MCDERMOTT INTERNATIONAL INC
Form 10-Q
October 25, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

OR

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

Commission File No. 001-08430

McDERMOTT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

REPUBLIC OF PANAMA (State or Other Jurisdiction of Incorporation or Organization)	72-0593134 (I.R.S. Employer Identification No.)
757 N. ELDRIDGE PKWY	
HOUSTON, TEXAS	77079

(Address of Principal Executive Offices) (Zip Code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 October 21, 2016 was 241,339,574.

McDERMOTT INTERNATIONAL, INC.

INDEX—FORM 10-Q

PART I—FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
	(In thousands, except share and per share amounts)			
Revenues	$558,543	$805,857	$1,994,202	$2,402,857
Costs and Expenses:				
Cost of operations	455,499	720,961	1,666,974	2,121,942
Selling, general and administrative expenses	46,983	44,664	137,386	144,133
Impairment loss	11,758	-	44,069	6,808
Loss (gain) on asset disposals	(588)	(100)	(950)	1,443
Restructuring expenses	1,836	6,346	10,687	32,126
Total costs and expenses	515,488	771,871	1,858,166	2,306,452
Operating income	43,055	33,986	136,036	96,405
Other income (expense):				
Interest expense, net	(17,431)	(13,015)	(41,324)	(38,179)
Gain (loss) on foreign currency, net	376	(1,373)	(4,781)	(898)
Other income, net	4,861	1,556	3,776	1,100
Total other expense	(12,194)	(12,832)	(42,329)	(37,977)
Income before provision for income taxes	30,861	21,154	93,707	58,428
Provision for income taxes	15,976	9,094	55,110	30,504
Income before income (loss) from Investments in Unconsolidated Affiliates	14,885	12,060	38,597	27,924
Income (loss) from Investments in Unconsolidated Affiliates	1,507	(4,526)	(2,844)	(18,748)
Net income	16,392	7,534	35,753	9,176
Less: Net income attributable to noncontrolling interest	284	3,868	1,160	8,491

Net income attributable to McDermott International, Inc.	$16,108	$3,666	$34,593	$685
Net income per share				
Net income attributable to McDermott International, Inc.				
Basic:	$0.07	$0.02	$0.14	$-
Diluted:	$0.06	$0.01	$0.12	$-
Shares used in the computation of net income per share:				
Basic:	240,899,888	238,594,178	240,093,169	238,128,962
Diluted:	283,907,353	280,797,155	283,132,920	279,025,262

See accompanying Notes to the Consolidated Financial Statements.

1

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
	(in thousands)			
Net income	$16,392	$7,534	$35,753	$9,176
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on investments	(3)	(27)	14	(11)
Gain (loss) on derivatives	3,566	(701)	38,978	9,973
Foreign currency translation	(5,031)	(9,333)	(12,401)	(16,319)
Other comprehensive income (loss), net of tax	(1,468)	(10,061)	26,591	(6,357)
Total comprehensive income (loss)	$14,924	$(2,527)	$62,344	$2,819
Less: Comprehensive income attributable to non-controlling interests	273	3,868	1,128	8,411
Comprehensive income (loss) attributable to McDermott International, Inc.	$14,651	$(6,395)	$61,216	$(5,592)

See accompanying Notes to the Consolidated Financial Statements.

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2016	December 31, 2015
	(In thousands, except share and per share amounts)	
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$500,456	$664,844
Restricted cash and cash equivalents	99,632	116,801
Accounts receivable—trade, net	274,700	208,474
Accounts receivable—other	43,140	66,689
Contracts in progress	301,736	435,829
Other current assets	37,253	34,641
Total current assets	1,256,917	1,527,278
Property, plant and equipment	2,566,534	2,467,352
Less accumulated depreciation	(876,010)	(856,493)
Property, plant and equipment, net	1,690,524	1,610,859
Accounts receivable—long-term retainages	125,941	155,061
Investments in Unconsolidated Affiliates	17,123	26,551
Deferred income taxes	6,932	18,822
Other assets	40,935	48,505
Total assets	$3,138,372	$3,387,076
Liabilities and Equity		
Current liabilities:		
Notes payable and current maturities of long-term debt	$50,046	$24,882
Accounts payable	169,108	279,821
Accrued liabilities	297,745	330,943
Advance billings on contracts	84,280	164,773
Income taxes payable	26,359	23,787
Total current liabilities	627,538	824,206
Long-term debt	704,346	819,001
Self-insurance	16,284	18,653
Pension liability	23,774	24,066
Non-current income taxes	60,440	52,559
Other liabilities	109,687	101,870
Commitments and contingencies		
Stockholders' Equity:		
Common stock, par value $1.00 per share, authorized 400,000,000 shares; issued 249,628,949 and 246,841,128 shares, respectively	249,629	246,841
	1,691,918	1,687,059

Capital in excess of par value (including prepaid common stock purchase contracts)		
Accumulated deficit	(226,291)	(260,884)
Accumulated other comprehensive loss	(67,332)	(93,955)
Treasury stock, at cost: 8,289,375 and 7,824,204 shares, respectively	(94,892)	(92,262)
Stockholders' Equity—McDermott International, Inc.	1,553,032	1,486,799
Noncontrolling interest	43,271	59,922
Total Equity	1,596,303	1,546,721
Total Liabilities and Equity	$3,138,372	$3,387,076

See accompanying Notes to the Consolidated Financial Statements.

3

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

	Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
Cash flows from operating activities:		
Net income	$35,753	$9,176
Non-cash items included in net income:		
Depreciation and amortization	66,892	75,982
Drydock amortization	9,863	13,910
Impairment loss	44,069	6,808
Stock-based compensation charges	14,011	12,991
Loss from investments in unconsolidated affiliates	2,844	18,748
Loss (gain) on asset disposals	(950)	1,443
Restructuring (gain) expense	(1,500)	11,954
Deferred income taxes	11,889	2,315
Other non-cash items	(1,657)	3,164
Changes in operating assets and liabilities that provided (used) cash:		
Accounts receivable	(29,661)	11,294
Contracts in progress, net of Advance billings on contracts	53,608	(260,317)
Accounts payable	(110,196)	98,552
Accrued and other current liabilities	(13,426)	(7,269)
Pension liability	(1,209)	(1,319)
Income taxes	10,453	(10,360)
Other assets and liabilities, net	34,816	7,582
Total cash provided by (used in) operating activities	125,599	(5,346)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(197,393)	(66,118)
Decrease in restricted cash and cash equivalents	17,169	51,769
Investments in unconsolidated affiliates	(4,105)	(6,960)
Proceeds from asset dispositions	1,123	10,669
Sales and maturities of available-for-sale securities	-	3,175
Other, net	-	417
Total cash used in investing activities	(183,206)	(7,048)
Cash flows from financing activities:		
Repayment of debt	(93,755)	(18,004)
Repurchase of common stock	(3,909)	-
Payment of debt issuance costs	(8,256)	-
Distribution to noncontrolling interest	-	(24)
Other, net	-	(928)
Total cash used in financing activities	(105,920)	(18,956)
Effects of exchange rate changes on cash and cash equivalents	(861)	(2,574)

Net decrease in cash and cash equivalents	(164,388)	(33,924)
Cash and cash equivalents at beginning of period	664,844	665,309
Cash and cash equivalents at end of period	$500,456	$631,385

See accompanying Notes to the Consolidated Financial Statements.

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

	Common Stock Par Value	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholder's Equity	Noncontrolling Interest ("NCI")	Total Equity
	(in thousands)							
Balance at January 1, 2016	$246,841	$1,687,059	$(260,884)	$(93,955)	$(92,262)	$1,486,799	$59,922	$1,546,721
Net income	-	-	34,593	-	-	34,593	1,160	35,753
Other comprehensive income (loss), net of tax	-	-	-	26,623	-	26,623	(32)	26,591
Common stock issued	3,235	(3,235)	-	-	-	-	-	-
Stock-based compensation charges	-	8,329	-	-	-	8,329	-	8,329
Purchase of treasury shares	-	-	-	-	(3,909)	(3,909)	-	(3,909)
Retirement of common stock	(447)	(832)	-	-	1,279	-	-	-
Purchase of shares from NCI	-	597	-	-	-	597	(17,779)	(17,182)
Balance at September 30, 2016	$249,629	$1,691,918	$(226,291)	$(67,332)	$(94,892)	$1,553,032	$43,271	$1,596,303

See accompanying Notes to the Consolidated Financial Statements.

5

McDERMOTT INTERNATIONAL, INC

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

TABLE OF CONTENTS

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

NOTE 1—BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

Basis of Presentation

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

Classification

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

Recently Issued and Adopted Accounting Guidance

Statement of Cash Flows—In August 2016, the Financial Accounting Standards Board (the “FASB”) issued Accounting Standards Update (“ASU”) 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU clarifies how entities should classify certain cash receipts and cash payments in their statements of cash flows. The new guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. We adopted this ASU in the third quarter of 2016. Our retrospective adoption did not have a material impact on the presentation of our Consolidated Financial Statements.

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

In February 2015, the FASB issued ASU 2015-02, Consolidation: Amendments to the Consolidation Analysis, which amends and changes the consolidation analysis currently required under U.S. GAAP. This ASU modifies the process used to evaluate whether limited partnerships and similar entities are variable interest entities or voting interest entities; affects the analysis performed by reporting entities regarding variable interest entities, particularly those with fee arrangements and related party relationships; and provides a scope exception for certain investment funds.

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

Going Concern—In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. Under this ASU, we are required to assess our ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about our ability to continue as a going concern, including our management's plan to alleviate any such substantial doubt. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter with early adoption permitted. We adopted this ASU in the third quarter of 2016. Except for the disclosures set forth in this paragraph, our adoption of the ASU did not impact the presentation of our Consolidated Financial Statements or the disclosures in the Consolidated Financial Statements.

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

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

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

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

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

Financial Assets and Liabilities—In January 2016, the FASB issued ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities. Under this new guidance, entities will be required to measure all investments in equity securities that are

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

not subject to equity method or consolidation accounting at fair value, with changes recognized in net income. Fair value changes related to instrument-specific credit risk in financial liabilities accounted for under the fair value option in Accounting Standards Codification 825 must be recorded in other comprehensive income instead of earnings. ASU 2016-01 also changes presentation and disclosure requirements for financial assets and liabilities. ASU 2016-01 is effective for interim and annual periods beginning after December 15, 2017, with early adoption not permitted except related to changes in fair value for financial liabilities. We are currently assessing the impact of these amendments on our future Consolidated Financial Statements and related disclosures.

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

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

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

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

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

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

NOTE 2—REVENUE RECOGNITION

Unapproved Change Orders

As of September 30, 2016, total unapproved change orders included in our estimates at completion aggregated approximately $139 million, of which approximately $21 million was included in backlog. As of September 30, 2015, total unapproved change orders included in our estimates at completion aggregated approximately $146 million, of which approximately $23 million was included in backlog.

Claims Revenue

The amount of revenues and costs included in our estimates at completion (i.e., contract values) associated with claims was $16 million and $10 million as of September 30, 2016 and 2015, respectively, all in our Middle East segment. These amounts are determined based on various factors, including our analysis of the underlying contractual language and our experience in making and resolving claims. Our unconsolidated joint ventures did not include any material claims revenue or associated costs in their financial results for the quarters ended September 30, 2016 and 2015.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

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

Loss Recognition

As of September 30, 2016, we have provided for our estimated costs to complete for 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 immediately in cost of operations in the Consolidated Statements of Operations.

For loss projects, it is possible that our estimates of gross profit could increase or decrease based on changes in productivity, actual downtime and the resolution of change orders and claims with the customers. The provision for estimated losses on all active uncompleted projects is a component of "Advance billings on contracts" in our Consolidated Balance Sheets.

As of September 30, 2016 and December 31, 2015 there were no active projects which were in a significant loss position.

NOTE 3—USE OF ESTIMATES

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

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

Three months ended September 30, 2016

Operating income for the three months ended September 30, 2016 was positively impacted by net favorable changes in estimates totaling approximately $34 million across all segments.

Americas, Europe and Africa Segment (“AEA”)—This segment was positively impacted by net favorable changes in estimates, aggregating approximately $6 million, none of which individually were material.

Middle East Segment (“MEA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately $12 million, including changes due to productivity improvements and associated cost savings related to a Saudi Aramco project. The remaining changes attributable to other miscellaneous projects were not individually material.

Asia Segment (“ASA”)—This segment was positively impacted by net favorable changes in estimates aggregating approximately $16 million, which were primarily driven by cost savings associated with our vessel productivity improvements, as well as favorable changes in estimates at completion on several active projects. Those changes were partially offset by net unfavorable changes on an active project, which was not material.

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

Nine months ended September 30, 2016

Operating income for the nine months ended September 30, 2016 was positively impacted by net favorable changes in estimates totaling approximately $101 million across all segments.

AEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately $29 million, primarily due to (1) successful execution and close-out improvements on two significant projects, PB Litoral and Exxon Julia Subsea Tieback; and (2) productivity improvements and associated cost savings related to our DB 50 and NO 102 vessels' marine campaigns undertaken in the Gulf of Mexico. Included in the change was a reversal of a $7 million provision for liquidated damages, due to an agreed additional extension of the PB Litoral project completion date. Those changes were partially offset by net unfavorable changes on multiple projects, none of which were individually material.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately $29 million, primarily due to productivity improvements and associated cost savings related to the DB 27 and the Intermac 406 vessels, both associated with Saudi Aramco projects, due to improved execution. Those favorable changes in estimates were partially offset by marine equipment downtime due to weather on a project in Qatar.

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately $43 million, primarily driven by cost savings associated with productivity improvements on our CSV 108 vessel activities and favorable agreement on outstanding change orders on active and completed projects during the 2016 period. Those changes were partially offset by net unfavorable changes on multiple projects, none of which were individually material.

Three months ended September 30, 2015

Operating income for the three months ended September 30, 2015 was impacted by net unfavorable changes in cost estimates totaling approximately $8 million.

AEA—This segment had net unfavorable changes in estimates aggregating approximately $11 million. Results for the third quarter of 2015 included $6 million due to changes in the marine campaign execution plan on the PB Litoral EPCI project in Mexico and charges associated with a legal settlement. The changes in the PB Litoral marine campaign execution plan were due to carryover of offshore scope and revised cost estimates for hookup campaign. These changes were partially offset by the extension of the project completion date on the PB Litoral project, which resulted in a $13 million provision reversal for liquidated damages.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately $6 million. Projects in Saudi Arabia were positively impacted by: (1) a $6 million favorable change order for vessel downtime; (2) productivity improvements and associated cost savings on a cable-lay project in Saudi Arabia totaling approximately $3 million; and (3) $1 million in net positive changes in estimates on multiple projects, which were not individually material. These favorable changes were partially offset by a $4 million increase in pipelay cost estimates on a U.A.E. project, primarily due to changes in execution plan as a result of needing to substitute with a third-party vessel and hookup associated issues.

ASA—This segment had net unfavorable changes in estimates aggregating approximately $3 million. The deterioration was primarily due to $8 million of cost overruns and weather downtime on an installation project in Brunei, partially offset by $5 million of net positive changes in estimates on multiple projects, which were not individually material.

Nine months ended September 30, 2015

Operating income for the nine months ended September 30, 2015 was positively impacted by net favorable changes in estimates totaling approximately $21 million across all segments.

AEA—This segment had net unfavorable changes in estimates aggregating approximately $1 million. For the nine months ended September 30, 2015, the AEA segment was positively impacted by: (1) $13 million provision reversal for liquidated damages due to the extension of the PB Litoral project completion date; (2) $4 million due to productivity improvements on the Agile charter; and (3) $3 million each attributable to the Papa Terra project due to reduced cost estimates and to the North Ocean 105 vessel (the “NO 105”) due to reduced demobilization cost resulting from revised project plans. Those changes were partially offset by $6 million due to changes in the marine campaign execution on the PB Litoral project discussed above and charges associated with a legal settlement. Other multiple projects experience net positive changes in estimates of $1 million, which were not individually material.

MEA—This segment was positively impacted by net favorable changes in estimates aggregating approximately $16 million. The following four projects, in Saudi Arabia, were positively impacted: (1) $11 million of changes in estimates mostly due to productivity improvements and associated cost savings on the Intermac 406, which was working on a cable lay project; (2) $5 million of cost savings associated with revised cable lay scope; (3) $5 million as a result of an agreement with the customer on compensation for vessel downtime due to weather and standby delays; and (4) $4 million related to marine hook-up campaign savings. The KJO Hout project in the Neutral Zone was positively impacted by $7 million due to changes in revenue recovery and cost savings resulting from customer-approved design optimization. Those favorable changes were partially offset by: (1) $9 million increase in pipelay cost estimates on a U.A.E. project as a result of changes in our execution plan; (2) $5 million negative impact on another EPCI project in Saudi Arabia due to an increase in cost estimates on onshore scope; and (3) $2 million of unfavorable changes in estimates on multiple projects, none of which were individually material.

ASA—This segment was positively impacted by net favorable changes in estimates aggregating approximately $6 million. Improvements were driven by $4 million of productivity gains and improvements in cost estimates realized on the Gorgon MRU fabrication project, as well as $10 million net improvements on multiple projects that were not individually material. Those improvements were partially offset by $8 million in cost overruns resulting from weather downtime on an installation project in Brunei.

NOTE 4—RESTRUCTURING

In 2014 we completed a major review of our cost structure, and subsequently implemented a plan, which we referred to as the McDermott Profitability Initiative (the “MPI”), to increase our profitability and flexibility through reduced fixed and variable costs. The plan included personnel reductions, centralization of operational activities, other cost reduction initiatives and certain asset impairments. The previously announced move of our ASA regional headquarters from Singapore to Kuala Lumpur, along with additional sourcing initiatives, is substantially complete. We completed the MPI restructuring during third quarter of 2016.

We continued our efforts to improve our cost structure by initiating the Additional Overhead Reduction program (“AOR”) during the fourth quarter of 2015. AOR actions, which have included personnel reductions affecting direct operating and selling, general and administrative expenses, were substantially complete as of September 30, 2016.

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

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

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)

The following table presents amounts incurred during the three and nine months ended September 30, 2016 and 2015, as well as amounts incurred from the inception of our restructuring efforts up to September 30, 2016. Amounts expected to be incurred in the fourth quarter of 2016 are not material.

	Incurred in the three months ended September 30,		Incurred in the nine months ended September 30,		Incurred from inception to September 30,
	2016	2015	2016	2015	2016
	(in thousands)				
Americas Restructuring	$ -	$ (27)	$ (1,500)	$ 2,308	$ 44,044
Corporate Restructuring	-	-	-	-	6,601
MPI					
Severance and other personnel-related costs					
AEA	-	2,360	-	6,411	6,646
MEA	-	71	-	982	856
ASA	1,165	387	2,590	3,973	8,694
Corporate and other	-	-	-	1,119	1,611
Asset impairment and disposal					
ASA	-	-	-	7,471	7,471
Legal and other advisor fees					
ASA	-	-	-	-	-
Corporate and other	-	3,555	222	6,335	11,639
Other					
AEA	-	-	-	-	692
ASA	-	-	2,436	3,527	8,370
Corporate and other	-	-	-	-	983
	1,165	6,373	5,248	29,818	46,962
AOR					
Severance and other personnel-related costs					
AEA	321	-	3,529	-	3,529
ASA	235	-	235	-	235
Corporate and other	-	-	836	-	836
Legal and other advisor fees					-
Corporate	-	-	1,968	-	2,768
Other					
AEA	-	-	166	-	166
MEA	-	-	17	-	17
Corporate and other	115	-	188	-	188
	671	-	6,939	-	7,739

Total	$1,836	$6,346	$10,687	$32,126	$ 105,346
By segment					
AEA	$321	$2,333	$2,195	$8,719	$ 55,077
MEA	-	71	17	982	873
ASA	1,400	387	5,261	14,971	24,770
Corporate and other	115	3,555	3,214	7,454	24,626
Total	$1,836	$6,346	$10,687	$32,126	$ 105,346

13

McDERMOTT INTERNATIONAL, INC.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS—(continued)