

MCDERMOTT INTERNATIONAL INC
Form 10-Q
November 05, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from _____ to _____

Commission File No. 001-08430

McDERMOTT INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

REPUBLIC OF PANAMA
(State or Other Jurisdiction of
Incorporation or Organization)

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

757 N. ELDRIDGE PKWY
HOUSTON, TEXAS
(Address of Principal Executive Offices) (Zip Code)

77079

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of shares of the registrant's common stock outstanding at October 27, 2014 was 237,646,523.

McDERMOTT INTERNATIONAL, INC.

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PART I—FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements
McDERMOTT INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Nine Months Ended	
	September 30, 2014 (unaudited)	2013	September 30, 2014	2013
	(In thousands, except share and per share amounts)			
Revenues	\$414,595	\$686,856	\$1,494,489	\$2,141,594
Costs and Expenses:				
Cost of operations	370,271	686,415	1,394,062	2,122,488
Selling, general and administrative expenses	55,113	46,443	167,387	151,286
Gains on asset disposals	(4,818)	(763)	(57,026)	(15,492)
Restructuring expenses	4,724	4,040	12,112	19,502
Total costs and expenses	425,290	736,135	1,516,535	2,277,784
Equity in Loss of Unconsolidated Affiliates	(3,448)	(3,375)	(5,647)	(12,967)
Operating Loss	(14,143)	(52,654)	(27,693)	(149,157)
Other Income (Expense):				
Interest income (expense) - net	(11,847)	363	(50,531)	1,133
Gain (loss) on foreign currency-net	(2,397)	4,460	143	10,838
Other income (expense) - net	473	1,062	(104)	1,813
Total other income (expense)	(13,771)	5,885	(50,492)	13,784
Loss before Provision for Income Taxes and Noncontrolling Interests	(27,914)	(46,769)	(78,185)	(135,373)
Provision for Income Taxes	1,464	12,278	9,741	45,493
Net Loss	(29,378)	(59,047)	(87,926)	(180,866)
Less: net income attributable to noncontrolling interest	4,306	5,023	6,541	12,074
Net Loss Attributable to McDermott International, Inc.	\$(33,684)	\$(64,070)	\$(94,467)	\$(192,940)

Loss per Common Share:

Basic:

Net loss attributable to McDermott International, Inc.	(0.14)	(0.27)	(0.40)	(0.82)
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Diluted:

Loss from operations, less noncontrolling interests	(0.14)	(0.27)	(0.40)	(0.82)
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Shares used in the computation of earnings per share:

Basic:	237,429,394	236,257,920	237,262,044	236,132,847
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Diluted:	237,429,394	236,257,920	237,262,044	236,132,847
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See accompanying notes to condensed consolidated financial statements.

McDERMOTT INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2013	
	2014	2013	2014	2013
	(unaudited)			
	(in thousands)			
Net Loss	\$(29,378)	\$(59,047)	\$(87,926)	\$(180,866)
Other comprehensive income (loss), net of tax:				
Amortization of benefit plan costs	3,432	3,438	10,298	10,308
Unrealized gain on investments	(7)	158	-	599
Translation adjustments	(1,455)	(1,245)	(2,714)	(765)
Gain (loss) on derivatives	(32,930)	25,090	(17,664)	(44,988)
Other comprehensive income (loss), net of tax ⁽¹⁾	(30,960)	27,441	(10,080)	(34,846)
Total Comprehensive Loss	\$(60,338)	\$(31,606)	\$(98,006)	\$(215,712)
Less: Comprehensive Income Attributable to Non-controlling Interests	4,290	5,026	6,494	12,050
Comprehensive Loss Attributable to McDermott International, Inc.	\$(64,628)	\$(36,632)	\$(104,500)	\$(227,762)

(1) The tax impacts on amounts presented in other comprehensive income are not significant. See accompanying notes to condensed consolidated financial statements.

McDERMOTT INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2014	December 31, 2013
	(Unaudited)	
	(In thousands, except share and per share amounts)	
Assets		
Current Assets:		
Cash and cash equivalents	\$643,951	\$118,702
Restricted cash and cash equivalents	239,315	23,652
Accounts receivable – trade, net	271,019	381,858
Accounts receivable – other	75,741	89,273
Contracts in progress	336,920	425,986
Deferred income taxes	7,004	7,091
Assets held for sale	14,253	1,396
Other current assets	58,603	32,242
Total Current Assets	1,646,806	1,080,200
Property, Plant and Equipment	2,390,385	2,367,686
Less accumulated depreciation	(807,990)	(889,009)
Net Property, Plant and Equipment	1,582,395	1,478,677
Accounts Receivable – Long-Term Retainages	132,248	65,365
Investments in Unconsolidated Affiliates	43,713	50,536
Deferred Income Taxes	18,008	16,766
Assets Held for Sale	-	12,243
Investments	2,613	13,511
Other Assets	101,533	90,073
Total Assets	\$3,527,316	\$2,807,371
Liabilities and Equity		
Current Liabilities:		
Notes payable and current maturities of long-term debt	\$27,002	\$39,543
Accounts payable	292,129	398,739
Accrued liabilities	328,005	365,224
Advance billings on contracts	200,258	278,929
Deferred income taxes	17,738	17,892
Income taxes payable	16,626	20,657
Total Current Liabilities	881,758	1,120,984
Long-Term Debt	873,289	49,019
Self-Insurance	23,740	20,531
Pension Liability	14,762	15,681

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Non-current Income Taxes	52,187	56,042
Other Liabilities	92,887	104,770
Commitments and Contingencies (Note 10)		
Stockholders' Equity:		
Common stock, par value \$1.00 per share, authorized 400,000,000 shares; issued 244,966,109 and 244,271,365 shares at September 30, 2014 and December 31, 2013, respectively	244,966	244,271
Capital in excess of par value (including prepaid common stock purchase contracts)	1,663,850	1,414,457
Accumulated Deficit	(165,624)	(71,157)
Treasury stock, at cost; 7,322,694 and 7,130,294 shares at at September 30, 2014 and December 31, 2013, respectively	(96,654)	(97,926)
Accumulated other comprehensive loss	(150,164)	(140,131)
Stockholders' Equity - McDermott International, Inc.	1,496,374	1,349,514
Noncontrolling interest	92,319	90,830
Total Equity	1,588,693	1,440,344
Total Liabilities and Equity	3,527,316	2,807,371

See accompanying notes to condensed consolidated financial statements.

McDERMOTT INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30, 2014 2013 (Unaudited) (In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	\$(87,926)	\$(180,866)
Non-cash items included in net loss:		
Depreciation and amortization	68,655	60,114
Drydock amortization	15,567	14,179
Stock-based compensation charges	14,387	15,492
Net periodic pension benefit cost	9,245	(955)
Equity in loss of unconsolidated affiliates	5,647	12,967
Gain on foreign currency-net	(143)	(10,838)
Restructuring activity	(2,235)	12,940
Gain on asset disposals	(57,026)	(15,492)
Benefit for deferred taxes	(4,175)	(3,761)
Other non-cash items	6,406	280
Changes in assets and liabilities, net of effects from acquisitions and dispositions:		
Accounts receivable	44,368	50,206
Net contracts in progress and advance billings on contracts	10,353	44,601
Accounts payable	(99,588)	(27,953)
Accrued and other current liabilities	(16,200)	3,038
Pension liability and accrued postretirement and employee benefits	1,180	(29,196)
Derivative instruments and hedging activities	1,671	(46,270)
Other assets and liabilities	(22,484)	(66,596)
TOTAL CASH USED IN OPERATING ACTIVITIES	(112,298)	(168,110)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(216,526)	(225,397)
Increase in restricted cash and cash equivalents	(215,663)	(372)
Purchases of available-for-sale securities	(1,997)	(9,886)
Sales and maturities of available-for-sale securities	12,903	39,210
Proceeds from the sale and disposal of assets	70,252	37,189
Other investing activities	(5,076)	(8,503)
TOTAL CASH USED IN INVESTING ACTIVITIES	(356,107)	(167,759)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from 8.00% senior Notes	500,000	-
Proceeds from Term Loan	300,000	-
Proceeds from prepaid common stock purchase contracts issuance	240,044	-
Proceeds from amortizing notes issuance	47,456	-
Issuance of common stock	170	-

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Payments - long term debt	(39,542)	-
Borrowings - short term debt	250,000	80,000
Payments - short term debt	(250,000)	(88,567)
Debt issuance costs	(46,914)	-
Distributions to noncontrolling interests	(5,002)	(12,493)
Other financing activities	(1,707)	(1,033)
TOTAL CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	994,505	(22,093)
EFFECTS OF EXCHANGE RATE CHANGES ON CASH	(851)	185
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	525,249	(357,777)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	118,702	640,147
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$643,951	\$282,370

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid during the period for:

Income taxes (net of refunds)	\$21,273	\$90,462
Interest expense (net of amount capitalized)	\$9,136	\$-

See accompanying notes to condensed consolidated financial statements.

McDERMOTT INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EQUITY

	Common Stock Shares (Unaudited) (In thousands, except for share amounts)	Par Value	Capital in Excess of Par Value	Accumulated Deficit	Accumulated Other Comprehensive Loss	Treasury Stock	Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance December 31, 2012	243,442,156	\$243,442	\$1,391,271	\$445,756	\$(94,413)	\$(98,725)	\$1,887,331	\$64,774	\$1,952,105
Net loss	-	-	-	(192,940)	-	-	(192,940)	12,074	(180,866)
Other comprehensive loss, net of tax	-	-	-	-	(34,822)	-	(34,822)	(24)	(34,846)
Exercise of stock options	54,454	55	93	-	-	-	148	-	148
Share vesting	444,398	444	(444)	-	-	-	-	-	-
Purchase of treasury shares	-	-	-	-	-	(1,088)	(1,088)	-	(1,088)
Stock-based compensation charges	-	-	14,369	-	-	1,123	15,492	-	15,492
Distributions to noncontrolling interests	-	-	-	-	-	-	-	(12,493)	(12,493)
Balance at September 30, 2013	243,941,008	\$243,941	\$1,405,289	\$252,816	\$(129,235)	\$(98,690)	\$1,674,121	\$64,331	\$1,738,452
Balance December 31, 2013	244,271,365	\$244,271	\$1,414,457	\$(71,157)	\$(140,131)	\$(97,926)	\$1,349,514	\$90,830	\$1,440,344
Net loss	-	-	-	(94,467)	-	-	(94,467)	6,541	(87,926)
Other comprehensive loss, net of tax	-	-	-	-	(10,033)	-	(10,033)	(47)	(10,080)
Exercise of stock options	169,322	170	193	-	-	-	363	-	363
Share vesting	525,422	525	(525)	-	-	-	-	-	-
Purchase of treasury shares	-	-	-	-	-	(1,460)	(1,460)	-	(1,460)
Stock-based compensation	-	-	9,681	-	-	2,732	12,413	-	12,413

charges									
Issuance of tangible equity units	-	-	240,044	-	-	-	240,044	-	240,044
Distributions to noncontrolling interests	-	-	-	-	-	-	-	(5,005)	(5,005)
Balance at September 30, 2014	244,966,109	\$244,966	\$1,663,850	\$(165,624)	\$(150,164)	\$(96,654)	\$1,496,374	\$92,319	\$1,588,693

See accompanying notes to condensed consolidated financial statements.

McDERMOTT INTERNATIONAL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1—BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

McDermott International, Inc. (“MII”), a corporation incorporated under the laws of the Republic of Panama in 1959, is a leading engineering, procurement, construction and installation (“EPCI”) company focused on designing and executing complex offshore oil and gas projects worldwide. Providing fully integrated EPCI services, we deliver fixed and floating production facilities, pipeline installations and subsea systems from concept to commissioning. Operating in approximately 20 countries across the Americas, Middle East, Asia Pacific, the North Sea and Africa, our integrated resources include approximately 14,000 employees and 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 unaudited condensed consolidated financial statements, unless the context otherwise indicates, “we,” “us” and “our” mean MII and its consolidated subsidiaries.

Basis of Presentation

We have presented our unaudited condensed consolidated financial statements in U.S. Dollars, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”) applicable to interim reporting. 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 accompanying notes in our annual report on Form 10-K for the year ended December 31, 2013.

We have included all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation. These condensed consolidated financial statements include the accounts of McDermott International, Inc., its consolidated subsidiaries and controlled entities. 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 “unconsolidated affiliates” or “joint ventures.” We have eliminated all intercompany transactions and accounts.

Certain 2013 amounts in the condensed consolidated balance sheets and statement of cash flows, reflecting the non cash impacts on gain of foreign exchange, have been reclassified to conform to the 2014 presentation.

Business Segments

In March 2014, we changed our organizational structure to orient around our offshore and subsea business activities through four primary geographic regions. The four geographic regions, which we consider to be our operating segments, consist of Asia Pacific, Americas (previously Atlantic), Middle East and North Sea and Africa. The Caspian is no longer considered an operating segment and will continue to be aggregated in the Middle East reporting segment. The North Sea and Africa operating segment is also aggregated into the Middle East reporting segment due to the proximity of regions and similarities in the nature of services provided, economic characteristics and oversight responsibilities. Accordingly, we continue to report financial results under reporting segments consisting of Asia Pacific, Americas and the Middle East. We also report certain corporate and other non-operating activities under the heading "Corporate and other," which primarily reflects corporate personnel and activities, incentive compensation programs and other costs that are generally fully allocated to our operating segments. The only corporate costs not allocated to our operating segments are the restructuring costs associated with our corporate reorganization. See Note 9 for summarized financial information on our segments.

Revenue Recognition

We determine the appropriate accounting method for each of our long-term contracts before work on the project begins. We generally recognize contract revenues and related costs on a percentage-of-completion method for individual contracts or combinations of contracts based on work performed, man hours, or a cost-to-cost method, as applicable to the activity involved. We include the amount of accumulated contract costs and estimated earnings that exceed billings to customers in contracts in progress. We include billings to customers that exceed accumulated contract costs and estimated earnings in advance billings on contracts. Most

long-term contracts contain provisions for progress payments. We expect to invoice customers for and collect all unbilled revenues. Certain costs are generally excluded from the cost-to-cost method of measuring progress, such as significant procurement costs for materials and third-party subcontractors. Total estimated project costs, and resulting 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.

In addition, change orders, which are a normal and recurring part of our business, can increase (sometimes substantially) the future scope and cost of a job. Therefore, change order awards (although frequently beneficial in the long term) can have the short-term effect of reducing the job percentage of completion and thus the revenues and profits recognized to date. We regularly review contract price and cost estimates as the work progresses and reflect adjustments in profit, proportionate to the job percentage of completion in the period when those estimates are revised. Revenue from unapproved change orders is generally recognized to the extent of the lesser of amounts we expect to recover or costs incurred. Additionally, to the extent that claims included in backlog, including those that arise from change orders which are under dispute or which have been previously rejected by the customer, are not resolved in our favor, there could be reductions in or reversals of previously reported revenues and profits, and charges against current earnings, which could be material. Unapproved change orders that are disputed by the customer are treated as claims.

As of September 30, 2014, total unapproved change orders included in our estimates at completion aggregated approximately \$352.3 million, of which approximately \$168.9 million was included in backlog. As of September 30, 2013, total unapproved change orders included in our estimates at completion aggregated approximately \$468.0 million, of which approximately \$138.0 million was included in backlog.

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 those associated with weather or sea conditions. Claims revenue, when recorded, is only recorded to the extent of the lesser of the amounts we expect to recover or the associated costs incurred in our consolidated financial statements. We include certain unapproved claims in the applicable contract values when we have a legal basis to do so, consider collection to be probable and believe we can reliably estimate the ultimate value. Amounts attributable to unapproved change orders are not included in claims unless and until they are disputed by the customer. We continue to actively engage in negotiations with our customers on our outstanding claims. However, these claims may be resolved at amounts that differ from our current estimates, which could result in increases or decreases in future estimated contract profits or losses. Claims are generally negotiated over the course of the respective projects and many of our projects are long-term in nature. None of the pending claims as of September 30, 2014 were the subject of any litigation proceedings.

The amount of revenues and costs included in our estimates at completion (i.e., contract values) associated with such claims was \$6.5 million and \$186.3 million as of September 30, 2014 and September 30, 2013, respectively. All of these claim amounts at September 30, 2014 were related to our Middle East segment. Approximately 41%, 8% and 51% of these claim amounts as of September 30, 2013 were related to our Asia Pacific, Americas and Middle East segments, respectively. For the three- and nine-month periods ended September 30, 2014, no revenues or costs pertaining to claims were included in our condensed consolidated financial statements. For the three- and nine-month periods ended September 30, 2013, \$17.6 million and \$56.9 million of revenues and costs pertaining to claims were included in our condensed consolidated financial statements, respectively.

Our unconsolidated joint ventures did not include any claims revenue or associated cost in their financial results for the three- and nine-month periods ended September 30, 2014. For the three- and nine-month periods ended

September 30, 2013, our unconsolidated joint ventures included nil and \$3.7 million, respectively, of claims and associated costs in their financial results.

Deferred Profit Recognition

For contracts as to which we are unable to estimate the final profitability due to their uncommon nature, including first-of-a-kind projects, we recognize equal amounts of revenue and cost until the final results can be estimated more precisely. For these contracts, we only recognize gross margin when reliably estimable and the level of uncertainty has been significantly reduced, which we generally determine to be when the contract is at least 70% complete. We treat long-term construction contracts that contain such a level of risk and uncertainty that estimation of the final outcome is impractical as deferred profit recognition contracts. If, while being accounted for under our deferred profit recognition policy, a current estimate of total contract costs indicates a loss, the projected loss is recognized in full and the project is accounted for under our normal revenue recognition guidelines. At September 30, 2014, no projects were being accounted for under our deferred profit recognition policy.

Completed Contract Method

Under the completed contract method, revenue and gross profit is recognized only when a contract is completed or substantially complete. We generally do not enter into fixed-price contracts without an estimate of cost to complete that we believe to be reasonable. However, it is possible that in the time between contract execution and the start of work on a project, we could lose the ability to forecast cost to complete based on intervening events, including, but not limited to, experience on similar projects, civil unrest, strikes and volatility in our expected costs. In such a situation, we would use the completed contract method of accounting for that project. We did not enter into any contracts that we accounted for under the completed contract method during the quarters ended September 30, 2014 and September 30, 2013.

Loss Recognition

A risk associated with fixed-priced contracts is that revenue from customers may not 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 and vessel productivity, vessel repair requirements, weather downtime, subcontractor or supplier performance, pipeline lay rates or steel and other raw material prices. Increases in costs associated with our fixed-price contracts could have a material adverse impact on our consolidated financial condition, results of operations and cash flows. Alternatively, reductions in overall contract costs at completion could materially improve our consolidated financial condition, results of operations and cash flows.

As of September 30, 2014, we have provided for our estimated costs to complete on all of our ongoing contracts. However, it is possible that current estimates could change due to unforeseen events, which could result in adjustments to overall contract costs. Variations from estimated contract performance could result in material adjustments to operating results for any fiscal quarter or year. For all contracts, if a current estimate of total contract cost indicates a loss, the projected loss is recognized in full when determined.

Of the September 30, 2014 backlog, approximately \$385.4 million relates to four active projects that are in loss positions, whereby future revenues are expected to equal costs when recognized. Included in this amount is \$169.0 million of backlog associated with an EPCI project in Altamira, which is expected to be completed in the fourth quarter of 2015, and \$116.1 million pertaining to a five-year charter of the Agile in Brazil, which began in early 2012, both of which are in our Americas segment. The amount also includes \$91.1 million of backlog relating to an EPCI project in Saudi Arabia, which is expected to be completed by early 2016 and \$9.2 million relating to another EPCI project in Saudi Arabia scheduled for completion during the fourth quarter of 2014, both of which are being conducted in our Middle East segment. These four projects represent 100% of the backlog amount in a loss position. It is possible that our estimates of gross profit could increase or decrease based on changes in productivity, actual downtime and the resolution of change orders and claims with the customers.

Use of Estimates

We use estimates and assumptions to prepare our financial statements in conformity with GAAP. These estimates and assumptions affect the amounts we report in our financial statements and accompanying notes. Our actual results could differ from these estimates, and variances could materially affect our financial condition and results of operations in future periods. Changes in project estimates generally exclude change orders and changes in scope, but may include, without limitation, unexpected changes in weather conditions, productivity, unanticipated vessel repair requirements, customer, subcontractor and supplier delays and other costs. We generally expect to experience a reasonable amount of unanticipated events, and some of these events can result in significant cost increases above cost amounts we previously estimated. As of September 30, 2014, we have provided for our estimated costs to complete on all of our ongoing contracts. However, it is possible that current estimates could change due to unforeseen events,

which could result in adjustments to overall contract costs. Variations from estimated contract performance could result in material adjustments to operating results.

The following is a discussion of our most significant changes in estimates that impacted operating income for the three months and nine months ended September 30, 2014 and 2013.

Three months ended September 30, 2014

Operating income for the three months ended September 30, 2014 was impacted by changes in cost estimates relating to projects in each of our segments.

The Asia Pacific segment was positively impacted by favorable changes in estimates aggregating approximately \$20.2 million from three projects. On a recently completed marine installation project in Brunei, reduction in estimated costs to complete from productivity improvements on marine vessels and offshore support activities resulted in a favorable change of approximately \$10.8 million. On two previously completed projects, insurance claim collection and final project close-out adjustments resulted in a combined additional recovery of approximately \$9.5 million during the three months ended September 30, 2014.

The Middle East segment deteriorated by a net amount of approximately \$5.4 million due to change in estimates during the three months ended September 30, 2014. On one EPCI project in Saudi Arabia, estimated costs to complete increased by \$7.9 million, primarily as a result of vessel downtime due to weather and standby delays (which may be recoverable from the customer, but were not recognizable at September 30, 2014). On two other EPCI projects in Saudi Arabia, estimated costs to complete increased by an aggregate of \$6.7 million, as a result of revisions to project execution plans, primarily due to extended offshore hookup campaigns, increased vessel mobilization activities, and delays in the completion of onshore activities. On another EPCI project in Saudi Arabia, we increased our overall estimated costs to complete by approximately \$8.6 million, reflecting the costs of an incremental mobilization and inefficiencies of executing out-of-sequence work due to a revised execution plan, which resulted from delayed access to the project site. These negative changes were offset by an improvement of approximately \$17.8 million on a pipelay project in the Caspian, primarily due to increased cost recovery estimates based on positive developments during the three months ended September 30, 2014 from the ongoing project close-out process with the customer. This project was completed earlier in 2014.

The Americas segment improved by a net \$1.5 million from changes in estimates on five projects. On a subsea project in the U.S. Gulf of Mexico completed during the period, project close-out savings on marine spread costs and increased cost recovery based on positive developments from the ongoing negotiations with the customer resulted in a reduction of project losses of \$12.4 million during the three months ended September 30, 2014. Two projects completed earlier in 2014 improved by an aggregate of approximately \$4.8 million based on positive developments from ongoing project close-out negotiations with the customers. These improvements were partially offset by negative changes of approximately \$10.9 million on an EPCI project in Altamira, primarily due to increased cost estimates to complete the project as a result of a revised fabrication execution plan, and reduced cost recovery of approximately \$4.8 million on a fabrication project in Morgan City completed during 2013, based on an agreement in principle reached with the customer during the three months ended September 30, 2014, which resulted in lower-than-anticipated recoveries.

Nine months ended September 30, 2014

Operating income for the nine months ended September 30, 2014 was impacted by changes in cost estimates relating to projects in each of our segments.

The Asia Pacific segment experienced net favorable changes in estimates aggregating approximately \$53.5 million, due to changes in estimates on four projects. Changes in estimates on a subsea project in Malaysia resulted in improvements of approximately \$31.5 million during the nine months ended September 30, 2014, primarily related to productivity improvements on our marine vessels and offshore support activities, as well as project close-out savings. On a recently completed marine installation project in Brunei, a reduction in estimated costs to complete from productivity improvements on marine vessels and offshore support activities resulted in a favorable change of approximately \$11.8 million. On two previously completed projects, insurance claim collection and final project close-out adjustments resulted in a combined additional recovery of approximately \$10.3 million during the nine months ended September 30, 2014.

The Middle East segment was negatively impacted by net unfavorable changes aggregating approximately \$10.7 million, due to changes in four projects. On two EPCI projects in Saudi Arabia, we increased our estimated costs at completion by approximately \$42.4 million, primarily as a result of vessel downtime due to weather and standby delays (which may be recoverable from the customer, but which were not recognizable at September 30, 2014) and

reduced productivity levels and increased cost estimates to complete the onshore scope of one of the projects. On another EPCI project in Saudi Arabia, we increased our overall estimated costs to complete by approximately \$15.2 million, to reflect cost overruns related to (1) the onshore work, which was substantially completed in July 2014, and (2) delays in completing the offshore work, due to delayed access to the project site, resulting in a revised execution plan. The revised execution plan included the costs of an incremental mobilization and reflected inefficiencies of executing out-of-sequence work. These negative changes were partially offset by approximately \$46.9 million of increased cost recovery estimates on a pipelay project in the Caspian, based on positive developments during the nine months ended September 30, 2014 from the ongoing project close-out process with the customer. This project was substantially completed in June 2014.

The Americas segment was negatively impacted by net unfavorable changes in estimates aggregating approximately \$41.5 million associated with five projects. On an EPCI project in Altamira, we increased our estimated costs to complete by approximately \$66.3 million, due to liquidated damages and extended project management costs arising from unexpected project delays and projected fabrication cost increases reflecting reduced productivity and execution plan changes to mitigate further project delays, as well as procurement and marine installation cost increases. This project is in a loss position and is estimated to be completed in the fourth quarter of 2015. On a subsea project in the U. S. Gulf of Mexico, we increased our estimated costs to complete by a net amount of approximately \$10.1 million, primarily due to increased costs from equipment downtime issues on the North Ocean 102 (the "NO 102"), our primary vessel working on the project, partially offset by project close-out savings on marine spread costs and increased cost recovery estimates based on positive developments from the ongoing negotiations with the customer. This project, which was in a loss position, was completed during the nine months ended September 30, 2014. On a fabrication project in Morgan City completed during 2013, we reduced our cost recovery estimates by approximately \$7.8 million, mainly based on an agreement in principle with

the customer during the nine months ended September 30, 2014, which resulted in lower-than-anticipated recoveries. These negative impacts were partially offset by \$37.4 million of project close-out improvements on an EPCI project in Brazil, from marine cost reductions upon completion of activities and increased recoveries due to successful developments from ongoing approval process for additional weather-related compensation. We also recognized \$5.2 million cost reductions, mainly due to project close-out improvements, on a marine installation project in the U. S. Gulf of Mexico.

Three months ended September 30, 2013

The Asia Pacific segment was primarily impacted by changes in estimates on one subsea project in Malaysia. On that project, we increased our estimated cost at completion by approximately \$66 million in the three months ended September 30, 2013, primarily due to an accelerated project execution schedule agreed with the customer and further delays in vessel availability related to downtime for the Lay Vessel North Ocean 105 (the "NO 105"). The change in cost estimate was partially offset by approximately \$33 million of improvements resulting from commercial negotiations with our customer in which we agreed to expedite project completion by returning to a single marine campaign project execution plan, including working in adverse weather periods on a best-efforts basis, with reimbursable weather downtime, and the customer agreed to re-establish the project completion date and waive liquidated damages. The \$66 million of additional costs were driven by several factors, including continued NO 105 major pipe-lay system commissioning problems and the additional cost impacts of the commercial negotiations noted above, which required a revised execution plan transferring work scope from the NO 105 to the NO 102 and the Emerald Sea, which were added to the fleet of vessels working on the project. This resulted in increased costs from additional vessel mobilizations, increased daily operating costs and decreased productivity from working in adverse weather periods. This project was completed during the three months ended June 30, 2014.

The Middle East segment was impacted by changes in estimates on a pipelay project in the Caspian. We increased our cost recovery estimates by approximately \$29.0 million during the three months ended September 30, 2013, based on preliminary verbal agreements and then-recent commercial negotiations with the customer. Based on information available at that time, it was our opinion that the cost recovery was probable and the contractual negotiations would be completed as planned. This project was completed during the three months ended March 31, 2014.

The Americas segment was impacted by changes in estimates on one project in Mexico. On that project, we recognized approximately \$9.0 million of project losses in the three months ended September 30, 2013, primarily due to increased fabrication costs associated with increases to the scope of the project and incremental costs associated with labor productivity. The project is currently in a loss position and is expected to be completed in the fourth quarter of 2015.

Nine months ended September 30, 2013

The Asia Pacific segment was primarily impacted by changes in estimates on three projects. On one project (the project in Malaysia described above), in the nine months ended September 30, 2013 we increased our estimated cost at completion by a net of approximately \$99 million. An aggregate of \$132.0 million of increased cost to complete the project was primarily due to delays resulting from direct and indirect impacts of the equipment modification problems during the final commissioning stage of the major pipelay systems upgrade to the NO 105 and the other cost increase factors described above. Those items were partially offset by a \$33 million improvement resulting from the commercial negotiations described above. On two EPCI projects completed during the first half of 2013, we benefited in the aggregate from approximately \$14 million of reduced at-completion costs, primarily due to efficiencies associated with marine campaigns.

The Middle East segment was impacted by changes in estimates on an EPCI project in Saudi Arabia and a pipelay project in the Caspian. On the EPCI project in Saudi Arabia, we increased our estimated costs at completion by approximately \$38.0 million in the nine months ended September 30, 2013, primarily as a result of revisions to the project's execution plan, increases in our estimated costs to complete due to an extended offshore hookup campaign requiring multiple vessel mobilizations and, to a lesser extent, delays in the completion of onshore activities. While the project recognized losses in the nine months ended September 30, 2013, it remains in an overall profitable position. On the pipelay project in the Caspian, we increased our cost recovery estimates by approximately \$47.7 million during the nine months ended September 30, 2013 based on preliminary verbal agreements and then-recent commercial negotiations with the customer. Based on information available at that time, it was our opinion that the cost recovery was probable and the contractual negotiations would be completed as planned. This project was completed during the three months ended March 31, 2014.

The Americas segment was impacted by changes in estimates on a fabrication project in Morgan City and an EPCI project in Altamira. On those two projects, we recognized an aggregate of approximately \$21.0 million of incremental project losses in the nine months ended September 30, 2013, primarily due to lower-than-expected labor productivity and incremental fabrication costs. The fabrication project in Morgan City that experienced lower labor productivity was completed during the fourth quarter of 2013, while

the EPCI project in Altamira that recognized additional fabrication costs is expected to be completed in the fourth quarter of 2015. That project is in a loss position.

Loss Contingencies

We record liabilities for loss contingencies when it is probable that a liability has been incurred and the amount of loss is reasonably estimable. We provide disclosure when there is a reasonable possibility that the ultimate loss will exceed the recorded provision or if such loss is not reasonably estimable. We are currently involved in litigation and other proceedings, as discussed in Note 10. We have accrued our estimates of the probable losses associated with these matters, and associated legal costs are generally recognized in selling, general and administrative expenses as incurred. However, our losses are typically resolved over long periods of time and are often difficult to estimate due to various factors, including the possibility of multiple actions by third parties. Therefore, it is possible future earnings could be affected by changes in our estimates related to these matters.

Cash and Cash Equivalents

Our cash and cash equivalents are highly liquid investments with maturities of three months or less when we purchase them. We record cash and cash equivalents as restricted when we are unable to freely use such cash and cash equivalents for our general operating purposes. A majority of our restricted cash and cash equivalents represents collateralizing letters of credit as further discussed in Note 3.

Investments

We classify investments available for current operations as current assets in the accompanying balance sheets, and we classify investments held for long-term purposes as noncurrent assets. We adjust the amortized cost of debt securities for amortization of premiums and accretion of discounts to maturity. That amortization is included in interest income. We include realized gains and losses on our investments in other income (expense)—net. The cost of securities sold is based on the specific identification method. We include interest earned on securities in interest income.

Investments in Unconsolidated Affiliates

We generally use the equity method of accounting for affiliates in which our investment ownership ranges from 20% to 50%, and in which we do not exercise control over the entity. Currently, most of our investments in affiliates that are not consolidated are recorded using the equity method.

Accounts Receivable

Accounts Receivable—Trade, Net

A summary of contract receivables is as follows:

	September 30, 2014	December 31, 2013
	(in thousands)	
Contract receivables:		
Contracts in progress	\$176,754	\$192,745

Completed contracts	34,821	77,248
Retainages	86,883	127,698
Unbilled	4,304	14,571
Less allowances	(31,743)	(30,404)
Accounts receivable—trade, net	\$271,019	\$381,858

We expect to invoice our unbilled receivables once certain milestones or other metrics are reached, and we expect to collect all unbilled amounts. We believe that our provision for losses on uncollectible accounts receivable is adequate for our credit loss exposure.

Contract retainages generally represent amounts withheld by our customers until project completion, in accordance with the terms of the applicable contracts. The following is a summary of retainages on our contracts:

	September 30, 2014	December 31, 2013
	(in thousands)	
Retainages expected to be collected within one year	\$86,883	\$127,698
Retainages expected to be collected after one year	132,248	65,365
Total retainages	\$219,131	\$193,063

We have included in accounts receivable—trade, net, retainages expected to be collected within one year.

Accounts Receivable—Other

A summary of accounts receivable— other is as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Other taxes receivable	\$26,874	\$14,934
Receivables from unconsolidated affiliates	19,842	36,181
Accrued unbilled revenue	13,278	15,696
Intercompany unbilled cost	7,248	5,373
Employee receivables	4,286	4,532
Foreign currency forward contracts	328	11,641
Other	3,885	916
Accounts receivable-other	\$75,741	\$89,273

Employee receivables are expected to be collected within 12 months, and any allowance for doubtful accounts on our accounts receivable—other is based on our estimate of the amount of probable losses due to the inability to collect these amounts (based on historical collection experience and other available information). As of September 30, 2014 and December 31, 2013, no such allowance for doubtful accounts was recorded.

Contracts in Progress and Advance Billings on Contracts

Contracts in progress were \$336.9 million and \$426.0 million at September 30, 2014 and December 31, 2013, respectively. Advance billings on contracts were \$200.3 million at September 30, 2014 and \$278.9 million at December 31, 2013. A detail of the components of contracts in progress and advance billings on contracts is as follows:

September December
30, 2014 31, 2013

(In thousands)

Costs incurred less costs of revenue recognized	\$ 103,467	\$ 65,113
Revenues recognized less billings to customers	233,453	360,873

Contracts in Progress	\$ 336,920	\$ 425,986
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September December
30, 2014 31, 2013

(In thousands)

Billings to customers less revenue recognized	\$ 680,962	\$ 466,205
Costs incurred less costs of revenue recognized	(480,704)	(187,276)

Advance Billings on Contracts	\$ 200,258	\$ 278,929
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Other Non-Current Assets

We have included debt issuance costs in other non-current assets. The current portion of debt-issuance costs has been included in other current assets. We amortize debt issuance costs as interest expense on a straight-line basis over the life of the related debt. The following summarizes the changes in the carrying amount of these assets:

	Nine months ended September 30, 2014	Year ended December 31, 2013
	(In thousands)	
Balance at beginning of period	\$ 14,951	\$ 13,761
Debt issuance costs	46,914	4,905
Former Credit Agreement debt issuance cost write off	(11,913)	-
Amortization of interest expense	(7,628)	(3,715)
	42,324	14,951
Less: Current portion	(11,244)	-
Noncurrent portion	\$ 31,080	\$ 14,951

Also included in other non-current assets is long-term deferred drydock expenses, long-term prepaid rent and other prepaid expenses.

Fair Value of Financial Instruments

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. An established hierarchy for inputs is used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in valuing the asset or liability and are developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions about the factors that market participants would use in valuing the asset or liability.

Fair value is estimated by applying the following hierarchy, which prioritizes the inputs used to measure fair value into three levels and bases the categorization within the hierarchy upon the lowest level of input that is available and significant to the fair value measurement:

- Level 1—inputs are based on quoted prices for identical instruments traded in active markets.
 - Level 2—inputs are based on quoted prices for similar instruments in active markets, quoted prices for similar or identical instruments in inactive markets and model-based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets and liabilities.
 - Level 3—inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques that include option pricing models, discounted cash flow models and similar valuation techniques.
- The carrying amounts that we have reported for financial instruments, including cash and cash equivalents, accounts receivables and accounts payable approximate their fair values. See Note 6 for additional information regarding fair

value measurements.

Derivative Financial Instruments

Our worldwide operations give rise to exposure to changes in certain market conditions, which may adversely impact our financial performance. When we deem it appropriate, we use derivatives as a risk management tool to mitigate the potential impacts of certain market risks. The primary market risk we manage through the use of derivative instruments is movement in foreign currency exchange rates. We use foreign currency derivative contracts to reduce the impact of changes in foreign currency exchange rates on our operating results. We use these instruments to hedge our exposure associated with revenues and/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.

In certain cases, contracts with our customers contain provisions under which some payments from our customers are denominated in U.S. Dollars and other payments are denominated in a foreign currency. In general, the payments denominated in a foreign currency are designed to compensate us for costs that we expect to incur in such foreign currency. In these cases, we may use derivative instruments to reduce the risks associated with foreign currency exchange rate fluctuations arising from differences in timing of our foreign currency cash inflows and outflows. See Note 5 for additional information regarding derivative financial instruments.

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Foreign Currency Translation

We translate assets and liabilities of our foreign operations, other than operations in highly inflationary economies, into U.S. Dollars at period-end exchange rates, and we translate income statement items at average exchange rates for the periods presented. We record adjustments resulting from the translation of foreign currency financial statements as a component of accumulated other comprehensive income (loss) ("AOCI"), net of tax.

Earnings per Share

We have computed earnings per common share on the basis of the weighted average number of common shares, and, where dilutive, common share equivalents, outstanding during the indicated periods. See Note 8 for our earnings per share computations.

Accumulated Other Comprehensive Loss

The components of AOCI included in stockholders' equity are as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Foreign currency translation adjustments	\$(5,276)	\$(2,562)
Net gain on investments	238	238
Net loss on derivative financial instruments	(63,003)	(45,386)
Unrecognized losses on benefit obligations	(82,123)	(92,421)
Accumulated other comprehensive loss	\$(150,164)	\$(140,131)

The following tables present the components of AOCI and the amounts that were reclassified during the period:

2014 period

	Foreign currency gain (loss)	Unrealized holding loss on investment	Deferred gain (loss) on derivatives ⁽¹⁾	Defined benefit pension plans loss ⁽²⁾	TOTAL
For the three months ended September 30, 2014					
	(in thousands)				
Balance, June 30, 2014	\$(3,821)	\$ 245	\$ (30,090)	\$(85,555)	\$(119,221)
Other comprehensive income (loss) before reclassification	(1,455)	(7)	(39,563)	-	(41,025)

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Amounts reclassified from AOCI	-	-	6,650	3,432	10,082
Net current period other comprehensive income (loss)	(1,455)	(7)	(32,913)	3,432	(30,943)
Balance, September 30, 2014	\$ (5,276)	\$ 238	\$ (63,003)	\$ (82,123)	\$ (150,164)
	Foreign	Unrealized	Deferred	Defined	
	currency	holding	gain (loss)	benefit	
	gain	loss on	on	pension	
For the nine months ended September 30, 2014	(loss)	investment	derivatives ⁽¹⁾	plans	TOTAL
				loss ⁽²⁾	
	(in thousands)				
Balance, December 31, 2013	\$ (2,562)	\$ 238	\$ (45,386)	\$ (92,421)	\$ (140,131)
Other comprehensive income (loss) before reclassification	(2,714)	-	(26,764)	-	(29,478)
Amounts reclassified from AOCI	-	-	9,147	10,298	19,445
Net current period other comprehensive income (loss)	(2,714)	-	(17,617)	10,298	(10,033)
Balance, September 30, 2014	\$ (5,276)	\$ 238	\$ (63,003)	\$ (82,123)	\$ (150,164)

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2013 period

	Foreign currency gain (loss)	Unrealized holding loss on investment	Deferred gain (loss) on derivatives ⁽¹⁾	Defined benefit pension plans loss ⁽²⁾	TOTAL
For the three months ended September 30, 2013					
Balance, June 30, 2013	\$(2,886)	\$ (1,875)	\$ (58,316)	\$(93,596)	\$(156,673)
Other comprehensive income (loss) before reclassification	(1,245)	158	24,767	-	\$23,680
Amounts reclassified from AOCI	-	-	320	3,438	\$3,758
Net current period other comprehensive income (loss)	(1,245)	158	25,087	3,438	27,438
Balance, September 30, 2013	\$(4,131)	\$ (1,717)	\$ (33,229)	\$(90,158)	\$(129,235)
For the nine months ended September 30, 2013					
Balance, December 31, 2012	\$(3,366)	\$ (2,316)	\$ 11,735	\$(100,466)	\$(94,413)
Other comprehensive income (loss) before reclassification	(765)	599	(46,246)	-	\$(46,412)
Amounts reclassified from AOCI	-	-	1,282	10,308	\$11,590
Net current period other comprehensive income (loss)	(765)	599	(44,964)	10,308	(34,822)
Balance, September 30, 2013	\$(4,131)	\$ (1,717)	\$ (33,229)	\$(90,158)	\$(129,235)

(in thousands)

(1) Refer to Note 5 for additional details.

(2) Refer to Note 4 for additional details.

(3) Reclassified to cost of operations and gain on foreign currency, net.

(4) Reclassified to selling, general and administrative expenses.

Recently Issued Accounting Standards

In August 2014, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" ("ASU 2014-15"). Currently, there is no guidance in effect under U.S. GAAP regarding management's responsibility to assess whether there is substantial doubt about an entity's ability to continue as a going concern. Under ASU 2014-15, we will be

required to assess our ability to continue as a going concern each interim and annual reporting period and provide certain disclosures if there is substantial doubt about our ability to continue as a going concern, including management's plan to alleviate the substantial doubt. ASU 2014-15 is effective for annual periods ending after December 15, 2016 and interim periods thereafter with early adoption permitted. We are currently assessing the impact of the adoption of ASU 2014-15 on our future financial statements and related disclosures.

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers". This ASU will supersede most of the existing revenue recognition requirements in U.S. GAAP and will require entities to recognize revenue at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. It also requires significantly expanded disclosures regarding the qualitative and quantitative information of an entity's nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU No. 2014-09 is effective for us for annual and interim reporting periods beginning after December 15, 2016, with early application not permitted. We have the choice to apply it either retrospectively to each reporting period presented or by recognizing the cumulative effect of applying it at the date of initial application (January 1, 2017) and not adjusting comparative information. We are currently evaluating the requirements of this ASU and have not yet determined its impact on our consolidated financial statements.

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements and Property, Plant, and Equipment — Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity", which amends the definition of a discontinued operation by raising the threshold for a disposal to qualify as discontinued operations. ASU 2014-08 will also require entities to provide additional disclosures about discontinued operations as well as disposal transactions that do not meet the discontinued operations criteria. The pronouncement is effective prospectively for all disposals (except disposals classified as held for

sale before the adoption date) or components initially classified as held for sale in periods beginning on or after December 15, 2014. Early adoption is permitted. We are currently assessing the impact of the adoption of ASU 2014-08 on our future financial statements and related disclosures.

NOTE 2—ACQUISITION AND DISPOSITIONS

Acquisition

During the quarter ended March 31, 2013, we entered into a share purchase agreement to acquire all of the issued and outstanding shares of capital stock of Deepsea Group Limited, a United Kingdom-based company that provides subsea and other engineering services to international energy companies, primarily through offices in the United Kingdom and the United States. Total consideration was approximately \$9.0 million, which includes cash (\$6.0 million) and the delivery of 313,580 restricted shares of MII common stock (out of treasury). The transaction was accounted for using the acquisition method and, accordingly, assets acquired and liabilities assumed were recorded at their respective fair values.

During the quarter ended December 31, 2013, we entered into two joint ventures with TH Heavy Engineering Berhad (“THHE”), whereby we acquired a 30% interest in a subsidiary of THHE, THHE Fabricators Sdn. Bhd., and THHE acquired a 30% interest in our Malaysian subsidiary, Berlian McDermott Sdn. Bhd. Accounting for these transactions is preliminary at September 30, 2014 and is pending finalization of these transactions by the end of 2014. As of September 30, 2014, we recorded an equity method investment of approximately \$25.5 million, a non-controlling interest of approximately \$20.9 million and an increase in capital in excess of par value of approximately \$4.6 million arising from these transactions.

Non-Core Asset Sales and Vessel-Impairment Charges

During the quarter ended September 30, 2014, we committed to a plan to sell vessel equipment, including dynamic positioning thrusters and a deepwater pipelay winch system. These items of equipment were part of upgrades to one of our marine vessels. We cancelled those upgrades in December 31, 2013. Assets classified as held for sale are no longer depreciated.

We previously committed to a plan to sell four of our multi-function marine vessels, specifically the Bold Endurance, DB 16, DB 26 and the DLB KP1. During the three months ended September 30, 2014, we completed the sale of the DB16 for aggregate cash proceeds of approximately \$16.1 million, resulting in a gain of approximately \$4.7 million. During the quarter ended March 31, 2014, we completed the sale of the DLB KP1 for aggregate cash proceeds of approximately \$8.4 million, resulting in a gain of approximately \$6.4 million. During the nine months ended September 30, 2013, we completed the sale of the Bold Endurance and the DB 26 for aggregate cash proceeds of approximately \$32.0 million, resulting in an aggregate gain of approximately \$12.5 million.

In April 2014, we completed the sale of our Harbor Island facility near Corpus Christi, Texas for proceeds of approximately \$31.7 million, resulting in a gain of approximately \$25.0 million, which has been recognized in our Americas segment.

In June 2014, as part of our plan to discontinue utilization of our Morgan City facility, we disposed of several assets, including certain equipment, for aggregate cash proceeds of approximately \$13.6 million, resulting in an aggregate gain of approximately \$11.4 million, of which approximately \$1.3 million was recorded in connection with our Americas restructuring, discussed below. This portion of the gain pertained to impairments previously recorded in the six months ended June 30, 2013 in connection with the Americas restructuring.

Also in June 2014, we cancelled a pipelay system originally intended for the Construction Support Vessel 108 (“CSV 108”), which resulted in a \$10.7 million improvement to the cancellation cost estimate included in the \$37.8 million of vessel-impairment charges recognized during the quarter ended December 31, 2013.

Americas and Corporate Restructuring

We commenced a restructuring of our Americas operations during the quarter ended June 30, 2013, which involves our Morgan City, Louisiana, Houston, Texas, New Orleans, Louisiana and Brazil locations. The restructuring involves, among other things, reductions of management, administrative, fabrication and engineering personnel, and discontinued utilization of the Morgan City facility. Future fabrication operations in the Americas segment are expected to be executed using the Altamira, Mexico facility. In addition, we exited our joint venture operation in Brazil. Costs associated with our Americas restructuring activities primarily include severance and other personnel-related costs, costs associated with exiting the joint venture in Brazil, asset impairment and relocation costs, environmental reserves and future unutilized lease costs.

In October 2013, we announced certain executive management changes that became effective during the fourth quarter of 2013. In March 2014, we changed our organizational structure to orient around offshore and subsea business activities through four primary geographic regions. Costs associated with our corporate reorganization activities will primarily include severance, relocation and other personnel-related costs and costs for advisors.

The following table presents total amounts incurred during the nine months ended September 30, 2014, as well as amounts incurred from the inception of our restructuring efforts up to September 30, 2014 and amounts expected to be incurred in the future by major type of cost and by segment.

	Incurred in three months ended September 30, 2014	Incurred in nine months ended September 30, 2014	Incurred from restructuring inception to September 30, 2014	Estimate of remaining amounts to be incurred	Total
Americas					
Impairments and write offs	\$ 100	\$ (1,240)	\$ 12,923	\$ 77	\$13,000
Severance and other personnel-related costs	(155)	3,099	12,744	456	13,200
Morgan City environmental reserve	-	-	5,925	-	5,925
Morgan City yard-related expenses	2,879	5,528	9,703	6,297	16,000
Other	-	-	158	4,717	4,875
	\$ 2,824	\$ 7,387	\$ 41,453	\$ 11,547	\$53,000
Corporate					
Severance and other personnel-related costs	\$ 53	\$ 961	\$ 2,622	\$ 378	\$3,000
Legal and other advisor fees	1,117	3,034	3,034	4,236	7,270
Other	730	730	730	-	730
	1,900	4,725	6,386	4,614	11,000
Total	\$ 4,724	\$ 12,112	\$ 47,839	\$ 16,161	\$64,000

Accrued liabilities associated with restructuring activities were approximately \$5.3 million and \$8.0 million as of September 30, 2014 and December 31, 2013, respectively.

NOTE 3—LONG-TERM DEBT AND NOTES PAYABLE

During April 2014, we refinanced our existing obligations, and replaced in its entirety, our then existing \$950.0 million credit agreement (the “Former Credit Agreement”) with a new credit agreement (the “New Credit Agreement”), which provides for:

- a \$400.0 million first-lien, first-out three-year letter of credit facility (the “LC Facility”); and
- a \$300.0 million first-lien, second-out five-year term loan (the “Term Loan”).

Additionally, during April 2014, we completed the following new financing transactions:

- the issuance of \$500.0 million of second-lien seven-year senior secured notes.
- the issuance of \$287.5 million of tangible equity units composed of (1) three-year amortizing, senior unsecured notes, in an aggregate principal amount of \$47.5 million, and (2) prepaid common stock purchase contracts.

With the completion of these financing transactions in April 2014, we terminated the bridge loan commitment we had obtained from an affiliate of Goldman, Sachs, & Co. (“Goldman Sachs”). As a result of the termination of the bridge loan commitment, the fee we previously paid to Goldman Sachs to obtain the bridge loan commitment was recognized as interest expense in the first half of 2014. Due to the replacement of the Former Credit Agreement, the unamortized issuance fees related to the Former Credit Agreement were also recognized as interest expense in the first half of 2014. The total additional interest expense related to these items was approximately \$28.0 million.

The Former Credit Agreement provided for revolving credit borrowings and issuances of letters of credit in an aggregate outstanding amount of up to \$950.0 million. Proceeds from borrowings under the Former Credit Agreement were available for working capital needs and other general corporate purposes. At December 31, 2013, there were no borrowings outstanding, and letters of credit issued under the Former Credit Agreement totaled \$214.3 million. At December 31, 2013, there was \$735.7 million available

for borrowings or to meet letter of credit requirements under the Former Credit Agreement. During the year ended December 31, 2013, our outstanding borrowings under the Former Credit Agreement did not exceed \$80.0 million, and we had average outstanding borrowings under the Former Credit Agreement of approximately \$23.5 million, with an average interest rate of 2.28%. In addition, at December 31, 2013, we had \$96.9 million in outstanding unsecured bilateral letters of credit. At March 31, 2014, there was \$250.0 million of revolving credit borrowings outstanding under the Former Credit Agreement, all of which were repaid during April 2014.

New Credit Facilities

The indebtedness and other obligations under the New Credit Agreement are unconditionally guaranteed on a senior secured basis by substantially all of our wholly owned subsidiaries, other than our captive insurance subsidiary (collectively, the “Guarantors”). In connection with the New Credit Agreement, we paid certain fees to the lenders thereunder, as well as certain arrangement fees to the arrangers and agents for the New Credit Agreement, which we have capitalized and are amortizing to interest expense over the respective terms of the LC Facility and the Term Loan. We also paid certain fees to the initial purchasers of the senior secured notes and to the underwriter of the tangible equity units referred to below, which we have capitalized and are amortizing to interest expense over the respective terms of the related indebtedness.

LC Facility and Cash-Collateralized Bilateral Letters of Credit

The LC Facility provides for an initial letter of credit capacity of \$400.0 million and allows for uncommitted increases in capacity of \$100.0 million through December 31, 2014 and an additional \$100.0 million thereafter, potentially increasing the total capacity to \$600.0 million through the term of the LC Facility. Letters of credit issuable under the LC Facility support the obligations of McDermott and its affiliates and joint ventures. The aggregate amount of the LC Facility available for financial letters of credit is capped at 25% of the total LC Facility. As of September 30, 2014, the aggregate face amount of letters of credit issued under the LC Facility was \$192.9 million. There were no financial letters of credit issued under the LC facility as of September 30, 2014.

In addition, the LC Facility permits us to deposit up to \$300.0 million with letter of credit issuers to cash collateralize letters of credit issued on a bilateral basis outside the credit facility. As of September 30, 2014, we had an aggregate face amount of approximately \$134.0 million of such letters of credit outstanding supported by cash collateral, including financial letters of credit of \$19.8 million. We have included the supporting cash collateral in restricted cash and cash equivalents in the accompanying condensed consolidated balance sheet as of September 30, 2014.

The LC Facility is secured on a first-lien, first-out basis (with relative priority over the Term Loan) by pledges of the capital stock of all the Guarantors and mortgages on, or other security interests in, substantially all the tangible and intangible assets of our company and the Guarantors, subject to specific exceptions.

The LC Facility contains various customary affirmative covenants, as well as specific affirmative covenants, including specific reporting requirements and a requirement for ongoing periodic financial reviews by a financial advisor. The LC Facility also requires compliance with various negative covenants, including limitations with respect to the incurrence of other indebtedness and liens, restrictions on acquisitions, capital expenditures and other investments, restrictions on sale/leaseback transactions and restrictions on prepayments of other indebtedness.

The LC Facility requires us to generate consolidated earnings before interest, taxes, depreciation and amortization (“EBITDA”) of at least certain specified amounts over the term of the facility. The LC Facility also requires us to maintain a ratio of fair market value of vessel collateral to the sum of (1) the outstanding principal amount of the Term Loan, (2) the aggregate amount of undrawn financial letters of credit outstanding under the LC Facility, (3) all drawn but unreimbursed letters of credit under the LC Facility, and (4) mark-to-market foreign exchange exposure that is not

cash secured of at least 1.20:1.00. The LC Facility also specifies maximum capital expenditures over the term of the facility and requires us to maintain at least \$200.0 million of minimum available cash, at the end of each quarter. We were in compliance with the covenants under the LC Facility as of September 30, 2014.

The LC Facility provides for a commitment fee of 0.50% per year on the unused portion of the LC Facility and letter of credit fees at an annual rate of 2.25% for performance letters of credit and 4.50% for financial letters of credit, as well as customary issuance fees and other fees and expenses.

Term Loan

The Term Loan is secured on a first-lien, second-out basis (with the LC Facility having relative priority over the Term Loan) by pledges of the capital stock of all the Guarantors and mortgages on, or other security interests in, substantially all tangible and intangible assets of our company and the Guarantors, subject to specific exceptions. As of September 30, 2014, we had \$299.3 million in borrowings outstanding under the Term Loan agreement, of which \$3.0 million was classified as current notes payable.

The Term Loan requires mandatory prepayments from: (1) the proceeds from the sale of assets, as well as insurance proceeds, in each case subject to certain exceptions, to the extent such proceeds are not reinvested in our business within 365 days of receipt; (2) net cash proceeds from the incurrence of indebtedness not otherwise permitted under the New Credit Agreement; and (3) 50% of amounts deemed to be “excess cash flow,” subject to specified adjustments. The Term Loan also requires quarterly amortization payments equal to \$750,000. The Term Loan also provides for a prepayment premium if we prepay or re-price the Term Loan prior to April 16, 2015.

The Term Loan requires compliance with various customary affirmative and negative covenants. We must also maintain a ratio of “ownership adjusted fair market value” of marine vessels to the sum of (1) the outstanding principal amount of the Term Loan and (2) the aggregate principal amount of unreimbursed drawings and advances under the LC Facility of at least 1.75:1.00. As of September 30, 2014, we were in compliance with all of the covenants under the Term Loan.

The Term Loan was incurred with 25 basis points of original issue discount and bears interest at a floating rate, which can be, at our option, either: (1) a LIBOR rate for a specified interest period (subject to a LIBOR “floor” of 1.00%) plus an applicable margin of 4.25%; or (2) an alternate base rate (subject to a base rate “floor” of 2.00%) plus an applicable margin of 3.25%.

Senior Notes

During April 2014 we issued \$500.0 million in aggregate principal amount of 8.000% senior secured notes due 2021 (the “Notes”) in a private placement in accordance with Rule 144A and Regulation S under the Securities Act of 1933, as amended. Interest on the Notes is payable semi-annually in arrears on May 1 and November 1 of each year, beginning on November 1, 2014, at an annual rate of 8%. The Notes are scheduled to mature on May 1, 2021. As of September 30, 2014, there was \$500.0 million of Senior Notes outstanding.

The Notes are unconditionally guaranteed on a senior secured basis by the Guarantors, and the Notes are secured on a second-lien basis by pledges of capital stock of certain of our subsidiaries and mortgages and other security interests covering (1) specified marine vessels owned by certain of the Guarantors and (2) substantially all the other tangible and intangible assets of our company and the Guarantors, subject to exceptions for certain assets.

At any time or from time to time on or after May 1, 2017, at our option, we may redeem the Notes, in whole or in part, at the redemption prices (expressed as percentages of principal amount of the Notes to be redeemed) set forth below, together with accrued and unpaid interest to the redemption date, if redeemed during the 12-month period beginning May 1 of the years indicated:

Year	Percentage
2017	104%
2018	102%
2019 and thereafter	100%

The Indenture governing the Notes contains covenants that, among other things, limit our ability and the ability of our restricted subsidiaries to: (1) incur or guarantee additional indebtedness or issue preferred stock; (2) make investments or certain other restricted payments; (3) pay dividends or distributions on capital stock or purchase or redeem subordinated indebtedness; (4) sell assets; (5) create restrictions on the ability of our restricted subsidiaries to pay dividends or make other payments to us; (6) create certain liens; (7) sell all or substantially all of our assets or merge or consolidate with or into other companies; (8) enter into transactions with affiliates; and (9) create unrestricted subsidiaries. Many of those covenants would become suspended if the Notes were to attain an investment grade rating

from both Moody's Investors Service, Inc. and Standard and Poor's Ratings Services and no default has occurred. The covenants mentioned above are subject to a number of important exceptions and limitations.

Tangible Equity Units

During April 2014, we issued 11,500,000 6.25% tangible equity units ("Units"), each with a stated amount of \$25.00. Each Unit consists of (1) a prepaid common stock purchase contract and (2) a senior amortizing note due April 1, 2017 (each an "Amortizing Note") that has an initial principal amount of \$4.1266 per Amortizing Note, bears interest at a rate of 7.75% per annum and has a final scheduled installment payment date of April 1, 2017.

The prepaid common stock purchase contracts were accounted for as additional paid-in capital totaling \$240.0 million. As of September 30, 2014, the Amortizing Notes were recorded as long-term debt totaling \$44.1 million, of which \$15.0 million was classified as current notes payable.

Each prepaid common stock purchase contract will automatically settle on April 1, 2017, unless settled earlier: (1) at the holder's option, upon which we will deliver shares of our common stock, based on the applicable settlement rate and applicable market value of our stock as determined under the purchase contract; or (2) at our option, upon which we will deliver shares of our common stock, based upon the stated maximum settlement rate of 3.5562 shares per Unit, subject to adjustment. Potential dilutive common shares that may be issued for the settlement of the common stock purchase contracts totaled 40.9 million at September 30, 2014, based on the maximum number of shares issuable per Unit. The potential minimum number of shares issuable is 33.4 million, which represents 2.9030 per Unit. The maximum and minimum settlement rates for the Units are subject to adjustment for certain dilutive events.

North Ocean Financing

North Ocean 105

On September 30, 2010, MII, as guarantor, and North Ocean 105 AS, in which we have a 75% ownership interest, as borrower, entered into a financing agreement to finance a portion of the construction costs of the NO105. The agreement provides for borrowings of up to \$69.4 million, bearing interest at 2.76% per year, and requires principal repayment in 17 consecutive semi-annual installments, which commenced on October 1, 2012. Borrowings under the agreement are secured by, among other things, a pledge of all of the equity of North Ocean 105 AS, a mortgage on the NO 105, and a lien on substantially all of the other assets of North Ocean 105 AS. MII unconditionally guaranteed all amounts to be borrowed under the agreement. As of September 30, 2014 and December 31, 2013, there was \$53.1 million and \$57.2 million, respectively, in borrowings outstanding under this agreement, of which (as of each date) approximately \$8.2 million was classified as current notes payable.

North Ocean 102

In December 2009, J. Ray McDermott, S.A. ("JRMSA"), a wholly owned subsidiary of MII, entered into a vessel-owning joint venture transaction with Oceanteam ASA. JRMSA had guaranteed approximately 50% of this debt based on its ownership percentages in the vessel-owning companies. The outstanding debt bore interest at a rate equal to the three-month LIBOR (which was subject to reset every three months) plus a margin of 3.315%. JRMSA paid in full the approximately \$31.4 million notes payable balance upon maturity during January 2014. JRMSA expects to exercise its option to purchase Oceanteam ASA's 50% ownership interest in the vessel-owning companies in December 2014. As of December 31, 2013, we reported consolidated notes payable of \$31.4 million on our consolidated balance sheet, all of which was classified as current notes payable and paid in full in early 2014.

Unsecured Bilateral Letters of Credit and Bank Guarantees

In 2012, McDermott Middle East, Inc. and MII executed a general reimbursement agreement in favor of a bank located in the UAE relating to issuances of bank guarantees in support of contracting activities in the Middle East and India. As of September 30, 2014 and December 31, 2013, bank guarantees issued under these arrangements totaled \$57.4 million and \$55.8 million, respectively. In 2007 and in 2012, JRMSA and MII executed general unsecured reimbursement agreements in favor of three institutions that were lenders under the Former Credit Agreement relating to issuances of letters of credit in support of contracting activities, primarily in Asia and the Middle East. Letters of credit issued under two of these arrangements have either been replaced by letters of credit under the LC Facility or cash collateralized. The letters of credit issued under these arrangements totaled \$12.0 million and \$39.8 million as of September 30, 2014 and December 31, 2013, respectively.

On April 20, 2012, McDermott and one of its wholly owned subsidiaries, McDermott Australia Pty. Ltd. ("McDermott Australia"), entered into a secured Letter of Credit Reimbursement Agreement (the "Reimbursement Agreement") with Australia and New Zealand Banking Group Limited ("ANZ"). In accordance with the terms of the Reimbursement

Agreement, ANZ issued letters of credit in the aggregate amount of approximately \$109.0 million to support McDermott Australia's performance obligations under contractual arrangements relating to a field development project. The obligations of McDermott and McDermott Australia under the Reimbursement Agreement are secured by McDermott Australia's interest in the contractual arrangements and certain related assets. During the nine months ended September 30, 2014, we replaced these letters of credit with letters of credit and cash collateralized letters of credit under the LC Facility.

Surety Bonds

In 2012 and 2011, MII executed general agreements of indemnity in favor of surety underwriters based in Mexico relating to surety bonds issued in support of contracting activities of J. Ray McDermott de México, S.A. de C.V. and McDermott, Inc., both subsidiaries of MII. As of September 30, 2014 and December 31, 2013, bonds issued under these arrangements totaled \$51.1 million and \$43.5 million, respectively. In October 2013, MII executed general agreements of indemnity in favor of surety underwriters relating to surety bonds in support of vessels operating in Brazil. The project requiring these bonds was completed during the quarter

ended June 30, 2014, allowing us to cancel the outstanding bonds. Accordingly, as of September 30, 2014, there were no bonds issued under these arrangements. As of December 31, 2013, the bonds issued under these arrangements totaled \$106.3 million.

Long-term debt and notes payable obligations

A summary of our long-term debt obligations are as follows:

	September 30, 2014	December 31, 2013
	(In thousands)	
Long-term debt consists of:		
Senior Notes	\$ 500,000	\$ -
Term Loan	299,250	-
NO 105 Construction Financing	53,104	57,189
Amortizing Notes	44,121	-
Capital lease obligation	3,073	-
Other financing	743	-
NO 102 Construction Financing	-	31,373
	900,291	88,562
Less: Amounts due within one year	27,002	39,543
Total long-term debt	\$ 873,289	\$ 49,019

NOTE 4—PENSION PLANS

Although we currently provide retirement benefits for most of our U.S. employees through sponsorship of the McDermott Thrift Plan, some of our longer-term U.S. employees and former employees are entitled to retirement benefits under the McDermott (U.S.) Retirement Plan, a non-contributory qualified defined benefit pension plan (the “McDermott Plan”), and several non-qualified supplemental defined benefit pension plans. The McDermott Plan and the non-qualified supplemental defined benefit pension plans are collectively referred to herein as the “Domestic Plans.” The McDermott Plan has been closed to new participants since 2006, and benefit accruals were frozen completely in 2010.

We also sponsor a defined benefit pension plan established under the laws of the Commonwealth of the Bahamas, the J. Ray McDermott, S.A. Third Country National Employees Pension Plan (the “TCN Plan”), which provides retirement benefits for certain of our current and former foreign employees. Effective August 1, 2011, new entry into the TCN Plan was closed, and effective December 31, 2011, benefit accruals under the TCN Plan were frozen. Effective January 1, 2012, we established a new global defined contribution plan to provide retirement benefits to non-U.S. expatriate employees who may have otherwise obtained benefits under the TCN Plan.

Retirement benefits under the McDermott Plan and the TCN Plan are generally based on final average compensation and years of service, subject to the applicable freeze in benefit accruals under the plans. Our funding policy is to fund the plans as recommended by the respective plan actuaries and in accordance with the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), or other applicable law. The Pension Protection Act of 2006 (“PPA”) amended ERISA and modified the funding requirements for certain defined benefit pension plans including the McDermott Plan. Funding provisions under the PPA accelerated funding requirements are applicable to the McDermott Plan to ensure full funding of benefits accrued.

Net periodic (benefit) cost for the Domestic Plans and the TCN Plan includes the following components:

	Domestic Plans			
	Three Months		Nine Months Ended	
	Ended		September 30,	
	September 30,	September 30,	September 30,	September 30,
	2014	2013	2014	2013
	(Unaudited)			
	(In thousands)			
Interest cost	\$6,743	\$5,999	\$20,230	\$17,997
Expected return on plan assets	(6,875)	(9,577)	(20,626)	(28,730)
Recognized net actuarial loss and other	3,552	2,932	10,658	8,798
Net periodic (benefit) cost	\$3,420	\$(646)	\$10,262	\$(1,935)

	TCN Plan			
	Three Months		Nine Months	
	Ended		Ended	
	September 30,		September 30,	
	2014	2013	2014	2013
	(Unaudited)			
	(In thousands)			
Interest cost	\$475	\$466	\$1,425	\$1,400
Expected return on plan assets	(741)	(651)	(2,221)	(1,952)
Recognized net actuarial loss and other	(73)	507	(221)	1,522
Net periodic (benefit) cost	\$(339)	\$322	\$(1,017)	\$970

NOTE 5—DERIVATIVE FINANCIAL INSTRUMENTS

We enter into derivative financial instruments primarily to hedge certain firm purchase commitments and forecasted transactions denominated in foreign currencies. We record these contracts at fair value on our condensed consolidated balance sheets. Depending on the hedge designation at the inception of the contract, the related gains and losses on these contracts are either: (1) deferred as a component of AOCI until the hedged item is recognized in earnings; (2) offset against the change in fair value of the hedged firm commitment through earnings; or (3) recognized immediately in earnings. At inception and on an ongoing basis, we assess the hedging relationship to determine its effectiveness in offsetting changes in cash flows or fair value attributable to the hedged risk. 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. 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. Gains and losses on derivative financial instruments that are immediately recognized in earnings are included as a component of gain (loss) on foreign currency-net in our condensed consolidated statements of operations.

As of September 30, 2014, the majority of our foreign currency forward contracts were designated as cash flow hedging instruments. In addition, we deferred approximately \$63.0 million of net losses on these derivative financial instruments in AOCI, and we expect to reclassify approximately \$33.1 million of deferred losses out of AOCI by September 2015, as hedged items are recognized. The notional value of our outstanding derivative contracts totaled \$893.5 million at September 30, 2014, with maturities extending through 2017. Of this amount, approximately \$525.7 million is associated with various foreign currency expenditures we expect to incur on one of our Asia Pacific segment EPCI projects. These instruments consist of contracts to purchase or sell foreign-denominated currencies. As of September 30, 2014, the fair value of these contracts was in a net liability position totaling \$30.4 million. The fair value of outstanding derivative instruments is determined using observable financial market inputs, such as quoted market prices, and is classified as Level 2 in nature.

The following tables summarize our derivative financial instruments:

Asset and Liability Derivatives

	September 30, 2014	December 31, 2013
	(in thousands)	
Derivatives Designated as Hedges:		
Location:		
Accounts receivable-other	\$328	\$11,641
Other assets	1	1,647
Total asset derivatives	\$329	\$13,288
Accounts payable	\$15,283	\$20,209
Other liabilities	15,484	21,846
Total liability derivatives	\$30,767	\$42,055

The Effects of Derivative Instruments on our Financial Statements

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013	September 30, 2014	September 30, 2013
	(in thousands)		(in thousands)	
Derivatives Designated as Hedges:				
Amount of gain/(loss) recognized in other comprehensive income (loss)	\$(39,563)	\$24,743	\$(26,764)	\$(46,270)
Income (loss) reclassified from AOCI into income: effective portion				
Location				
Cost of operations	\$6,788	\$(270)	\$7,283	\$(1,101)
Gain(loss) recognized in income (loss): ineffective portion and amount excluded from effectiveness testing				
Location				
Gain (loss) on foreign currency—net	\$(386)	\$3,136	\$3,842	\$7,578

NOTE 6—FAIR VALUE MEASUREMENTS

The following is a summary of our available-for-sale securities measured at fair value:

	September 30, 2014			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Mutual funds ⁽¹⁾	\$2,213	\$ -	\$2,213	\$ -
Commercial paper	400	-	400	-
Total	\$2,613	\$ -	\$2,613	\$ -

December
31, 2013
Total