MCDERMOTT INTERNATIONAL INC
Form 10-Q
April 24, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018

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	72-0593134
(State or Other Jurisdiction of	(I.R.S. Employer
Incorporation or Organization)	Identification No.)
4424 West Sam Houston Parkway North	
HOUSTON, TEXAS	77041
(Address of Principal Executive Offices)	(Zip Code)

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth 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
		Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 April 20, 2018 was 285,899,713.

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CONSOLIDATED FINANCIAL STATEMENTS

PART I: Item 1—FINANCIAL INFORMATION

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Three months Ended March 31,	
	2018	2017
	(In thousands, except share and per share amounts)	
Revenues	$607,818	$519,431
Costs and Expenses:		
Cost of operations	475,711	428,590
Research and development expenses	458	480
Selling, general and administrative expenses	48,934	36,533
Other operating (income) expenses, net	14,276	(2,211)
Operating income	68,439	56,039
Other expense:		
Interest expense, net	(11,608)	(17,706)
Other non-operating income, net	1,719	560
Income before provision for income taxes	58,550	38,893
Provision for income taxes	20,715	10,771
Income before loss from Investments in Unconsolidated Affiliates	37,835	28,122
Loss from Investments in Unconsolidated Affiliates	(3,713)	(3,927)
Net income	34,122	24,195
Less: Net income (loss) attributable to noncontrolling interest	(1,067)	2,279
Net income attributable to McDermott	$35,189	$21,916
Net income per share attributable to McDermott		
Basic	$0.12	$0.09
Diluted	$0.12	$0.08
Shares used in the computation of net income per share:		
Basic	284,658,938	241,829,988
Diluted	285,050,524	282,285,595

See accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED FINANCIAL STATEMENTS

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended March 31,	
	2018	2017
	(in thousands)	
Net income	$34,122	$24,195
Other comprehensive income (loss):		
Unrealized gain on investments	7	19
Gain on derivatives	230	2,135
Foreign currency translation	(596)	239
Total comprehensive income	33,763	26,588
Less: Comprehensive income (loss) attributable to noncontrolling interests	(1,067)	2,261
Comprehensive income attributable to McDermott	$34,830	$24,327

See accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED FINANCIAL STATEMENTS

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED BALANCE SHEETS

	March 31, 2018	December 31, 2017
	(In thousands, except share and per share amounts)	
Assets	(Unaudited)	
Current assets:		
Cash and cash equivalents	$412,725	$390,263
Restricted cash and cash equivalents	6,074	17,929
Accounts receivable—trade, net	395,073	328,302
Accounts receivable—other	52,818	40,730
Contracts in progress	506,420	621,411
Other current assets	43,519	35,615
Total current assets	1,416,629	1,434,250
Property, plant and equipment	2,659,414	2,651,087
Less accumulated depreciation	(994,237)	(985,273)
Property, plant and equipment, net	1,665,177	1,665,814
Accounts receivable—long-term retainages	40,154	39,253
Investments in Unconsolidated Affiliates	5,318	7,501
Deferred income taxes	17,400	17,616
Other assets	55,970	58,386
Total assets	$3,200,648	$3,222,820
Liabilities and Equity		
Current liabilities:		
Notes payable and current maturities of long-term debt	$24,264	$24,264
Accounts payable	191,561	279,109
Accrued liabilities	341,637	336,747
Advance billings on contracts	40,207	32,252
Income taxes payable	40,670	34,562
Total current liabilities	638,339	706,934
Long-term debt	512,994	512,713
Self-insurance	16,550	16,097
Pension liabilities	14,535	14,400
Non-current income taxes	63,798	62,881
Other liabilities	115,479	121,018
Total liabilities	1,361,695	1,434,043
Commitments and contingencies		
Stockholders' equity:		
Common stock, par value $1.00 per share, authorized 400,000,000 shares; issued 294,407,255 and 292,525,841 shares, respectively	294,407	292,526
Capital in excess of par value	1,657,744	1,663,091

Retained earnings/ (Accumulated deficit)	6,912	(48,221)
Accumulated other comprehensive loss	(50,807)	(50,448)
Treasury stock, at cost: 8,507,542 and 8,499,021 shares, respectively	(96,347)	(96,282)
Stockholders' Equity—McDermott	1,811,909	1,760,666
Noncontrolling interest	27,044	28,111
Total equity	1,838,953	1,788,777
Total liabilities and equity	$3,200,648	$3,222,820

See accompanying Notes to the Consolidated Financial Statements.

CONSOLIDATED FINANCIAL STATEMENTS

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended March 31, 2018	2017
	(In thousands)	
Cash flows from operating activities:		
Net income	$34,122	$24,195
Non-cash items included in net income:		
Depreciation and amortization	22,776	21,381
Stock-based compensation charges	6,642	4,637
Loss from investments in Unconsolidated Affiliates	3,713	3,927
Other non-cash items	2,642	2,990
Changes in operating assets and liabilities that provided (used) cash:		
Accounts receivable	(67,672)	161,321
Contracts in progress, net of Advance billings on contracts	142,890	(241,700)
Accounts payable	(89,641)	95,276
Accrued and other current liabilities	5,752	1,869
Other assets and liabilities, net	(24,128)	(25,444)
Total cash provided by operating activities	37,096	48,452
Cash flows from investing activities:		
Purchases of property, plant and equipment	(18,386)	(62,849)
Proceeds from asset dispositions	52	55,391
Investments in Unconsolidated Affiliates	(1,565)	-
Total cash used in investing activities	(19,899)	(7,458)
Cash flows from financing activities:		
Repayment of debt	(103)	(5,167)
Repurchase of common stock	(6,513)	(6,614)
Other	(79)	-
Total cash used in financing activities	(6,695)	(11,781)
Effects of exchange rate changes on cash, cash equivalents and restricted cash	105	213
Net increase in cash, cash equivalents and restricted cash	10,607	29,426
Cash, cash equivalents and restricted cash at beginning of period	408,192	612,333
Cash, cash equivalents and restricted cash at end of period	$418,799	$641,759

See accompanying Notes to the Consolidated Financial Statements.

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CONSOLIDATED FINANCIAL STATEMENTS

McDERMOTT INTERNATIONAL, INC.
CONSOLIDATED STATEMENTS OF EQUITY

(Unaudited)

	Common Stock Par Value	Capital in Excess of Par Value	Retained Earnings/ (Accumulated Deficit)	Accumulated Other Comprehensive Loss ("AOCI")	Treasury Stock	Stockholders' Equity	Noncontrolling Interest ("NCI")	Total Equity
	(in thousands)							
Balance at December 31, 2017	$292,526	$1,663,091	$(48,221)	$(50,448)	$(96,282)	$1,760,666	$28,111	$1,788,777
Adoption of ASC 606	-	-	19,944	-	-	19,944	-	19,944
Balance at January 1, 2018	292,526	1,663,091	(28,277)	(50,448)	(96,282)	1,780,610	28,111	1,808,721
Net income	-	-	35,189	-	-	35,189	(1,067)	34,122
Other comprehensive loss, net of tax	-	-	-	(359)	-	(359)	-	(359)
Common stock issued	2,740	(2,740)	-	-	-	-	-	-
Stock-based compensation charges	-	2,982	-	-	-	2,982	-	2,982
Purchase of treasury shares	-	-	-	-	(6,513)	(6,513)	-	(6,513)
Retirement of common stock	(859)	(5,589)	-	-	6,448	-	-	-
Balance at March 31, 2018	$294,407	$1,657,744	$6,912	$(50,807)	$(96,347)	$1,811,909	$27,044	$1,838,953

See accompanying Notes to the Consolidated Financial Statements.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1—BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

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

Basis of Presentation

The accompanying Consolidated Financial Statements are unaudited and have been prepared from our books and records in accordance with Rule 10-1 of Regulation S-X for interim financial information. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States ("U.S. GAAP") for complete financial statements. In the opinion of our management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. The results of operations for interim periods are not necessarily indicative of results of operations for a full year. These Consolidated Financial Statements should be read in conjunction with our Consolidated Financial Statements and Notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the U.S. Securities and Exchange Commission (the "SEC") on February 21, 2018 (the "2017 Form 10-K").

Classification

Certain prior year amounts have been reclassified for consistency with the current year presentation. Previously reported Consolidated Financial Statements have been adjusted to reflect those changes.

Recently Issued and Adopted Accounting Guidance

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

The FASB has issued several amendments to the standard, including clarification on accounting for licenses of intellectual property, identifying performance obligations, reporting gross versus net revenue and narrow-scope revisions and practical expedients.

Adoption—We adopted the new standard on January 1, 2018 (the "initial application" date):

- using the modified retrospective application, with no restatement of the comparative periods presented and a cumulative effect adjustment to retained earnings as of the date of adoption;
- applying the new standard only to those contracts that are not substantially complete at the date of initial application; and
- disclosing the impact of the new standard in our 2018 Consolidated Financial Statements.

Significant changes to our accounting policies as a result of adopting of the new standard are discussed below:

- We measure transfer of control utilizing an input method to measure progress for individual contracts or combinations of contracts based on the total cost of materials, labor, equipment and vessel operating costs and other costs incurred as applicable to each contract. Previously, under ASC Topic 605-35, Construction-Type and Production-Type Contracts (the "legacy GAAP"), we generally excluded certain costs from the cost-to-cost method of measuring project progress, such as significant costs for procured materials and third-party subcontractors;
- Our Consolidated Balance Sheet no longer reflect assets related to cost incurred in excess of cost recognized. Under legacy GAAP, we generally excluded certain costs from our cost-to-cost method of measuring progress towards completion, such as significant costs for procured materials and third-party subcontractors, which resulted in the recognition of cost incurred in excess of cost recognized as an asset on our Consolidated Financial Statements.
- Variable consideration, including change orders, claims, bonus, incentive fees and liquidated damages or penalties will be included in the estimated contract revenue at the most likely amount to which we expect to be entitled. We will include variable consideration in the estimated transaction price to the extent we concluded that it is probable a significant revenue reversal will not occur or when the uncertainty associated with the variable consideration is resolved.

Revenue Recognition

Contracts Our revenue is typically derived from long-term contracts that can span several years. We determine the appropriate accounting treatment for each of our contracts with customers before work on the project begins. We generally recognize contract revenues and related costs over-time.

Performance Obligation Satisfied Over Time A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC Topic 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Our performance obligations are generally satisfied over time as work progresses because of continuous transfer of control to the customer. For contracts with multiple performance obligations, we allocate the contract's transaction price to each performance obligation using our best estimate of the stand-alone selling price of each distinct good or service in the contract.

Method to Measure Progress—We measure transfer of control utilizing an input method to measure progress for individual contracts or combinations of contracts based on the cost incurred to total cost of materials, labor, equipment and vessel operating costs and other costs as applicable to each contract. These costs, once incurred, are considered a measure of progress and are expensed in the period in which they are incurred. Costs incurred prior to a project award, are generally expensed during the period in which they are incurred.

Total estimated project costs and resulting contract income are affected by changes in the expected cost of materials and labor, productivity, vessel costs, scheduling and other factors. Additionally, external factors such as weather, customer requirements and other factors outside of our control may affect the progress and estimated cost of a project's completion and, therefore, the timing and amount of revenue and income recognition. Changes in total estimated contract cost and losses, if any, are recognized in the period they are determined.

Performance Obligation Satisfied at a Point-in-Time Method—Contracts with performance obligations that do not meet the criteria to be recognized over time are required to be recognized "at a point-in-time", whereby revenue and gross profit is recognized only when a performance obligation is complete and a customer has obtained control of a promised asset. For contracts with revenues recognized at a point-in-time, we consider physical possession of the asset, legal transfer of title, significant risk rewards of ownership, customer acceptance and our rights to payment in determining when a performance obligation is complete.

Remaining Performance Obligations ("RPOs") RPOs represent the dollar amount of revenues we expect to recognize in the future from contracts that are in progress. These amounts are presented in U.S. dollars. Currency risks associated with RPOs that are not mitigated within the contracts are generally mitigated with the use of foreign currency derivative (hedging) instruments, when deemed significant. However, these actions may not eliminate all currency risk exposure included within our long-term contracts. We do not include expected revenues of contracts related to unconsolidated joint ventures in our RPOs, except to the extent of any contract awards we receive from those joint ventures.

RPOs may not be indicative of future operating results, and projects included in RPOs may be cancelled, modified or otherwise altered by customers.

Variable Consideration The nature of our contracts gives rise to several types of variable consideration, including unpriced change orders, claims, bonuses, incentive fees and liquidated damages or penalties. We estimate variable consideration based on the most likely amount to which we expect to be entitled. We include variable consideration in the estimated transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur or when we conclude that any significant uncertainty associated with the variable consideration is resolved. Our estimates of variable consideration and determination of whether to include estimated amounts in the transaction price are based largely on an assessment of our anticipated performance and all information (historical, current and forecasted) that is reasonably available to us. The effect of changes in our estimates of variable consideration on the transaction price is recognized as an adjustment to revenues (either as an increase in or a reduction of revenues) on a cumulative catch-up basis.

- Change Orders Change orders, which are a normal and recurring part of our business, can increase the future scope and cost of a project. Most of our change orders are not distinct from the existing contract and are accounted for as part of that existing contract. The effect of a change order on the transaction price and our measure of progress for the performance obligation to which it relates, is recognized as an adjustment to revenues (either as an increase in or a reduction of revenues) on a cumulative catch-up basis.

Change orders that may not be approved by the customer until the later stages of a contract or subsequent to the date a project is completed could significantly affect gross profit on a contract. Revenues from unapproved change orders are generally recognized to the extent of the amounts we expect to recover, consistent with our Variable Consideration policy discussed above. If it is probable that a reversal of revenues will occur, the costs attributable to change orders are treated as contract costs without incremental revenues. To the extent change orders included in the price are not resolved in our favor, there could be reductions in, or reversals of previously reported amounts of, revenues and profits, and charges against current earnings, which could be material.

- Claims Revenue—Claims revenue may relate to various factors, including the procurement of materials, equipment performance failures, change order disputes or schedule disruptions and other delays, including factors outside of our control, therefore we believe we are entitled to additional compensation. Claims revenue, when recorded, is only recorded to the extent of the amounts we expect to recover. We include certain unapproved claims in the transaction price when the claims are legally enforceable, we consider collection to be probable and believe we can reliably estimate the ultimate value. Amounts attributable to unpriced change orders are not included in claims. We continue to engage in negotiations with our customers on our outstanding claims. However, these claims may be resolved at amounts that differ from our current estimates, which could result in increases or decreases in future estimated contract profits or losses. Claims are generally negotiated over the course of the respective projects, many of which are long-term in nature.

Warranties Our contracts include assurance-type warranties that our performance is free from material defect and consistent with the specifications of our contracts, which do not give rise to a separate performance obligation.

Adoption of the new revenue standard resulted in changes to the timing of revenue recognition and in the reclassification between financial statement line items. See Note 3, Revenue Recognition, for further discussion.

Pension and Postretirement Benefits—In March 2017, the FASB issued Accounting Standards Update (“ASU”) 2017-07, Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit. This ASU requires bifurcation of certain components of net pension and postretirement benefit cost in the Consolidated Statements of Operations. We adopted this ASU effective as of

January 1, 2018. As a result, benefit costs, excluding service costs component, previously included in Selling, general and administrate expenses, are now included in Other non-operating income (expense), net in our Consolidated Statements of Operations. All comparable periods presented have been retrospectively revised to reflect this change.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Accounting Guidance Issued But Not Adopted as of March 31, 2018

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

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

NOTE 2—BUSINESS COMBINATION AGREEMENT WITH CHICAGO BRIDGE & IRON COMPANY N.V. (“CB&I”)

On December 18, 2017, McDermott International, Inc. (“McDermott”), Chicago Bridge & Iron Company N.V. (“CB&I”) and certain of their respective subsidiaries entered into a Business Combination Agreement (as amended, the “Business Combination Agreement”) pursuant to which CB&I and McDermott have agreed to combine their businesses through a series of transactions (the “Combination”). The Business Combination Agreement has been approved by the McDermott Board, the Management Board of CB&I and the Supervisory Board of CB&I.

Upon completion of the Combination, McDermott stockholders will own approximately 53 percent of the combined business on a fully diluted basis and CB&I shareholders will own approximately 47 percent. Under the terms of the Business Combination Agreement, we will exchange all issued and outstanding shares of CB&I common stock for shares of McDermott common stock at the exchange ratio described below. As a result CB&I shareholders will be entitled to receive 2.47221 shares of McDermott Common Stock for each share of CB&I Common Stock owned (or 0.82407 shares if McDermott effects a proposed three-to-one reverse stock split prior to the closing of the Combination), together with cash in lieu of fractional shares.

The Combination would be accounted for using the acquisition method of accounting in accordance with Accounting Standards Codifications (“ASC”) Topic 805, Business Combinations. McDermott would be considered the accounting acquirer based on the following facts: (1) upon completion of the Combination, McDermott’s stockholders will own approximately 53 percent of the combined business on a fully diluted basis; (2) a group of McDermott’s current directors, including Chairman of the Board, will constitute a majority of the Board of Directors; and (3) McDermott’s current President and Chief Executive Officer and current Executive Vice President and Chief Financial Officer will continue in those roles following the closing of the Combination. CB&I’s President and Chief Executive Officer will remain with the combined business for a transition period.

In connection with the Business Combination Agreement, we entered into or received commitment letters (including the exhibits and other attachments thereto, and together with any amendments, modifications or supplements thereto, the “Commitment Letters”) from certain financial institutions to provide debt financing for the Combination. Pursuant to the Commitment Letters, as amended and restated through the date of this report, we expect the following financing arrangements to be reflected in a new credit agreement to be entered into by certain of our subsidiaries (the “Borrowers”) on or before the closing of the Combination (the “New Credit Agreement”):

- a senior secured revolving credit facility providing for revolving credit borrowings and letters of credit in an aggregate principal or face amount of $1.0 billion outstanding at any one time (the “Revolving Facility”);
- a senior secured letter of credit facility providing for letters of credit in the aggregate face amount of $1.39 billion outstanding at any one time (the “LC Facility”); and

- a senior secured term loan facility providing for borrowings in the aggregate principal amount of $2.26 billion (the "Term Facility"), $319 million of which will be deposited into a cash collateral account to secure reimbursement obligations in respect of up to $310 million of letters of credit issuable under the Term Facility.

In addition, on April 18, 2018, McDermott Escrow 1, Inc. and McDermott Escrow 2, Inc. (together, the "Escrow Issuers") completed the previously announced offering of $1.3 billion in aggregate principal amount of 10.625% senior unsecured notes due 2024 (the "2024 Notes"). The Escrow Issuers represent variable interest entities which will be consolidated by McDermott International, Inc. beginning in the second quarter of 2018. The 2024 Notes were offered to qualified institutional buyers in reliance on Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), and to certain non-U.S. persons in transactions outside the United States in reliance on Regulation S under the Securities Act. The 2024 Notes were issued pursuant to an Indenture, dated April 18, 2018 (the "Indenture"), by and among the Escrow Issuers and Wells Fargo Bank, National Association, as trustee. The 2024 Notes are scheduled to mature on May 1, 2024.

Pursuant to an escrow agreement (the "Escrow Agreement"), by and among the Escrow Issuers and Wells Fargo Bank, National Association, as escrow agent (the "Escrow Agent"), the proceeds of the offering of the 2024 Notes, together with approximately $28 million, to provide funds sufficient to pay interest on the 2024 Notes through June 29, 2018, were deposited into a segregated escrow account with the Escrow Agent. The funds will remain in escrow until the date on which certain escrow conditions are satisfied and the escrow proceeds are released (the "Escrow Conditions"). Concurrent with the satisfaction of the Escrow Conditions, the Escrow Issuers will merge with and into McDermott Technology (Americas), Inc. ("McDermott Technology (Americas)") and McDermott Technology (US), Inc. (together with McDermott Technology (Americas), the "Post-Merger Co-Issuers"), with each Post-Merger Co-Issuer being a surviving entity that will assume, by operation of law, the obligations of the applicable Escrow Issuer under the 2024 Notes. Each of the Post-Merger Co-Issuers is a wholly owned subsidiary of McDermott International, Inc.

The 2024 Notes will be subject to a special mandatory redemption at a redemption price equal to 100% of the initial issue price of the 2024 Notes plus accrued interest to, but not including, the redemption date if the Escrow Conditions are not satisfied or the Escrow Issuers determine in their discretion that the Escrow Conditions are incapable of being satisfied on or prior to June 29, 2018.

The proceeds of the offering of the 2024 Notes and loans under the New Credit Agreement are intended to be used: (a) on the closing date for the Combination (the "Effective Date") to (1) consummate the Combination, including the repayment of certain existing indebtedness of CBI and its subsidiaries, (2) redeem Outstanding Senior Secured Notes, (3) prepay existing indebtedness under, and to terminate in full, the Current Credit Agreement (as defined in Note 8, Debt), and (4) pay fees and expenses in connection with the Combination, the New Credit Agreement and the issuance of the 2024 Notes; and (b) for working capital and other general corporate purposes. On the Effective Date, certain existing letters of credit outstanding under the Current Credit Agreement and certain existing letters of credit outstanding under CBI's existing credit facilities will be deemed issued under the New Credit Agreement, and letters of credit will be issued under the New Credit Agreement to backstop certain other existing letters of credit issued for the account of McDermott International, Inc., CBI and their respective subsidiaries and affiliates.

The Revolving Facility and the LC Facility are expected to mature on the fifth annual anniversary of the Effective Date. The Term Facility is expected to mature on the seventh annual anniversary of the Effective Date, unless on the date that is six months prior to the scheduled maturity date of the 2024 Notes, more than $350 million of the 2024 Notes are outstanding and our secured leverage ratio (as defined in the New Credit Agreement) is greater than or equal to 1.00 to 1.00, in which case the Term Facility will mature on such date.

From and after the Effective Date the indebtedness and other obligations under the New Credit Agreement, the 2024 Notes and the Indenture will be unconditionally guaranteed on a senior secured basis by McDermott International, Inc. and substantially all of its wholly owned subsidiaries, including wholly owned subsidiaries resulting from the consummation of the Combination (collectively, the “Guarantors”), other than its captive insurance subsidiary and certain other designated or immaterial subsidiaries. From and after the Effective Date, the obligations under the New Credit Agreement will be secured by first-priority liens on substantially all of the Borrowers’ and the Guarantors’ assets.

The New Credit Agreement is expected to include provisions for mandatory commitment reductions and prepayments in connection with, among other events and circumstances, certain asset sales and casualty events. In addition, we will be required to make an annual prepayment of term loans under the Term Facility and thereafter cash collateralize letters of credit issued under the Revolving Facility and the LC Facility with 75% of excess cash flow (as defined in the New Credit Agreement), reducing to 50% of excess cash flow and 25% of excess cash flow depending on our secured leverage ratio. The New Credit Agreement is expected to require the Borrowers to prepay the term loans made under the Term Facility on the last day of each fiscal quarter in an amount equal to approximately $6 million. The New Credit Agreement is expected to otherwise only require periodic interest payments until maturity.

Revolving loans under the Revolving Facility are expected to bear interest at the Borrowers' option at either the Eurodollar rate (as defined in the New Credit Agreement) plus a margin ranging from 3.75% to 4.25% per year or the base rate (the highest of the Federal Funds rate plus 0.50%, the 30-day Eurodollar rate plus 1.0%, or the administrative agent's prime rate) plus a margin ranging from 2.75% to 3.25% per year. The applicable margin will vary depending on our leverage ratio (as defined in the New Credit Agreement). Term loans under the Term Facility are expected to bear interest at the Borrowers' option at either the Eurodollar rate plus a margin of 5.00% per year or the base rate plus a margin of 4.00%, subject to a 1.0% floor with respect to the Eurodollar rate. The Borrowers are expected to be charged a commitment fee of 0.50% per year on the daily amount of the unused portions of the commitments under the Revolving Facility and the LC Facility. Additionally, with respect to all letters of credit outstanding under the New Credit Agreement, the Borrowers are expected to be charged a fronting fee of 0.25% per year and, with respect to all letters of credit outstanding under the New Credit Agreement, a participation fee of (1) between 3.75% to 4.25% per year in respect of financial letters of credit and (2) between 1.875% to 2.125% per year in respect of performance letters of credit, in each case depending on our leverage ratio. The Borrowers are also expected to be required to pay customary issuance fees and other fees and expenses in connection with the issuance of letters of credit under the New Credit Agreement. On the Effective Date, we will be required to pay upfront fees, ticking fees, commitment fees, arrangement fees and other fees to certain lenders, arrangers and agents of the New Credit Agreement.

The New Credit Agreement is expected to include the following financial covenants that will be tested on a quarterly basis, commencing September 30, 2018:

- a minimum permitted fixed charge coverage ratio (as defined in the New Credit Agreement) of 1.50 to 1.00;
- a maximum permitted leverage ratio of (1) 4.25 to 1.00 for each fiscal quarter ending on or before September 30, 2019, (2) 4.00 to 1.00 for the fiscal quarter ending December 31, 2019, (3) 3.75 to 1.00 for each fiscal quarter ending after December 31, 2019 and on or before December 31, 2020, (4) 3.50 to 1.00 for each fiscal quarter ending after December 31, 2020 and on or before December 31, 2021 and (5) 3.25 to 1.00 for each fiscal quarter ending after December 31, 2021; and
- a minimum liquidity (as defined in the New Credit Agreement, but generally meaning the sum of our cash and cash equivalents plus unused commitments under the New Credit Agreement available for revolving borrowings) requirement of $200 million.

In addition, the New Credit Agreement and the Indenture contain various covenants that, among other restrictions, will limit the ability of McDermott International, Inc. and each of its restricted subsidiaries to:

- incur or assume indebtedness;
- grant or assume liens;
- make acquisitions or engage in mergers;
- sell, transfer, assign or convey assets;
- make investments;
- repurchase equity and make dividends and certain other restricted payments;
- change the nature of its business;
- engage in transactions with affiliates;
- enter into burdensome agreements;
- modify its organizational documents;
- enter into sale and leaseback transactions;
- make capital expenditures;
- enter into speculative hedging contracts; and
- make prepayments on certain junior debt.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

The Indenture contains, and the New Credit Agreement is expected to contain, provisions relating to events of default that we believe are customary for similar financing arrangements.

During the first quarter of 2018, $11 million of costs associated with the Combination were expensed as incurred and were reported in Other operating (income) (expense) in our Consolidated Statements of Operations. Those costs included advisors' professional fees and integration costs related to the Combination.

NOTE 3—REVENUE RECOGNITION

Effect of ASC Topic 606 Adoption The cumulative effect of adopting ASC 606 due to change in method to measure project progress, as discussed in Note 1, Basis Of Presentation and Significant Accounting Policies, is as follows:

	Impact of ASC 606 adoption		
	Legacy GAAP	Adjustment	As reported
	(In thousands)		
Consolidated Statements of Operations for the quarter ended March 31, 2018			
Revenues	$590,307	$ 17,511	$607,818
Cost of operations	459,991	15,720	475,711