MCDERMOTT INTERNATIONAL INC
Form 10-Q
August 10, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

(Mark One) F O R M 1 0-Q

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

For the quarterly period ended June 30, 2009

OR

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

For the transition period from ______________to______________

Commission File No. 001-08430

McDERMOTT INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| REPUBLIC OF PANAMA<br>(State or Other Jurisdiction of Incorporation or Organization) | 72-0593134<br>(I.R.S. Employer Identification No.) |
| 777 N. ELDRIDGE PKWY.<br>HOUSTON, TEXAS<br>(Address of Principal Executive Offices) | 77079<br>(Zip Code) |

Registrant's Telephone Number, Including Area Code: (281) 870-5901

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 [ü] 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 [ü] 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 [P]

The number of shares of the registrant's common stock outstanding at July 31, 2009 was 229,905,704

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# PART I

## McDERMOTT INTERNATIONAL, INC.

## FINANCIAL INFORMATION

### Item 1. Condensed Consolidated Financial Statements

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McDERMOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|---|---|---|
| | (In thousands) | |
| Current Assets: | | |
| Cash and cash equivalents | $ 671,299 | $ 586,649 |
| Restricted cash and cash equivalents (Note 1) | 81,229 | 50,536 |
| Investments | 20,187 | 131,515 |
| Accounts receivable – trade, net | 731,419 | 712,055 |
| Accounts and notes receivable – unconsolidated affiliates | 1,268 | 1,504 |
| Accounts receivable – other | 87,929 | 139,062 |
| Contracts in progress | 381,196 | 311,713 |
| Inventories (Note 1) | 120,130 | 128,383 |
| Deferred income taxes | 103,568 | 97,069 |
| Other current assets | 67,228 | 58,499 |
| Total Current Assets | 2,265,453 | 2,216,985 |
| Property, Plant and Equipment | 2,362,922 | 2,234,050 |
| Less accumulated depreciation | 1,210,203 | 1,155,191 |
| Net Property, Plant and Equipment | 1,152,719 | 1,078,859 |
| Investments | 279,948 | 319,170 |
| Goodwill | 299,168 | 298,265 |
| Deferred Income Taxes | 264,018 | 335,877 |
| Investments in Unconsolidated Affiliates | 78,082 | 70,304 |
| Other Assets | 270,806 | 282,233 |
| TOTAL | $ 4,610,194 | $ 4,601,693 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|---|---|---|
| | (In thousands) | |
| Current Liabilities: | | |
| Notes payable and current maturities of long-term debt | $ 3,780 | $ 9,021 |
| Accounts payable | 487,396 | 551,435 |
| Accrued employee benefits | 236,075 | 205,521 |
| Accrued liabilities – other | 207,630 | 217,486 |
| Accrued contract cost | 128,807 | 97,041 |
| Advance billings on contracts | 816,948 | 951,895 |
| Accrued warranty expense | 128,195 | 120,237 |
| Income taxes payable | 50,608 | 55,709 |
| Total Current Liabilities | 2,059,439 | 2,208,345 |
| Long-Term Debt | 5,896 | 6,109 |
| Accumulated Postretirement Benefit Obligation | 105,464 | 107,567 |
| Self-Insurance | 93,988 | 88,312 |
| Pension Liability | 644,746 | 682,624 |
| Other Liabilities | 141,540 | 192,223 |
| Commitments and Contingencies (Note 3) | | |
| Stockholders' Equity: | | |
| Common stock, par value $1.00 per share, authorized 400,000,000 shares; issued 236,239,688 and 234,174,088 shares at June 30, 2009 and December 31, 2008, respectively | 236,240 | 234,174 |
| Capital in excess of par value | 1,274,112 | 1,252,848 |
| Retained earnings | 734,838 | 564,591 |
| Treasury stock at cost, 5,746,871 and 5,840,314 shares at June 30, 2009 and December 31, 2008, respectively | (67,779) | (63,026) |
| Accumulated other comprehensive loss | (624,660) | (672,415) |
| Stockholders' Equity – McDermott International, Inc. | 1,552,751 | 1,316,172 |
| Noncontrolling interest | 6,370 | 341 |
| Total Stockholders' Equity | 1,559,121 | 1,316,513 |

| | | |
|---|---|---|
| TOTAL | $ 4,610,194 | $ 4,601,693 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

| | Three Months Ended June 30, 2009 | Three Months Ended June 30, 2008 | Six Months Ended June 30, 2009 | Six Months Ended June 30, 2008 |
|---|---|---|---|---|
| | (Unaudited) (In thousands, except share and per share amounts) | | | |
| Revenues | $ 1,564,999 | $ 1,792,646 | $ 3,058,262 | $ 3,243,072 |
| Costs and Expenses: | | | | |
| Cost of operations | 1,275,058 | 1,432,736 | 2,503,680 | 2,621,432 |
| Gains on asset disposals – net | (1,897) | (17) | (656) | (11,460) |
| Selling, general and administrative expenses | 153,195 | 138,055 | 294,589 | 264,786 |
| Total Costs and Expenses | 1,426,356 | 1,570,774 | 2,797,613 | 2,874,758 |
| Equity in Income of Investees | 9,097 | 9,252 | 18,297 | 19,922 |
| Operating Income | 147,740 | 231,124 | 278,946 | 388,236 |
| Other Income (Expense): | | | | |
| Interest income (expense) - net | 4,987 | 8,186 | 6,844 | 18,641 |
| Other income (expense) – net | (10,201) | 1,843 | (20,971) | (2,097) |
| Total Other Income | (5,214) | 10,029 | (14,127) | 16,544 |
| Income before Provision for Income Taxes | 142,526 | 241,153 | 264,819 | 404,780 |
| Provision for Income Taxes | 44,645 | 63,602 | 88,523 | 103,982 |
| Net Income | 97,881 | 177,551 | 176,296 | 300,798 |
| Less: Net Income Attributable to Noncontrolling Interest | (5,326) | (12) | (6,049) | (69) |
| Net Income Attributable to McDermott International, Inc. | $ 92,555 | $ 177,539 | $ 170,247 | $ 300,729 |
| Earnings per Share: | | | | |
| Basic: | | | | |
| Net Income Attributable to McDermott International, Inc. | $ 0.40 | $ 0.78 | $ 0.74 | $ 1.33 |
| Diluted: | | | | |
| Net Income Attributable to McDermott International, Inc. | $ 0.40 | $ 0.77 | $ 0.73 | $ 1.31 |
| Shares used in the computation of earnings per share (Note 8): | | | | |

| | | | | |
|---|---|---|---|---|
| Basic | 229,273,441 | 226,862,500 | 228,794,113 | 226,247,335 |
| Diluted | 233,105,949 | 230,408,760 | 232,846,098 | 230,260,810 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

| | Three Months Ended June 30, 2009 | Three Months Ended June 30, 2008 | Six Months Ended June 30, 2009 | Six Months Ended June 30, 2008 |
|---|---|---|---|---|
| | (Unaudited) (In thousands) | | | |
| Net Income | $ 97,881 | $ 177,551 | $ 176,296 | $ 300,798 |
| Other Comprehensive Income: | | | | |
| Currency translation adjustments: | | | | |
| Foreign currency translation adjustments | 21,323 | 2,843 | 15,951 | 6,204 |
| Unrealized gains (losses) on derivative financial instruments: | | | | |
| Unrealized gains (losses) on derivative financial instruments | 6,619 | (1,334) | 4,765 | 3,214 |
| Reclassification adjustment for gains included in net income | (2,546) | (3,822) | (624) | (3,750) |
| Amortization of benefit plan costs | 14,267 | 6,490 | 28,422 | 13,029 |
| Unrealized gains (losses) on investments: | | | | |
| Unrealized gains (losses) arising during the period | 1,234 | (2,712) | (638) | (5,622) |
| Reclassification adjustment for net (gains) losses included in net income | (36) | 228 | (86) | (1,102) |
| Other Comprehensive Income | 40,861 | 1,693 | 47,790 | 11,973 |
| Total Comprehensive Income | 138,742 | 179,244 | 224,086 | 312,771 |
| Comprehensive Income Attributable to Noncontrolling Interest | (5,370) | (68) | (6,084) | (106) |
| Comprehensive Income Attributable to McDermott International, Inc. | $ 133,372 | $ 179,176 | $ 218,002 | $ 312,665 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Six Months Ended June 30, 2009 | 2008 |
|---|---|---|
| | (Unaudited) (In thousands) | |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income | $ 176,296 | $ 300,798 |
| Non-cash items included in net income: | | |
| Depreciation and amortization | 71,913 | 63,717 |
| Income of investees, less dividends | (4,012) | (8,528) |
| Gains on asset disposals – net | (656) | (11,460) |
| Provision for deferred taxes | 55,221 | 63,547 |
| Amortization of pension and postretirement costs | 44,094 | 20,266 |
| Excess tax benefits from FAS 123(R) stock-based compensation | (235) | (3,388) |
| Other, net | 26,725 | 21,193 |
| Changes in assets and liabilities, net of effects of acquisitions and divestitures: | | |
| Accounts receivable | (19,918) | (35,782) |
| Income tax receivable | 56,177 | (2,661) |
| Net contracts in progress and advance billings on contracts | (205,376) | (360,000) |
| Accounts payable | (69,860) | 26,321 |
| Income taxes | (10,093) | 3,002 |
| Accrued and other current liabilities | 24,466 | 22,743 |
| Pension liability, accumulated postretirement benefit obligation and accrued employee benefits | (12,567) | (129,834) |
| Other, net | (29,155) | (56,374) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 103,020 | (86,440) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Increase in restricted cash and cash equivalents | (30,693) | (5,239) |
| Purchases of property, plant and equipment | (129,386) | (120,393) |
| Net (increase) decrease in available-for-sale securities | 148,725 | (124,729) |
| Proceeds from asset disposals | 2,311 | 12,013 |
| Other, net | (2,117) | (2,048) |
| NET CASH USED IN INVESTING ACTIVITIES | (11,160) | (240,396) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Payment of long-term debt | (5,419) | (4,525) |
| Issuance of common stock | 342 | 7,467 |
| Payment of debt issuance costs | (45) | (1,564) |
| Excess tax benefits from FAS 123(R) stock-based compensation | 235 | 3,388 |
| Other, net | (64) | - |
| NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES | (4,951) | 4,766 |
| EFFECTS OF EXCHANGE RATE CHANGES ON CASH | (2,259) | (683) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 84,650 | (322,753) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 586,649 | 1,001,394 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 671,299 | $ 678,641 |
| | | |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid (received) during the period for: | | |

| | | | | |
|---|---|---|---|---|
| Interest (net of amount capitalized) | $ | 2,548 | $ | 4,006 |
| Income taxes (net of refunds) | $ | (16,903) | $ | 43,981 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
JUNE 30, 2009
(UNAUDITED)

## NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

We have presented our condensed consolidated financial statements in U.S. Dollars in accordance with the interim reporting requirements of Form 10-Q and Rule 10-01 of Regulation S-X. 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 notes in our annual report on Form 10-K for the year ended December 31, 2008.

We have included all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation. These condensed consolidated financial statements include the accounts of McDermott International, Inc. and its subsidiaries and controlled entities consistent with Financial Accounting Standards Board ("FASB") Interpretation No. 46(R), Consolidation of Variable Interest Entities (revised December 2003). 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 "joint ventures." We have eliminated all significant intercompany transactions and accounts. We have reclassified certain amounts previously reported to conform to the presentation at June 30, 2009 and for the three and six months ended June 30, 2009. We have evaluated subsequent events through August 10, 2009, the date of issuance of this report. We present the notes to our condensed consolidated financial statements on the basis of continuing operations, unless otherwise stated.

McDermott International, Inc. ("MII"), incorporated under the laws of the Republic of Panama in 1959, is an engineering and construction company with specialty manufacturing and service capabilities and is the parent company of the McDermott group of companies, including J. Ray McDermott, S.A. ("JRMSA") and The Babcock & Wilcox Company ("B&W"). In this quarterly report on Form 10-Q, unless the context otherwise indicates, "we," "us" and "our" mean MII and its consolidated subsidiaries.

We operate in three business segments: Offshore Oil and Gas Construction, Government Operations and Power Generation Systems, further described as follows:

- Our Offshore Oil and Gas Construction segment includes the business and operations of JRMSA, J. Ray McDermott Holdings, LLC and their respective subsidiaries. This segment supplies services primarily to offshore oil and gas field developments worldwide, including the front-end design and detailed engineering, fabrication and installation of offshore drilling and production facilities and installation of marine pipelines and subsea production systems. It also provides comprehensive project management and procurement services. This segment operates in most major offshore oil and gas producing regions, including the United States, Mexico, Canada, the Middle East, India, the Caspian Sea and Asia Pacific.

- Our Government Operations segment includes the business and operations of BWX Technologies, Inc., Babcock & Wilcox Nuclear Operations Group, Inc., Babcock & Wilcox Technical Services Group, Inc. and their respective subsidiaries. This segment manufactures nuclear components and provides various services to the U.S. Government, including uranium processing, environmental site restoration services and management and operating services for various U.S. Government-owned facilities, primarily within the nuclear weapons complex of the U.S. Department of Energy.

- Our Power Generation Systems segment includes the business and operations of Babcock & Wilcox Power Generation Group, Inc. ("B&W PGG"), Babcock & Wilcox Nuclear Power Generation Group, Inc. and their respective subsidiaries. This segment supplies fossil-fired boilers, commercial nuclear steam generators and components, environmental equipment and components, and related services to customers in different regions around the world. It designs, engineers, manufactures, constructs and services large utility and industrial power generation systems, including boilers used to generate steam in electric power plants, pulp and paper making, chemical and process applications and other industrial uses.

Operating results for the three and six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009. For further information, refer to the consolidated

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financial statements and the related footnotes included in our annual report on Form 10-K for the year ended December 31, 2008.

Comprehensive Loss

The components of accumulated other comprehensive loss included in stockholders' equity are as follows:

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|---|---|---|
| | (In thousands) | |
| Currency Translation Adjustments | $ 2,874 | $ (13,042) |
| Net Unrealized Loss on Investments | (9,702) | (8,978) |
| Net Unrealized Loss on Derivative Financial Instruments | (9,097) | (13,238) |
| Unrecognized Losses on Benefit Obligations | (608,735) | (637,157) |
| Accumulated Other Comprehensive Loss | $ (624,660) | $ (672,415) |

Inventories

The components of inventories are as follows:

| | June 30, 2009 (Unaudited) | December 31, 2008 |
|---|---|---|
| | (In thousands) | |
| Raw Materials and Supplies | $ 87,013 | $ 95,593 |
| Work in Progress | 7,556 | 12,157 |
| Finished Goods | 25,561 | 20,633 |
| Total Inventories | $ 120,130 | $ 128,383 |

Restricted Cash and Cash Equivalents

At June 30, 2009, we had restricted cash and cash equivalents totaling $81.2 million, $43.9 million of which was held in restricted foreign accounts, $28.8 million was held in escrow pending final payment on a legal settlement, $2.8 million was held as cash collateral for letters of credit, $5.0 million was held for future decommissioning of facilities, and $0.7 million was held to meet reinsurance reserve requirements of our captive insurance companies.

Warranty Expense

We generally accrue estimated expense to satisfy contractual warranty requirements of our Government Operations and Power Generation Systems segments when we recognize the associated revenue on the related contracts. We generally include warranty costs associated with our Offshore Oil and Gas Construction segment as a component of our total contract cost estimate to satisfy contractual requirements, and we record the associated expense under the percent-of-completion method of accounting for long-term construction contracts. In addition, we make specific provisions where we expect the actual warranty costs to significantly exceed the accrued estimates. Such provisions could have a material effect on our consolidated financial condition, results of operations and cash flows.

The following summarizes the changes in our accrued warranty expense:

| | Six Months Ended June 30, 2009 | Six Months Ended June 30, 2008 |
|---|---|---|
| | (Unaudited) (In thousands) | |
| Balance at beginning of period | $ 120,237 | $ 101,330 |
| Additions and adjustments | 16,417 | 9,286 |
| Charges | (8,459) | (3,982) |
| Balance at end of period | $ 128,195 | $ 106,634 |

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Research & Development Expense

Research and development activities are related to development and improvement of new and existing products and equipment, as well as conceptual and engineering evaluation for translation into practical applications. We charge to cost of operations the costs of research and development unrelated to specific contracts as incurred. For the six months ended June 30, 2009 and 2008 our net research and development expense included in cost of operations totaled approximately $21.1 million and $18.8 million, respectively.

Recently Adopted Accounting Standards

In May 2009, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 165, Subsequent Events. SFAS No. 165 incorporates specific accounting and disclosure requirements for subsequent events into U.S. generally accepted accounting principles, as part of the codification effort and in conjunction with SFAS Nos. 162 and 168. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position ("FSP") 141(R)-1, Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies. FSP 141(R)-1 amends and clarifies SFAS No. 141 to address subsequent measurement and accounting for, and disclosure of, assets and liabilities arising from contingencies in a business combination. On January 1, 2009, we adopted the provisions of FSP 141(R)-1. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued FSP 107-1, Interim Disclosures about Fair Value of Financial Instruments. FSP 107-1 amends SFAS No. 107, Disclosures about Fair Value of Financial Instruments, to require disclosures about fair value of financial instruments in financial statements. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In April 2008, the FASB issued FSP 142-3, Determination of the Useful Life of Intangible Assets. FSP 142-3 requires companies estimating the useful life of a recognized intangible asset to consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, to consider assumptions that market participants would use about renewals or extensions as adjusted for the entity-specific factors in SFAS No. 142, Goodwill and Other Intangible Assets. On January 1, 2009, we adopted the provisions of FSP 142-3 for the determination of the useful life of intangible assets. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued SFAS No. 161, Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133. SFAS No. 161 requires enhanced disclosures about derivative and hedging activities and is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. On January 1, 2009, we adopted the provisions of SFAS No. 161 for our disclosures about derivative instruments and hedging activities. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB No. 51. SFAS No. 160 establishes accounting and reporting standards pertaining to ownership interests in subsidiaries held by parties other than the parent, the amount of net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of any retained noncontrolling equity investment when a subsidiary is deconsolidated. It also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. On January 1, 2009, we adopted the provisions of SFAS No. 160. Noncontrolling interest has been presented as a separate component of stockholders' equity for the current reporting period and prior comparative reporting period.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations ("SFAS No. 141(R)"), which amends SFAS No. 141, Business Combinations. SFAS No. 141(R) broadens the guidance of SFAS No. 141, extending its applicability to all transactions and events in which one entity obtains control over one or more other businesses. It broadens the fair value measurements and recognition of assets acquired, liabilities assumed and interests transferred as a result of business combinations. It also provides disclosure requirements to enable users of the financial statements to evaluate the nature and financial effects of business combinations. On January 1, 2009, we adopted the provisions of SFAS 141(R). The adoption of these provisions did not have a material impact on our consolidated financial statements.

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Accounting Standards Not Yet Adopted

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles-a Replacement of FASB Statement No. 162. SFAS No. 168 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. This Statement will be effective for interim and annual reporting ending after September 15, 2009. We do not expect SFAS No. 168 to have a material impact on our consolidated financial statements.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R). SFAS No. 167 expands the scope of FASB Interpretation No. 46(R) and amends guidance for assessing and analyzing variable interest entities as defined in Interpretation No. 46(R). This Statement will be effective for fiscal years beginning after November 15, 2009. We do not expect SFAS No. 167 to have a material impact on our consolidated financial statements.

Other than as described above, there have been no material changes to the recent pronouncements discussed in our annual report on Form 10-K for the year ended December 31, 2008.

NOTE 2 – PENSION PLANS AND POSTRETIREMENT BENEFITS

Components of net periodic benefit cost included in net income are as follows:

| | Pension Benefits | | | | Other Benefits | | | |
|---|---|---|---|---|---|---|---|---|
| | Three Months Ended June 30, | | Six Months Ended June 30, | | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 |
| | (Unaudited) (In thousands) | | | | | | | |
| Service cost | $ 9,611 | $ 9,757 | $ 19,176 | $ 19,540 | $ 231 | $ 82 | $ 462 | $ 165 |
| Interest cost | 40,086 | 38,795 | 80,187 | 77,650 | 2,153 | 1,430 | 4,323 | 2,843 |
| Expected return on plan assets | (37,016) | (45,787) | (73,925) | (91,620) | (376) | - | (753) | - |
| Amortization of prior service cost | 697 | 768 | 1,387 | 1,537 | 17 | 19 | 32 | 38 |
| Amortization of transition obligation | - | - | - | - | 63 | 73 | 122 | 147 |
| Recognized net actuarial loss | 20,948 | 8,904 | 41,749 | 17,815 | 404 | 364 | 809 | 728 |
| Net periodic benefit cost | $ 34,326 | $ 12,437 | $ 68,574 | $ 24,922 | $ 2,492 | $ 1,968 | $ 4,995 | $ 3,921 |

NOTE 3 – COMMITMENTS AND CONTINGENCIES

Other than as noted below, there have been no material changes during the period covered by this Form 10-Q in the status of the legal proceedings disclosed in Note 11 to the consolidated financial statements in Part II of our annual report on Form 10-K for the year ended December 31, 2008.

Investigations and Litigation

With regard to the matter of Donald F. Hall and Mary Ann Hall, et al., v. Babcock & Wilcox Company, et al. (the "Hall Litigation"), the parties entered into the final settlement agreement described in our annual report on Form 10-K for the year ended December 31, 2008 (our "2008 10-K"), and that settlement was approved by the United States District Court for the Western District of Pennsylvania (the "District Court") in April 2009. In May 2009, B&W PGG paid approximately $52.5 million pursuant to the terms of the final settlement agreement, which is within the amount we have accrued for these claims. Additionally, B&W PGG and Atlantic Richfield Company ("ARCO"), a former defendant in the Hall Litigation, entered into the final settlement agreement described in our 2008 10-K, relating to B&W PGG's indemnity action against ARCO for any liability as a result of the Hall Litigation. The indemnity settlement was also approved by the District Court in April 2009. B&W PGG and Babcock & Wilcox Technical Services Group, Inc., formerly known as B&W Nuclear Environmental Services, Inc., have retained all insurance rights and intend to continue to pursue recovery from American Nuclear Insurers and mutual Atomic Energy Liability Underwriters ("ANI") to recover the amounts paid in settlement of the Hall Litigation in the matter of The Babcock & Wilcox Company et al. v. American Nuclear Insurers et al. (the "ANI

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Litigation”), which is pending before the Court of Common Pleas of Allegheny County, Pennsylvania. A hearing in the ANI Litigation is set for September 14, 2009 to determine the legal standard to be applied in determining ANI’s insurance coverage obligations with respect to the settlement of the Hall Litigation.

The three separate purported class action complaints against MII, Bruce W. Wilkinson (MII’s former Chief Executive Officer and Chairman of the Board), and Michael S. Taff (the Chief Financial Officer of MII) described in our 2008 10-K have been consolidated. In April 2009, our motion to transfer the consolidated cases to the Southern District of Texas was granted. On May 22, 2009, the plaintiffs filed an amended consolidated complaint, which, among other things, added Robert A. Deason (JRMSA’s President and Chief Executive Officer) as a defendant in the proceedings. On July 1, 2009, MII and the other defendants filed a motion to dismiss the complaint. The plaintiffs filed two responses to the motion to dismiss: (1) a motion to convert the motion to dismiss to a motion for summary judgment and granting the plaintiffs leave to conduct discovery, which was filed on July 10, 2009; and (2) an opposition to the motion to dismiss, which was filed on August 3, 2009. MII and the other defendants filed a response to the plaintiffs’ motion to convert on July 30, 2009 and intend to file a reply to the plaintiffs’ opposition to the motion to dismiss on or before August 24, 2009. None of the motions have yet been set for hearing by the Court.

With regard to the matter of Iroquois Falls Power Corp. v. Jacobs Canada Inc., et al., described in our 2008 10-K, Iroquois Falls Power Corp. (“Iroquois”) filed a notice of appeal of the decision of the Superior Court of Justice which denied the request of Iroquois to amend its complaint and assert new claims against the defendants based on a breach of contractual warranty. A hearing on the appeal was held on June 2, 2009. On June 25, 2009, the Court of Appeals for Ontario reversed the decision of the Superior Court sending the case back to the Superior Court for Iroquois to file an amended complaint on those new claims. We have until the end of September, 2009 to seek leave to appeal the Court of Appeals’ ruling.

For a detailed description of these and other proceedings, please refer to Note 11 to the consolidated financial statements included in Part II of our annual report on Form 10-K for the year ended December 31, 2008.

Other

Some of our contracts contain penalty 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 had potential exposure for liquidated damages, such damages ultimately were not asserted by our customers. As of June 30, 2009, we had not accrued for approximately $111 million of potential liquidated damages that we could incur based upon our current expectations of the time to complete certain projects in our Offshore Oil and Gas Construction segment. We do not believe any claims for these potential liquidated damages are probable of being assessed. The trigger dates for the majority of these potential liquidated damages occurred during the fourth quarter of 2008. We are in active discussions with our customers on the issues giving rise to delays in these projects, and we believe we will be successful in obtaining schedule extensions that should resolve the potential for liquidated damages being assessed. However, we may not achieve relief on some or all of the issues. For certain projects in our Offshore Oil and Gas Construction segment, we have currently provided for approximately $24 million in liquidated damages in our estimates of revenues and gross profit, of which approximately $22 million has been recognized in our financial statements to date, as we believe, based on the individual facts and circumstances, that these liquidated damages are probable.

NOTE 4 – DERIVATIVE FINANCIAL INSTRUMENTS

Our worldwide operations give rise to exposure to market risks from changes in foreign exchange rates. We use derivative financial instruments (primarily foreign currency forward-exchange contracts) to reduce the impact of changes in foreign exchange rates on our operating results. We use these instruments primarily to hedge our exposure associated with revenues 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.

We enter into derivative financial instruments primarily as hedges of certain firm purchase and sale commitments denominated in foreign currencies. We record these contracts at fair value on our consolidated balance sheets. Depending on the hedge designation at the inception of the contract, the related gains and losses on these contracts are either deferred in stockholders' equity (deficit) as a component of accumulated other comprehensive loss, until the

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hedged item is recognized in earnings, or offset against the change in fair value of the hedged firm commitment through earnings. 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. The gain or loss on a derivative instrument not designated as a hedging instrument is also immediately recognized in earnings. Gains and losses on derivative financial instruments that require immediate recognition are included as a component of other income (expense) – net in our consolidated statements of income.

We have designated all of our forward contracts as either cash flow or fair value hedging instruments. The hedged risk is the risk of changes in functional-currency-equivalent cash flows attributable to changes in spot exchange rates of forecasted transactions related to long-term contracts and certain capital expenditures. 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. At June 30, 2009, we had deferred approximately $9.1 million of net losses on these derivative financial instruments in accumulated other comprehensive loss. Of this amount, we expect to recognize approximately $1.0 million of income in the next 12 months.

At June 30, 2009, all of our derivative financial instruments consisted of foreign currency forward-exchange contracts. The notional value of our forward contracts totaled $348.5 million at June 30, 2009, with maturities extending to December 2011. These instruments consist primarily of contracts to purchase or sell Euros or Canadian Dollars. The fair value of these contracts totaled ($10.4) million. We are exposed to credit-related losses in the event of nonperformance by counterparties to derivative financial instruments. However, when possible, we enter into International Swaps and Derivative Association, Inc. agreements with our hedge counterparties to mitigate this risk. We also attempt to mitigate this risk by using major financial institutions with high credit ratings and limit our exposure to hedge counterparties based on their credit ratings. The counterparties to all of our derivative financial instruments are financial institutions included in our credit facilities described in Note 6 to the consolidated financial statements included in Part II of our annual report on Form 10-K for the year ended December 31, 2008. Our hedge counterparties have the benefit of the same collateral arrangements and covenants as described under these facilities.

The following tables summarize our derivative financial instruments at June 30, 2009 (unaudited):

| | Asset Derivatives June 30, 2009 | | | Liability Derivatives June 30, 2009 | | |
|---|---|---|---|---|---|---|
| | Balance Sheet Account | | Fair Value | Balance Sheet Account | | Fair Value |
| | | | (In thousands) | | | |
| Derivatives designated as hedging instruments: | | | | | | |
| Foreign-exchange contracts | Accounts receivable-other | $ | 3,777 | Accounts payable | $ | 12,697 |
| Derivatives not designated as hedging instruments: | | | | | | |
| Foreign-exchange contracts | Accounts receivable-other | $ | 1,548 | Accounts payable | $ | 3,067 |

The Effect of Derivative Instruments on the Statements of Financial Performance
June 30, 2009
(in thousands)

| | | Three Months Ended June 30, 2009 | Six Months Ended June 30, 2009 |
|---|---|---|---|
| Derivatives Designated as Hedges: | | | |
| Cash Flow Hedges: | | | |
| Foreign Exchange Contracts: | | | |
| Amount of gain (loss) recognized in other comprehensive income | | $ 8,479 | $ 5,607 |
| | | | |
| Income (loss) reclassified from accumulated other comprehensive loss into income: effective portion | | | |
| | Location | | |
| Revenues | | $ 364 | $ (214) |
| Cost of operations | | $ 2,120 | $ 1,194 |
| Other-net | | $ 275 | $ 238 |
| | | | |
| Gain (loss) recognized in income: portion excluded from effectiveness testing | | | |
| | Location | | |
| Other-net | | $ (492) | $ (1,592) |
| | | | |
| Derivatives Not Designated as Hedges: | | | |
| Foreign Exchange Contracts: | | | |
| Gain (loss) recognized in income: | | | |
| | Location | | |
| Other-net | | $ 1,942 | $ (6,347) |

NOTE 5 – FAIR VALUE MEASUREMENTS

The following is a summary of our available-for-sale securities measured at fair value at June 30, 2009 (in thousands) (unaudited):

| | 6/30/09 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Mutual funds | $ 4,379 | $ - | $ 4,379 | $ - |
| Certificates of deposit | 2,661 | - | 2,661 | - |
| U.S. Government and agency securities | 215,589 | 175,182 | 40,407 | - |
| Asset-backed securities and collateralized mortgage obligations | 9,498 | - | 3,053 | 6,445 |
| Corporate notes and bonds | 68,008 | - | 68,008 | - |
| Total | $ 300,135 | $ 175,182 | $ 118,508 | $ 6,445 |

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 period ended June 30, 2009 (in thousands):

| | |
|---|---|
| Balance, beginning of the year | $ 7,456 |
| Total realized and unrealized gains (losses): | |
| Included in other income (expense) | (7) |
| Included in other comprehensive income | 86 |
| Purchases, issuances and settlements | - |
| Principal repayments | (1,090) |
| Balance, end of period | $ 6,445 |

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Other Financial Instruments

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

Cash and cash equivalents and restricted cash and cash equivalents. The carrying amounts that we have reported in the accompanying consolidated balance sheets for cash and cash equivalents and restricted cash and cash equivalents approximate their fair values.

Long-term and short-term debt. We base the fair values of debt instruments on quoted market prices. Where quoted prices are not available, we base the fair values 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.

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

| | June 30, 2009 | | December 31, 2008 | |
|---|---|---|---|---|
| | Carrying Amount (Unaudited) | Fair Value | Carrying Amount | Fair Value |
| | (In thousands) | | | |
| Balance Sheet Instruments | | | | |
| Cash and cash equivalents | $ 671,299 | $ 671,299 | $ 586,649 | $ 586,649 |
| Restricted cash and cash equivalents | $ 81,229 | $ 81,229 | $ 50,536 | $ 50,536 |
| Investments | $ 300,135 | $ 300,135 | $ 450,685 | $ 450,685 |
| Debt | $ 9,676 | $ 9,757 | $ 15,130 | $ 15,221 |

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NOTE 6 – STOCK-BASED COMPENSATION

Total stock-based compensation expense recognized for the three and six months ended June 30, 2009 and 2008 was as follows:

| | Compensation Expense | Tax Benefit | Net Impact |
|---|---|---|---|
| | | (Unaudited) (In thousands) | |
| | Three Months Ended June 30, 2009 | | |
| Stock Options | $ 831 | $ (279) | $ 552 |
| Restricted Stock | 2,216 | (366) | 1,850 |
| Performance Shares | 4,871 | (1,712) | 3,159 |
| Performance and Deferred Stock Units | 2,768 | (923) | 1,845 |
| Total | $ 10,686 | $ (3,280) | $ 7,406 |
| | Three Months Ended June 30, 2008 | | |
| Stock Options | $ 245 | $ (74) | $ 171 |
| Restricted Stock | 1,876 | (293) | 1,583 |
| Performance Shares | 8,590 | (2,767) | 5,823 |
| Performance and Deferred Stock Units | 1,748 | (576) | 1,172 |
| Total | $ 12,459 | $ (3,710) | $ 8,749 |
| | Six Months Ended June 30, 2009 | | |
| Stock Options | $ 1,059 | $ (355) | $ 704 |
| Restricted Stock | 3,378 | (728) | 2,650 |
| Performance Shares | 11,396 | (3,894) | 7,502 |
| Performance and Deferred Stock Units | 3,878 | (1,289) | 2,589 |
| Total | $ 19,711 | $ (6,266) | $ 13,445 |
| | Six Months Ended June 30, 2008 | | |
| Stock Options | $ 766 | $ (234) | $ 532 |
| Restricted Stock | 2,216 | (386) | 1,830 |
| Performance Shares | 18,345 | (5,910) | 12,435 |
| Performance and Deferred Stock Units | 3,097 | (1,020) | 2,077 |
| Total | $ 24,424 | $ (7,550) | $ 16,874 |

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NOTE 7 – SEGMENT REPORTING

An analysis of our operations by segment is as follows:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 |
| | (Unaudited) (In thousands) | | | |
| REVENUES: | | | | |
| Offshore Oil and Gas Construction | | | | |