

MCDERMOTT INTERNATIONAL INC
Form 10-K
March 02, 2009

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

(Mark One)

F O R M 1 0 - K

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

For the fiscal year ended December 31, 2008
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 Number 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

Securities Registered Pursuant to Section 12(b) of the Act:

| | |
|--------------------------------|--|
| Title of each class | Name of each Exchange on which registered |
| Common Stock, \$1.00 par value | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer 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 aggregate market value of the registrant's common stock held by nonaffiliates of the registrant on the last business day of the registrant's most recently completed second fiscal quarter (based on the closing sales price on the New York Stock Exchange on June 30, 2008) was approximately \$14.2 billion.

The number of shares of the registrant's common stock outstanding at January 30, 2009 was 228,269,696.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the registrant's 2009 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

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Statements we make in this Annual Report on Form 10-K which express a belief, expectation or intention, as well as those that are not historical fact, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to various risks, uncertainties and assumptions, including those to which we refer under the headings “Cautionary Statement Concerning Forward-Looking Statements” and “Risk Factors” in Items 1 and 1A of Part I of this report.

PART I

Item 1. BUSINESS

General

McDermott International, Inc. (“MII”) is a leading global engineering and construction company with specialty manufacturing and service capabilities. We provide a variety of products and services to customers in the energy and power industries, including utilities and other power generators, major and national oil companies, and the United States Government. While we provide a wide range of products and services, our business segments are heavily focused on major projects. At any given time, a relatively few number of projects can represent a significant part of our operations. We have operations in more than 20 countries and over 20,000 employees worldwide.

MII was incorporated under the laws of the Republic of Panama in 1959 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 Annual Report on Form 10-K, unless the context otherwise indicates, “we,” “us” and “our” mean MII and its consolidated subsidiaries. MII’s common stock is listed on the New York Stock Exchange under the trading symbol MDR.

Business Segments

We operate in three business segments: Offshore Oil and Gas Construction, Government Operations and Power Generation Systems. For financial information about our segments, see Note 18 to our consolidated financial statements included in this report.

Offshore Oil and Gas Construction

Our Offshore Oil and Gas Construction segment includes the business and operations of JRMSA, J. Ray McDermott Holdings, LLC and their respective subsidiaries. Through this segment, we supply 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. We also provide comprehensive project management and procurement services, and we operate 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.

We operate a fleet of marine vessels used in major offshore construction and operate several fabrication facilities. Our Offshore Oil and Gas Construction segment’s principal fabrication facilities are located in Indonesia on Batam Island, in Dubai, U.A.E., Altamira, Mexico and near Morgan City, Louisiana. We also operate a portion of the Baku Deepwater Jacket Factory fabrication facility in Baku, Azerbaijan, which is owned by a subsidiary of the State Oil Company of the Azerbaijan Republic. These fabrication facilities are equipped with a wide variety of heavy-duty construction and fabrication equipment, including cranes, welding equipment, machine tools and robotic and other automated equipment. We fabricate a full range of offshore structures, from conventional jacket-type fixed platforms to intermediate water and deepwater platform configurations employing spar, compliant-tower and tension leg

technologies, as well as floating, production, storage and off-loading (“FPSO”) technology. For further details regarding our Offshore Oil and Gas Construction segment’s vessels and facilities, see Item 2, “Properties.”

Because of the more conducive weather conditions in certain geographic regions, most installation operations are conducted in the warmer months of the year in those areas, and many of our contracts are awarded with only a short period of time before the desired time of project performance. Major construction vessels have few alternative uses and, because of their nature and the environment in which they work, have relatively high fixed costs.

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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 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

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. Through this segment, we supply nuclear components, including the manufacture of U.S. Naval nuclear power systems for submarines and aircraft carriers, and provide various other 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 ("DOE").

We have over 50 years of experience in the ownership and operation of large nuclear development, production and reactor facilities. This segment's principal operations include:

- providing precision manufactured nuclear components for U.S. Government defense programs;
 - managing and operating nuclear production facilities;
 - managing and operating environmental management sites;
- managing spent nuclear fuel and transuranic waste for the DOE;
 - providing critical skills and resources for DOE sites; and
- developing and deploying next generation technology in support of U.S. Government programs.

With manufacturing facilities located in Barberton, Ohio, Euclid, Ohio, Mount Vernon, Indiana, Lynchburg, Virginia and Erwin, Tennessee, our Government Operations segment specializes in the design and manufacture of close-tolerance and high-quality equipment for nuclear applications (for further details regarding our Government Operations segment's facilities, see Item 2, "Properties"). In addition, we are a leading manufacturer of critical nuclear components, fuels and assemblies for government and commercial uses. We have supplied nuclear components for DOE programs since the 1950s, and we are the largest domestic supplier of research reactor fuel elements for colleges, universities and national laboratories. We also provide uranium-based products used for medical isotopes and convert or downblend high-enriched uranium into low-enriched fuel for use in commercial reactors to generate electricity. In addition, we have over 100 years of experience in supplying heavy fabrications for industrial use, including components for defense applications.

We work closely with the DOE supported non-proliferation program. Currently, this program is assisting in the development of a high-density, low-enriched uranium fuel required for high-enriched uranium test reactor conversions. We have also been a leader in the receipt, storage, characterization, dissolution, recovery and purification of a variety of uranium-bearing materials. All phases of uranium downblending and uranium recovery are provided at our Lynchburg, Virginia and Erwin, Tennessee sites.

We manage and operate complex, high-consequence nuclear and national security operations for the DOE and the National Nuclear Security Administration (“NNSA”), primarily through our joint ventures, as further outlined in the “Joint Ventures” section of Item 1. In addition to these joint ventures, Babcock & Wilcox Technical Services Clinch River, LLC was awarded a contract from USEC, Inc. in 2007 to manufacture classified metal parts for the American Centrifuge Program.

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We have an experienced staff of design and manufacturing engineers capable of performing full scope, prototype design work coupled with manufacturing integration. The design, engineering and other capabilities of our Government Operations segment include:

- steam separation equipment design and development;
- thermal-hydraulic design of reactor plant components;
- structural component design for precision manufacturing;
- materials expertise in high-strength, low-alloy steels, nickel-based materials and others;
 - material procurement of tubing, forgings, weld wire; and
 - metallographic and chemical analysis.

Our Government Operations segment's operations are generally capital intensive on the manufacturing side. The demand for nuclear components by the U.S. Government comprises a substantial portion of this segment's backlog. We expect that orders for nuclear components will continue to be a significant part of backlog for the foreseeable future; however, such orders are subject to defense department budget constraints.

Power Generation Systems

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. ("B&W NPG") and their respective subsidiaries. Through this segment, we supply fossil-fired boilers, commercial nuclear steam generators and components, environmental equipment and components, and related services to customers in different regions around the world. We design, engineer, manufacture, construct and service 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.

Through this segment's manufacturing facilities, which are located primarily in North America, we specialize in the fabrication of products used in the power generation industry and the provision of related services, including:

- engineered-to-order services, products and systems for energy conversion worldwide and related auxiliary equipment, such as burners, pulverizer mills, soot blowers and ash handlers;
- heavy-pressure equipment for energy conversion, such as boilers fueled by coal, oil, bitumen, natural gas, solid municipal waste, biomass and other fuels;
 - steam generators and reactor heads for nuclear power plants;
- environmental control systems, including both wet and dry scrubbers for flue gas desulfurization, modules for selective catalytic reduction of the oxides of nitrogen, equipment to capture particulate matter, such as baghouses and electrostatic precipitators, and similar devices; and
 - power plant equipment and related heavy mechanical erection services.

For further details regarding our Power Generation Systems segment's facilities, see Item 2, "Properties."

We support operating plants with a wide variety of additional services, including the installation of new systems and replacement parts, engineering services, construction, maintenance and field technical services, such as condition assessments and inventory services to help customers respond quickly to plant interruptions. We also provide power through cogeneration, refuse-fueled power plants and other independent power-producing facilities and participate in this market as contractors for engineer-procure-construct services, as equipment suppliers, as operations and maintenance contractors and as an owner.

Although it has been over 30 years since a new nuclear power plant commenced construction in the United States, we expect to participate in commercial nuclear projects and related opportunities in the future, through B&W NPG. This subsidiary was formed during 2007 to bring together our specialized engineering, services and manufacturing

capabilities within a dedicated organization focused on nuclear utility customers.

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;

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- 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;
- 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.

Our Power Generation Systems segment's products and services are capital intensive. As such, customer demand is heavily affected by the variations in customer's business cycles and by the overall economies of the countries in which they operate.

On February 22, 2006, B&W PGG and three of its subsidiaries (collectively the "Debtors") exited from their asbestos-related Chapter 11 Bankruptcy proceedings (the "Chapter 11 Bankruptcy"), which were commenced on February 22, 2000. The Chapter 11 Bankruptcy was initiated as a means to determine and resolve the asbestos-related liabilities of the Debtors. The Chapter 11 Bankruptcy was resolved through a settlement, which led to our contribution of rights under various insurance policies, cash and a promissory note, with an aggregate value of approximately \$2 billion, to a settlement trust, the channeling of asbestos-related personal injury claims to that trust and our retention of the equity ownership of the Debtors. Due to the Chapter 11 Bankruptcy, we did not consolidate the results of operations of the Debtors and their subsidiaries in our consolidated financial statements from February 22, 2000 through February 22, 2006.

Acquisitions

During 2008 and 2007, we completed acquisitions for total cash costs of approximately \$192 million and \$334 million, respectively. The following is a brief description of some of our key acquisitions:

Nuclear Fuel Services, Inc. On December 31, 2008, our Government Operations segment completed its acquisition of Nuclear Fuel Services, Inc., a provider of specialty nuclear fuels and related services, for approximately \$157 million, net of cash acquired. This business enhances our position as a leading provider of nuclear manufacturing and services for government and commercial markets.

Secunda International Limited. In July 2007, our Offshore Oil and Gas Construction segment acquired substantially all of the assets of Secunda International Limited, including 14 harsh-weather, multi-functional vessels and its shore-based operations. This business adds growth potential to our Oil and Gas Construction business and was acquired for approximately \$263 million, net of cash acquired.

Marine Mechanical Corporation. In May 2007, our Government Operations segment completed its acquisition of Marine Mechanical Corporation, which designs, manufactures and supplies electro-mechanical equipment used by the United States Navy. This business complements our other government-related nuclear activities and was acquired for approximately \$71 million, net of cash acquired.

We continue to evaluate accelerated growth opportunities achievable through acquisition or consolidation, in addition to pursuing internal growth strategies to advance our position in the energy arena of engineering and construction.

Contracts

We execute our contracts through a variety of methods, including fixed-price, cost-plus, cost-reimbursable, day-rate and unit-rate basis or some combination of those methods. Contracts are usually awarded through a competitive bid process, primarily based on price. However, other factors that customers may consider include plant or equipment availability, technical capabilities of equipment and personnel, efficiency, safety record and reputation.

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