Limited (the London Insurers), in the 23rd Judicial District Court, Assumption Parish, Louisiana, against MII, J. Ray McDermott, Inc. (JRMI) and two insurer defendants, Travelers and INA, seeking a declaration that the London Insurers have no obligation to indemnify MII and JRMI for certain bodily injury claims, including claims for asbestos and welding rod fume personal injury which have been filed by claimants in various state courts.

Additionally, Travelers filed a cross-claim requesting a declaration of non-coverage in approximately 20 underlying matters. This proceeding was stayed by the Court on January 3, 2005. We do not believe an adverse judgment or material losses in this matter are probable, and, accordingly, we have not accrued any amounts relating to this contingency. Although there is a possibility of an adverse judgment, the amount or potential range of loss is not estimable at this time. The insurer-plaintiffs in this matter commenced this proceeding in a purported attempt to obtain a determination of insurance coverage obligations for occupational exposure and/or environmental matters for which we have given notice that we could potentially seek coverage. Because estimating losses would require, for every matter, known and unknown, on a case by case basis, anticipating what impact on coverage a judgment would have and a determination of an otherwise expected insured value, damages cannot be reasonably estimated.

On December 16, 2005, a proceeding entitled *Antoine, et al. vs. J. Ray McDermott, Inc., et al.* (Antoine Suit), was filed in the 24th Judicial District Court, Jefferson Parish, Louisiana, by approximately 88 plaintiffs against approximately 215 defendants, including our subsidiaries formerly known as JRMI and Delta Hudson Engineering Corporation (DHEC), generally alleging injuries for exposure to asbestos, and unspecified chemicals, metals and noise while the plaintiffs were allegedly employed as Jones Act seamen. This case was dismissed by the Court on January 10, 2007, without prejudice to plaintiffs' rights to refile their claims. On January 29, 2007, 21 plaintiffs from the dismissed Antoine Suit filed a matter entitled *Boudreaux, et al. v. McDermott, Inc., et al.* (the Boudreaux Suit), in the United States District Court for the Southern District of Texas, against JRMI and our subsidiary formerly known as McDermott Incorporated, and approximately 30 other employer defendants, alleging Jones Act seaman status and generally alleging exposure to welding fumes, solvents, dyes, industrial paints and noise. The Boudreaux Suit was transferred to the United States District Court for the Eastern District of Louisiana on May 2, 2007, which entered an order in September 2007 staying the matter until further order of the Court due to the bankruptcy filing of one of the co-defendants. Additionally, on January 29, 2007, another 43 plaintiffs from the dismissed Antoine Suit filed a matter entitled *Antoine, et al. v. McDermott, Inc., et al.* (the New Antoine Suit), in the 164th Judicial District Court for Harris County, Texas, against JRMI, our subsidiary formerly known as McDermott Incorporated and approximately 65 other employer defendants and 42 maritime products defendants, alleging Jones Act seaman status and generally alleging



personal injuries for exposure to asbestos and noise. On April 27, 2007, the District Court entered an order staying all activity and deadlines in the New Antoine Suit, other than service of process and answer/appearance dates, until further order of the Court. The New Antoine Suit plaintiffs filed a motion to lift the stay on February 20, 2009, which is pending before the Texas District Court. On April 4, 2014, 20 of the plaintiffs in the

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New Antoine Suit voluntarily dismissed their claims against McDermott without prejudice to re-filing. The remaining plaintiffs seek monetary damages in an unspecified amount in both the Boudreaux Suit and New Antoine Suit cases and attorneys' fees in the New Antoine Suit. We cannot reasonably estimate the extent of a potential judgment against us, if any, and we intend to vigorously defend these suits.

On August 15, 2013 and August 20, 2013, two separate alleged purchasers of our common stock filed purported class action complaints against us, Stephen M. Johnson and Perry L. Elders in the United States District Court for the Southern District of Texas. Both of the complaints sought to represent a class of purchasers of our stock between November 6, 2012 and August 5, 2013, and alleged, among other things, that the defendants violated federal securities laws by disseminating materially false and misleading information and failing to disclose material information relating to weaknesses in project bidding and execution, poor risk evaluation, poor project management and losses in each of our reporting segments. Each complaint sought relief, including unspecified compensatory damages and an award for attorneys' fees and other costs. By order dated December 5, 2013, the District Court consolidated the two cases and appointed a lead plaintiff and lead plaintiff's counsel. The lead plaintiff filed a consolidated amended complaint on February 6, 2014. The consolidated amended complaint asserts substantially the same claims as were made in the two original complaints, with some additional factual allegations, and purports to extend the class period to August 6, 2013. It also seeks relief, including unspecified compensatory damages and an award for attorneys' fees and other costs. On April 7, 2014, MII and the other defendants filed a motion to dismiss the case, which motion is still pending before the court. We believe the substantive allegations contained in the complaints on file are without merit, and we intend to defend against these claims vigorously.

Additionally, 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, 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 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.

At March 31, 2014, we had total environmental reserves of \$6.3 million, all of which was included in noncurrent liabilities. We established an environmental reserve of \$5.9 million in connection with our plan to

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discontinue the utilization of our Morgan City fabrication facility. Inherent in the estimates of those reserves and recoveries are our expectations regarding the levels of contamination, remediation costs and recoverability from other parties, which may vary significantly as remediation activities progress. Accordingly, changes in estimates could result in material adjustments to our operating results, and the ultimate loss may differ materially from the amounts we have provided for in our consolidated financial statements.

***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 these provisions. These 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 March 31, 2014, it is possible that we may incur liabilities for liquidated damages aggregating approximately \$56.9 million, of which approximately \$37.9 million has been recorded in our financial statements, based on our actual or projected failure to meet certain specified contractual milestone dates. The dates for which these potential liquidated damages could arise extend to June 2015. We believe we will be successful in obtaining schedule extensions or other customer-agreed changes that should resolve the potential for additional liquidated damages. Accordingly, we believe that no amounts for these potential liquidated damages in excess of the amounts currently reflected in our financial statements 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.

***Contractual Obligations***

At March 31, 2014, we had outstanding obligations related to our new vessel construction contracts on the *LV 108* and *DLV 2000* of \$325.6 million in the aggregate, with \$132.4 million and \$193.2 million due in the years ending December 31, 2014 and 2015, respectively.

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

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

**CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS**

We are including the following discussion to inform our existing and potential security holders generally of some of the risks and uncertainties that can affect our company and to take advantage of the safe harbor protection for forward-looking statements that applicable federal securities law affords. This information should be read in conjunction with the unaudited condensed consolidated financial statements and the notes thereto included under Item 1 and the audited consolidated financial statements and the related notes and Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K for the year ended December 31, 2013.

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

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

future levels of revenues, operating margins, income from operations, net income or earnings per share;

outcome of project awards and scope, execution and timing of specific projects, including timing to complete and cost to complete these projects;

future project activities, including the commencement and subsequent timing of marine or installation campaigns on specific projects;

estimates of percentage of completion and contract profits or losses;

anticipated levels of demand for our products and services;

global demand for oil and gas and fundamentals of the oil and gas industry;

expectations regarding the trend towards offshore development of oil and gas;

market outlook for the EPCI market, including subsea;

expectations regarding backlog;

future levels of capital, environmental or maintenance expenditures;

the success or timing of completion of ongoing or anticipated capital or maintenance projects;

the adequacy of our sources of liquidity and capital resources;

interest expense;

the effectiveness of our derivative contracts in mitigating foreign currency risk;

results of our capital investment program;

expectations regarding the acquisition or divestiture of assets;

the ability to dispose of assets held for sale in a timely manner or for a price at or above net realizable value;

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the restructuring of our Americas operations, including the expected costs and timing of cost recognition;

the potential effects of judicial or other proceedings on our business, financial condition, results of operations and cash flows; and

the anticipated effects of actions of third parties such as competitors, or federal, foreign, state or local regulatory authorities, or plaintiffs in litigation.

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

general economic and business conditions and industry trends;

general developments in the industries in which we are involved;

decisions about offshore developments to be made by oil and gas companies;

the highly competitive nature of our industry;

our ability to appropriately bid, estimate and effectively perform projects on time, in accordance with the schedules established by the applicable contracts with customers;

changes in project design or schedule;

changes in scope or timing of work to be completed under contracts;

cancellations of contracts, change orders and other modifications and related adjustments to backlog and the resulting impact from using backlog as an indicator of future revenues or earnings;

the collectability of amounts reflected in change orders and claims relating to work previously performed on contracts;

the capital investment required to maintain and/or upgrade our fleet of vessels;

the ability of our suppliers and subcontractors to deliver raw materials in sufficient quantities and/or perform in a timely manner;

volatility and uncertainty of the credit markets;

our ability to comply with covenants in our credit agreements and other debt instruments and availability, terms and deployment of capital;

the unfunded liabilities of our pension plans may negatively impact our liquidity and, depending upon future operations, may impact our ability to fund our pension obligations;

the continued availability of qualified personnel;

the operating risks normally incident to our lines of business, including the potential impact of liquidated damages;

natural or man-caused disruptive events that could damage our facilities, equipment or our work-in-progress and cause us to incur losses and/or liabilities;

equipment failure;

changes in, or our failure or inability to comply with, government regulations;



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adverse outcomes from legal and regulatory proceedings;

impact of potential regional, national and/or global requirements to significantly limit or reduce greenhouse gas and other emissions in the future;

changes in, and liabilities relating to, existing or future environmental regulatory matters;

changes in tax laws;

rapid technological changes;

the consequences of significant changes in interest rates and currency exchange rates;

difficulties we may encounter in obtaining regulatory or other necessary approvals of any strategic transactions;

the risks associated with integrating acquired businesses;

the risk we may not be successful in updating and replacing current information technology;

social, political and economic situations in countries where we do business;

the risks associated with our international operations, including local content requirements;

interference from adverse weather or sea conditions;

the possibilities of war, other armed conflicts or terrorist attacks;

the effects of asserted and unasserted claims and the extent of available insurance coverages;

our ability to obtain surety bonds, letters of credit and financing;

our ability to maintain builder's risk, liability, property and other insurance in amounts and on terms we consider adequate and at rates that we consider economical;

the aggregated risks retained in our captive insurance subsidiary; and

the impact of the loss of insurance rights as part of the Chapter 11 Bankruptcy settlement concluded in 2006 involving several of our former subsidiaries.

We believe the items we have outlined above are important factors that could cause estimates in our financial statements to differ materially from actual results and those expressed in a forward-looking statement made in this quarterly report or elsewhere by us or on our behalf. We have discussed many of these factors in more detail elsewhere in this report and in our annual report on Form 10-K for the year ended December 31, 2013. These factors are not necessarily all the factors that could affect us. Unpredictable or unanticipated factors we have not discussed in this report could also have material adverse effects on actual results of matters that are the subject of our forward-looking statements. We do not intend to update our description of important factors each time a potential important factor arises, except as required by applicable securities laws and regulations. We advise our security holders that they should (1) be aware that factors not referred to above could affect the accuracy of our forward-looking statements and (2) use caution and common sense when considering our forward-looking statements.

## **Recent Developments**

### ***Refinancing Transactions***

During April 2014, we refinanced our existing obligations, and replaced in its entirety, our then existing \$950.0 million credit agreement (the Former Credit Agreement) with a new credit agreement (the New Credit Agreement), which provides for:

a \$400.0 million first-lien, first-out three-year letter of credit facility (the LC Facility); and

a \$300.0 million first-lien, second-out five-year term loan (the Term Loan).

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As of March 31, 2014 we had \$250.0 million of revolving credit borrowings outstanding and approximately \$376.0 million of letters of credit outstanding under the Former Credit Facility.

Additionally, during April 2014, we completed the following new financing transactions:

the issuance of \$500.0 million of second-lien seven-year senior secured notes (the Notes ).

the issuance of \$287.5 million of tangible equity units ( Units ) composed of (1) three-year amortizing, senior unsecured notes, in an aggregate principal amount of \$47.5 million, and (2) prepaid common stock purchase contracts.

With the completion of these financing transactions in April 2014, we terminated the bridge loan commitment we had obtained from an affiliate of Goldman, Sachs, & Co. ( Goldman Sachs ). As a result of the termination of the bridge loan commitment, the fee we previously paid to Goldman Sachs to obtain the bridge loan commitment will be recognized as interest expense in the second quarter of 2014. Due to the replacement of the Former Credit Agreement, the unamortized issuance fees related to the Former Credit Agreement will also be recognized as interest expense in the second quarter of 2014. The total additional interest expense related to these items is expected to be approximately \$28.0 million in the quarter ending June 30, 2014.

### ***Non-Core Asset Sales***

During the quarter ended March 31, 2014, we completed the sale of the *DLB KPI* for aggregate cash proceeds of approximately \$8.4 million, resulting in a gain of approximately \$6.4 million recognized in our Middle East segment. In April 2014, we completed the sale of our Harbor Island facility near Corpus Christi, Texas for proceeds of approximately \$31.7 million and a gain of approximately \$25.0 million, which will be recognized in our Americas segment.

### ***Americas and Corporate Restructuring***

We commenced a restructuring of our Americas operations during the quarter ended June 30, 2013, which involves our Morgan City, Louisiana, Houston, Texas, New Orleans, Louisiana and Brazil locations. The restructuring involves, among other things, reductions of management, administrative, fabrication and engineering personnel, and a plan to discontinue utilization of the Morgan City facility (after the completion of existing backlog projects, which are currently forecasted to be completed in the third quarter of 2014). Future fabrication operations in the Americas segment are expected to be executed using the Altamira, Mexico facility. In addition, we have reached an agreement to exit our joint venture operation in Brazil. Costs associated with our Americas restructuring activities primarily include severance and other personnel-related costs, costs associated with exiting the joint venture in Brazil, asset impairment and relocation costs, environmental reserves and future unutilized lease costs. The total costs are expected to range between \$55 million to \$60 million in the aggregate. Of the total anticipated costs, we incurred approximately \$3.6 million during the quarter ended March 31, 2014 and had incurred an aggregate of \$37.7 million as of March 31, 2014.

In October 2013, we announced certain executive management changes that became effective during the fourth quarter of 2013. In March 2014, we changed our organizational structure to orient around offshore and subsea business activities through four primary geographic regions. The four geographic regions consist of Asia Pacific, Americas (previously Atlantic), Middle East and North Sea and Africa. Costs associated with our corporate

reorganization activities will primarily include severance, relocation and other personnel-related costs and costs for advisors. The total of these costs is expected to range between \$20 million to \$25 million and to be incurred by the end of 2014. Of the total anticipated costs, we incurred approximately \$2.5 million during the quarter ended March 31, 2014 and had incurred an aggregate of \$4.2 million as of March 31, 2014.

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### **Accounting for Contracts**

We execute our contracts through a variety of methods, including fixed-price, cost reimbursable, cost-plus, day-rate and unit-rate basis or some combination of those methods, with fixed-price being the most prevalent. Contracts are usually awarded through a competitive bid process. Factors that customers may consider include price, facility or equipment availability, technical capabilities of equipment and personnel, efficiency, safety record and reputation.

Fixed-price contracts are for a fixed amount to cover costs and any profit element for a defined scope of work. Fixed-price contracts entail more risk to us because they require us to predetermine both the quantities of work to be performed and the costs associated with executing the work.

We have contracts that extend beyond one year. Most of our long-term contracts have provisions for progress payments. We attempt to cover anticipated increases in labor, material and service costs of our long-term contracts either through an estimate of such charges, which is reflected in the original price, or through risk-sharing mechanisms, such as escalation or price adjustments for items such as labor and commodity prices.

We generally recognize our contract revenues and related costs on a percentage-of-completion basis. Accordingly, for each contract, we regularly review contract price and cost estimates as the work progresses and reflect adjustments in profit proportionate to the percentage of completion of the related project in the period when we revise those estimates. To the extent that these adjustments result in a reduction or elimination of previously reported profits with respect to a project, we would recognize a charge against current earnings, which could be material.

Our arrangements with customers frequently require us to provide letters of credit, bid and performance bonds or guarantees to secure bids or performance under contracts. While these letters of credit, bonds and guarantees may involve significant dollar amounts, historically, there have been no material payments to our customers under these arrangements.

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 March 31, 2014, it is possible that we may incur liabilities for liquidated damages aggregating to approximately \$56.9 million, of which approximately \$37.9 million has been recorded in our financial statements, based on our actual or projected failure to meet certain specified contractual milestone dates. The dates for which these potential liquidated damages could arise extend to June 2015. We believe we will be successful in obtaining schedule extensions or other customer-agreed changes that should resolve the potential for additional liquidated damages. Accordingly, we believe that no amounts for these potential liquidated damages in excess of the amounts currently reflected in our financial statements 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.

Change orders, which are a normal and recurring part of our business, can increase (sometimes substantially) the future scope and cost of a job. Therefore, change order awards (although frequently beneficial in the long term) can have the short-term effect of reducing the job percentage of completion and thus the revenues and profits recognized to date. We regularly review contract price and cost estimates as the work progresses and reflect adjustments in profit, proportionate to the job percentage of completion in the period when those estimates are revised. Revenue from unapproved change orders is recognized to the extent of amounts management expects to recover or costs incurred. Unapproved change orders that are disputed by the customer are treated as claims.

In the event of a contract deferral or cancellation, we generally would be entitled to recover costs incurred, settlement expenses and profit on work completed prior to deferral or termination. Significant or numerous cancellations could adversely affect our business, financial condition, results of operations and cash flows.

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### **Critical Accounting Policies and Estimates**

For a discussion of critical accounting policies and estimates we use in the preparation of our consolidated financial statements, refer to Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K for the year ended December 31, 2013. See Note 1 to our unaudited condensed consolidated financial statements included in this report for information on recently adopted accounting standards.

### **Business Segments and Results of Operations**

#### ***Business Segments***

In March 2014, we changed our organizational structure to orient around our offshore and subsea business activities through four primary geographic regions. The four geographic regions, which we consider to be our operating segments, consist of Asia Pacific, Americas, Middle East, and North Sea and Africa. The Caspian is no longer considered an operating segment and will continue aggregated in the Middle East reporting segment. The North Sea and Africa operating segment is also aggregated into the Middle East reporting segment due to the proximity of regions and similarities in the nature of services provided, economic characteristics and oversight responsibilities. Accordingly, we continue to report financial results under reporting segments consisting of Asia Pacific, Americas and the Middle East. 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 be allocated to our operating segments are the restructuring costs associated with our corporate reorganization. See Note 9 for summarized financial information on our segments.

#### ***Asia Pacific Segment***

Through our Asia Pacific segment, we serve the needs of customers primarily in Australia, Indonesia, Vietnam, Malaysia and Thailand. Project focus in this segment includes the fabrication and installation of fixed and floating structures and the installation of pipelines and subsea systems. The majority of our projects in this segment are performed on an engineering, procurement, construction and installation ( EPCI ) basis. Engineering and procurement services are provided by our Singapore office and are supported by additional resources located in Chennai, India. The primary fabrication facility for this segment is located on Batam Island, Indonesia. Additionally, through our equity ownership interest in two separate joint ventures, we have access to fabrication capacity in China and Malaysia.

#### ***Americas Segment***

Through our Americas segment, we serve the needs of customers primarily in the United States, Brazil, Mexico and Trinidad. Project focus in this segment includes the fabrication and installation of fixed and floating structures and the installation of pipelines and subsea systems. Engineering and procurement services are supported by engineering resources in Chennai, India, Dubai, U.A.E. and Houston. The primary fabrication facility for this segment is located in Altamira, Mexico. We are in the process of preparing for the discontinued utilization of the Morgan City fabrication facility, as further discussed below under the caption Americas and Corporate Restructuring.

#### ***Middle East Segment***

Through our Middle East segment, which includes the Caspian region, the North Sea and Africa, we serve the needs of customers in Saudi Arabia, Qatar, the United Arab Emirates (U.A.E.), Kuwait, India, Azerbaijan, Russia, the North

Sea, West Africa, and East Africa. Project focus in this segment relates primarily to the fabrication and offshore installation of fixed and floating structures and the installation of pipelines and subsea systems. The majority of our projects in this segment are performed on an EPCI basis. Engineering and procurement services are provided by our Dubai, U.A.E., Chennai, India, Al Khobar, Saudi Arabia and United Kingdom offices and are supported by additional resources from our Houston office. The primary fabrication facility for this segment is located in Dubai, U.A.E.



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

**Results of Operations***Selected Financial Data:*

|  | <b>Three Months Ended<br/>March 31,</b> |                   |
|--|---|-------------------|
|  | <b>2014</b>                             | <b>2013</b>       |
|  | <b>(In thousands)</b>                   |                   |
| <b>Revenues:</b>                             |   |                   |
| Asia Pacific                                 | \$ 161,825                              | \$ 326,062        |
| Americas                                     | 181,625                                 | 148,184           |
| Middle East                                  | 260,361                                 | 333,242           |
| <b>Total Revenues</b>                        | <b>\$ 603,811</b>                       | <b>\$ 807,488</b> |
| Cost of Operations                           | 591,493                                 | 712,814           |
| Selling, general and administrative expenses | 55,397                                  | 52,226            |
| Restructuring charges                        | 6,125                                   |                   |
| Gain on asset disposals                      | (6,439)                                 | (14,716)          |
| <b>Total costs and expenses</b>              | <b>646,576</b>                          | <b>750,324</b>    |
| Equity in Loss of Unconsolidated Affiliates  | 1,123                                   | (4,131)           |
| <b>Operating Income (Loss):</b>              |   |                   |
| Asia Pacific                                 | \$ 2,091                                | \$ 87,952         |
| Americas                                     | (31,811)                                | (16,410)          |
| Middle East                                  | (9,428)                                 | (18,509)          |
| Corporate                                    | (2,494)                                 |                   |
| <b>Total Operating Income</b>                | <b>\$ (41,642)</b>                      | <b>\$ 53,033</b>  |
| <b>Other Income (Expense):</b>               |   |                   |
| Interest income                              | 61                                      | 342               |
| Gain (loss) on foreign currency net          | (4,082)                                 | (2,526)           |
| Other income (expense) net                   | (265)                                   | 782               |
| <b>Total Other Income (Expense)</b>          | <b>(4,286)</b>                          | <b>(1,402)</b>    |

|   |                    |                  |
|---|--------------------|------------------|
| Income before provision for income taxes and noncontrolling interests | (45,928)           | 51,631           |
| Provision for Income Taxes  | 3,489              | 27,313           |
| Net Income Attributable to Noncontrolling Interests                   | 536                | 3,765            |
| <b>Net Income Attributable to McDermott International, Inc.</b>       | <b>\$ (49,953)</b> | <b>\$ 20,553</b> |

*Three months ended March 31, 2014 vs. three months ended March 31, 2013*

*Revenues*

Revenues declined approximately 25%, or \$203.7 million, to \$603.8 million in the three months ended March 31, 2014 compared to \$807.5 million for the corresponding prior-year period, primarily attributable to decreases in our Asia Pacific and Middle East segments.

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Revenues in our Asia Pacific segment declined approximately 50%, or \$164.3 million, to \$161.8 million in the three months ended March 31, 2014 from \$326.1 million in the corresponding prior-year period, largely due to the absence of marine activity on two of our EPCI projects in Australia that had significant marine activity during the three months ended March 31, 2013 and were completed during the year ended December 31, 2013.

Revenues in our Middle East segment declined approximately 22%, or \$72.8 million, to \$260.4 million in the three months ended March 31, 2014 from \$333.2 million in the corresponding prior-year period, largely due to the substantial completion of activities on multiple EPCI projects in Saudi Arabia and India and a pipelay project in the Caspian. These projects had significantly higher marine activity during the three months ended March 31, 2013 and were substantially completed during the year ended December 31, 2013. These decreases were partially offset by increased activity on an EPCI project in Saudi Arabia.

The revenue declines in our Asia Pacific and Middle East segments were partially offset by improvements in our Americas segment. In this segment revenues increased approximately 23%, or \$33.4 million, to \$181.6 million in the three months ended March 31, 2014 compared to \$148.2 million in the three months ended March 31, 2013, primarily due to increased marine activity in Brazil and the U.S. Gulf of Mexico during the three months ended March 31, 2014, partially offset by lower Morgan City fabrication activity on projects that were completed during the year ended December 31, 2013.

*Cost of Operations*

Cost of operations decreased approximately 17%, or \$121.3 million, primarily due to decreases in our Asia Pacific and Middle East segments. Cost of operations in our Asia Pacific segment decreased by \$89.8 million, driven primarily by the absence of marine activity on two of our EPCI projects in Australia that had significant marine activity during the three months ended March 31, 2013 and were completed during the year ended December 31, 2013. The decrease in our Middle East segment of \$79.9 million was primarily attributable to the substantial completion of activities on multiple EPCI projects in Saudi Arabia, India and a pipelay project in the Caspian. These projects had significant marine activity during the three months ended March 31, 2013 and were substantially completed during the year ended December 31, 2013. These decreases were partially offset by increased activity on an EPCI project in Saudi Arabia. Cost of operations in our Americas segment increased by \$48.4 million, primarily due to increased marine activity in Brazil and the U.S. Gulf of Mexico and increased fabrication activity at the Altamira fabrication facility during the three months ended March 31, 2014, partially offset by lower Morgan City fabrication activity on projects that were completed during the year ended December 31, 2013.

*Operating Income (Loss)*

Operating results decreased approximately \$94.6 million to an operating loss of \$41.6 million in the three months ended March 31, 2014 compared to operating income of \$53.0 million for the corresponding prior-year period, attributable to declines in the Asia Pacific and Americas segments.

Operating income in our Asia Pacific segment declined \$85.9 million to \$2.1 million in the three months ended March 31, 2014 compared to \$88.0 million for the corresponding prior-year period. The decrease was primarily due to an approximate \$91.2 million decline in operating income from two of our EPCI projects in Australia, which had significant marine activity in the three months ended March 31, 2013 and were completed during the year ended December 31, 2013. The decline in operating income was partly offset by an improvement of approximately \$27.8 million on a subsea project in Malaysia, primarily driven by changes to the estimated costs at completion due to favorable productivity on our marine vessels as well as offshore support activities and recognition of approved change orders.

Operating results at our Middle East segment improved by approximately \$9.1 million to an operating loss of \$9.4 million in the three months ended March 31, 2014 compared to an operating loss of \$18.5 million for the corresponding prior-year period. An improvement of \$12.3 million was driven primarily by recognition of

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approved change orders on a pipe lay project in the Caspian. Recognition of the gain on the sale of the *DLB KPI* resulted in an improvement of \$6.4 million during the three months ended March 31, 2014. The improvements were partially offset by declines in two EPCI projects in Saudi Arabia aggregating approximately \$12.9 million, primarily attributable to an increase in estimated costs to complete as a result of vessel downtime due to weather and standby delays and adverse productivity on fabrication and engineering activities. Both projects remained in a profitable position at March 31, 2014.

The Americas segment recognized an operating loss of \$31.8 million in the three months ended March 31, 2014 compared to an operating loss of \$16.4 million in the three months ended March 31, 2013. On an EPCI project in Altamira, we increased our estimated cost at completion by approximately \$36.8 million, primarily due to expected delays in final project delivery, resulting in a revised execution plan, increased fabrication labor costs and recognition of liquidated damages. The decline was partially offset by an improvement of approximately \$17.2 million related to increased marine activity in the U.S. Gulf of Mexico and increased utilization of the Altamira fabrication facility.

*Operating Margins*

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

*Other Items in Operating Income*

Selling, general and administrative expenses increased \$3.2 million to \$55.4 million in the three months ended March 31, 2014 as compared to \$52.2 million in the three months ended March 31, 2013, primarily as a result of increased amortization of deferred non-cash benefit plan losses.

Equity in earnings of unconsolidated affiliates improved approximately \$5.2 million, primarily due to profit recognized from our FloaTEC joint venture.

Operating loss was further impacted by restructuring expense of approximately \$6.1 million incurred in the three months ended March 31, 2014 as discussed above under Recent Developments-Americas and Corporate Restructuring.

*Other Items*

Results for the quarters ended March 31, 2014 and 2013 were not significantly impacted by interest income, expense or other expense, due primarily to lower cash and cash equivalents balances, the continuation of low interest rates in general and the capitalization of interest expense on capital projects.

Loss on foreign currency net increased by \$1.6 million to a loss of \$4.1 million in the three months ended March 31, 2014 from a loss of \$2.5 million in the three months ended March 31, 2013, primarily due to foreign currency losses of \$3.2 million and losses related to derivative instruments and hedging activities of \$0.9 million recognized during the three months ended March 31, 2014, as compared to foreign currency gains of \$0.3 million and losses related to

derivative instruments and hedging activities of \$2.8 million recognized during the three months ended March 31, 2013.

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During the quarter ended March 31, 2012, we entered into derivative contracts to mitigate currency exchange movements associated with various foreign currency expenditures we expect to incur on one of our Asia Pacific segment EPCI projects, through 2017. While we currently believe that these contracts will be effective in mitigating the associated currency exchange risks, it is possible that changes in the EPCI project may cause reduced effectiveness of these derivative contracts. Therefore, we may experience larger gains or losses on foreign currency movements due to the ineffective portion or the portion excluded from the assessment of effectiveness of these and other derivative contracts.

At March 31, 2014, our derivative financial instruments consisted primarily of foreign currency forward contracts. The notional value of our outstanding derivative contracts totaled approximately \$1.0 billion at March 31, 2014, with maturities extending through 2017. Of this amount, approximately \$635.3 million is associated with various foreign currency expenditures we expect to incur on the Asia Pacific segment EPCI project.

### *Provision for Income Taxes*

For the three months ended March 31, 2014, we recognized a loss before provision for income taxes of \$45.9 million, compared to income of \$51.6 million in the three months ended March 31, 2013. In the aggregate, the provision for income taxes was \$3.5 million and \$27.3 million for the three months ended March 31, 2014 and 2013, respectively.

The decline in the provision for income taxes was principally driven by lower taxable income, which was partially offset by losses in certain tax jurisdictions where we did not recognize a tax benefit.

### *Noncontrolling Interests*

Net income attributable to noncontrolling interests decreased by \$3.3 million to \$0.5 million in the three months ended March 31, 2014 compared to \$3.8 million for the three months ended March 31, 2013, primarily due to decreased activity and lower net income at our joint ventures.

## **Backlog**

Backlog represents the dollar amount of revenues we expect to recognize in the future from contracts awarded and in progress. Backlog is not a measure defined by generally accepted accounting principles and is not a measure of contract profitability. Our methodology for determining backlog may not be comparable to methodologies used by other companies in determining their backlog amounts. We generally include expected revenues of contracts in our backlog when we enter into a written confirmation with our customers. We do not include expected revenues of contracts related to unconsolidated joint ventures in our backlog. Backlog may not be indicative of future operating results, and projects in our backlog may be cancelled, modified or otherwise altered by customers. We can provide no assurance as to the profitability of our contracts reflected in backlog.

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Of the March 31, 2014 backlog amount of \$4.4 billion, approximately \$550.7 million relates to nine active projects that are in loss positions, whereby future revenues are expected to equal costs when recognized. Included in this amount is \$191.6 million of backlog associated with an EPCI project in Altamira, which is expected to be completed in the third quarter of 2015, \$144.6 million pertaining to a five-year charter of the *Agile* in Brazil, which began in early 2012, and \$65.9 million relating to a subsea project in the U.S. Gulf of Mexico scheduled for completion during 2014, all of which are being conducted by our Americas segment. The amount also includes \$91.5 million of backlog relating to an EPCI project in Saudi Arabia, in our Middle East segment, which is expected to be completed by the end of 2015. These four projects represent approximately 90% of the backlog amount in a loss position. 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.

|               | <b>March 31,<br/>2014</b>    |      | <b>December 31,<br/>2013</b> |      |
|---------------|------------------------------|------|------------------------------|------|
|               | <b>(Dollars in millions)</b> |      |                              |      |
| Asia Pacific  | \$ 2,232                     | 51%  | \$ 2,365                     | 49%  |
| Middle East   | 1,437                        | 33%  | 1,653                        | 35%  |
| Americas      | 695                          | 16%  | 784                          | 16%  |
| Total Backlog | \$ 4,364                     | 100% | \$ 4,802                     | 100% |

Of the March 31, 2014 backlog, we expect to recognize revenues as follows:

|               | <b>2014</b>          | <b>2015</b> | <b>Thereafter</b> |
|---------------|----------------------|-------------|-------------------|
|               | <b>(In millions)</b> |             |                   |
| Total Backlog | \$ 2,040             | \$ 2,095    | \$ 229            |

**Liquidity and Capital Resources**

Our primary sources of liquidity are cash flows generated from operations and cash from the refinancing transactions we completed during April 2014. Management believes that our cash flows from operations and the sources of liquidity and capital resources described below will be sufficient to fund our liquidity requirements for at least the next twelve months.

Due to our recent refinancing transactions, we estimate that the average interest rate on our borrowings increased from 2.76% as at March 31, 2014 to 7.2% as at April 30, 2014.

**Former Credit Agreement**

The Former Credit Agreement provided for revolving credit borrowings and issuances of letters of credit in an aggregate outstanding amount of up to \$950.0 million. Proceeds from borrowings under the Former Credit Agreement were available for working capital needs and other general corporate purposes.

At March 31, 2014, there was \$250.0 million of revolving credit borrowings outstanding, and letters of credit issued under the Former Credit Agreement totaled approximately \$376.0 million, including letters of credit in the aggregate



amount of \$109.0 million issued in February 2014 to replace the letters of credit issued by Australia and New Zealand Banking Group Limited discussed below. During the quarter ended March 31, 2014, our outstanding borrowings under the Former Credit Agreement did not exceed \$250.0 million, and we had average outstanding borrowings under the Former Credit Agreement of approximately \$165.0 million, with an average interest rate of 3.45%. At December 31, 2013, there were no borrowings outstanding, and letters of credit issued under the Former Credit Agreement totaled approximately \$214.3 million.

At March 31, 2014, the applicable margin for Eurodollar-rate loans was 2.00%, the applicable margin for base-rate loans was 1.00%, the letter of credit fee for financial letters of credit was 2.00%, the letter of credit fee

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for performance letters of credit was 1.00%, and the commitment fee for unused portions of the Former Credit Agreement was 0.3%. The Former Credit Agreement did not have a floor for the base rate or the Eurodollar rate.

Obligations under the Former Credit Agreement were secured on a first-lien basis by pledges of capital stock of certain of our subsidiaries and mortgages and other security interests covering (1) all of our personal property and substantially all of the personal property of our wholly owned subsidiaries, subject to exceptions for bank accounts, equipment and certain other assets, and (2) certain of our marine vessels.

### ***New Credit Facilities***

During April 2014 we entered into the New Credit Agreement, which provides for the LC Facility and the Term Loan.

The New Credit Agreement includes the \$400.0 million first-lien, first-out LC Facility, which is scheduled to mature on April 16, 2017, and the \$300.0 million first-lien, second-out Term Loan, which is scheduled to mature April 16, 2019. The indebtedness and other obligations under the New Credit Agreement are guaranteed by substantially all of our material, wholly owned subsidiaries, other than our captive insurance subsidiary (collectively, the Guarantors).

In connection with the New Credit Agreement, we paid certain fees to the lenders thereunder, as well as certain arrangement fees to the arrangers and agents for the New Credit Facilities, which we intend to amortize to interest expense over the respective terms of the LC Facility and the Term Loan.

### ***LC Facility***

The LC Facility provides for an initial letter of credit capacity of \$400.0 million and allows for uncommitted increases in capacity of \$100.0 million through December 31, 2014 and an additional \$100.0 million thereafter, potentially increasing the total capacity to \$600.0 million through the term of the LC Facility. Letters of credit issuable under the LC Facility support the obligations of McDermott and its affiliates and joint ventures. The aggregate amount of the LC Facility available for financial letters of credit is capped at 25% of the total LC Facility.

The LC Facility is secured on a first-lien, first-out basis (with relative priority over the Term Loan) by pledges of the capital stock of all the Guarantors and mortgages on, or other security interests in, substantially all the tangible and intangible assets of our company and the Guarantors, subject to specific exceptions.

The LC Facility contains various customary affirmative covenants, as well as specific affirmative covenants, including specific reporting requirements and a requirement for ongoing periodic financial reviews by a financial advisor. The LC Facility also requires compliance with various negative covenants, including limitations with respect to the incurrence of other indebtedness and liens, restrictions on acquisitions, capital expenditures and other investments, restrictions on sale/leaseback transactions and restrictions on prepayments of other indebtedness.

The LC Facility requires us to meet a minimum EBITDA (as defined) covenant, which requires that we generate consolidated EBITDA of at least certain specified amounts for different periods over the term of the facility. The LC Facility also requires us to maintain a ratio of fair market value of vessel collateral to the sum of (1) the outstanding principal amount of the Term Loan, (2) the aggregate amount of undrawn financial letters of credit outstanding under the LC Facility, (3) all drawn but unreimbursed letters of credit under the LC Facility, and (4) mark-to-market foreign exchange exposure that is not cash secured of at least 1.20:1.00. The LC Facility also requires us to maintain at least \$200.0 million of minimum available cash, excluding restricted cash, at the end of each quarter.



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The LC Facility provides for a commitment fee of 0.50% per year on the unused portion of the LC Facility and letter of credit fees at an annual rate of 2.25% for performance letters of credit and 4.50% for financial letters of credit, as well as customary issuance fees and other fees and expenses.

*Term Loan*

The Term Loan is secured on a first-lien, second-out basis (with the LC Facility having relative priority over the Term Loan) by pledges of the capital stock of all the Guarantors and mortgages on, or other security interests in, substantially all tangible and intangible assets of our company and the Guarantors, subject to specific exceptions.

The Term Loan requires mandatory prepayments from: (1) the proceeds from the sale of assets, as well as insurance proceeds, in each case subject to certain exceptions, to the extent such proceeds are not reinvested in our business within 365 days of receipt; (2) net cash proceeds from the incurrence of indebtedness not otherwise permitted by the New Credit Facilities; and (3) 50% of amounts deemed to be excess cash flow, subject to specified adjustments. The Term Loan also requires quarterly amortization payments equal to \$750,000. The Term Loan also provides for a prepayment premium if we prepay or re-price the Term Loan prior to April 16, 2016.

The Term Loan requires compliance with various customary affirmative and negative covenants. We must also maintain a ratio of ownership adjusted fair market value of marine vessels to the sum of (1) the outstanding principal amount of the Term Loan and (2) the aggregate principal amount of unreimbursed drawings and advances under the LC Facility of at least 1.75:1.00.

The Term Loan was incurred with 25 basis points of original issue discount and bears interest at a floating rate, which can be, at our option, either: (1) a LIBOR rate for a specified interest period (subject to a LIBOR floor of 1.00%) plus an applicable margin of 4.25%; or (2) an alternate base rate (subject to a base rate floor of 2.00%) plus an applicable margin of 3.25%.

*Senior Notes*

During April 2014 we issued \$500.0 million in aggregate principal amount of 8.000% senior secured notes due 2021 (the Notes) in a private placement in accordance with Rule 144A and Regulation S under the Securities Act of 1933, as amended. Interest on the Notes is payable semi-annually in arrears on May 1 and November 1 of each year, beginning on November 1, 2014, at an annual rate of 8%. The Notes are scheduled to mature on May 1, 2021.

The Notes are unconditionally guaranteed on a senior secured basis by the Guarantors, and the Notes are secured on a second lien basis by pledges of capital stock of certain of our subsidiaries and mortgages and other security interests covering (1) specified marine vessels owned by certain of the Guarantors and (2) substantially all the other tangible and intangible assets of our company and the Guarantors, subject to exceptions for certain assets.

At any time or from time to time on or after May 1, 2017, at our option, we may redeem the Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount of the Notes to be redeemed) set forth below, together with accrued and unpaid interest to the redemption date, if redeemed during the 12-month period beginning May 1 of the years indicated:

| Year | Percentage |
|------|------------|
| 2017 | 104%       |

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|                     |      |
|---------------------|------|
| 2018                | 102% |
| 2019 and thereafter | 100% |

The Indenture governing the Notes contains covenants that, among other things, limit our ability and the ability of our restricted subsidiaries to: (1) incur or guarantee additional indebtedness or issue preferred stock;

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(2) make investments or certain other restricted payments; (3) pay dividends or distributions on capital stock or purchase or redeem subordinated indebtedness; (4) sell assets; (5) create restrictions on the ability of our restricted subsidiaries to pay dividends or make other payments to us; (6) create certain liens; (7) sell all or substantially all of our assets or merge or consolidate with or into other companies; (8) enter into transactions with affiliates; and (9) create unrestricted subsidiaries. Many of those covenants would become suspended if the Notes were to attain an investment grade rating from both Moody's Investors Service, Inc. and Standard and Poor's Ratings Services and no default has occurred. The covenants mentioned above are subject to a number of important exceptions and limitations.

***Units***

During April 2014, we issued 11,500,000 6.25% tangible equity units, each with a stated amount of \$25.00. Each Unit consists of (1) a prepaid common stock purchase contract and (2) a senior amortizing note due April 1, 2017 (each an Amortizing Note ) that has an initial principal amount of \$4.1266 per Amortizing Note, bears interest at a rate of 7.75% per annum and has a final scheduled installment payment date of April 1, 2017. Each prepaid common stock purchase contract will automatically settle on April 1, 2017, unless settled earlier: (1) at the holder's option, upon which we will deliver shares of our common stock, based on the applicable settlement rate and applicable market value of our stock as determined under the purchase contract; or (2) at our option, upon which we will deliver shares of our common stock, based upon the stated maximum settlement rate of 3.5562 shares per unit, subject to adjustment.

***North Ocean Financing******North Ocean 102***

In December 2009, J. Ray McDermott, S.A. ( JRMSA ), a wholly owned subsidiary of MII, entered into a vessel-owning joint venture transaction with Oceanteam ASA. JRMSA has guaranteed approximately 50% of this debt based on its ownership percentages in the vessel-owning companies. The outstanding debt bore interest at a rate equal to the three-month LIBOR (which was subject to reset every three months) plus a margin of 3.315%. JRMSA paid in full the approximately \$31.4 million notes payable balance upon maturity during January 2014. JRMSA expects to exercise its option to purchase Oceanteam ASA's 50% ownership interest in the vessel-owning companies in December 2014. As of December 31, 2013 we reported a consolidated notes payable of \$31.4 million on our consolidated balance sheet, all of which was classified as current notes payable.

***North Ocean 105***

On September 30, 2010, MII, 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 *North Ocean 105*. The agreement provides for borrowings of up to \$69.4 million, bearing interest at 2.76% per year, and requires principal repayment in 17 consecutive semi-annual installments, which commenced on October 1, 2012. 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 *North Ocean 105*, and a lien on substantially all of the other assets of North Ocean 105 AS. MII unconditionally guaranteed all amounts to be borrowed under the agreement. At March 31, 2014 and December 31, 2013, there was \$57.2 million in borrowings outstanding under this agreement, of which approximately \$8.2 million was classified as current notes payable.

***Unsecured Bilateral Letters of Credit and Bank Guarantees***

In 2012, McDermott Middle East, Inc, and MII executed a general reimbursement agreement in favor of a bank located in the UAE relating to issuances of bank guarantees in support of contracting activities in the Middle East and

India. As of March 31, 2014 and December 31, 2013, bank guarantees issued under these arrangements totaled \$56.2 million and \$55.8 million, respectively. In 2007 and in 2012, JRMSA and MII

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executed general unsecured reimbursement agreements in favor of two institutions that were lenders under the Former Credit Agreement relating to issuances of letters of credit in support of contracting activities primarily in Asia and the Middle East. The letters of credit issued under these arrangements totaled \$23.3 million and \$26.0 million as of March 31, 2014 and December 31, 2013, respectively.

On April 20, 2012, McDermott and one of its wholly owned subsidiaries, McDermott Australia Pty. Ltd. ( McDermott Australia ), entered into a secured Letter of Credit Reimbursement Agreement (the Reimbursement Agreement ) with Australia and New Zealand Banking Group Limited ( ANZ ). In accordance with the terms of the Reimbursement Agreement, ANZ issued letters of credit in the aggregate amount of approximately \$109.0 million to support McDermott Australia s performance obligations under contractual arrangements relating to a field development project. The obligations of McDermott and McDermott Australia under the Reimbursement Agreement are secured by McDermott Australia s interest in the contractual arrangements and certain related assets. During February 2014, we replaced these letters of credit with letters of credit issued under the Former Credit Agreement and subsequently replaced those letters of credit with letters of credit under the LC Facility.

***Surety Bonds***

In 2012 and 2011, MII executed general agreements of indemnity in favor of surety underwriters based in Mexico relating to surety bonds issued in support of contracting activities of J. Ray McDermott de Mèxico, S.A. de C.V. and McDermott, Inc, both subsidiaries of MII. As of March 31, 2014 and December 31, 2013, bonds issued under these arrangements totaled \$42.1 million and \$43.5 million, respectively. In October 2013, MII executed general agreements of indemnity in favor of surety underwriters relating to surety bonds in support of vessels operating in Brazil. The bonds issued under these arrangements totaled \$111.2 million and \$106.3 million as of March 31, 2014 and December 31, 2013, respectively.

***Cash, Cash Equivalents and Investments***

At March 31, 2014, we had cash and cash equivalents, restricted cash and investments of \$316.9 million. In the aggregate, our cash and cash equivalents, restricted cash and investments increased by \$783.1 million to \$1.1 billion at April 30, 2014, primarily due to the refinancing transactions.

At March 31, 2014, we had current restricted cash and cash equivalents totaling \$43.3 million, all of which was held in restricted foreign-entity accounts.

At March 31, 2014, we had investments with a fair value of \$5.4 million. Our investment portfolio consists of commercial paper and mutual funds. Our investments are classified as available for sale and are carried at fair value with unrealized gains and losses, net of tax, reported as a component of other comprehensive income (loss). Our net unrealized gain on investments was \$0.2 million at March 31, 2014. During the year ended December 31, 2013, we recognized other than temporary impairment of \$1.6 million on the asset-backed securities and collateralized mortgage obligations. Our net unrealized gain on investments was \$0.2 million as of December 31, 2013.

Our current assets, less current liabilities, excluding cash and cash equivalents and current restricted cash, declined by \$251.3 million to a negative \$434.4 million at March 31, 2014 from a negative \$183.1 million at December 31, 2013, primarily due to the increases in short term notes payables and accounts payable.

***Cash Flow Activities Continuing Operations***



*Operating activities.* Our net cash used in operating activities was \$22.3 million in the three months ended March 31, 2014, compared to \$187.1 million in the three months ended March 31, 2013. This reduction was primarily attributable to an increase in our accounts payable and accrued liabilities balances and higher accounts receivable collections.

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*Investing activities.* Our net cash used in investing activities was \$43.0 million in the three months ended March 31, 2014, compared to cash provided by investing activities of \$17.0 million in the three months ended March 31, 2013. This change was primarily attributable to proceeds associated with vessel sales that occurred during the three months ended March 31, 2013, an increase in restricted cash balances and a decrease in the sales and purchases of available-for-sale securities.

*Financing activities.* Our net cash provided by financing activities was \$214.8 million in the three months ended March 31, 2014 as compared to net cash used in financing activities of \$8.7 million in the three months ended March 31, 2013. The change was primarily attributable to borrowings under the Former Credit Agreement, partially offset by repayment of the debt associated with the *North Ocean 102*.

***Capital Expenditures***

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

Capital expenditures for the three months ended March 31, 2014 were \$37.9 million, as compared to \$37.7 million for the three months ended March 31, 2013. Capital expenditures for the three months ended March 31, 2014 were primarily attributable to the construction of the *Lay Vessel 108* ( *LV 108* ) and the continued development of our Altamira Mexico fabrication facility, as well as costs associated with upgrading the capabilities of other marine vessels. Capital expenditures for the three months ended March 31, 2013 were primarily attributable to the construction of the *LV 108* and the *North Ocean 105*, as well as costs associated with upgrading the capabilities of other marine vessels.

In addition, based, in December 2012, we entered into a contract to construct another vessel the *Deepwater Lay Vessel 2000* ( *DLV 2000* ). Like the *LV 108*, the *DLV 2000* is designed for advanced deepwater subsea and marine construction operations. Prior to December 31, 2015, we expect to incur capital expenditures ranging from approximately \$325.0 million to \$350.0 million associated with the construction of the *LV 108* and *DLV 2000* vessels.

***Derivative Contracts***

We previously entered into derivative contracts to mitigate currency exchange movements primarily associated with certain firm purchase commitments and various foreign currency expenditures we expect to incur on one of our Asia Pacific segment's EPCI projects through 2017. While we currently believe that these contracts will be effective in mitigating the associated currency exchange risks, it is possible that changes in the project may cause reduced effectiveness of these derivative contracts. Therefore, we may experience larger gains or losses on foreign currency movements due to the ineffective portion or the portion excluded from the assessment of effectiveness of these and other derivative contracts.

At March 31, 2014, our derivative financial instruments consisted primarily of foreign currency forward contracts. The notional value of our outstanding derivative contracts totaled approximately \$1.0 billion at March 31, 2014, with maturities extending through 2017. Of this amount, approximately \$635.3 million is associated with various foreign currency expenditures we expect to incur on the Asia Pacific segment EPCI project.

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

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

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We have operations in many locations around the world, and, as a result, our financial results could be significantly affected by factors such as changes in currency exchange rates or weak economic conditions in foreign markets. In order to manage the risks associated with currency exchange rate fluctuations, we attempt to hedge those risks with foreign currency derivative instruments. Historically, we have hedged those risks with foreign currency forward contracts. In certain cases, contracts with our customers may contain provisions under which payments from our customers are denominated in U.S. Dollars and in a foreign currency. The payments denominated in a foreign currency are designed to compensate us for costs that we expect to incur in such foreign currency. In these cases, we may use derivative instruments to reduce the risks associated with currency exchange rate fluctuations arising from differences in timing of our foreign currency cash inflows and outflows. Our operational cash flows and cash balances, though predominately held in U.S. dollars, may consist of different currencies at various points in time in order to execute our project contracts globally. Non-U.S. denominated asset and liability balances are subject to currency fluctuations when measured period to period for financial reporting purposes in U.S. dollars.

We have exposure to changes in interest rates under our credit facilities (see Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources). At March 31, 2014, we had \$250.0 million of outstanding borrowings under the Former Credit Agreement. We had no material future earnings or cash flow exposures from changes in interest rates on our other outstanding debt obligations, as substantially all of these obligations had fixed interest rates.

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

**Interest Rate Sensitivity**

The following tables provide information about our financial instruments that are sensitive to changes in interest rates. The tables present principal cash flows and related weighted-average interest rates by expected maturity dates.

|   | Principal Amount by Expected Maturity (In thousands) |         |         |         |         |            |          | Fair Value at<br>March 31,<br>2014 |
|---|--|---------|---------|---------|---------|------------|----------|------------------------------------|
|   | Years Ending December 31,                            |         |         |         |         |            |          |                                    |
|   | 2014   | 2015    | 2016    | 2017    | 2018    | Thereafter | Total    |                                    |
| Investments   | \$ 3,248   | \$      | \$      | \$      | \$      | \$ 1,975   | \$ 5,223 | \$ 5,437                           |
| Average Interest Rate                               | 0.22%  |         |         |         |         |            |          |                                    |
| Long-term Debt<br>(including current<br>maturities) | \$ 8,417   | \$8,417 | \$8,417 | \$8,417 | \$8,170 | \$ 16,340  | \$58,178 | \$ 59,234                          |
| Average Interest Rate                               | 2.76%  | 2.76%   | 2.76%   | 2.76%   | 2.76%   | 2.76%      |          |                                    |

|                       | Principal Amount by Expected Maturity (In thousands) |      |      |      |      |            |           | Fair Value at<br>December 31,<br>2013 |
|-----------------------|--|------|------|------|------|------------|-----------|---------------------------------------|
|                       | Years Ending December 31,                            |      |      |      |      |            |           |                                       |
|                       | 2014   | 2015 | 2016 | 2017 | 2018 | Thereafter | Total     |                                       |
| Investments           | \$   | \$   | \$   | \$   | \$   | \$ 14,908  | \$ 14,908 | \$ 13,511                             |
| Average Interest Rate |  |      |      |      |      | 1.02%      |           |                                       |

|   |           |          |          |          |          |           |           |           |
|---|-----------|----------|----------|----------|----------|-----------|-----------|-----------|
| Long-term Debt<br>(including current<br>maturities) | \$ 39,543 | \$ 8,170 | \$ 8,170 | \$ 8,170 | \$ 8,170 | \$ 16,339 | \$ 88,562 | \$ 90,005 |
| Average Interest Rate <sup>(1)</sup>                | 2.78%     | 2.76%    | 2.76%    | 2.76%    | 2.76%    | 2.76%     |           |           |

(1) Fixed and floating interest rates through the year ending December 31, 2014 and fixed interest rates thereafter.

**Table of Contents****Currency Exchange Rate Sensitivity**

The following table provides information about our foreign currency forward contracts outstanding at March 31, 2014 and presents such information in U.S. dollar equivalents. The table presents notional amounts and related weighted-average exchange rates by expected (contractual) maturity dates and constitutes a forward-looking statement. These notional amounts generally are used to calculate the contractual payments to be exchanged under the contract. The average contractual exchange rates are expressed using market convention, which is dependent on the currencies being bought and sold under the forward contract.

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

| <b>Foreign Currency</b> | <b>Year<br/>Ending<br/>December 31,<br/>2014</b> | <b>Fair Value at<br/>March 31,<br/>2014</b> | <b>Average<br/>Contractual<br/>Exchange<br/>Rate</b> |
|-------------------------|--|---|--|
| Australian Dollar       | \$ 115,079                                       | \$ (6,548)                                  | 0.9776   |
| Danish Krone            | \$ 20,960  | \$ 420                                      | 5.5255   |
| Euros                   | \$ 162,298                                       | \$ 4,214                                    | 1.3447   |
| Pound Sterling          | \$ 51,798  | \$ 623                                      | 1.6195   |
| Indonesian Rupiah       | \$ 5,201   | \$ 201                                      | 64.0225  |
| Norwegian Kroner        | \$ 158,128                                       | \$ 170                                      | 6.0228   |
| Singapore Dollar        | \$ 180,504                                       | \$ (2,511)                                  | 1.2404   |

| <b>Foreign Currency</b> | <b>Year<br/>Ending<br/>December 31,<br/>2015</b> | <b>Fair Value<br/>at<br/>March 31,<br/>2014</b> | <b>Average<br/>Contractual<br/>Exchange<br/>Rate</b> |
|-------------------------|--|---|--|
| Australian Dollar       | \$ 112,778                                       | \$ (5,866)                                      | 0.9479   |
| Danish Krone            | \$ 26,578  | \$ 1,061  | 5.6226   |
| Euros                   | \$ 2,020   | \$ 76   | 1.3272   |
| Pound Sterling          | \$ 2,900   | \$ 51   | 1.5922   |
| Norwegian Kroner        | \$ 17,541  | \$ (22)   | 6.0553   |
| Singapore Dollars       | \$ 67,849  | \$ (2,317)                                      | 1.2139   |

| <b>Foreign Currency</b> | <b>Year<br/>Ending<br/>December 31,<br/>2016</b> | <b>Fair Value<br/>at<br/>March 31,<br/>2014</b> | <b>Average<br/>Contractual<br/>Exchange Rate</b> |
|-------------------------|--|---|--|
| Australian Dollar       | \$ 77,104  | \$ (4,071)                                      | 0.9349   |
| Danish Krone            | \$ 6,654   | \$ 273  | 5.6143   |
| Euros                   | \$ 961   | \$ 41   | 1.3312   |
| Pound Sterling          | \$ 834   | \$ 13   | 1.5917   |

| <b>Foreign Currency</b> | <b>Year<br/>Ending<br/>December 31,</b> | <b>Fair Value<br/>at<br/>March 31,</b> | <b>Average<br/>Contractual<br/>Exchange Rate</b> |
|-------------------------|---|--|--|
|-------------------------|---|--|--|

|                   | <b>2017</b> | <b>2014</b> |        |
|-------------------|-------------|-------------|--------|
| Australian Dollar | \$ 19,632   | \$ (827)    | 0.9062 |
| Euros             | \$ 458      | \$ 24       | 1.3348 |

#### **Item 4. Controls and Procedures**

As of the end of the period covered by this quarterly report, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) adopted by the SEC under the Securities Exchange Act of 1934, as amended (the Exchange Act)). Our disclosure controls and procedures were developed through a process in which our management applied its judgment in assessing the costs and benefits of such controls and procedures, which, by their nature, can provide only reasonable assurance regarding the control objectives. You

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should note that the design of any system of disclosure controls and procedures is based in part upon various assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Based on the evaluation referred to above, our Chief Executive Officer and Chief Financial Officer concluded that the design and operation of our disclosure controls and procedures are effective as of March 31, 2014 to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and such information is accumulated and communicated to management, including our principal executive and principal financial officers or persons performing similar functions, as appropriate to allow timely decisions regarding disclosure. There has been no change in our internal control over financial reporting during the quarter ended March 31, 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings**

For information regarding ongoing investigations and litigation, see Note 10 to our unaudited condensed consolidated financial statements in Part I of this report, which we incorporate by reference into this Item.

**Item 1A. Risk Factors**

The following discussion updates the risk factor disclosure in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2013.

*Our debt and funded debt levels have increased significantly as a result of our recently completed refinancing transactions.*

Our debt and funded debt obligations have increased significantly as a result of our recently completed financing transactions. Our significant debt and funded debt levels and related debt service obligations could have negative consequences, including:

requiring us to dedicate significant cash flow from operations to the payment of principal, interest and other amounts payable on our debt, which would reduce the funds we have available for other purposes, such as working capital, capital expenditures and acquisitions;

making it more difficult or expensive for us to obtain any necessary future financing for working capital, capital expenditures, debt service requirements, debt refinancing, acquisitions or other purposes;

reducing our flexibility in planning for or reacting to changes in our industry and market conditions;

making us more vulnerable in the event of a downturn in our business; and

exposing us to increased interest rate risk given that a portion of our debt obligations are at variable interest rates.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table provides information on our purchases of equity securities during the quarter ended March 31, 2014, all of which involved repurchases of shares of MII common stock in connection with the vesting of restricted stock units pursuant to the provisions of employee benefit plans that permit the repurchase of common stock to satisfy statutory tax withholding obligations associated with the vesting of restricted stock units:

| <b>Period</b>                  | <b>Total number of shares purchased</b> | <b>Average price paid per share</b> | <b>Total number of shares purchased as part of publicly announced plans or programs</b> | <b>Maximum number of shares that may yet be purchased under the plans or programs</b> |
|--------------------------------|---|-------------------------------------|---|---|
| January 1 - January 31, 2014   | 414                                     | \$ 9.05                             | not applicable  | not applicable  |
| February 1 - February 28, 2014 | 4,719                                   | 8.58                                | not applicable  | not applicable  |
| March 1 - March 31, 2014       | 100,828                                 | 7.38                                | not applicable  | not applicable  |
| <b>Total</b>                   | <b>105,961</b>                          | <b>\$ 7.43</b>                      | <b>not applicable</b>   | <b>not applicable</b>   |

### Item 5. Other Information

On May 6, 2014, our Board of Directors (the "Board") approved the amended and restated McDermott International, Inc. Director and Executive Deferred Compensation Plan (the "DCP"). The amendment to the DCP revised the definition of a "Change in Control" under the DCP. The DCP is attached hereto as Exhibit 10.4 and is incorporated herein by reference.

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Additionally, on May 5, 2014, the Compensation Committee of the Board approved discretionary bonus awards for Perry L. Elders, our Senior Vice President and Chief Financial Officer, and Liane K. Hinrichs, our Senior Vice President, General Counsel and Corporate Secretary, in the amount of \$50,000 each, in recognition of their respective contributions to and results achieved in connection with our recent refinancing transactions.

**Item 6. Exhibits****Exhibit**

| <b>Number</b> | <b>Description</b>   |
|---------------|--|
| 3.1*          | McDermott International, Inc. s Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to McDermott International, Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2008 (File No. 1-08430)).  |
| 3.2*          | McDermott International, Inc. s Amended and Restated By-Laws (incorporated by reference to Exhibit 3.2 to McDermott International, Inc. s Annual Report on Form 10-K for the year ended December 31, 2010 (file No. 1-08430)).   |
| 3.3*          | Amended and Restated Certificate of Designation of Series D Participating Preferred Stock of McDermott International, Inc. (incorporated by reference to Exhibit 3.3 to McDermott International, Inc. s Quarterly Report on Form 10-Q for the quarter ended September 30, 2001 (File No. 1-08430)).  |
| 4.1*          | Indenture, dated April 16, 2014, by and among McDermott International, Inc., the Guarantors party thereto and Wells Fargo Bank, National Association, as Trustee, relating to 8.000% Senior Notes due 2021 (incorporated by reference to Exhibit 4.1 to McDermott International, Inc. s Current Report on Form 8-K filed on April 16, 2014 (File No. 1-08430)).  |
| 4.2*          | Form of 8.000% Senior Note due 2021 (incorporated by reference to Exhibit 4.2 to McDermott International, Inc. s Current Report on Form 8-K filed on April 16, 2014 (File No. 1-08430)).   |
| 4.3*          | Credit Agreement, dated April 16, 2014, by and among McDermott International, Inc., McDermott Finance L.L.C., a syndicate of lenders and letter of credit issuers, Crédit Agricole Corporate and Investment Bank, as administrative agent and collateral agent for the LC Facility and the Term Loan and as joint lead arranger and joint bookrunner for the LC Facility, Wells Fargo Securities, LLC, as joint lead arranger and joint bookrunner for the LC Facility, Wells Fargo Bank, N.A., as syndication agent for the LC Facility, and Goldman Sachs Lending Partners LLC, as sole lead arranger, sole bookrunner and sole syndication agent for the Term Loan (incorporated by reference to Exhibit 4.3 to McDermott International, Inc. s Current Report on Form 8-K filed on April 16, 2014 (File No. 1-08430)). |
| 4.4*          | Intercreditor Agreement, dated April 16, 2014, by and among McDermott International, Inc., McDermott Finance L.L.C., the other Guarantors party thereto, Crédit Agricole Corporate and Investment Bank, as first priority agent, and Wells Fargo Bank, National Association, as second priority agent (incorporated by reference to Exhibit 4.4 to McDermott International, Inc. s Current Report on Form 8-K filed on April 16, 2014 (File No. 1-08430)).   |
| 4.5*          | Form of First Lien Pledge and Security Agreement, dated April 16, 2014, made by McDermott International, Inc. and the Guarantors party thereto in favor of Crédit Agricole Corporate and   |

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Investment Bank, as collateral agent (incorporated by reference to Exhibit 4.5 to McDermott International, Inc. s Current Report on Form 8-K filed on April 16, 2014 (File No. 1-08430)).

- 4.6\* Form of Second Lien Pledge and Security Agreement, dated April 16, 2014, made by McDermott International, Inc. and the Guarantors party thereto in favor of Wells Fargo Bank, National Association, as collateral agent (incorporated by reference to Exhibit 4.6 to McDermott International, Inc. s Current Report on Form 8-K filed on April 16, 2014 (File No. 1-08430)).
- 4.7\* Indenture, dated April 7, 2014, between McDermott International, Inc. and U.S. Bank National Association (incorporated by reference to Exhibit 4.1 to McDermott International, Inc. s Current Report on Form 8-K filed on April 7, 2014 (File No. 1-08430)).

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| <b>Exhibit</b> | <b>Description</b>  |
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| <b>Number</b>  | <b>Description</b>  |
| 4.8*           | First Supplemental Indenture dated April 7, 2014, between McDermott International, Inc. and U.S. Bank National Association relating to Amortizing Notes included in Tangible Equity Units (incorporated by reference to Exhibit 4.2 to McDermott International, Inc.'s Current Report on Form 8-K filed on April 7, 2014 (File No. 1-08430)). |
| 4.9*           | Purchase Contract Agreement, dated April 7, 2014, between McDermott International, Inc. and U.S. Bank National Association, relating to Tangible Equity Units (incorporated by reference to Exhibit 4.3 to McDermott International, Inc.'s Current Report on Form 8-K filed on April 7, 2014 (File No. 1-08430)).                             |
| 4.10*          | Form of Unit for Tangible Equity Units (incorporated by reference to Exhibit 4.4 to McDermott International, Inc.'s Current Report on Form 8-K filed on April 7, 2014 (File No. 1-08430)).  |
| 4.11*          | Form of Purchase Contract, relating to Tangible Equity Units (incorporated by reference to Exhibit 4.5 to McDermott International, Inc.'s Current Report on Form 8-K filed on April 7, 2014 (File No. 1-08430)).  |
| 4.12*          | Form of Amortizing Note, relating to Tangible Equity Units (incorporated by reference to Exhibit 4.6 to McDermott International, Inc.'s Current Report on Form 8-K filed on April 7, 2014 (File No. 1-08430)).  |
| 10.1*          | Form of 2014 Restricted Stock Unit Grant Agreement (incorporated by reference to Exhibit 10.1 to McDermott International, Inc.'s Current Report on Form 8-K filed on March 7, 2014).  |
| 10.2*          | Form of 2014 Performance Share Grant Agreement (incorporated by reference to Exhibit 10.2 to McDermott International, Inc.'s Current Report on Form 8-K filed on March 7, 2014).  |
| 10.3           | Separation Agreement dated February 27, 2014 between J. Ray McDermott, S.A. and Stewart A. Mitchell.  |
| 10.4           | McDermott International, Inc. Director and Executive Deferred Compensation Plan, as Amended and Restated May 6, 2014.   |
| 10.5           | Form of 2014 Non-Executive Director Restricted Stock Grant Letter.  |
| 31.1           | Rule 13a-14(a)/15d-14(a) certification of Chief Executive Officer.  |
| 31.2           | Rule 13a-14(a)/15d-14(a) certification of Chief Financial Officer.  |
| 32.1           | Section 1350 certification of Chief Executive Officer.  |
| 32.2           | Section 1350 certification of Chief Financial Officer.  |
| 101.INS XBRL   | Instance Document   |
| 101.SCH XBRL   | Taxonomy Extension Schema Document  |
| 101.CAL XBRL   | Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB XBRL   | Taxonomy Extension Label Linkbase Document  |
| 101.PRE XBRL   | Taxonomy Extension Presentation Linkbase Document   |

\* Incorporated by reference to the filing indicated.

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**SIGNATURES**

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

McDERMOTT INTERNATIONAL, INC.

By: */s/ PERRY L. ELDERS*  
**Perry L. Elders**

**Senior Vice President and Chief Financial Officer**

**(Principal Financial Officer and Principal Accounting  
Officer)**

May 7, 2014

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