

MCDERMOTT INTERNATIONAL INC

Form 10-Q

November 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 September 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  
(State or Other Jurisdiction of  
Incorporation or Organization)

72-0593134  
(I.R.S. Employer Identification No.)

777 N. ELDRIDGE PKWY.  
HOUSTON, TEXAS  
(Address of Principal Executive Offices)

77079  
(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  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

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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 30, 2009 was 230,171,481.

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Rule 13A-14(A)/15D-14(A) Certification of Chief Executive Officer

Section 1350 Certification of Chief Executive Officer

Section 1350 Certification of Chief Financial Officer

XBRL Instance Document

XBRL Taxonomy Extension Calculation Linkbase

XBRL Taxonomy Extension Label Linkbase

XBRL Taxonomy Extension Presentation Linkbase

XBRL Taxonomy Extension Schema

XBRL Taxonomy Extension Definition Linkbase

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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

|   | September<br>30,<br>2009<br>(Unaudited) | December<br>31,<br>2008 |
|---|---|-------------------------|
|   | (In thousands)                          |                         |
| Current Assets:   |   |                         |
| Cash and cash equivalents                                 | \$784,463                               | \$586,649               |
| Restricted cash and cash equivalents (Note 1)             | 64,050                                  | 50,536                  |
| Investments   | 16                                      | 131,515                 |
| Accounts receivable – trade, net                          | 650,350                                 | 712,055                 |
| Accounts and notes receivable – unconsolidated affiliates | 4,461                                   | 1,504                   |
| Accounts receivable – other                               | 86,241                                  | 139,062                 |
| Contracts in progress                                     | 503,420                                 | 311,713                 |
| Inventories (Note 1)                                      | 116,195                                 | 128,383                 |
| Deferred income taxes                                     | 90,824                                  | 97,069                  |
| Other current assets                                      | 62,932                                  | 58,499                  |
| <b>Total Current Assets</b>                               | <b>2,362,952</b>                        | <b>2,216,985</b>        |
| Property, Plant and Equipment                             | 2,440,113                               | 2,234,050               |
| Less accumulated depreciation                             | 1,250,990                               | 1,155,191               |
| <b>Net Property, Plant and Equipment</b>                  | <b>1,189,123</b>                        | <b>1,078,859</b>        |
| Investments   | 241,908                                 | 319,170                 |
| Goodwill  | 292,369                                 | 298,265                 |
| Deferred Income Taxes                                     | 278,563                                 | 335,877                 |
| Investments in Unconsolidated Affiliates                  | 86,031                                  | 70,304                  |
| Other Assets  | 284,698                                 | 282,233                 |
| <b>TOTAL</b>  | <b>\$4,735,644</b>                      | <b>\$4,601,693</b>      |

See accompanying notes to condensed consolidated financial statements.



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McDERMOTT INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

LIABILITIES AND STOCKHOLDERS' EQUITY

|  | September<br>30,<br>2009<br>(Unaudited) | December<br>31,<br>2008 |
|--|---|-------------------------|
|  | (In thousands)                          |                         |
| Current Liabilities:   |   |                         |
| Notes payable and current maturities of long-term debt   | \$5,288                                 | \$9,021                 |
| Accounts payable   | 531,398                                 | 551,435                 |
| Accrued employee benefits  | 237,054                                 | 205,521                 |
| Accrued liabilities – other  | 194,667                                 | 217,486                 |
| Accrued contract cost  | 127,857                                 | 97,041                  |
| Advance billings on contracts  | 708,086                                 | 951,895                 |
| Accrued warranty expense   | 122,904                                 | 120,237                 |
| Income taxes payable   | 69,855                                  | 55,709                  |
| <b>Total Current Liabilities</b>   | <b>1,997,109</b>                        | <b>2,208,345</b>        |
| <b>Long-Term Debt</b>  | <b>5,828</b>                            | <b>6,109</b>            |
| Accumulated Postretirement Benefit Obligation  | 106,255                                 | 107,567                 |
| Self-Insurance   | 84,465                                  | 88,312                  |
| Pension Liability  | 674,047                                 | 682,624                 |
| Other Liabilities  | 142,842                                 | 192,223                 |
| Commitments and Contingencies (Note 3)   |   |                         |
| Stockholders' Equity:  |   |                         |
| Common stock, par value \$1.00 per share, authorized 400,000,000 shares; issued 236,495,637 and 234,174,088 shares at September 30, 2009 and December 31, 2008, respectively | 236,496                                 | 234,174                 |
| Capital in excess of par value   | 1,287,764                               | 1,252,848               |
| Retained earnings  | 852,945                                 | 564,591                 |
| Treasury stock at cost, 6,103,951 and 5,840,314 shares at September 30, 2009 and December 31, 2008, respectively   | (67,773 )                               | (63,026 )               |
| Accumulated other comprehensive loss   | (590,565 )                              | (672,415 )              |
| Stockholders' Equity – McDermott International, Inc.   | 1,718,867                               | 1,316,172               |
| Noncontrolling interest  | 6,231                                   | 341                     |
| <b>Total Stockholders' Equity</b>  | <b>1,725,098</b>                        | <b>1,316,513</b>        |



|       |             |             |
|-------|-------------|-------------|
| TOTAL | \$4,735,644 | \$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<br>September 30,<br>2009 |             | September 30,<br>2008                              |             |
|--|---|-------------|--|-------------|
|  |   |             | (Unaudited)  |             |
|  |   |             | (In thousands, except share and per share amounts) |             |
|  | 2009  |             | 2008   |             |
| Revenues   | \$1,675,678                                 | \$1,664,851 | \$4,733,940  | \$4,907,923 |
| Costs and Expenses:                                      |   |             |  |             |
| Cost of operations                                       | 1,383,046                                   | 1,445,749   | 3,886,726  | 4,067,181   |
| Gains (losses) on asset disposals – net                  | 323   | 138         | (333 )   | (11,322 )   |
| Selling, general and administrative expenses             | 160,565                                     | 139,512     | 455,154  | 404,298     |
| Total Costs and Expenses                                 | 1,543,934                                   | 1,585,399   | 4,341,547  | 4,460,157   |
| Equity in Income of Investees                            | 13,050                                      | 12,521      | 31,347   | 32,443      |
| Operating Income (Loss)                                  | 144,794                                     | 91,973      | 423,740  | 480,209     |
| Other Income (Expense):                                  |   |             |  |             |
| Interest income – net                                    | 2,179                                       | 5,151       | 9,023  | 23,792      |
| Other income (expense) – net                             | (3,127 )                                    | 2,945       | (24,098 )  | 848         |
| Total Other Income (Expense)                             | (948 )                                      | 8,096       | (15,075 )  | 24,640      |
| Income before Provision for Income Taxes                 | 143,846                                     | 100,069     | 408,665  | 504,849     |
| Provision for Income Taxes                               | 23,793                                      | 14,271      | 112,316  | 118,253     |
| Net Income   | 120,053                                     | 85,798      | 296,349  | 386,596     |
| Less: Net Income Attributable to Noncontrolling Interest | (1,946 )                                    | (227 )      | (7,995 )   | (296 )      |
| Net Income Attributable to McDermott International, Inc. | \$118,107                                   | \$85,571    | \$288,354  | \$386,300   |
| Earnings per Share:                                      |   |             |  |             |
| Basic:   |   |             |  |             |
| Net Income Attributable to McDermott International, Inc. | \$0.51                                      | \$0.38      | \$1.26   | \$1.70      |
| Diluted:   |   |             |  |             |
| Net Income Attributable to McDermott International, Inc. | \$0.50                                      | \$0.37      | \$1.24   | \$1.68      |

Shares used in the computation of earnings per share  
(Note 8):

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|         |             |             |             |             |
|---------|-------------|-------------|-------------|-------------|
| Basic   | 229,989,368 | 227,440,858 | 229,192,531 | 226,645,175 |
| Diluted | 234,314,619 | 230,463,651 | 233,335,605 | 230,328,423 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

|   | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|---|-------------------------------------|-----------|------------------------------------|------------|
|   | 2009                                | 2008      | 2009                               | 2008       |
|   | (Unaudited)                         |           |                                    |            |
|   | (In thousands)                      |           |                                    |            |
| Net Income  | \$ 120,053                          | \$ 85,798 | \$ 296,349                         | \$ 386,596 |
| Other Comprehensive Income (Loss):  |                                     |           |                                    |            |
| Currency translation adjustments:   |                                     |           |                                    |            |
| Foreign currency translation adjustments                                  | 8,927                               | (15,036 ) | 24,878                             | (8,832 )   |
| Unrealized gains (losses) on derivative financial instruments:            |                                     |           |                                    |            |
| Unrealized gains (losses) on derivative financial instruments             | 8,673                               | (18,923 ) | 13,438                             | (15,709 )  |
| Reclassification adjustment for gains included in net income              | (1,306 )                            | 1,058     | (1,930 )                           | (2,692 )   |
| Amortization of benefit plan costs  | 15,918                              | 5,275     | 44,340                             | 18,304     |
| Unrealized gains (losses) on investments:                                 |                                     |           |                                    |            |
| Unrealized gains (losses) arising during the period                       | 1,737                               | (1,989 )  | 1,099                              | (7,611 )   |
| Reclassification adjustment for net (gains) losses included in net income | 147                                 | (358 )    | 61                                 | (1,460 )   |
| Other Comprehensive Income (Loss)   | 34,096                              | (29,973 ) | 81,886                             | (18,000 )  |
| Total Comprehensive Income  | 154,149                             | 55,825    | 378,235                            | 368,596    |
| Comprehensive Income Attributable to Noncontrolling Interest              | (1,947 )                            | (207 )    | (8,031 )                           | (313 )     |
| Comprehensive Income Attributable to McDermott International, Inc.        | \$ 152,202                          | \$ 55,618 | \$ 370,204                         | \$ 368,283 |

See accompanying notes to condensed consolidated financial statements.

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

|   | Common<br>Shares                     | Stock<br>Par<br>Value | Capital In<br>Excess of<br>Par Value | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Treasury<br>Stock | Stockholders'<br>Equity<br>MII | Non-<br>Controlling<br>Interest | Total<br>Stockhold<br>Equity |
|---|--------------------------------------|-----------------------|--------------------------------------|----------------------|---|-------------------|--------------------------------|---------------------------------|------------------------------|
|   | (In thousands, except share amounts) |                       |                                      |                      |   |                   |                                |                                 |                              |
| Balance<br>December 31,<br>2008                               | 234,174,088                          | \$234,174             | \$1,252,848                          | \$564,591            | \$(672,415)   | \$(63,026)        | \$1,316,172                    | \$341                           | \$1,316,513                  |
| Net income  | -                                    | -                     | -                                    | 288,354              | -   | -                 | 288,354                        | 7,995                           | 296,349                      |
| Amortization of<br>benefit plan costs                         | -                                    | -                     | -                                    | -                    | 44,340  | -                 | 44,340                         | -                               | 44,340                       |
| Unrealized gain<br>on investments                             | -                                    | -                     | -                                    | -                    | 1,160   | -                 | 1,160                          | -                               | 1,160                        |
| Translation<br>adjustments                                    | -                                    | -                     | -                                    | -                    | 24,842  | -                 | 24,842                         | 36                              | 24,878                       |
| Unrealized gain<br>on derivatives                             | -                                    | -                     | -                                    | -                    | 11,508  | -                 | 11,508                         | -                               | 11,508                       |
| Exercise of stock<br>options                                  | 184,158                              | 184                   | 372                                  | -                    | -   | 157               | 713                            | -                               | 713                          |
| Excess tax<br>benefits on stock<br>options                    | -                                    | -                     | (2,458 )                             | -                    | -   | -                 | (2,458 )                       | -                               | (2,458 )                     |
| Contributions to<br>thrift plan                               | 773,101                              | 773                   | 10,590                               | -                    | -   | -                 | 11,363                         | -                               | 11,363                       |
| Shares returned to<br>treasury                                | -                                    | -                     | -                                    | -                    | -   | (4,904 )          | (4,904 )                       | -                               | (4,904 )                     |
| Accelerated<br>vesting  | 1,364,290                            | 1,365                 | (1,365 )                             | -                    | -   | -                 | -                              | -                               | -                            |
| Sale of subsidiary<br>shares to<br>noncontrolling<br>interest | -                                    | -                     | 2,086                                | -                    | -   | -                 | 2,086                          | (2,086)                         | -                            |
| Stock-based<br>compensation<br>charges                        | -                                    | -                     | 25,691                               | -                    | -   | -                 | 25,691                         | -                               | 25,691                       |
| Distributions to<br>noncontrolling<br>interests               | -                                    | -                     | -                                    | -                    | -   | -                 | -                              | (55 )                           | (55 )                        |
| Balance<br>September 30,<br>2009                              | 236,495,637                          | \$236,496             | \$1,287,764                          | \$852,945            | \$(590,565)   | \$(67,773)        | \$1,718,867                    | \$6,231                         | \$1,725,100                  |
| Balance<br>December 31,                                       | 231,722,659                          | \$231,723             | \$1,145,829                          | \$135,289            | \$(281,933)   | \$(63,903)        | \$1,167,005                    | \$373                           | \$1,167,377                  |

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|   |             |           |             |           |             |            |             |        |             |
|---|-------------|-----------|-------------|-----------|-------------|------------|-------------|--------|-------------|
| Net Income                                | -           | -         | -           | 386,300   | -           | -          | 386,300     | 296    | 386,596     |
| Amortization of benefit plan costs        | -           | -         | -           | -         | 18,304      | -          | 18,304      | -      | 18,304      |
| Unrealized loss on investments            | -           | -         | -           | -         | (9,071 )    | -          | (9,071 )    | -      | (9,071 )    |
| Translation adjustments                   | -           | -         | -           | -         | (8,849 )    | -          | (8,849 )    | 17     | (8,832 )    |
| Unrealized loss on derivatives            | -           | -         | -           | -         | (18,401 )   | -          | (18,401 )   | -      | (18,401 )   |
| Exercise of stock options                 | 1,435,135   | 1,436     | (459 )      | -         | -           | 7,092      | 8,069       | -      | 8,069       |
| Excess tax benefits on stock options      | -           | -         | 6,404       | -         | -           | -          | 6,404       | -      | 6,404       |
| Contributions to thrift plan              | 202,619     | 202       | 9,647       | -         | -           | -          | 9,849       | -      | 9,849       |
| Restricted stock issuances – net          | 259,666     | 259       | (259 )      | -         | -           | -          | -           | -      | -           |
| Purchase of treasury shares               | -           | -         | -           | -         | -           | (6,234 )   | (6,234 )    | -      | (6,234 )    |
| Stock-based compensation charges          | -           | -         | 30,550      | -         | -           | -          | 30,550      | -      | 30,550      |
| Distributions to noncontrolling interests | -           | -         | -           | -         | -           | -          | -           | (310 ) | (310 )      |
| Balance September 30, 2008                | 233,620,079 | \$233,620 | \$1,191,712 | \$521,589 | \$(299,950) | \$(63,045) | \$1,583,926 | \$376  | \$1,584,302 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

|  | Nine Months Ended<br>September 30,<br>2009      2008<br>(Unaudited)<br>(In thousands) |                   |
|--|---|-------------------|
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |   |                   |
| Net Income   | \$296,349   | \$386,596         |
| Non-cash items included in net income:   |   |                   |
| Depreciation and amortization  | 118,871   | 95,059            |
| Income of investees, less dividends  | (11,458 )   | (12,592 )         |
| Gains on asset disposals – net   | (333 )  | (11,322 )         |
| Provision for deferred taxes   | 43,264  | 87,512            |
| Amortization of pension and postretirement costs   | 68,877  | 28,424            |
| Excess tax benefits from FAS 123(R) stock-based compensation                                   | 2,458   | (6,404 )          |
| Other, net   | 36,736  | 34,922            |
| Changes in assets and liabilities, net of effects of acquisitions and divestitures:            |   |                   |
| Accounts receivable  | 62,932  | 21,412            |
| Income tax receivable  | 57,169  | 10,666            |
| Net contracts in progress and advance billings on contracts                                    | (442,373 )  | (516,623 )        |
| Accounts payable   | (22,099 )   | 19,544            |
| Income taxes   | 10,571  | (5,335 )          |
| Accrued and other current liabilities  | (1,461 )  | 57,586            |
| Pension liability, accumulated postretirement benefit obligation and accrued employee benefits | 13,961  | (201,109 )        |
| Other, net   | (36,056 )   | (95,421 )         |
| <b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>                                     | <b>197,408</b>  | <b>(107,085 )</b> |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |   |                   |
| Increase in restricted cash and cash equivalents   | (13,514 )   | (3,731 )          |
| Purchases of property, plant and equipment   | (190,207 )  | (189,384 )        |
| Acquisition of businesses, net of cash acquired  | (8,497 )  | (33,731 )         |
| Net decrease (increase) in available-for-sale securities                                       | 208,435   | (70,992 )         |
| Proceeds from asset disposals  | 2,724   | 12,023            |
| Other, net   | (2,676 )  | (2,029 )          |
| <b>NET CASH USED IN INVESTING ACTIVITIES</b>   | <b>(3,735 )</b>   | <b>(287,844 )</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |   |                   |
| Payment of long-term debt  | (5,652 )  | (4,660 )          |
| Increase in short-term borrowing   | 1,606   | 2,920             |
| Issuance of common stock   | 713   | 8,069             |
| Payment of debt issuance costs   | (56 )   | (1,611 )          |
| Excess tax benefits from FAS 123(R) stock-based compensation                                   | (2,458 )  | 6,404             |
| Other, net   | (109 )  | -                 |
| <b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>                                     | <b>(5,956 )</b>   | <b>11,122</b>     |
| <b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH</b>  | <b>10,097</b>   | <b>(3,239 )</b>   |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                                    | <b>197,814</b>  | <b>(387,046 )</b> |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD</b>  | <b>586,649</b>  | <b>1,001,394</b>  |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>  | <b>\$784,463</b>  | <b>\$614,348</b>  |

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for:

|                                      |         |          |
|--------------------------------------|---------|----------|
| Interest (net of amount capitalized) | \$1,855 | \$5,967  |
| Income taxes (net of refunds)        | \$93    | \$49,193 |

See accompanying notes to condensed consolidated financial statements.

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McDERMOTT INTERNATIONAL, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
SEPTEMBER 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 the Financial Accounting Standards Board (the “FASB”) Topic Consolidation. 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 September 30, 2009 and for the three and nine months ended September 30, 2009. We have evaluated subsequent events through November 9, 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.
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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 nine months ended September 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

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consolidated 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:

|   | September<br>30,<br>2009<br>(Unaudited) | December<br>31,<br>2008 |
|---|---|-------------------------|
|   | (In thousands)                          |                         |
| Currency Translation Adjustments                        | \$ 11,800                               | \$(13,042 )             |
| Net Unrealized Loss on Investments                      | (7,818 )                                | (8,978 )                |
| Net Unrealized Loss on Derivative Financial Instruments | (1,730 )                                | (13,238 )               |
| Unrecognized Losses on Benefit Obligations              | (592,817 )                              | (637,157 )              |
| Accumulated Other Comprehensive Loss                    | \$(590,565 )                            | \$(672,415 )            |

## Inventories

The components of inventories are as follows:

|                            | September<br>30,<br>2009<br>(Unaudited) | December<br>31,<br>2008 |
|----------------------------|---|-------------------------|
|                            | (In thousands)                          |                         |
| Raw Materials and Supplies | \$85,493                                | \$95,593                |
| Work in Progress           | 7,277                                   | 12,157                  |
| Finished Goods             | 23,425                                  | 20,633                  |
| Total Inventories          | \$116,195                               | \$128,383               |

## Restricted Cash and Cash Equivalents

At September 30, 2009, we had restricted cash and cash equivalents totaling \$64.1 million, \$51.1 million of which was held in restricted foreign accounts, \$4.5 million was held in escrow pending final payment on a legal settlement, \$3.6 million was held as cash collateral for letters of credit, \$4.3 million was held for future decommissioning of facilities, and \$0.6 million was held to meet reinsurance reserve requirements of our captive insurance companies. It is possible that a significant portion of restricted cash at September 30, 2009 will not be released within the next twelve months.

## 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:

|                                | Nine Months Ended<br>September 30,<br>2009                      2008<br>(Unaudited)<br>(In thousands) |            |
|--------------------------------|---|------------|
| Balance at beginning of period | \$ 120,237  | \$ 101,330 |
| Additions and adjustments      | 16,651  | 14,482     |
| Charges                        | (13,984 )   | (6,174 )   |
| Balance at end of period       | \$ 122,904  | \$ 109,638 |

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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. Substantially all of these costs are in our Power Generation Systems segment and include costs related to the development of carbon capture and sequestration and our modular and scalable nuclear reactor business, mPower. For the three months ended September 30, 2009 and 2008, our net research and development expense included in cost of operations totaled approximately \$12.8 million and \$9.9 million, respectively. For the nine months ended September 30, 2009 and 2008, our net research and development expense totaled approximately \$33.9 million and \$28.7 million, respectively. We expect to continue significant spending on research and development projects, as we continue development on our carbon capture and sequestration efforts and our commercial nuclear and mPower reactor projects.

Acquisitions

In September 2009, a subsidiary of B&W acquired certain assets of Instrumentation Y Mantenimiento De Caldersa, A.A. for approximately \$12.3 million. In connection with this acquisition, we recorded goodwill of approximately \$8.5 million, property, plant and equipment of approximately \$3.1 million and other current assets of approximately \$0.7 million.

In September 2009, we finalized our purchase price allocation for the Nuclear Fuel Services, Inc. acquisition, which we completed on December 31, 2008. The purchase price adjustments included a reduction in goodwill of approximately \$16.2 million and an increase in property, plant and equipment of approximately \$18.6 million.

Recently Adopted Accounting Standards

In June 2009, the FASB issued Statement of Financial Accounting Standards (“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 made the FASB Accounting Standards Codification (the “Codification”) the single source of U.S. GAAP used by nongovernmental entities in preparation of financial statements, except for rules and interpretive releases of the Securities and Exchange Commission (the “SEC”) under authority of federal securities laws, which are the sources of authoritative accounting guidance for SEC registrants. The Codification is meant to simplify user access to all authoritative accounting guidance by reorganizing U.S. GAAP pronouncements into roughly 90 accounting topics within a consistent structure; its purpose is not to create new accounting and reporting guidance. The Codification supersedes all existing non-SEC accounting and reporting standards and was effective for us beginning July 1, 2009. Following SFAS No. 168, the FASB will not issue new standards in the form of Statements, FASB Staff Positions, or Emerging Issues Task Force Abstracts; instead, it will issue Accounting Standards Updates. The FASB will not consider Accounting Standards Updates as authoritative in their own right; these updates will serve only to update the Codification, provide background information about the guidance, and provide the bases for conclusions on the change(s) in the Codification. In the discussion that follows, references in “italics” relate to Codification Topics and Subtopics, and their descriptive titles, as appropriate.

In May 2009, the FASB issued the Topic Subsequent Events. This section of the Codification incorporates specific accounting and disclosure requirements for subsequent events into U.S. generally accepted accounting principles. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued a revision to the Topic Business Combinations. This revision amends and clarifies the Topic Business Combinations 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 this update. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In April 2009, the FASB issued a revision to the Topic Financial Instruments. This revision requires disclosures about fair value of financial instruments in notes to interim financial statements as well as annual financial statements. The notes to our financial statements were updated for this revision.

In April 2008, the FASB issued a revision to the Topic Intangibles – Goodwill and Other. This revision requires companies estimating the useful life of a recognized intangible asset to consider their historical experience in

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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 this topic. On January 1, 2009, we adopted this revision. The adoption of these provisions did not have a material impact on our consolidated financial statements.

In March 2008, the FASB issued a revision to the Topic Derivatives and Hedging. This revision 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 this revision for our disclosures about derivative instruments and hedging activities. The notes to our financial statements were updated for this revision.

In December 2007, the FASB issued a revision to the Topic Consolidation. This revision 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 this revision. 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 a revision to the Topic Business Combinations. This revision broadens the guidance of this Topic, 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 this revision. The adoption of these provisions did not have a material impact on our consolidated financial statements.

Accounting Standards Not Yet Adopted

In June 2009, the FASB issued a revision to the topic Consolidation. This revision expands the scope of this topic and amends guidance for assessing and analyzing variable interest entities. This revision will be effective for fiscal years beginning after November 15, 2009. We do not expect this revision 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.

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## 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 |          | Nine Months Ended |           | Three Months Ended |         | Nine Months Ended |         |
|                                       | 2009               | 2008     | 2009              | 2008      | 2009               | 2008    | 2009              | 2008    |
|                                       | (Unaudited)        |          |                   |           |                    |         |                   |         |
|                                       | (In thousands)     |          |                   |           |                    |         |                   |         |
| Service cost                          | \$9,824            | \$9,105  | \$29,000          | \$28,645  | \$234              | \$81    | \$696             | \$246   |
| Interest cost                         | 40,475             | 37,856   | 120,662           | 115,506   | 2,169              | 1,416   | 6,492             | 4,259   |
| Expected return on plan assets        | (37,334)           | (46,859) | (111,259)         | (138,479) | (377)              | -       | (1,130)           | -       |
| Amortization of prior service cost    | 955                | 517      | 2,342             | 2,054     | 17                 | 18      | 49                | 56      |
| Amortization of transition obligation | -                  | -        | -                 | -         | 66                 | 71      | 188               | 218     |
| Recognized net actuarial loss         | 23,339             | 7,193    | 65,088            | 25,008    | 405                | 363     | 1,214             | 1,091   |
| Net periodic benefit cost             | \$37,259           | \$7,812  | \$105,833         | \$32,734  | \$2,514            | \$1,949 | \$7,509           | \$5,870 |

## 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 are pursuing recovery from American Nuclear Insurers and Mutual Atomic Energy Liability Underwriters (“ANI”) of 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 Litigation”), which is pending before the Court of Common Pleas of Allegheny County, Pennsylvania. On September 14, 2009, the Court of Common Pleas held a hearing 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 Court has not yet issued its ruling.



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: (1) a response to the plaintiffs' motion to convert on July 30, 2009; and (2) a reply in support of the defendants' motion to dismiss on August 24, 2009. On August 28, 2009, the Court denied the plaintiffs' motion to convert, and, on September 4, 2009, the Court advised us that the motion to dismiss has been referred to a magistrate. We

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anticipate that the magistrate will make a recommendation to the Court as to whether to grant or deny the motion to dismiss and, thereafter, the Court will rule on the motion to dismiss.

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. 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. On September 21, 2009, we filed a notice to appeal the Court of Appeals’ decision with the Supreme Court of Canada; however, the Court has not scheduled a hearing on the appeal.

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 September 30, 2009, we have liquidated damage contingencies of approximately \$100 million based on our failure to meet such specified contractual milestone dates, all in our Offshore Oil and Gas Construction segment, of which \$14 million has been recorded in our financial statements. We do not believe any additional claims for these potential liquidated damages are probable of being assessed. The trigger dates for these potential liquidated damages range from June of 2008 to September 30, 2009. 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.

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 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 cash flow hedges. 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. Ineffective portions of our forward contracts are recorded in other income (expense) – net on our Condensed Consolidated Statements of Income. At September 30, 2009, we had deferred approximately \$1.7 million of net losses on these derivative financial instruments in accumulated other comprehensive loss. We expect to recognize substantially all of this amount in the next 12 months.

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At September 30, 2009, all of our derivative financial instruments consisted of foreign currency forward-exchange contracts. The notional value of our forward contracts totaled \$336.0 million at September 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 \$1.5 million, all of which are Level 2 in nature (See Note 5). 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 September 30, 2009 (unaudited):

|  | Asset Derivatives<br>September 30, 2009 |  | Liability Derivatives<br>September 30, 2009 |               |
|--|---|--|---|---------------|
|  | Balance Sheet<br>Account                | Fair<br>Value<br>(Unaudited)<br>(In thousands) | Balance Sheet<br>Account                    | Fair<br>Value |
| Derivatives designated as hedging instruments:     |   |  |   |               |
| Foreign-exchange contracts                         | Accounts receivable-other               | \$7,552  | Accounts payable                            | \$6,365       |
| Derivatives not designated as hedging instruments: |   |  |   |               |
| Foreign-exchange contracts                         | Accounts receivable-other               | \$920  | Accounts payable                            | \$593         |

The Effect of Derivative Instruments on the Statements of Financial Performance  
September 30, 2009  
(Unaudited)  
(In thousands)

|   | Three<br>Months<br>Ended<br>September<br>30,<br>2009 | Nine<br>Months<br>Ended<br>September<br>30,<br>2009 |
|---|--|---|
| Derivatives Designated as Hedges:   |  |   |
| Cash Flow Hedges:   |  |   |
| Foreign Exchange Contracts:   |  |   |
| Amount of gain (loss) recognized in other comprehensive income                                      | \$10,454   | \$16,061  |
| Income (loss) reclassified from accumulated other comprehensive loss into income: effective portion |  |   |
| Location  |  |   |

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|  |         |            |
|--|---------|------------|
| Revenues   | \$507   | \$293      |
| Cost of operations   | \$1,000 | \$2,194    |
| Other – net  | \$(95   | ) \$143    |
| Gain (loss) recognized in income: portion<br>excluded from effectiveness testing |         |            |
| Location   |         |            |
| Other – net  | \$671   | \$(921 )   |
| Derivatives Not Designated as Hedges:  |         |            |
| Foreign Exchange Contracts:  |         |            |
| Gain (loss) recognized in income:  |         |            |
| Location   |         |            |
| Other – net  | \$375   | \$(5,972 ) |

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## NOTE 5 – FAIR VALUE MEASUREMENTS

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

|   | 9/30/09   | Level 1   | Level 2  | Level 3 |
|---|-----------|-----------|----------|---------|
| Mutual funds  | \$4,778   | \$-       | \$4,778  | \$-     |
| Certificates of deposit   | 2,524     | -         | 2,524    | -       |
| U.S. Government and agency securities                           | 171,863   | 156,963   | 14,900   | -       |
| Asset-backed securities and collateralized mortgage obligations | 10,214    | -         | 3,076    | 7,138   |
| Corporate notes and bonds                                       | 52,545    | -         | 52,545   | -       |
| Total   | \$241,924 | \$156,963 | \$77,823 | \$7,138 |

The following is a summary of our available-for-sale securities measured at fair value at December 31, 2008 (in thousands) (unaudited):

|   | 12/31/08  | Level 1   | Level 2   | Level 3 |
|---|-----------|-----------|-----------|---------|
| Mutual funds  | \$4,253   | \$-       | \$4,253   | \$-     |
| Commercial paper  | 19,080    | -         | 19,080    | -       |
| Certificates of deposit   | 36,014    | -         | 36,014    | -       |
| U.S. Government and agency securities                           | 285,420   | 242,204   | 43,216    | -       |
| Foreign government bonds  | 5,000     | -         | 5,000     | -       |
| Asset-backed securities and collateralized mortgage obligations | 11,375    | -         | 3,919     | 7,456   |
| Corporate notes and bonds                                       | 52,545    | -         | 89,543    | -       |
| Total   | \$450,685 | \$242,204 | \$201,025 | \$7,456 |

## 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 September 30, 2009 (in thousands):

|   |          |
|---|----------|
| Balance, beginning of the year                | \$7,456  |
| Total realized and unrealized gains (losses): |          |
| Included in other income (expense)            | (1 )     |
| Included in other comprehensive income        | 1,476    |
| Purchases, issuances and settlements          | -        |
| Principal repayments                          | (1,793 ) |
| Balance, end of period                        | \$7,138  |

## 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.

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

|                                      | September 30, 2009                |            | December 31, 2008  |              |
|--------------------------------------|-----------------------------------|------------|--------------------|--------------|
|                                      | Carrying<br>Amount<br>(Unaudited) | Fair Value | Carrying<br>Amount | Fair Value   |
| (In thousands)                       |                                   |            |                    |              |
| <b>Balance Sheet Instruments</b>     |                                   |            |                    |              |
| Cash and cash equivalents            | \$ 784,463                        | \$ 784,463 | \$ 586,649         | \$ 586,649   |
| Restricted cash and cash equivalents | \$ 64,050                         | \$ 64,050  | \$ 50,536          | \$ 50,536    |
| Investments                          | \$ 241,924                        | \$ 241,924 | \$ 450,685         | \$ 450,685   |
| Debt                                 | \$ 11,116                         | \$ 11,299  | \$ 15,130          | \$ 15,221    |
| Forward contracts                    | \$ 1,514                          | \$ 1,514   | \$ (26,291 )       | \$ (26,291 ) |

**NOTE 6 – STOCK-BASED COMPENSATION**

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

|  | Compensation<br>Expense | Tax<br>Benefit<br>(Unaudited) | Net<br>Impact |
|--|-------------------------|-------------------------------|---------------|
|  | (In thousands)          |                               |               |
| Three Months Ended September 30,<br>2009 |                         |                               |               |
| Stock Options                            | \$900                   | \$(303 )                      | \$597         |
| Restricted Stock                         | 1,160                   | (370 )                        | 790           |
| Performance Shares                       | 3,945                   | (1,309 )                      | 2,636         |
| Performance and Deferred Stock Units     | 2,469                   | (817 )                        | 1,652         |
| Total                                    | \$8,474                 | \$(2,799 )                    | \$5,675       |
| Three Months Ended September 30,<br>2008 |                         |                               |               |
| Stock Options                            | \$14                    | \$(5 )                        | \$9           |
| Restricted Stock                         | 1,127                   | (305 )                        | 822           |
| Performance Shares                       | 8,084                   | (2,578 )                      | 5,506         |
| Performance and Deferred Stock Units     | (37 )                   | 14                            | (23 )         |
| Total                                    | \$9,188                 | \$(2,874 )                    | \$6,314       |
| Nine Months Ended September 30, 2009     |                         |                               |               |
| Stock Options                            | \$1,959                 | \$(658 )                      | \$1,301       |
| Restricted Stock                         | 4,538                   | (1,098 )                      | 3,440         |
| Performance Shares                       | 15,341                  | (5,203 )                      | 10,138        |
| Performance and Deferred Stock Units     | 6,347                   | (2,106 )                      | 4,241         |
| Total                                    | \$28,185                | \$(9,065 )                    | \$19,120      |
| Nine Months Ended September 30, 2008     |                         |                               |               |
| Stock Options                            | \$780                   | \$(239 )                      | \$541         |



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|                                      |          |             |          |
|--------------------------------------|----------|-------------|----------|
| Restricted Stock                     | 3,343    | (691 )      | 2,652    |
| Performance Shares                   | 26,429   | (8,488 )    | 17,941   |
| Performance and Deferred Stock Units | 3,060    | (1,006 )    | 2,054    |
| Total                                | \$33,612 | \$(10,424 ) | \$23,188 |

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## NOTE 7 – SEGMENT REPORTING

An analysis of our operations by segment is as follows:

|  | Three Months Ended<br>September 30,<br>2009 |             | Nine Months Ended<br>September 30,<br>2009 |             |
|--|---|-------------|--|-------------|
|  | 2008  | 2008        | 2009                                       | 2008        |
|  | (Unaudited)                                 |             |  |             |
|  | (In thousands)                              |             |  |             |
| <b>REVENUES:</b>   |   |             |  |             |
| Offshore Oil and Gas Construction  | \$1,026,700                                 | \$814,701   | \$2,567,924                                | \$2,332,918 |
| Government Operations  | 259,752                                     | 222,434     | 778,254                                    | 638,792     |
| Power Generation Systems   | 389,638                                     | 630,955     | 1,389,802                                  | 1,945,324   |
| Adjustments and Eliminations(1)  | (412 )                                      | (3,239 )    | (2,040 )                                   | (9,111 )    |
|  | \$1,675,678                                 | \$1,664,851 | \$4,733,940                                | \$4,907,923 |
| <b>(1) Segment revenues are net of the following intersegment transfers and other adjustments:</b> |   |             |  |             |
| Offshore Oil and Gas Construction Transfers  | \$19  | \$3,007     | \$693                                      | \$8,400     |
| Government Operations Transfers  | 393   | 232         | 1,347                                      | 656         |
| Power Generation Systems Transfers   | -   | -           | -  | 55          |
|  | \$412                                       | \$3,239     | \$2,040                                    | \$9,111     |
| <b>OPERATING INCOME:</b>   |   |             |  |             |
| <b>Segment Operating Income:</b>   |   |             |  |             |
| Offshore Oil and Gas Construction  | \$107,001                                   | \$(18,655 ) | \$221,209                                  | \$132,187   |
| Government Operations  | 10,818                                      | 26,585      | 96,689                                     | 87,491      |
| Power Generation Systems   | 29,980                                      | 78,998      | 128,818                                    | 249,498     |
|  | \$147,799                                   | \$86,928    | \$446,716                                  | \$469,176   |
| <b>Gains (Losses) on Asset Disposals – Net:</b>  |   |             |  |             |
| Offshore Oil and Gas Construction  | \$120                                       | \$(110 )    | \$953                                      | \$1,732     |
| Government Operations  | (101 )                                      | -           | (101 )                                     | -           |
| Power Generation Systems   | (342 )                                      | (25 )       | (300 )                                     | 9,593       |
|  | \$(323 )                                    | \$(135 )    | \$552                                      | \$11,325    |
| <b>Equity in Income (Loss) of Investees:</b>   |   |             |  |             |
| Offshore Oil and Gas Construction  | \$(596 )                                    | \$(921 )    | \$(2,797 )                                 | \$(2,671 )  |
| Government Operations  | 9,081                                       | 7,966       | 26,435                                     | 27,513      |
| Power Generation Systems   | 4,565                                       | 5,476       | 7,709                                      | 7,601       |
|  | \$13,050                                    | \$12,521    | \$31,347                                   | \$32,443    |
| <b>Segment Income:</b>   |   |             |  |             |
| Offshore Oil and Gas Construction  | \$106,525                                   | \$(19,686 ) | \$219,365                                  | \$131,248   |
| Government Operations  | 19,798                                      | 34,551      | 123,023                                    | 115,004     |
| Power Generation Systems   | 34,203                                      | 84,449      | 136,227                                    | 266,692     |
|  | 160,526                                     | 99,314      | 478,615                                    | 512,944     |
| Corporate  | (15,732 )                                   | (7,341 )    | (54,875 )                                  | (32,735 )   |

|                        |           |          |           |           |
|------------------------|-----------|----------|-----------|-----------|
| Total Operating Income | \$144,794 | \$91,973 | \$423,740 | \$480,209 |
|------------------------|-----------|----------|-----------|-----------|

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## NOTE 8 – EARNINGS PER SHARE

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

|  | Three Months Ended                                 |             | Nine Months Ended |             |
|--|--|-------------|-------------------|-------------|
|  | September 30,                                      |             | September 30,     |             |
|  | 2009   | 2008        | 2009              | 2008        |
|  | (Unaudited)  |             |                   |             |
|  | (In thousands, except share and per share amounts) |             |                   |             |
| <b>Basic:</b>  |  |             |                   |             |
| Net income for basic computation   | \$ 118,107   | \$ 85,571   | \$ 288,354        | \$ 386,300  |
| Weighted average common shares   | 229,989,368  | 227,440,858 | 229,192,531       | 226,645,175 |
| Basic earnings per common share  | \$ 0.51  | \$ 0.38     | \$ 1.26           | \$ 1.70     |
| <b>Diluted:</b>  |  |             |                   |             |
| Net income for diluted computation   | \$ 118,107   | \$ 85,571   | \$ 288,354        | \$ 386,300  |
| Weighted average common shares (basic)   | 229,989,368  | 227,440,858 | 229,192,531       | 226,645,175 |
| Effect of dilutive securities:   |  |             |                   |             |
| Stock options, restricted stock and performance shares   | 4,325,251  | 3,022,793   | 4,143,074         | 3,683,248   |
| Adjusted weighted average common shares and assumed exercises of stock options and vesting of stock awards | 234,314,619  | 230,463,651 | 233,335,605       | 230,328,423 |
| Diluted earnings per common share  | \$ 0.50  | \$ 0.37     | \$ 1.24           | \$ 1.68     |

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

## CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS

The following 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, 2008.

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

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.

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 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,” “believe,” “expect,” “anticipate,” “plan,” “goal” or other words that convey the uncertainty of future events or outcomes. In addition, sometimes we will specifically describe a statement as being a forward-looking statement and refer to this cautionary statement.

In addition, various statements in this quarterly report on Form 10-Q, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements. These forward-looking statements speak only as of the date of this report; we disclaim any obligation to update these

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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;
- decisions on spending by the U.S. Government and electric power generating companies;
  - the highly competitive nature of most of our businesses;
- cancellations of and adjustments to backlog and the resulting impact from using backlog as an indicator of future earnings;
- our ability to perform projects in our Offshore Oil and Gas Construction segment on time, in accordance with the schedules established by the applicable contracts with customers;
  - changes in legislation and regulations which impact the ability of inverted companies and their subsidiaries to obtain contracts from the U.S. Government;
  - the ability of our suppliers to deliver raw materials in sufficient quantities and 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, our ability to fund our pension obligations may be impacted;
  - the continued availability of qualified personnel;
- the operating risks normally incident to our lines of business, including the potential impact of liquidated damages;
  - changes in, or our failure or inability to comply with, government regulations;
  - adverse outcomes from legal and regulatory proceedings;
- impact of potential regional, national and/or global requirements to significantly limit or reduce greenhouse gas emissions in the future;
  - changes in, and liabilities relating to, existing or future environmental regulatory matters;
    - rapid technological changes;
  - the realization of deferred tax assets, including through a reorganization we completed in December 2006;
    - 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 businesses we acquire;
- the risk we might not be successful in updating and replacing current key financial and human resources legacy systems with enterprise systems;
- social, political and economic situations in foreign countries where we do business, including countries in the Middle East and Asia Pacific and the former Soviet Union;
  - the possibilities of war, other armed conflicts or terrorist attacks;
    - the affects of asserted and unasserted claims;
  - 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 insurance captives; and
- the impact of the loss of certain insurance rights as part of the Chapter 11 bankruptcy settlement.

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

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, 2008. 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

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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

### GENERAL

#### Capital Intensive Business Segments

In general, our business segments are composed of capital-intensive businesses that rely on large contracts for a substantial amount of their revenues. Each of our business segments is financed under a separate credit facility. Our debt covenants limit using the financial resources of or the movement of excess cash from one segment for the benefit of the other. For further discussion, see “Liquidity and Capital Resources” below.

#### Accounting for Contracts

As of September 30, 2009, in accordance with the percentage-of-completion method of accounting, we have provided for our estimated costs to complete 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. The risk on fixed-priced contracts is that revenue from the customer does not rise to 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 productivity, pipeline lay rates or steel and other raw material prices. In some instances, we guarantee completion dates related to our projects. Increases in costs on our fixed-price contracts could have a material adverse impact on our consolidated results of operations, financial condition and cash flows. Alternatively, reductions in overall contract costs at completion could materially improve our consolidated results of operations, financial condition and cash flows.

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 September 30, 2009, we have liquidated damage contingencies of approximately \$100 million based on our failure to meet such specified contractual milestone dates, all in our Offshore Oil and Gas Construction segment, of which \$14 million has been recorded in our financial statements. We do not believe any additional claims for these potential liquidated damages are probable of being assessed. The trigger dates for these potential liquidated damages range from June of 2008 to September 30, 2009. 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.

#### Regulation of Inverted Companies

As a result of our reorganization we completed in 1982 through a transaction commonly referred to as an “inversion,” the parent company of our group of companies is McDermott International, Inc. (“MII”), a corporation organized under the laws of the Republic of Panama. Certain prior and current U.S. legislative proposals and enactments have sought to prohibit the U.S. Government from contracting with so-called “inverted” companies and their subsidiaries in connection with various government operations. To date, such legislative actions have not adversely affected our U.S. Government contract work, although there can be no assurance that this would continue to be the case.

Additionally, on July 1, 2009, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (the “FAR Councils”), acting under the U.S. Federal Acquisition Regulation (the “FAR”), adopted interim rules,



with an immediate effective date, that established contracting procedures to implement a mandate in the Omnibus Appropriations Act, 2009, that generally prohibits federal agencies from awarding new contracts to inverted companies and their subsidiaries with U.S. federal appropriated funds for fiscal year 2009 and certain prior fiscal years. The current version of the proposed U.S. federal appropriations legislation for 2010 contains restrictions on contracting with inverted companies similar to those in the 2009 Omnibus Appropriations Act. The public comment period for the interim rules under the FAR ended on August 31, 2009. As of the date of this report, it is uncertain as to when the FAR councils will adopt final rules and whether and the extent to which the final rules may differ from the interim rules. We believe the interim rules do not have any impact on any of our existing contracts, and we believe that they should not impact our ability to enter into subcontracts relating to any government projects. The

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interim rules are not clear as to how joint ventures are impacted, including those in which we are the majority or controlling owner.

The impact that the adoption of the interim rules under the FAR will have on our ability to pursue new contract awards, directly or indirectly, with the U.S. Government and its agencies is unclear. Additionally, the form in which, or the scope of, any final rules under the FAR or any other rules or regulations governing U.S. federal contracts using appropriated funds that may be adopted, or any potential future legislation impacting such rules and regulations, is also unclear. We are taking steps to determine what actions may be appropriate to mitigate any adverse impact. These steps could include, in addition to seeking, to the extent available, any appropriate waivers under the rules, one or more transactions that would result in significant changes to our corporate organization and structure. Depending on the application of the interim rules and the actual provisions of the anticipated final rules and regulations, we may not be able to mitigate, fully or partially, any material adverse impact from the adoption of such rules or regulations. We derive a substantial amount of our revenues and profits from services provided to the U.S. Government, mainly through our Government Operations segment, and any exclusion from pursuing future U.S. Government contract work could have a material adverse effect on our financial condition, results of operations or cash flows.

## Taxation of Inverted Companies

As a result of our reorganization in 1982 discussed above, MII is the parent company of our group of companies. Tax legislative proposals intending to eliminate some perceived tax advantages of companies that have legal domiciles outside the U.S. but operate in the U.S. through one or more subsidiaries have repeatedly been introduced in the U.S. Congress. Recent examples include, but are not limited to, legislative proposals that would broaden the circumstances in which a non-U.S. company would be considered a U.S. resident for U.S. tax purposes. It is possible that, if legislation is enacted in this area, we could be subject to a substantial increase in our corporate income taxes and, consequently, decrease our future net income and increase our future cash outlays for taxes. Although we are unable to predict the form in which any proposed legislation might become law or the nature of regulations that may be promulgated under any such future legislative enactments, such laws or regulations could have a material adverse effect on our financial condition, results of operations or cash flows.

## Offshore Oil and Gas Construction Segment

Our Offshore Oil and Gas Construction segment's activity depends mainly on the capital expenditures for offshore construction services of oil and gas companies and on foreign governments for construction of development projects in the regions in which we operate. This segment's operations are generally capital intensive, and a number of factors influence its activities, including:

- oil and gas prices, along with expectations about future prices;
- the cost of exploring for, producing and delivering oil and gas;
  - the terms and conditions of offshore leases;
- the discovery rates of new oil and gas reserves in offshore areas;
  - the ability of businesses in the oil and gas industry to raise capital; and
  - local and international political and economic conditions.

## Government Operations Segment

The revenues of our Government Operations segment are largely a function of defense spending by the U.S. Government. As a supplier of major nuclear components for certain U.S. Government programs, this segment is a significant participant in the defense industry.

## Power Generation Systems Segment

Our Power Generation Systems segment's overall activity depends mainly on the capital expenditures of electric power generating companies and other steam-using industries. Several factors influence these expenditures, including:

- prices for electricity, along with the cost of production and distribution;
  - prices for coal and natural gas and other sources used to produce electricity;
  - demand for electricity, paper and other end products of steam-generating facilities;
    - availability of other sources of electricity, paper or other end products;
    - requirements for environmental improvements;
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- impact of potential regional, state, national and/or global requirements to significantly limit or reduce greenhouse gas emissions in the future;
  - level of capacity utilization at operating power plants, paper mills and other steam-using facilities;
- requirements for maintenance and upkeep at operating power plants and paper mills to combat the accumulated effects of wear and tear;
  - ability of electric generating companies and other steam users to raise capital; and
- relative prices of fuels used in boilers, compared to prices for fuels used in gas turbines and other alternative forms of generation.

#### Research and Development

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. Substantially all of these costs are in our Power Generation Systems segment and include costs related to the development of carbon capture and sequestration and our modular and scalable nuclear reactor business, mPower. For the three months ended September 30, 2009 and 2008, our net research and development expense included in cost of operations totaled approximately \$12.8 million and \$9.9 million, respectively. For the nine months ended September 30, 2009 and 2008, our net research and development expense totaled approximately \$33.9 million and \$28.7 million, respectively. We expect to continue significant spending on research and development projects, as we continue development on our carbon capture sequestration efforts and our commercial nuclear and mPower reactor projects.

For a summary of the critical accounting policies and estimates that we use in the preparation of our unaudited condensed consolidated financial statements, see Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our annual report on Form 10-K for the year ended December 31, 2008. There have been no material changes to these policies during the nine months ended September 30, 2009, except as disclosed in Note 1 of the notes to condensed consolidated financial statements included in this report.

#### RESULTS OF OPERATIONS – THREE MONTHS ENDED SEPTEMBER 30, 2009 VS. THREE MONTHS ENDED SEPTEMBER 30, 2008

##### McDermott International, Inc. (Consolidated)

Revenues increased approximately 1%, or \$10.8 million, to \$1,675.7 million in the three months ended September 30, 2009 compared to \$1,664.9 million for the corresponding period of 2008. In the third quarter of 2009, as compared to the third quarter of 2008, our Offshore Oil and Gas Construction segment experienced a \$212.0 million, or 26%, increase in revenues and our Government Operations segment experienced a \$37.4 million or 17% increase in revenues. These increases were partially offset by our Power Generation Systems segment which experienced a \$241.4 million, or 38%, reduction in its revenues, primarily due to a decrease in its utility steam and system fabrication business revenues.

Segment operating income increased \$60.9 million to \$147.8 million in the three months ended September 30, 2009 from \$86.9 million for the corresponding period of 2008. The segment operating income of our Offshore Oil and Gas Construction segment increased \$125.7 million in the three months ended September 30, 2009 as compared to the third quarter of 2008, primarily attributable to improved project performance in our Middle East region. The segment operating income of our Government Operations and Power Generation Systems segments decreased by \$15.8 million and \$49.0 million, respectively, in the three months ended September 30, 2009 compared to the corresponding period in 2008. We experienced a significant increase in our pension plan expense in the three months ended September 30, 2009 compared to the corresponding period in 2008 totaling approximately \$29.4 million. This increase was primarily attributable to amortization of losses on pension plan assets experienced in the year ended 2008.

For purpose of this discussion and the discussions that follow, segment operating income is before equity in income (loss) of investees and gains (losses) on asset disposals - net.

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Offshore Oil and Gas Construction

Revenues increased 26%, or \$212.0 million, to \$1,026.7 million in the three months ended September 30, 2009 compared to \$814.7 million in the corresponding period of 2008, primarily attributable to increases in our Middle East (\$306.8 million) and Caspian (\$42.5 million) regions, partially offset by decreases in our Asia Pacific (\$76.3 million) and Americas (\$20.9 million) regions.

Segment operating income increased \$125.7 million from a loss of \$18.7 million in the three months ended September 30, 2008 to income of \$107.0 million in the three months ended September 30, 2009, primarily attributable to improvements in project performance in our Middle East region. In the three months ended September 30, 2008, we recognized approximately \$90.0 million of contract losses on the expected costs to complete various projects primarily in our Middle East region. In the three months ended September 30, 2009 we also experienced increased segment operating income from our Asia Pacific region as a result of project improvements and increased segment operating income from our Caspian region, partially offset by a decrease in segment operating income from our Americas region. In addition, we realized benefits from project close-outs totaling approximately \$14.0 million in the three months ended September 30, 2009 compared to approximately \$16.0 million in the corresponding period of 2008.

Government Operations

Revenues increased approximately 17%, or \$37.4 million, to \$259.8 million in the three months ended September 30, 2009 compared to \$222.4 million for the corresponding period of 2008, primarily attributable to our acquisition of Nuclear Fuel Services, Inc. ("NFS") (\$32.9 million) and additional volume in the manufacture of nuclear components of certain U.S. Government programs and recovery work. These improvements were partially offset by lower volumes in the manufacture of components for a commercial uranium enrichment project (\$10.4 million) and lower volumes in engineering and laboratory services. Additionally, we experienced lower revenues from our management and operating contracts at several government sites.

Segment operating income decreased \$15.8 million to \$10.8 million in the three months ended September 30, 2009 compared to \$26.6 million for the corresponding period of 2008, primarily attributable to losses incurred at NFS due to production delays and poor productivity with respect to its downblending contracts. We also experienced increased pension expense in the three months ended September 30, 2009 compared to the corresponding period of 2008. In addition, we experienced lower volumes related to a commercial uranium enrichment project and lower margins from our management and operating contracts at several government sites. These decreases were partially offset by additional volumes in the manufacture of nuclear components for certain U.S. Government programs and recovery work.

Equity income of investees increased \$1.1 million to \$9.1 million in the three months ended September 30, 2009 compared to \$8.0 million in the corresponding period of 2008, primarily attributable to decreases in expenses and higher fees earned at two of our sites in Tennessee, partially offset by lower fees earned from a contract in Idaho.

Power Generation Systems

Revenues decreased approximately 38%, or \$241.4 million, to \$389.6 million in the three months ended September 30, 2009, compared to \$631.0 million in the corresponding period of 2008, primarily attributable to decreased revenues from our utility steam and system fabrication business (\$160.1 million), fabrication, repair and retrofit of existing facilities business (\$53.2 million), replacement parts business (\$10.0 million), boiler auxiliary equipment business (\$9.8 million), industrial boilers business (\$6.8 million), and nuclear service business (\$6.2 million).

Segment operating income decreased \$49.0 million to \$30.0 million in the three months ended September 30, 2009 compared to \$79.0 million in the corresponding period of 2008, primarily attributable to lower volumes in our utility steam and system fabrication business, fabrication, repair and retrofit of existing facilities business, replacement parts business, and industrial boilers business, combined with lower margins in our nuclear service business. We also experienced higher pension expense in the three months ended September 30, 2009 compared to the corresponding period in 2008. These decreases were partially offset by profit increases attributable to improved margins in our operations and maintenance business.

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Equity in income of investees decreased \$0.9 million to \$4.6 million in the three months ended September 30, 2009 from \$5.5 million in the corresponding period of 2008, primarily attributable to our joint venture in China.

## Corporate

Unallocated Corporate expenses increased \$8.4 million to \$15.7 million in the three months ended September 30, 2009, as compared to \$7.3 million for the corresponding period of 2008, primarily attributable to increased pension expense attributable to amortization of losses on pension plan assets experienced in the year ended 2008, and higher compensation expenses. We also experienced an increase in information technology expenses in the three months ended September 30, 2009 compared to the corresponding period of 2008. These increases were partially offset by improvements in our captive insurers attributable primarily to favorable results from our actuarially determined workmen's compensation liabilities.

## Other Income Statement Items

Interest income (expense) - net decreased \$3.0 million to \$2.2 million of income in the three months ended September 30, 2009, primarily due to lower average interest rates on our investments, and an increase in interest expense attributable to borrowings and amortization of fees under our credit facilities. These decreases were partially offset by an increase in capitalized interest.

Other income (expense) – net decreased by \$6.0 million to expense of \$3.1 million in the three months ended September 30, 2009 from income of \$2.9 million for the corresponding period of 2008, primarily due to higher currency translation exchange losses incurred in the third quarter of 2009.

## Provision for Income Taxes

For the three months ended September 30, 2009, the provision for income taxes increased \$9.5 million to \$23.8 million, while income before provision for income taxes increased \$43.7 million to \$143.8 million. Our effective tax rate for the three months ended September 30, 2009 was approximately 16.5%, as compared to 14.3% for the three months ended September 30, 2008. The 2008 quarter included \$45 million of additional tax assets and benefits resulting primarily from the release of state tax valuations and audit activity offset by losses in certain non-U.S. tax jurisdictions that had no corresponding tax benefit.

Income before provision for income taxes, provision for income taxes and effective tax rates for our U.S. and non-U.S. jurisdictions are as shown below:

|                   | Income<br>before Provision for<br>Income Taxes |            | Provision for<br>Income Taxes |             | Effective Tax Rate |           |
|-------------------|--|------------|-------------------------------|-------------|--------------------|-----------|
|                   | For the three months ended September 30,       |            |                               |             | 2009               | 2008      |
|                   | 2009   | 2008       | 2009                          | 2008        |                    |           |
|                   | (In thousands)                                 |            | (In thousands)                |             |                    |           |
| United States     | \$ 4,463                                       | \$ 99,139  | \$ 3,035                      | \$ (2,980 ) | 68.00 %            | (3.01 %)  |
| Non-United States | 139,383  | 930        | 20,758                        | 17,251      | 14.89 %            | 1854.95 % |
| Total             | \$ 143,846                                     | \$ 100,069 | \$ 23,793                     | \$ 14,271   | 16.54 %            | 14.26 %   |



We are subject to U.S. federal income tax at a rate of 35% on our U.S. operations, plus the applicable state income taxes on our profitable U.S. subsidiaries. Our non-U.S. earnings are subject to tax at various tax rates and different tax regimes, such as a deemed profits tax regime. These variances, along with variances in our mix of income from these jurisdictions, contribute to shifts in our effective tax rate.

RESULTS OF OPERATIONS – NINE MONTHS ENDED SEPTEMBER 30, 2009 vs. NINE MONTHS ENDED SEPTEMBER 30, 2008

McDermott International, Inc. (Consolidated)

Revenues decreased approximately 3.5%, or \$174.0 million, to \$4,733.9 million in the nine months ended

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September 30, 2009 compared to \$4,907.9 million for the corresponding period of 2008. Our Power Generation Systems segment experienced a 28.6%, or \$555.5 million, reduction in its revenues for the nine months ended September 30, 2009 compared to 2008 attributable primarily to decreased revenues from its utility steam and system fabrication business. Our Offshore Oil and Gas Construction and Government Operations segments generated increases in revenues totaling \$235.0 million and \$139.5 million, respectively, in the nine months ended September 30, 2009 compared to the corresponding period of 2008. The increase in revenues from our Offshore Oil and Gas Construction segment was primarily attributable to projects in our Middle East region. The increase in revenues from our Government Operations segment was primarily attributable to the acquisition of NFS.

Segment operating income decreased \$22.5 million to \$446.7 million in the nine months ended September 30, 2009 from \$469.2 million for the corresponding period of 2008. The segment operating income of our Power Generation Systems segment decreased \$120.7 million in the nine months ended September 30, 2009, as compared to the corresponding period in 2008, primarily attributable to decreased segment operating income from its utility steam and system fabrication business. These decreases were partially offset by \$9.2 million and \$89.0 million increases in the segment operating income of our Government Operations and Offshore Oil and Gas Construction segments, respectively, in the nine months ended September 30, 2009, as compared to the corresponding period in 2008. We experienced a significant increase in our pension plan expense in the nine months ended September 30, 2009 compared to the corresponding period of 2008 totaling approximately \$73.1 million. This increase was primarily attributable to amortization of losses on pension plan assets experienced in the year ended 2008.

### Offshore Oil and Gas Construction

Revenues increased 10%, or \$235.0 million, to \$2,567.9 million in the nine months ended September 30, 2009 compared to \$2,332.9 million in the corresponding period of 2008, primarily attributable to increases from our Middle East region (\$527.0 million). This increase was partially offset by decreases from our Asia Pacific (\$99.6 million), Caspian (\$84.9 million) and Americas (\$48.7 million) regions.

Segment operating income increased \$89.0 million to \$221.2 million in the nine months ended September 30, 2009 from \$132.2 million in the corresponding period of 2008 primarily attributable to improvements in project performance in our Middle East region. In the nine months ended September 30, 2008, we recognized approximately \$90.0 million of contract losses related to the expected costs to complete various projects, primarily in our Middle East region. In addition, we experienced an increase in segment operating income from our Asia Pacific region as a result of project improvements and an increase in segment operating income from our Americas region from project close-outs and change orders, partially offset by a decrease in segment operating income from our Caspian region. We realized benefits from project close-outs totaling approximately \$50.0 million in the nine months ended September 30, 2009 compared to approximately \$38.0 million in the corresponding period of 2008. We also experienced a reduction in selling, general and administrative expenses totaling \$5.1 million in the nine months ended September 30, 2009 compared to the corresponding period of 2008.

### Government Operations

Revenues increased 21.8%, or \$139.5 million, to \$778.3 million in the nine months ended September 30, 2009 compared to \$638.8 million for the corresponding period of 2008, primarily attributable to our acquisition of NFS (\$120 million) and additional volumes in the manufacture of nuclear components of certain U.S. Government programs and recovery work. These improvements were partially offset by lower volumes in the manufacture of components for a commercial uranium enrichment project, engineering and laboratory services and lower revenues from our management and operating contracts at several government sites.

Segment operating income increased \$9.2 million to \$96.7 million in the nine months ended September 30, 2009 compared to \$87.5 million for the corresponding period of 2008, primarily attributable to our acquisition of NFS and

additional volumes in the manufacture of nuclear components of certain U.S. Government programs and recovery work. These improvements were partially offset by increased pension expense, lower revenues from our management and operating contracts at several government sites and lower volumes related to a commercial uranium enrichment project.

Equity income of investees decreased \$1.1 million to \$26.4 million in the nine months ended September 30, 2009 compared to \$27.5 million in the corresponding period of 2008, primarily attributable to cost savings incentives earned in 2008 for a site in Louisiana, and lower fees earned from a site in Idaho. These decreases were partially offset by increased fees earned at sites in Tennessee and Idaho.

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Power Generation Systems

Revenues decreased approximately 29%, or \$555.5 million, to \$1,389.8 million for the nine months ended September 30, 2009 compared to \$1,945.3 million for the corresponding period of 2008, primarily attributable to decreased revenues from our utility steam and system fabrication business (\$401.9 million), fabrication, repair and retrofit of existing facilities business (\$106.1 million), replacement parts business (\$21.3 million), nuclear steam generators business (\$18.2 million), and industrial boiler business (\$9.8 million).

Segment operating income decreased \$120.7 million to \$128.8 million for the nine months ended September 30, 2009 compared to \$249.5 million for the corresponding period of 2008, primarily attributable to lower volumes in our utility steam and system fabrication business and our fabrication, repair and retrofit of existing facilities business. In addition we experienced lower margins and volumes in our replacement parts and nuclear steam generator businesses, and lower margins in nuclear service and industrial boilers business. We also experienced higher pension expense in the nine months ended September 30, 2009. These decreases were partially offset by improved margins in our operations and maintenance business.

Gains (losses) on asset disposals - net decreased by \$9.9 million from the corresponding period of 2008. The prior year included a gain on the sale of our Dumbarton, Scotland facilities.

Corporate

Unallocated corporate expenses increased \$22.2 million to \$54.9 million in the nine months ended September 30, 2009, as compared to \$32.7 million for the corresponding period of 2008, primarily attributable to increased pension expense from the amortization of losses on pension plan assets experienced in the year ended 2008, and higher compensation expenses. We also experienced an increase in information technology expenses in the nine months ended September 30, 2009 compared to the corresponding period of 2008. These increases were partially offset by improvements in our captive insurers, attributable primarily to favorable results from our actuarially determined workmen's compensation liabilities.

Other Income Statement Items

Interest income (expense) - net decreased \$14.8 million to \$9.0 million of income in the nine months ended September 30, 2009, primarily due to reduced cash and investment balances and lower average interest rates on our investments, and an increase in interest expense attributable to borrowings and amortization of fees under our credit facilities. These decreases were partially offset by an increase in capitalized interest.

Other income (expense) - net increased by \$24.9 million to expense of \$24.1 million in the nine months ended September 30, 2009 from income of \$0.8 million for the corresponding period of 2008, primarily due to higher currency exchange losses incurred in 2009.

Provision for Income Taxes

For the nine months ended September 30, 2009, the provision for income taxes decreased \$6.0 million to \$112.3 million, while income before provision for income taxes decreased \$96.2 million to \$408.7 million. Our effective tax rate for the nine months ended September 30, 2009 was approximately 27.5%, as compared to 23.4% for the nine months ended September 30, 2008. In the nine months ended September 30, 2008, we recognized certain tax assets and benefits totaling approximately \$55 million from the release of state valuation allowances and as a result of audit activity offset by losses in certain non-U.S. tax jurisdictions that had no corresponding tax benefit.

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Income before provision for income taxes, provision for income taxes and effective tax rates for our U.S. and non-U.S. jurisdictions are as shown below:

|                   | Income<br>before Provision for<br>Income Taxes |            | Provision for<br>Income Taxes |            | Effective Tax Rate |         |
|-------------------|--|------------|-------------------------------|------------|--------------------|---------|
|                   | For the nine months ended September 30,        |            |                               |            | 2009               | 2008    |
|                   | 2009   | 2008       | 2009                          | 2008       |                    |         |
|                   | (In thousands)                                 |            | (In thousands)                |            |                    |         |
| United States     | \$ 134,017                                     | \$ 281,105 | \$ 57,876                     | \$ 59,369  | 43.19 %            | 21.12 % |
| Non-United States | 274,648  | 223,744    | 54,440                        | 58,884     | 19.82 %            | 26.32 % |
| Total             | \$ 408,665                                     | \$ 504,849 | \$ 112,316                    | \$ 118,253 | 27.48 %            | 23.42 % |

We are subject to U.S. federal income tax at a rate of 35% on our U.S. operations, plus the applicable state income taxes on our profitable U.S. subsidiaries. Our non-U.S. earnings are subject to tax at various tax rates and different tax regimes, such as a deemed profits tax regime. These variances, along with variances in our mix of income from these jurisdictions, contribute to shifts in our effective tax rate.

## Backlog

Backlog is not a measure recognized by generally accepted accounting principles. It is possible that our methodology for determining backlog may not be comparable to methods used by other companies. We generally include expected revenue in our backlog when we receive written confirmation from our customers. Backlog may not be indicative of future operating results, and projects in our backlog may be cancelled, modified or otherwise altered by customers.

|                                   | September<br>30,<br>2009 | December<br>31,<br>2008 |
|-----------------------------------|--------------------------|-------------------------|
|                                   | (Unaudited)              |                         |
|                                   | (In millions)            |                         |
| Offshore Oil and Gas Construction | \$3,943                  | \$4,457                 |
| Government Operations             | 2,539                    | 2,883                   |
| Power Generation Systems          | 2,062                    | 2,476                   |
| Total Backlog                     | \$8,544                  | \$9,816                 |

Of the September 30, 2009 backlog, we expect to recognize revenues as follows:

|                                   | 2009                      | 2010    | Thereafter |
|-----------------------------------|---------------------------|---------|------------|
|                                   | (Unaudited)               |         |            |
|                                   | (In approximate millions) |         |            |
| Offshore Oil and Gas Construction | \$810                     | \$2,145 | \$988      |
| Government Operations             | 230                       | 800     | 1,509      |
| Power Generation Systems          | 400                       | 840     | 822        |
| Total Backlog                     | \$1,440                   | \$3,785 | \$3,319    |

At September 30, 2009, the Offshore Oil and Gas Construction backlog included approximately \$333 million related to contracts in or near loss positions, which are estimated to recognize future revenues with approximately zero percent gross margins. In the three months ended September 30, 2009 we recognized approximately \$306 million in revenues related to these contracts. It is possible that our estimates of gross profit could increase or decrease based on improved productivity, actual downtime and the resolution of change orders and claims with our customers.

At September 30, 2009, Government Operations' backlog with the U.S. Government was \$2.5 billion, which was substantially fully funded. Approximately \$4.4 million had not been funded as of September 30, 2009.

We believe the current worldwide credit and economic environment and short-term uncertainty regarding environmental regulations have affected customers in the electric utility industry more than our other customers.

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While we have not experienced significant delays on existing projects in our Power Generation Systems' backlog, we have experienced some delays in expected bookings on new planned projects.

At September 30, 2009, Power Generation Systems' backlog with the U.S. Government was \$5.1 million, all of which was fully funded.

### Liquidity and Capital Resources

#### Offshore Oil and Gas Construction

On June 6, 2006, one of our subsidiaries, J. Ray McDermott, S.A., entered into a senior secured credit facility with a syndicate of lenders (the "JRMSA Credit Facility"). As amended to date, the JRMSA Credit Facility provides for borrowings and issuances of letters of credit in an aggregate amount of up to \$800 million and is scheduled to mature on June 6, 2011. The proceeds of the JRMSA Credit Facility are available for working capital needs and other general corporate purposes of our Offshore Oil and Gas Construction segment.

JRMSA's obligations under the JRMSA Credit Facility are unconditionally guaranteed by substantially all of our wholly owned subsidiaries comprising our Offshore Oil and Gas Construction segment and secured by liens on substantially all the assets of those subsidiaries (other than cash, cash equivalents, equipment and certain foreign assets), including their major marine vessels.

Other than customary mandatory prepayments on certain contingent events, the JRMSA Credit Facility requires only interest payments on a quarterly basis until maturity. JRMSA is permitted to prepay amounts outstanding under the JRMSA Credit Facility at any time without penalty.

The JRMSA Credit Facility contains customary financial covenants relating to leverage and interest coverage and includes covenants that restrict, among other things, debt incurrence, liens, investments, acquisitions, asset dispositions, dividends, prepayments of subordinated debt, mergers, transactions with affiliates and capital expenditures. At September 30, 2009, JRMSA was in compliance with all of the covenants set forth in the JRMSA Credit Facility.

While there were no borrowings outstanding as of September 30, 2009, we borrowed under the JRMSA Credit Facility for working capital purposes during the quarter ended September 30, 2009. We expect to access the JRMSA Credit Facility for similar borrowings, as needed, in the future. As of September 30, 2009, letters of credit issued under the JRMSA Credit Facility totaled \$214.0 million, and there was a total of \$586.0 million available for borrowings or to meet letter of credit requirements. Borrowings under this facility during the September 30, 2009 quarter had an applicable average interest rate of approximately 3.75% per year. In addition, JRMSA and its subsidiaries had \$292.9 million in outstanding unsecured letters of credit under separate arrangements with financial institutions at September 30, 2009.

In 2007, JRMSA executed a general agreement of indemnity in favor of a surety underwriter based in Mexico relating to surety bonds that underwriter issued in support of contracting activities of J. Ray McDermott de Mèxico, S.A. de C.V., a subsidiary of JRMSA. As of September 30, 2009, bonds issued under this arrangement totaled \$7.7 million.

Based on the liquidity position of our Offshore Oil and Gas Construction segment, we believe this segment has sufficient cash and letter of credit and borrowing capacity to fund its operating requirements for at least the next 12 months.

### Government Operations

On December 9, 2003, one of our subsidiaries, BWX Technologies, Inc. (“BWXT”), entered into a senior unsecured credit facility with a syndicate of lenders (the “BWXT Credit Facility”), which is currently scheduled to mature March 18, 2010. This facility provides for borrowings and issuances of letters of credit in an aggregate amount of up to \$135 million. The proceeds of the BWXT Credit Facility are available for working capital needs and other general corporate purposes of our Government Operations segment.

The BWXT Credit Facility contains customary financial and nonfinancial covenants and reporting requirements. The financial covenants require maintenance of a maximum leverage ratio, a minimum fixed charge

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coverage ratio and a maximum debt to capitalization ratio within our Government Operations segment. At September 30, 2009, BWXT was in compliance with all of the covenants set forth in the BWXT Credit Facility.

The BWXT Credit Facility only requires interest payments on a quarterly basis until maturity. Amounts outstanding under the BWXT Credit Facility may be prepaid at any time without penalty.

At September 30, 2009, there were no borrowings outstanding, but letters of credit issued under the BWXT Credit Facility totaled \$54.2 million. At September 30, 2009, there was \$80.8 million available for borrowings or to meet letter of credit requirements under the BWXT Credit Facility. If there had been borrowings under this facility, the applicable interest rate at September 30, 2009 would have been 3.50% per year.

At September 30, 2009, Nuclear Fuel Services, Inc., a subsidiary of BWXT, had \$3.8 million in letters of credit issued by various commercial banks on its behalf. The obligations to the commercial banks issuing such letters of credit are secured by cash, short-term certificates of deposit and certain real and intangible assets.

Based on the liquidity position of our Government Operations segment, we believe this segment has sufficient cash and letter of credit and borrowing capacity to fund its operating requirements for at least the next 12 months.

Power Generation Systems

On February 22, 2006, one of our subsidiaries, Babcock & Wilcox Power Generation Group, Inc., entered into a senior secured credit facility with a syndicate of lenders (the "B&W PGG Credit Facility"). As amended to date, this facility provides for borrowings and issuances of letters of credit in an aggregate amount of up to \$400 million and is scheduled to mature on February 22, 2011. The proceeds of the B&W PGG Credit Facility are available for working capital needs and other similar corporate purposes of our Power Generation Systems segment.

B&W PGG's obligations under the B&W PGG Credit Facility are unconditionally guaranteed by all of our domestic subsidiaries included in our Power Generation Systems segment and secured by liens on substantially all the assets of those subsidiaries, excluding cash and cash equivalents.

The B&W PGG Credit Facility only requires interest payments on a quarterly basis until maturity. Amounts outstanding under the B&W PGG Credit Facility may be prepaid at any time without penalty.

The B&W PGG Credit Facility contains customary financial covenants, including maintenance of a maximum leverage ratio and a minimum interest coverage ratio within our Power Generation Systems segment and covenants that, among other things, restrict the ability of this segment to incur debt, create liens, make investments and acquisitions, sell assets, pay dividends, prepay subordinated debt, merge with other entities, engage in transactions with affiliates and make capital expenditures. At September 30, 2009, B&W PGG was in compliance with all of the covenants set forth in the B&W PGG Credit Facility.

As of September 30, 2009, there were no outstanding borrowings but letters of credit issued under the B&W PGG Credit Facility totaled \$190.7 million. At September 30, 2009, there was \$209.3 million available for borrowings or to meet letter of credit requirements under the B&W PGG Credit Facility. If there had been borrowings under this facility, the applicable interest rate at September 30, 2009 would have been 3.25% per year.

Certain foreign subsidiaries of B&W PGG have credit arrangements with various commercial banks for the issuance of bank guarantees. The aggregate value of all such bank guarantees as of September 30, 2009 was \$17.4 million.

MII, B&W PGG and McDermott Holdings, Inc. have jointly executed certain general agreements of indemnity in favor of surety underwriters relating to surety bonds issued in support of B&W PGG's contracting activity. As of

September 30, 2009, bonds issued under these arrangements in support of contracts totaled approximately \$81.5 million. Any claim successfully asserted against a surety by one or more of the bond obligees would likely be recoverable from MII, B&W PGG and McDermott Holdings, Inc. under the indemnity agreements.

Based on the liquidity position of our Power Generation Systems segment, we believe this segment has sufficient cash and letter of credit and borrowing capacity to fund its operating requirements for at least the next 12 months.

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Other

In aggregate, our cash and cash equivalents, restricted cash and cash equivalents and investments increased by \$2.5 million to \$1,090.4 million at September 30, 2009 from \$1,087.9 million at December 31, 2008, primarily due to cash provided by operating activities.

Our working capital, excluding cash and cash equivalents and restricted cash and cash equivalents, improved by \$145.8 million to a negative \$482.7 million at September 30, 2009 from a negative \$628.5 million at December 31, 2008, primarily due to the increase in the net amount of contracts in progress and advance billings on contracts, partially offset by a decrease in short term investments and accounts receivable.

Our net cash provided by (used in) operations improved by \$304.5 million to net cash provided by operations of \$197.4 million in the nine months ended September 30, 2009 from net cash used in operations of \$107.1 million for the nine months ended September 30, 2008. This change was primarily attributable to net improvements in our contracts in progress and advance billings on contracts, and a decrease in cash used in our pension, postretirement and employee benefit obligations.

Our net cash used in investing activities decreased by \$284.1 million to \$3.7 million in the nine months ended September 30, 2009 from \$287.8 million in the nine months ended September 30, 2008. This change was primarily attributable to a net increase in available-for-sale securities during the nine months ended September 30, 2009.

Our net cash provided by (used in) financing activities changed by \$17.1 million to net cash used in financing activities of \$6.0 million in the nine months ended September 30, 2009 from net cash provided by financing activities of \$11.1 million in the nine months ended September 30, 2008, primarily due to lower excess tax benefits related to stock-based compensation, and issuance of common stock.

At September 30, 2009, we had restricted cash and cash equivalents totaling \$64.1 million, \$51.1 million of which was held in restricted foreign accounts, \$4.5 million was held in escrow pending final payment on a legal settlement, \$3.6 million was held as cash collateral for letters of credit, \$4.3 million was held for future decommissioning of facilities, and \$0.6 million was held to meet reinsurance reserve requirements of our captive insurance companies. It is possible that a significant portion of restricted cash at September 30, 2009 will not be released within the next twelve months

At September 30, 2009, we had investments with a fair value of \$241.9 million. Our investment portfolio consists primarily of investments in government obligations and other highly liquid money market instruments. As of September 30, 2009, we had pledged approximately \$33.3 million fair value of these investments in connection with certain reinsurance agreements.

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 loss. Our net unrealized loss on investments was in an unrealized loss position totaling \$7.8 million at September 30, 2009. At December 31, 2008, we had unrealized losses on our investments totaling \$9.0 million. The major components of our investments in an unrealized loss position are corporate bonds, asset-backed obligations and commercial paper. Based on our analysis of these investments, we believe that none of our available-for-sale securities were other than temporarily impaired at September 30, 2009.

See Note 1 to our unaudited condensed consolidated financial statements included in this report for information on new and recently adopted accounting standards.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposures to market risks have not changed materially from those disclosed in Item 7A included in Part II of our annual report on Form 10-K for the year ended December 31, 2008.

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

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“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 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 September 30, 2009 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 as appropriate to allow timely decisions regarding disclosure. There has been no change in our internal control over financial reporting during the quarter ended September 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II  
OTHER INFORMATION

Item 1. Legal Proceedings

For information regarding ongoing investigations and litigation, see Note 3 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

Recent U.S. regulation may adversely affect our ability to contract with the U.S. Government

As a result of our reorganization we completed in 1982 through a transaction commonly referred to as an “inversion,” the parent company of our group of companies, is McDermott International, Inc. (“MII”), a corporation organized under the laws of the Republic of Panama. Certain prior and current U.S. legislative proposals and enactments have sought to prohibit the U.S. Government from contracting with so-called “inverted” companies and their subsidiaries in connection with various government operations. To date, such legislative actions have not adversely affected our U.S. Government contract work, although there can be no assurance that this would continue to be the case.

Additionally, on July 1, 2009, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (the “FAR Councils”), acting under the U.S. Federal Acquisition Regulation (the “FAR”), adopted interim rules, with an immediate effective date, that established contracting procedures to implement a mandate in the Omnibus Appropriations Act, 2009, that generally prohibits federal agencies from awarding new contracts to inverted companies and their subsidiaries with U.S. federal appropriated funds for fiscal year 2009 and certain prior fiscal years. The current version of the proposed U.S. federal appropriations legislation for 2010 contains restrictions on contracting with inverted companies similar to those in the 2009 Omnibus Appropriations Act. The public comment period for the interim rules under the FAR ended on August 31, 2009. As of the date of this report, it is uncertain as to when the FAR councils will adopt final rules and whether and the extent to which the final rules may differ from the interim rules. We believe the interim rules do not have any impact on any of our existing contracts, and we believe that they should not impact our ability to enter into subcontracts relating to any government projects. The interim rules are not clear as to how joint ventures are impacted, including those in which we are the majority or controlling owner.

The impact that the adoption of the interim rules under the FAR will have on our ability to pursue new contract awards, directly or indirectly, with the U.S. Government and its agencies is unclear. Additionally, the form in which, or the scope of, any final rules under the FAR or any other rules or regulations governing U.S. federal contracts using

appropriated funds that may be adopted, or any potential future legislation impacting such rules and regulations, is also unclear. We are taking steps to determine what actions may be appropriate to mitigate any adverse impact. These steps could include, in addition to seeking, to the extent available, any appropriate waivers under the rules, one or more transactions that would result in significant changes to our corporate organization and structure. Depending on the application of the interim rules and the actual provisions of the anticipated final rules and regulations, we may not be able to mitigate, fully or partially, any material adverse impact from the adoption of such rules or regulations. We derive a substantial amount of our revenues and profits from services provided to the U.S. Government, mainly through

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our Government Operations segment, and any exclusion from pursuing future U.S. Government contract work could have a material adverse effect on our financial condition, results of operations or cash flows.

A change in tax laws could have a material adverse effect on us by substantially increasing our corporate income taxes and, consequently, decreasing our future net income and increasing our future cash outlays for taxes

As a result of our reorganization in 1982 discussed above, MII is the parent company of our group of companies. Tax legislative proposals intending to eliminate some perceived tax advantages of companies that have legal domiciles outside the U.S. but operate in the U.S. through one or more subsidiaries have repeatedly been introduced in the U.S. Congress. Recent examples include, but are not limited to, legislative proposals that would broaden the circumstances in which a non-U.S. company would be considered a U.S. resident for U.S. tax purposes. It is possible that, if legislation is enacted in this area, we could be subject to a substantial increase in our corporate income taxes and, consequently, decrease our future net income and increase our future cash outlays for taxes. Although we are unable to predict the form in which any proposed legislation might become law or the nature of regulations that may be promulgated under any such future legislative enactments, such laws or regulations could have a material adverse effect on our financial condition, results of operations or cash flows.

## 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 September 30, 2009, all of which involved repurchases of restricted shares of MII common stock pursuant to the provisions of employee benefit plans that permit the repurchase of restricted shares to satisfy statutory tax withholding obligations associated with the lapse of restrictions applicable to those shares:

| Period                                 | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|--|----------------------------------|------------------------------|--|--|
| July 1, 2009 – July 31, 2009           | 81                               | \$20.50                      | not applicable   | not applicable   |
| August 1, 2009 – August 31, 2009       | 2,999                            | \$22.92                      | not applicable   | not applicable   |
| September 1, 2009 – September 30, 2009 | -                                | -                            | not applicable   | not applicable   |
| Total                                  | 3,080                            | \$22.86                      | not applicable   | not applicable   |

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Item 6. Exhibits

Exhibit 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)).

Exhibit 3.2\* - McDermott International, Inc.'s Amended and Restated By-Laws (incorporated by reference to Exhibit 3.1 to McDermott International, Inc.'s Current Report on Form 8-K dated May 3, 2006 (File No. 1-08430)).

Exhibit 3.3\* - Amended and Restated Certificate of Designation of Series D Participating Preferred Stock (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)).

Exhibit 31.1 - Rule 13a-14(a)/15d-14(a) certification of Chief Executive Officer.

Exhibit 31.2 - Rule 13a-14(a)/15d-14(a) certification of Chief Financial Officer.

Exhibit 32.1 - Section 1350 certification of Chief Executive Officer.

Exhibit 32.2 - Section 1350 certification of Chief Financial Officer.

Exhibit 101 – Interactive data files.

\*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.

/s/ Michael S. Taff

By: Michael S. Taff  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer and Duly  
Authorized  
Representative)

/s/ Dennis S. Baldwin

By: Dennis S. Baldwin  
Vice President and Chief Accounting  
Officer  
(Principal Accounting Officer and Duly  
Authorized  
Representative)

November 9, 2009

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EXHIBIT INDEX

Exhibit

Number Description

- 3.1\* McDermott International, Inc.'s Articles of Incorporation, as amended (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 3.1 to McDermott International, Inc.'s Current Report on Form 8-K dated May 3, 2006 (File No. 1-08430)).
- 3.3\* Amended and Restated Certificate of Designation of Series D Participating Preferred Stock (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)).
- 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 Interactive data files

\*Incorporated by reference to the filing indicated.

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