

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended March 31, 1978

Commission file number 1-4095

J. RAY McDERMOTT & CO., INC.

(Exact name of Registrant as specified in its Charter)

Delaware
(State or other Jurisdiction of
Incorporation or Organization)74-1032246
(I.R.S. Employer
Identification No.)1010 Common Street,
New Orleans, Louisiana
(Address of Principal Executive Offices)70112
(Zip Code)

Registrant's Telephone Number, including area code 504/587-4411

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

| Title of Each Class | Name of Each Exchange on Which Registered |
|---|--|
| Common Stock \$1 Par Value | New York Stock Exchange |
| Series A \$2.20 Cumulative Convertible Preferred Stock | New York Stock Exchange |
| Series B \$2.60 Cumulative Preferred Stock | New York Stock Exchange |
| 9.70% Sinking Fund Debentures Due December, 1999 | New York Stock Exchange |
| 8.90% Notes Payable Due December, 1984 | New York Stock Exchange |

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

None

(Title of Class)

None

(Title of Class)

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, and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the close of the period covered by this report.

Class

Outstanding at March 31, 1978

Common stock, par value
\$1.00 per share

31,990,300

790205 0209

Items 1. and 3. BUSINESS AND PROPERTIES

GENERAL

J. Ray McDermott & Co., Inc. (the Company) was incorporated in 1946 as a successor to businesses which had been engaged in providing construction services to the oil and gas industry since the 1920's. A pioneer in offshore platform and pipeline construction in the Gulf of Mexico, the Company's services have principally consisted of engineering, fabrication, and installation of fixed offshore platforms, pipelines and other facilities for worldwide offshore development (as distinguished from exploratory) drilling and production operations. The Company also provides engineering and construction services for oil production in shoreline and marshland areas (principally in Louisiana and Texas), operates two shipyards in Louisiana for the construction, repair and maintenance of tugboats, barges and other small vessels, and is engaged in the engineering and construction of processing plants for the oil, gas and petrochemical industries and in the manufacture and sale of large air-cooled heat exchangers.

Effective on March 31, 1978, The Babcock & Wilcox Company (B & W) was merged into a wholly-owned subsidiary of the Company. The discussion of the business and properties of the Company set forth below does not include the business and properties of B & W. Following this discussion there is set forth certain information with respect to the business and summary of operations of B & W which have been reproduced from the Form 10-K for the year ended December 31, 1977 filed by B & W with the Securities and Exchange Commission.

Revenues, operating income and their respective percentage contributions are reflected below for the principal business segments of the Company over the past five years.

REVENUES

| | FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|-------------------------------|----------------------------------|------------------|--------------------|--------------------|--------------------|
| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| | (In thousands of dollars) | | | | |
| Marine Construction Services | \$379,311 | \$684,309 | \$1,010,105 | \$1,089,455 | \$1,116,119 |
| Onshore Construction Services | <u>46,445</u> | <u>58,516</u> | <u>91,973</u> | <u>134,386</u> | <u>177,592</u> |
| Total | <u>\$425,756</u> | <u>\$742,825</u> | <u>\$1,102,078</u> | <u>\$1,223,841</u> | <u>\$1,293,711</u> |

% OF REVENUES

| | FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|-------------------------------|----------------------------------|-------------|-------------|-------------|-------------|
| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| Marine Construction Services | 89% | 92% | 92% | 89% | 86% |
| Onshore Construction Services | <u>11%</u> | <u>8%</u> | <u>8%</u> | <u>11%</u> | <u>14%</u> |
| TOTAL | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

OPERATING INCOME

| | FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|-------------------------------|----------------------------------|-----------------|------------------|------------------|------------------|
| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| | (In thousands of dollars) | | | | |
| Marine Construction Services | \$44,966 | \$95,893 | \$219,752 | \$247,644 | \$205,559 |
| Onshore Construction Services | <u>1,451</u> | <u>(2,611)</u> | <u>10,529</u> | <u>11,987</u> | <u>15,364</u> |
| TOTAL | <u>\$46,417</u> | <u>\$93,282</u> | <u>\$230,281</u> | <u>\$259,631</u> | <u>\$220,923</u> |

% OF OPERATING INCOME

| | FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|-------------------------------|----------------------------------|-------------|-------------|-------------|-------------|
| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| Marine Construction Services | 97% | 100% | 95% | 95% | 93% |
| Onshore Construction Services | <u>3%</u> | <u>-</u> | <u>5%</u> | <u>5%</u> | <u>7%</u> |
| TOTAL | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

For the fiscal year ended March 31, 1978, Marine Construction Services and Onshore Construction Services have been determined on a basis different than in prior years to conform with FASB 14 on Segment Reporting. Operating income for prior years was after allocation of general corporate expenses but operating income for the fiscal year ended March 31, 1978, is before allocation of general corporate expenses of \$23,155,000. For the prior years, Onshore Construction Services consisted of amounts attributable principally to Hudson Engineering Corporation and its subsidiaries, and Marine Construction Services represented all other. For the fiscal year ended March 31, 1978, Marine Construction Services represent those services whose ultimate destination was offshore, and Onshore Construction Services represents those services whose ultimate destination was on land. Had the revenues and operating income for these services been reported as in prior years, revenue for Marine Construction Services and Onshore Construction Services would have been \$1,134,673,000, and \$159,038,000, respectively, and operating income would have been \$215,253,000, and \$5,670,000, respectively. See Note 12 to consolidated financial statements for certain information with respect to the Company's industry segments.

The amounts and approximate percentages of the Company's total revenues and total operating income derived from operations outside of the United States were as follows:

REVENUES

| FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|----------------------------------|-------------|-------------|-------------|-------------|
| (In thousands of dollars) | | | | |
| <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| \$242,180 | \$493,016 | \$707,021 | \$752,083 | \$655,155 |
| 57% | 66% | 64% | 61% | 51% |

OPERATING INCOME

| FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|----------------------------------|-------------|-------------|-------------|-------------|
| (In thousands of dollars) | | | | |
| <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
| \$31,333 | \$69,502 | \$151,195 | \$177,093 | \$92,663 |
| 68% | 75% | 66% | 68% | 42% |

The percentage contribution of operations outside the United States to the Company's consolidated net income has been substantially higher than the percentage contribution to operating income before provision for income taxes shown above because the Company's foreign subsidiaries have been subject to foreign tax rates which are lower than the United States corporate statutory rate of 48% and because the Company is not required to provide for deferred United States income taxes with respect to undistributed net income of foreign subsidiaries. See Note 6 to consolidated financial statements. The President has recommended legislation which would phase out evenly over a three year period the present deferral of income tax on unrepatriated earnings of foreign subsidiaries of United States corporations. Such legislation would not affect pre-1979 unrepatriated earnings of such subsidiaries. International operations of the Company are subject to the usual risks arising out of foreign government regulation of such operations, including unsettled political situations, expropriation and demands for local participations.

Although domestic activity has remained at a relatively high level, the continuation of the slow-down in worldwide hydrocarbon development in offshore areas has resulted in lower profit margins reflecting intense competition in all of the Company's foreign markets and a lower rate of utilization of the Company's equipment, particularly in the North Sea, Southeast Asia and West Africa. Gross profit margins decreased to 15% for the fiscal year ended March 31, 1978, as compared with 21% for the fiscal year ended March 31, 1977. The Company expects this lower rate of utilization and pressure on profit margins to continue for the current fiscal year.

MARINE CONSTRUCTION SERVICES

The Company's principal expertise has been in the design, construction and installation of specialized offshore, fixed platforms and marine pipelines used for development drilling, production and transportation of oil and gas. The Company

also engages in the engineering and construction of processing plants for the oil, gas, chemical, petrochemical and mineral industries for offshore installation.

Platforms, which are permanent in nature and fixed to the ocean floor by pilings driven through their structural legs, have been installed by the Company in water depths in excess of 850 feet. Engineering, fabrication and installation of the first section of a structure erected in 1,020 feet of water in the Gulf of Mexico was recently completed. These platforms have had to be engineered to withstand increasingly greater weights and stresses as oil companies have moved into deeper waters as well as into areas subject to severe weather conditions.

The Company is a world leader in the fabrication of offshore structures. Its principal fabrication yard is located on 1,384 acres of leased land near Morgan City, Louisiana. A smaller yard is maintained at Harvey, Louisiana. The Company also operates fabrication yards on leased premises in the Middle East at Dubai, United Arab Emirates, in West Africa at Warri, Nigeria; in Southeast Asia at Singapore; and on Batam Island, Indonesia. In 1972, the Company purchased 800 acres of land near Inverness, Scotland, where a major fabrication yard has been set up to service customers in the North Sea area. The equipment used at these yards, which is capable of fabricating a full range of offshore structures, consists principally of cranes, welding equipment, machine tools, and other fabricating equipment, most of which is movable. In addition to its shipyard located at Morgan City, the Company owns a shipyard in New Iberia, Louisiana located on 160 acres of land.

Expiration dates, including renewal options, of leases covering land for fabrication yards are as follows:

| | |
|------------------------|-------------------|
| Morgan City, Louisiana | Years 2001 - 2024 |
| Warri, Nigeria | Year 2065 |
| Singapore | Year 2000 |
| Dubai, U. A. E. | Year 1980 |

Underwater pipelaying operations conducted by the Company have also required the development of new techniques and equipment as water depths have increased. The Company has the capability of installing pipelines with an outside diameter (including concrete coating) of up to 72 inches. Underwater jet trenching equipment is used to bury pipelines under the ocean floor.

In connection with its construction and pipelaying activities, the Company conducts extensive diving operations, which, because of the water depths involved, require sophisticated equipment including the use of diving bells and an underwater habitat.

The Company operates one of the largest fleets of marine equipment used in offshore construction. The nucleus of a "construction spread" is a large derrick barge, pipelaying barge, pipeburying barge, or combination derrick-pipelaying barge that is capable of offshore operations over an extended period of time in remote locations. The lift capacities of these derrick or combination derrick-pipelaying barges currently range from 250 to 1,100 tons. Thirteen (13) of the Company's barges presently have lift capacities of 500 tons or more. Currently under construction is a derrick barge capable of handling a 2,000 ton lift. The barges, which range in length from 240 to 448 feet, are fully equipped with revolving cranes, auxiliary cranes, welding equipment, pile driving hammers, anchor winches,

and a variety of other gear. Existing vessels have quarters for as many as 272 men.

The Company owns and operates 9 derrick barges, 9 pipelaying barges, 10 combination derrick-pipelaying barges and 4 pipeburying barges. In addition, major supporting equipment owned includes 48 tug and utility boats and 80 cargo barges, crewboats and other vessels. Major spreads of equipment are located in the Gulf of Mexico, the Middle East, Southeast Asia, the North Sea, and offshore West Africa and Latin America.

The Company's Shipyard Group, with yards in Morgan City and New Iberia, Louisiana, supplies complete maintenance and construction facilities for the industry and is a builder of large tugs, packaged rigs, dredges, oceanographic research and ocean-going work vessels.

ONSHORE CONSTRUCTION SERVICES

The Company, through its wholly-owned Hudson Engineering Corporation subsidiary acquired in 1969, as well as the Company's foreign operating entities, is engaged in the engineering and construction of onshore processing plants for the oil, gas, chemical, petrochemical and mineral industries. Hudson also manufactures heat exchangers, principally for refineries, chemical plants and electrical generating plants, which utilize air cooling for dissipation of process plant heat directly into the atmosphere, obviating the necessity to use water. Hudson's air-cooled heat exchangers are manufactured at a facility in Beasley, Texas.

CUSTOMERS AND COMPETITION

The Company's principal customers consist of the larger domestic and international oil and gas companies and foreign governments. In most cases, customers contract with the Company for the design, construction and installation of a specific platform, pumping station or production network. Contracts are usually awarded on a competitive bid basis. Work to be performed is contracted for a fixed price, cost plus or a day rate basis. Almost all contracts call for progress payments and the Company endeavors to include price escalation clauses in its larger, longer-term contracts. Included in the Company's backlog at March 31, 1978 are 5 long-term contracts each having a sales value approximately equal to or in excess of 3% of the backlog. Such contracts are with major international oil and gas companies and foreign governments and range in amount from approximately \$34 million to approximately \$109 million. The Company's contracts covering work performed in foreign areas generally provide for payment in United States dollars, with exceptions for payments in foreign currencies in amounts approximately equal to expenses to be incurred by the Company in such currencies. For information relating to foreign exchange gains and losses see Note 1 to consolidated financial statements.

The Company's main competitor in offshore construction has operations similar in size to those of the Company but is a subsidiary of a company which also provides other services to the oil and gas industry. In addition, a number of smaller companies compete with the Company in various parts of the world, but none has the geographical distribution nor the breadth of capabilities of the Company and its main competitor.

BACKLOG

The backlog of the Company was approximately \$1,131,000,000 as of March 31, 1978. At March 31, 1977, backlog was \$1,291,000,000. It is estimated that \$780,000,000 of the backlog will be completed by March 31, 1979. Substantial fluctuations in backlog as of any date are not unusual primarily because of large variances in the time requirement for contracts awarded; therefore, backlog at any specific date may not be meaningful for the overall business activity of the Company.

FACTORS AFFECTING DEMAND

The level of marine construction activity has from time to time fluctuated widely, principally due to changes in the levels of capital expenditures of the larger domestic and international oil and gas companies for such purposes. These expenditures are influenced by the sale and expiration dates of offshore leases both in the United States and abroad; the discovery rates of new oil and gas reserves in offshore areas of the world; local and international political conditions; price and production controls and other governmental regulations; and the ability of the oil and gas industry to generate capital. Various income tax laws passed in the United States Congress could adversely affect the industry's capital expenditures. In recent years, particularly in the United States, proposed sales of offshore leases have also been affected by the opposition of environmental protection and conservation groups. In addition, Congress is considering legislation which could delay future sales of offshore leases.

RAW MATERIALS

The raw material used in the business of the Company such as steel plate, welding gases, concrete, fuel oil and gasoline, are available from many sources and the Company is not dependent upon any single supplier or source. Relatively high demand for raw materials and fuels have, in the past, caused the Company to have reduced availability. The Company believes that such reduced availability has not had any material adverse effect on its business, but is unable to predict what effect future developments may have. Substantial reductions in supplies could have adverse effects on the Company's activities.

PATENTS AND LICENSES

The Company owns a modest number of patents and has pending several patent applications covering various products and processes. The Company is also licensed under patents owned by others, and is also licensor of several of its patents. The Company attempts to obtain patents on apparatuses, processes, and materials developed by it; however, it does not consider patent protection necessary or essential to the operations of its business.

RESEARCH ACTIVITIES

The Company maintains a research and development program to improve its present operations and to provide a basis for future operational needs. The program stresses equipment improvement, development of new equipment, improving operating techniques, and conceptual and engineering evaluation for translation into practical modes of operations.

The approximate dollar amount for the most recent fiscal year for research activities relating to the development of new equipment, products and services for

the Company is \$2,453,000. Approximately 82 professional employees were engaged full time in this activity. All research activities for development of new products and services and improvement of existing products were company sponsored.

INSURANCE

The Company's offshore construction business is subject to the usual risks of operations at sea, with additional exposure due to the utilization of expensive and technical construction equipment under sometimes extreme weather conditions, often in remote areas of the world. In addition, the Company operates in many cases on or in proximity to existing offshore facilities which are subject to damage by the Company and such damage could result in the escape of oil and gas into the sea.

While the Company maintains liability and property insurance that it considers normal in the industry, it does not maintain insurance covering certain risks for which insurance is not available or is only available at rates which the Company considers uneconomical. Among such risks are war and confiscation in certain areas of the world at certain times, and pollution liability in excess of relatively low limits. Depending on competitive conditions and other factors, the Company endeavors to obtain contractual protection against uninsured risks from its customers.

The Company has two wholly-owned insurance subsidiaries. To date, these subsidiaries have written policies concerning general liability, builders' risk within certain limits, marine hull, and workmen's compensation for the Company and certain subsidiaries. No insurance has been written for unrelated parties to date.

EMPLOYEES

At March 31, 1978, McDermott employed under its direct supervision approximately 20,650 persons. Approximately 16,930 of these employees were engaged in marine construction operations (including the shipyard operations) and approximately 3,720 were engaged in onshore construction activities. McDermott considers its relations with its employees to be satisfactory.

The Marine Fabricators, Shipbuilding and Offshore Workers, Local 2000, United Brotherhood of Carpenters and Joiners of America, AFL-CIO, has filed a petition with the National Labor Relations Board seeking to represent all of the Company's approximately 1,500 production and maintenance employees at the Morgan City fabrication division. The Company has opposed the petition on the grounds that such employees do not constitute an appropriate bargaining unit. The Regional Director of the National Labor Relations Board has determined that such employees do not constitute an appropriate bargaining unit. This determination is being appealed. If the petition is approved by the National Labor Relations Board and if the union is thereafter selected by a majority of such employees as their bargaining representative, the union would have the right to bargain with the Company on behalf of such employees with respect to their wages, hours and working conditions.

THE BABCOCK & WILCOX COMPANY

At a special meeting of the stockholders of B & W and the Company held on March 30, 1978, the stockholders of each company approved a proposal pursuant to which B & W would be merged into a wholly-owned subsidiary of the Company. The merger has been effected in accordance with an Agreement and Plan of Reorganization, dated as of February 15, 1978, which provided that each outstanding share of common stock of B & W (other than shares owned by the Company) would be converted into one share of Series A \$2.20 Cumulative Convertible Preferred Stock and one share of Series B \$2.60 Cumulative Preferred Stock of the Company. The business combination of B & W and the Company is being accounted for under the "purchase" method. See Note 2 to consolidated financial statements for the consolidated results of the Company and B & W on a pro forma basis for the fiscal years ended March 31, 1977 and 1978.

Reproduced below is certain material contained in B & W's Form 10-K for the calendar year ended December 31, 1977 under Item 1. Business and Item 2. Summary of Operations, filed by B & W with the Securities and Exchange Commission. The reproduced material is being furnished by the Company for information purposes only and the Company has not independently verified the accuracy of such material.

"Item 1. Business

- (a) B & W is engaged in the design, manufacture and sale of products which are classified into the following industry segments: steam generating and associated equipment, tubular products, refractory products, automated machines and machine tools and control valves. Recently, B & W has also formed a unit to manufacture advanced composite materials for industrial use. The unit is essentially in the development stage. Steam generating and associated equipment and tubular products are the two major industry segments of B & W and together accounted for 93% of the consolidated sales and 91% of the consolidated income from operations for the year ended December 31, 1977.
- (b) Listed below are the sales and approximate percentage contribution to income from operations of steam generating and associated equipment and tubular products for each of the four years ended Decemer 31, 1976:

| | For the Calendar Year | | | |
|---|-----------------------|--------------------|------------------|------------------|
| | <u>1976</u> | <u>1975</u> | <u>1974</u> | <u>1973</u> |
| | (In Thousands) | | | |
| Steam generating and associated equipment: | | | | |
| Sales to unaffiliated customers..... | \$1,308,000 | \$1,132,000 | \$913,100 | \$791,000 |
| Intersegment sales.... | <u>1,900</u> | <u>1,200</u> | <u>1,300</u> | <u>1,400</u> |
| Total Sales..... | <u>\$1,309,900</u> | <u>\$1,133,200</u> | <u>\$914,400</u> | <u>\$792,400</u> |
| Approximate percentage contribution to income from operations..... | <u>53%</u> | <u>34%</u> | <u>28%</u> | <u>39%</u> |

Tubular products:

| | | | | |
|--------------------------------------|-------------------|-------------------|------------------|------------------|
| Sales to unaffiliated customers..... | \$ 280,200 | \$ 323,400 | \$271,800 | \$198,200 |
| Intersegment sales.... | 77,900 | 85,200 | 64,300 | 40,300 |
| Total Sales..... | <u>\$ 358,100</u> | <u>\$ 408,600</u> | <u>\$336,100</u> | <u>\$238,500</u> |

| | | | | |
|--|------------|------------|------------|------------|
| Approximate percentage contribution to income from operations..... | <u>36%</u> | <u>54%</u> | <u>70%</u> | <u>54%</u> |
|--|------------|------------|------------|------------|

For a discussion of the factors which have affected sales and operating income of steam generating and associated equipment and tubular products, see the Management Discussion and Analysis of the Summary of Operations.

Transfers between segments included in intersegment sales are priced in a manner comparable to products sold to unaffiliated customers.

There is set forth below for the year ended December 31, 1977 certain information for industry segments:

| | (In Thousands) | | | | |
|---|----------------------------------|---------------------|-------------------|------------------------------------|--------------------|
| | Steam Generating Equipment | Tubular Products | Other Products | Adjustments and Eliminations | Consolidated |
| Sales to unaffiliated customers.... | \$1,434,500 | \$319,200 | \$123,500 | \$ | \$1,877,200 |
| Intersegment sales.. | 1,500 | 74,300 | 14,900 | (90,700) | |
| Total revenue..... | <u>1,436,000</u> | <u>393,500</u> | <u>138,400</u> | <u>(90,700)</u> | <u>1,877,200</u> |
| Costs and operating expenses..... | 1,322,200 | 359,200 | 130,800 | (97,600) | 1,714,600 |
| Allocated general corporate expenses. | 17,100 | 6,300 | 2,000 | | 25,400 |
| | <u>1,339,300</u> | <u>365,500</u> | <u>132,800</u> | <u>(97,600)</u> | <u>1,740,000</u> |
| Income from operations..... | <u>\$ 96,700</u> | <u>\$ 28,000</u> | <u>\$ 5,600</u> | <u>\$ 6,900(1)</u> | <u>\$ 137,200</u> |
| Identifiable assets at December 31, 1977..... | <u>\$ 655,800</u> | <u>\$348,700</u> | <u>\$140,200</u> | <u>\$ (600)</u> | <u>\$1,144,100</u> |
| Corporate assets(2). | | | | | <u>\$ 165,600</u> |
| Total assets at December 31, 1977..... | | | | | <u>\$1,309,700</u> |
| Additions to PP&E(3) | <u>\$ 40,500</u> | <u>\$ 14,300</u> | <u>\$ 6,800</u> | | <u>\$ 61,600</u> |
| Corporate additions to PP&E(3)..... | | | | | <u>100</u> |
| Total additions to PP&E(3)..... | | | | | <u>\$ 61,700</u> |

| | | | | |
|-----------------------------|-----------|----------|----------|------------------|
| Depreciation..... | \$ 23,300 | \$ 9,900 | \$ 3,700 | \$ 36,900 |
| Corporate depreciation..... | | | | 100 |
| Total depreciation | | | | <u>\$ 37,000</u> |

NOTE:

- (1) Primarily attributable to share of other joint venturer in losses of Babcock-Brown Boveri Reaktor, GmbH. (BBR).
- (2) Corporate assets are principally cash and marketable securities.
- (3) Property, plant and equipment

(c) Products

Steam generating equipment includes individually engineered complete fossil fuel boilers, nuclear steam systems, and nuclear fuel and nuclear fuel assemblies for electric utility and marine applications as well as fossil fuel boilers for industrial processes and power generation. Steam generating equipment also includes specially engineered accessories and components, such as air heaters, fans, precipitators, cleaning systems for heat transfer surfaces, nuclear reactor components, control and performance computers, automatic controls and instruments and nuclear control-rod drives. Associated equipment includes individually engineered recovery processes and pollution control systems for the process and utility industries, tubular hoods for basic oxygen and electric furnaces, heavy pressure vessels and heat exchangers, hollow forgings for steam piping and other uses and reflective metallic thermal insulation. In addition to designing and manufacturing the foregoing steam generating and associated equipment, B & W through a separate construction unit also is engaged in the erection of certain of this and other equipment. During each of the years 1973 through 1977 (other than 1974) fossil-fueled steam generating and associated equipment accounted for approximately one-half of total sales and nuclear fueled steam generating and associated equipment and nuclear fuel accounted for approximately one-quarter of such sales. In 1974 the respective contributions were approximately two-fifths and one-third of such sales. B & W's total nuclear business was profitable in these years with the exception of 1973. Government nuclear business was profitable in all these years; however, the commercial nuclear activity sustained losses in these years particularly as a result of operations of BBR in 1975, 1976 and 1977 (see Item 1.(d) below).

Tubular products include stainless, alloy and carbon steel, seamless and welded tubes and pipe, tubular and solid shapes, extrusions, special metal tubes, welding fittings and flanges, and seamless rolled rings. These are principally "specialty" products of high quality and engineered for special applications. Material amounts of tubes are manufactured by B & W to satisfy its own requirements as well as those of other manufacturers of steam generating equipment; however, the major portion of B & W's tubes are sold to others for use in the bearing industry, the petroleum industry, the machinery industry, the primary metal industry, the fabricated metal industry and the construction industry.

Refractory products include kaolin clays, specially engineered and vacuum formed ceramic fibers, insulating and specialty firebrick, plastics, mortars, castables and special oxide refractories. These refractories are used in high temperature furnaces for various heating and heat treating purposes and in other applications where the temperatures and rates of combustion or chemical reactions are unusually demanding.

Automated machines and machine tools include individually engineered transfer or multi-station machines for production lines, precision boring machines, broaching machines and broaches, large grinders, cutting tools, hydraulic accessories, production tracer lathes and numerical control machines. This equipment is sold to manufacturers in various industries for use in their manufacturing processes and in the products manufactured by them.

Control valves employ the Self-DRAG concept and include manual and automatic control valves, regulators and other valves for the problem valve market. Problem valve applications occur where conventional products encounter performance problems such as noise, cavitation, destructive vibration and other conditions due to high fluid velocity and mass flow rates.

Markets

B & W's steam generating and associated equipment is sold to its customers in the United States and Canada through its own sales force and to its customers in foreign countries principally through independent sales agents. Tubular Products are sold principally to B & W's customers through its own sales force, but also are sold to distributors. Substantially all of B & W's refractory products and control valves are sold directly to its customers by its own sales force. Automated machines and machine tools are sold to B & W's customers principally through its own sales forces, but are also sold through independent sales agents.

The approximate distribution of 1977 and 1976 shipments by markets was as follows:

| | <u>1977</u> | <u>1976</u> |
|----------------------------|-------------|-------------|
| Electric Utilities | 52% | 50% |
| Government | 12 | 13 |
| Warehouse and Distributors | 8 | 7 |
| Machinery | 7 | 7 |
| Transportation | 4 | 4 |
| Pulp and Paper | 4 | 3 |
| Chemical and Petroleum | 3 | 5 |
| Fabricated Metal Products | 3 | 3 |
| Primary Metals | 1 | 3 |
| Miscellaneous | 6 | 5 |
| | <u>100%</u> | <u>100%</u> |

Sales to domestic government agencies, including sales to government owned utilities which are included with Electric Utilities above, amounted to \$331,400,000 in 1977. These sales were primarily shipments of steam generating and associated equipment products.

Competition

All principal products of B & W are sold under highly competitive conditions. Steam generating equipment orders are customarily awarded in response to competitive bids submitted pursuant to proposals based on the estimated cost of each job. A relatively small number of companies specializing in large steam generating equipment compete with B & W in the fossil fuel field. B & W also competes with manufacturers of gas turbines for utility, industrial and marine use. In sales of nuclear steam generating equipment B & W also competes with a small number of companies, including two major manufacturers whose reported sales of this equipment significantly exceed those of B & W, but which do not compete with it in the sale of fossil fuel boilers. In the sale of nuclear fuel, B & W competes with each of the other manufacturers of nuclear steam generating equipment as well as with independent suppliers of nuclear fuel, including several large petroleum and mining companies. A number of companies are in competition with B & W in small industrial boilers, tubular products, refractory products, automated machines and machine tools and control valves.

Backlog

The backlog of orders believed to be firm as of December 31, 1977 was \$4,305,400,000, as compared with \$4,125,800,000 as of December 31, 1976. Substantially all of this backlog consists of steam generating and associated equipment. Of the backlog of orders at December 31, 1977, it is expected that there will be recorded as sales (principally on the percentage of completion method) approximately 32% in 1978, approximately 46% in 1979-81, and approximately 22% thereafter.

B & W expects that there will be a drop-off in production of commercial nuclear components during the 1978-80 period. The three contracts for nuclear supply systems awarded in the industry and received by B & W in 1976 have been delayed. Because of the uncertainty and delays affecting nuclear energy, there is a possibility of further cancellations and stretch-outs in production of existing orders.

B & W attempts to cover increased costs of anticipated changes in general labor rates and material costs on long-term contracts either through an estimation of such changes which is reflected in the original fixed price or through price escalation clauses. All utility proposals since late 1973 and virtually all new contracts entered since that time contain escalation clauses, which are designed to protect B & W against increasing costs of material and labor. B & W's nuclear and fossil steam system contracts are subject to possible delays due to governmental requirements, environmental restraints, the actions of intervenors and financial conditions currently impacting utility companies. As to each deferment or cancellation, B & W is entitled to a financial settlement related to the individual circumstances of the contract.

Raw Materials

The principal raw materials used by B & W to construct steam generating and associated equipment consist of carbon and alloy steels in various forms, such as plate, structurals, bars, sheet, strip, heavy wall pipe and tubes.

Significant amounts of components are also purchased for assembly into the equipment. These raw materials and components generally are purchased by B & W as needed for individual contracts except that its requirements for tubes are supplied mainly by B & W itself. In periods of high demand for steel and other metal products, a short supply in certain raw materials required to be purchased by B & W has existed from time to time.

The principal raw materials used by B & W in the manufacture of nuclear fuel consist of uranium, plutonium, zircalloy and nickel. Although certain of B & W's commercial nuclear fuel contracts provide for it to furnish the uranium, the responsibilities under most of its recent nuclear contracts are generally limited to fabrication and the customer is to furnish the uranium. B & W presently owns or has under contract sufficient uranium to satisfy the requirements under the nuclear fuel contracts where it is supplying uranium.

The principal raw materials used by B & W in the manufacture of tubular products consist of steel, steel scrap, special metals and alloying materials. Most of the steel and special metals used for seamless tubemaking purposes is produced by B & W's own electric furnace facilities, but B & W purchases its requirements for strip steel in the open market. Most of the steel scrap and alloying materials consumed are also purchased in the open market. A shortage in raw materials, such as nickel and molybdenum, has existed from time to time, although no such shortage exists at the present time.

The principal raw material used to produce B & W's refractory products is kaolin clay which it obtains from its own mine. Also used are bauxite, alumina, silicon carbide, gypsum, plaster and wood chips, which are purchased on the open market.

The principal raw material used by B & W in the manufacture of automated machines and machine tools and control valves is steel in various forms. B & W purchases from other manufacturers certain components for assembly into its automated machines and machine tools. It also purchases actuators and other control mechanisms for inclusion in control valves.

The shortage of natural gas impacts the manufacture of tubular products, refractory products and certain steam generating products. B & W has developed alternate sources of energy to substitute for natural gas in the affected operations; however, the result is to increase significantly its energy costs. The impact of the pending National Energy Act on natural gas supplies which may be available to B & W is not determinable at this time.

Patents

Many United States and foreign patents have been issued to B & W. In addition, many patent applications are outstanding and patent licenses have been acquired when advantageous to B & W. While B & W regards its patents and licenses as of value, no single patent or group of related patents is believed to be material in relation to its business as a whole.

Research and Development

B & W maintains research and development centers in Alliance, Ohio and Lynchburg, Virginia and also conducts developmental activities at its various manufacturing plants. During the fiscal year ended December 31, 1977,

approximately \$34,700,000 (\$34,500,000 in 1976) was spent by B & W on research activities, of which approximately \$8,300,000 (\$7,100,000 in 1976) was paid for by customers of B & W. Research activities sponsored by B & W were related to both the development of new products and the improvement of existing products, while the majority of customer sponsored research activities were related to the development of new products.

Government Regulation

B & W's compliance with Federal, state and local environmental protection regulations necessitated capital expenditures of \$3,100,000 in 1977 (\$3,400,000 in 1976), and it expects to spend another \$20,000,000 over the next five years. However, B & W cannot predict all the environmental requirements or circumstances which will exist in the future. The recurring cost of complying with environmental regulations was a charge against income before taxes of \$5,700,000 in 1977 (\$3,100,000 in 1976).

Reports on business subject to the Renegotiation Act of 1951 have been cleared by the the Renegotiation Board through the year 1970. Reports have been filed for the years 1971 to 1975. In addition, due to the uncertain status of the future of the renegotiation process, contractors have been granted an extension until July 15, 1978 to file the 1976 report. The 1976 report will cover the period January 1 through September 30, 1976, the date the Board's statutory authority over Government contracts ended, unless Congress extends the Board's authority prior to filing. B & W has been assigned for renegotiation for the years 1971 through 1975. It is the opinion of B & W that it had no excessive profits subject to recapture under renegotiation in the years under review.

Insurance

B & W maintains general liability and property insurance coverage that it considers normal in its industry. In addition to coverage under nuclear liability and property insurance with respect to its five nuclear facilities, two of these facilities are covered by the limitations of liability and indemnity provisions of the Price-Anderson Act described below.

B & W's insurance policies do not cover liability and property damage losses resulting from nuclear incidents at facilities of its utility customers. To protect against such losses, B & W has obtained contractual indemnification from such customers and waivers of their insurers' rights of subrogation and generally has been named as an additional insured under its customers' nuclear property insurance policies. In addition, B & W's third-party nuclear liability is an insured risk under such customer's nuclear liability policies and the Price-Anderson indemnity discussed below.

Provisions of the Atomic Energy Act of 1954, as amended, commonly referred to as the Price-Anderson Act, among other things, limit the liability of manufacturers of licensed nuclear facilities and other indemnified parties to an aggregate of \$560 million per nuclear incident and indemnify such persons in an aggregate amount which when added to amounts available under commercially available liability insurance policies will total \$560 million. In March 1977, the United States District Court for the Western District of North Carolina, in a case involving nuclear plants of Duke Power Company, declared the Price-Anderson Act unconstitutional as violative of the due

process and equal protection clauses of the United States Constitution. (Carolina Environmental Study Group, Inc. v. United States Atomic Energy Commission (431F. Supp. 203)). The decision has been appealed by the Nuclear Regulatory Commission (successor to the Atomic Energy Commission) and Duke Power Company.

Employees

At December 31, 1977, B & W and its subsidiaries had approximately 39,000 employees. At that date approximately 17,000 hourly manufacturing employees in North America were members of labor unions.

- (d) The following tables set forth certain financial information by geographic area. Intercompany transfers to other geographical areas are primarily shipments of steam generating and associated products from U.S. based operations to foreign subsidiaries and are priced in a manner comparable to products sold to unaffiliated customers.

Year Ended December 31, 1977
(In Thousands)

| | <u>Canada</u> | <u>Germany</u> | <u>Other</u> | <u>Adjustments and Eliminations</u> | <u>Foreign</u> | <u>United States</u> | <u>Adjustments and Eliminations</u> | <u>Consolidated</u> |
|--|------------------|--------------------|-----------------|---|--------------------|--------------------------|---|---------------------|
| Sales to unaffiliated customers | \$157,300 | \$ 57,100 | \$13,100 | \$ | \$226,500 | \$1,650,700 | \$ | \$1,877,200 |
| Transfers between geographical areas | <u>2,400</u> | | <u>1,000</u> | <u>(600)</u> | <u>2,800</u> | <u>33,900</u> | <u>(36,700)</u> | |
| Total | <u>\$159,700</u> | <u>\$ 57,100</u> | <u>\$13,100</u> | <u>\$ (600)</u> | <u>\$229,300</u> | <u>\$1,684,600</u> | <u>\$ (36,700)</u> | <u>\$1,877,200</u> |
| Income (loss) from operations | <u>\$ 7,300</u> | <u>\$ (20,000)</u> | <u>\$ 1,200</u> | | <u>\$ (11,500)</u> | <u>\$ 143,400</u> | <u>\$ 5,300 (1)</u> | <u>\$ 137,200</u> |
| Identifiable assets at December 31, 1977 | <u>\$ 82,300</u> | <u>\$ 16,300</u> | <u>\$11,300</u> | <u>\$ (100)</u> | <u>\$109,800</u> | <u>\$1,045,400</u> | <u>\$ (11,100)</u> | <u>\$1,144,100</u> |
| Corporate assets (2) | | | | | | | | <u>165,600</u> |
| Total assets at December 31, 1977 | | | | | | | | <u>\$1,309,700</u> |

Note:

- (1) Primarily attributable to share of other joint venturer in losses of BBR.
(2) Corporate assets are principally cash and marketable securities.

Export sales from B & W's United States operations to unaffiliated foreign customers did not exceed 6% of consolidated sales for any of the five years ended December 31, 1977.

A significant portion of B & W's shipments arose from foreign operations, primarily in Canada and Germany. The Canadian operations are profitable, principally reflecting the results of B & W Canada Ltd. The German operations continued to be unprofitable in 1977.

B & W entered the nuclear market in Germany in 1971 with the formation of BBR, owned jointly by B & W and Brown Boveri of Germany. It was expected that the nuclear program would continue to develop and utilize its existing technology and know-how to expand not only in Germany, but also in other areas of the continent. BBR received its first order in 1972 for a 1300 Mw system for the Mulheim-Karlich plant of Rheinisch-Westfälisches Elektrizitätswerk (AG) in Essen.

BBR's financial performance has been unfavorable and has had a significant impact on B & W's results for 1977 and 1976. This unfavorable performance resulted primarily from two factors: (1) BBR has only a single contract and the volume of its business is insufficient to absorb its costs and (2) unanticipated cost overruns, in part attributable to major changes in licensing requirements which have been adopted in West Germany since BBR received the Mulheim-Karlich contract. BBR is entitled to recover some of these additional costs and is actively pursuing its claims.

B & W's 1977 results assume the completion of arrangements with respect to BBR which would limit the liabilities (other than contingent liabilities) of B & W attributable to BBR to amounts which do not exceed those recorded in the accounts. These arrangements have been approved by the managements and Boards of Directors of B & W, Brown Boveri of Switzerland and Brown Boveri of Germany, the joint owner. Formal agreements reflecting these arrangements are currently being prepared.

B & W's share in BBR's loss from operations was \$14,400,000 for 1977 and \$18,100,000 for 1976, which resulted in a total loss from operations of foreign subsidiaries of \$11,500,000 and \$10,700,000 for the respective periods.

B & W FORM 10K - CONTINUED

ITEM 2. SUMMARY OF OPERATIONS

THE BABCOCK & WILCOX COMPANY AND SUBSIDIARY COMPANIES

CONSOLIDATED SUMMARY OF OPERATIONS

| | For the Calendar Year | | | | |
|--|-----------------------|-----------------|-----------------|-----------------|-----------------|
| | 1977 | 1976 | 1975 | 1974 | 1973 |
| Sales | \$1,877,200,000 | \$1,691,800,000 | \$1,565,000,000 | \$1,277,200,000 | \$1,063,700,000 |
| Income from operations | 137,200,000 | 111,400,000 | 105,600,000 | 75,200,000 | 43,100,000 |
| Interest expense | 14,700,000 | 14,800,000 | 23,900,000 | 22,100,000 | 10,200,000 |
| U.S. and foreign taxes on income | 63,600,000 | 47,200,000 | 40,700,000 | 24,700,000 | 14,500,000 |
| Net income | 61,800,000 | 53,100,000 | 42,300,000 | 34,100,000 | 22,100,000 |

Summary of operations - (continued)

Management Discussion and Analysis of the Summary of Operations

Comparison of 1977 with 1976

Sales - Sales of \$1,877,200,000 increased 11% from \$1,691,800,000 in 1976. The increased sales were primarily attributable to increased shipments of steam generating equipment, principally to utilities, and a higher volume of tubular products.

Income from operations - Income from operations was \$137,200,000 in 1977 or 23% higher than the \$111,400,000 recorded in 1976. Income from operations as a percent of sales was 7.3% in 1977 compared with 6.6% in 1976.

The increased income from operations and improved profitability was due to the higher volume of shipments of steam generating and associated equipment primarily to utilities. In addition, 1976 income from operations was reduced an estimated \$10,500,000 by strikes at various plants, principally related to steam generating and associated equipment.

Income from operations from B & W's nuclear business continued profitable in 1977 and was substantially higher than in 1976. Government nuclear business continued to be profitable and the commercial nuclear business would have been profitable except for the operations of BBR (see Item 1.(d)).

The improved results from steam generating and associated equipment were partially offset by lower earnings from tubular products despite higher shipments. While tubular products continued to make a substantial contribution, profitability was lower because of an unfavorable mix of products shipped together with insufficient price relief to offset cost increases including substantially higher energy costs. In addition, the total income from operations of all other industry segments was lower in 1977 due to increased manufacturing and other costs without adequate price relief.

Interest Expense - Interest expense was \$14,700,000 in 1977, approximately the same as the \$14,800,000 in 1976 as lower average interest rates in 1977 offset higher average borrowings.

U.S. and Foreign Income Tax - Income tax expense of \$63,600,000 was 35% higher than 1976 tax expense of \$47,200,000 due to a 25% increase in income before taxes and a higher effective tax rate. The higher effective tax rate of 50.5% in 1977 compared to 46.9% in 1976 was principally due to lower investment tax credits in 1977.

Net Income - Net income increased 16% to \$61,800,000 or \$5.06 per share in 1977 from \$53,100,000 or \$4.37 a share in 1976. The higher net income resulted, primarily, from the increase in income from operations partially offset by a higher effective tax rate.

Comparison of 1976 to 1975 and 1975 to 1974

Sales - Sales of \$1,691,800,000 in 1976 increased 8% from \$1,565,000,000 in 1975. Sales in 1975 were 23% higher than sales of \$1,277,200,000 in 1974. The increase in 1976 was principally due to a higher level of shipments in steam generating and associated equipment. In 1975 and 1976, there was substantial demand for all of the principal classes of B & W's products. However, tubular products sales decreased in 1976 from the level of 1975 as a result of reduced activity in the

markets these products serve.

Income from Operations - Income from operations of \$111,400,000 in 1976 increased 5% from \$105,600,000 in 1975. The principal contributor to increased income from operations in 1976 was steam generating and associated equipment, despite strikes of various durations at certain plants manufacturing these products. Also in 1976, the fossil utility and industrial boiler business experienced significantly higher earnings on increased shipments. B & W was also relieved in 1976 of the impact of inflationary cost increases on fixed price contracts which affected results in 1974 and 1975. In addition, there were substantial increases in fossil repair and replacement parts business.

In 1976 B & W changed the actuarial cost method used in determining pension expense and funding of major pension funds from projected cost methods to the accrued benefit cost method with projected final compensation. This change added approximately \$3,500,000 to income from operations in 1976.

It is estimated that the strikes at various plants reduced income from operations by approximately \$10,500,000 in 1976. In addition, tubular products earnings were down substantially from the record earnings of 1975 as a result of lower shipments and increased manufacturing costs without adequate price relief. Refractories and automated machines and machine tools earnings were also lower than the 1975 results.

Income from operations in 1975 was 40% higher than in 1974, when income from operations totaled \$75,200,000. Income from operations in 1975 reflected increased earnings for tubular products, refractories, automated machines and machine tools and increased profitability of the fossil utility and industrial boiler business. In addition, in 1975 B & W obtained some relief on various fixed price fossil steam generating contracts. Material shortages experienced in 1974 eased somewhat during 1975 and purchased scrap costs were lower in 1975 than 1974.

Increased energy costs during 1975 and 1976 adversely affected the profitability of all industry segments, despite the substantial conservation efforts by B & W to reduce energy consumption. Conversion of facilities to use fuels other than natural gas prevented curtailment of operations, but resulted in substantially higher energy costs.

Repair and maintenance expenses increased in both 1975 and 1976 to higher levels due to continued high rates of production in most operations. The increase in 1975 resulted primarily from higher rates of production of tubular products. Other costs, including labor, fringe benefits and administrative expenses also increased, reflecting a more complex business environment, the impact of regulatory requirements and continued inflation.

B & W's total nuclear business was profitable in 1975 and 1976. Profitable government nuclear business was, however, substantially offset in 1976 by losses in B & W's commercial nuclear activity, particularly from operations of BBR. Lack of new business for BBR beyond its one utility contract, which was taken at unfavorable prices and, in addition, cost increases due to delays and to regulatory requirements, were largely responsible for these losses.

Income from operations as a percent of sales was 6.6% in 1976, approximately the same as the 6.7% in 1975 but higher than the 5.9% in 1974. The 6.6% return on sales in 1976 was achieved despite the impact of the strikes and lower shipments of more profitable tubular products. In both 1975 and 1976, the improvement in income

from operations as a percent of sales over 1974 reflected the enhanced profitability of the fossil boiler business and continued management efforts to implement cost reduction programs and to improve operating efficiency throughout B & W.

Interest Expense - Interest expense in 1976 of \$14,800,000 was 38% lower than 1975. This significant decrease resulted from a combination of substantially reduced average total debt levels in 1976 and lower interest rates. Interest expense in 1975 of \$23,900,000 was 8% higher than 1974. Average outstanding debt in 1975 was somewhat higher than 1974, which resulted in increased interest costs despite the fact that rates trended lower during the year. The higher average debt levels were due to continuing high capital expenditures, which reached a record level of \$69,700,000 in 1975, and to higher working capital requirements to support increased volume.

The higher earnings in 1976 and improved cash flow allowed B & W to reduce outstanding debt by 59% to \$101,100,000 at December 31, 1976, compared with \$246,700,000 at the end of 1975 and \$273,100,000 at the end of 1974. As a result of improved cash flow from higher earnings and the sale of B & W's interest in its British affiliate, Babcock & Wilcox Ltd., in 1975, B & W was able to reduce its term loan by \$25,000,000. This term loan was completely repaid in 1976 and the related revolving credit agreement was cancelled.

In addition, in 1976 B & W improved its working capital position by refinancing certain bank lines of credit of its Canadian subsidiary, Babcock & Wilcox Canada Ltd., with \$25,000,000 aggregate principal amount of 9% Guaranteed Notes due December 1, 1996. Under the note agreements pursuant to which the Guaranteed Notes were issued, Babcock & Wilcox Canada Ltd. will repay the Guaranteed Notes in annual installments of \$1,650,000 beginning December 1, 1982.

In January 1977, B & W issued \$60,000,000, in aggregate principal amount of 8 1/2% Notes due January 1, 1997 to various institutional lenders. Payments on the Notes will be made in annual installments of \$3,960,000 beginning January 1, 1983. B & W secured the long-term loan to take advantage of favorable money market conditions to meet projected long-term capital needs.

Interest costs in 1975 and 1974 were substantially higher than in 1973 and 1972. In 1971 and 1972, B & W was able to reduce debt from the relatively high levels of 1969 and 1970 due to improved earnings, somewhat lower capital expenditures and stable working capital requirements. Interest rates in 1971 and 1972 were also relatively lower than in the preceding two years.

In 1972, B & W embarked on a substantial capital program in response to demand for its products, particularly tubular products, and to satisfy pollution control and OSHA requirements. At the same time, working capital needs increased with the higher sales volume. In 1973 B & W made a significant investment in Babcock & Wilcox Ltd. These factors increased the need for higher debt levels. In addition, interest rates climbed to unprecedented levels during 1974. The combination of increased debt levels and higher interest rates resulted in the significantly increased interest costs in the 1974 - 1975 period.

U.S. and Foreign Income Tax - U.S. and foreign income taxes were \$47,200,000 in 1976 or 16% higher than 1975. U.S. and foreign income taxes in 1975 were \$40,700,000 or 65% higher than in 1974. The increase in taxes in 1976 resulted from the 21% increase in pre-tax earnings, partially offset by a lower effective

tax rate of 46.9% in 1976, compared with 49% in 1975. The effective tax rate in 1974 was 41.9%

The principal reasons for the lower effective tax rate in 1976, as compared with 1975, were significantly increased investment tax credits and the sale of B & W's investment in Babcock & Wilcox Ltd. in 1975. The effect of the sale of this investment was to increase the effective rate. Because the proceeds of the sale were lower than its carrying value at equity, but higher than the cost to B & W (and its tax basis in the investment), the sale gave rise to a book loss without a corresponding reduction in tax expense. However, since the proceeds were higher than the tax basis, it was necessary to make a provision for the taxable capital gain as measured from the cost basis of the investment. This sale was also a principal reason for the higher effective tax rate in 1975 as compared with 1974. In addition, in 1975 BBR incurred higher losses than in 1974, which increased the effective tax rate as a tax benefit was not available because of the uncertainty of the utilization of a loss carryforward tax credit. Increased losses in 1976 over 1975 at BBR partially offset the higher investment credits and the impact of the sale of Babcock & Wilcox Ltd. on the 1975 effective tax rate.

In 1974 and 1973 the effective tax rate was lower than the statutory rate. The differences between the effective rates and the statutory rate in those years relate principally to investment tax credits and the net effect on the composite tax rate of operations of B & W's subsidiaries and affiliates not subject to the U.S. statutory rate.

Net Income - Net income in 1976 was \$53,100,000 or \$4.37 per share and increased 25% over the previous year. The record shipments and operating income, together with the reduced interest costs, were the principal reasons for the increased earnings. The lower effective tax rate and higher investment income, due primarily to interest on short-term investments as a result of B & W's favorable cash position, also contributed to earnings performance in 1976. In addition, the change in accounting for pensions in 1976 resulted in an increase in net income of approximately \$1,800,000, or \$.15 per share. These increases were partially offset by the impact of strikes at various B & W plants in 1976 which was estimated to have reduced net income by approximately \$5,500,000, or \$.45 a share.

In 1975, net income was \$42,300,000, or \$3.49 per share, and increased 24% over 1974. This increase was partially offset by increased interest expense and the sharply increased effective tax rate. In addition, the sale of B & W's investment in Babcock & Wilcox Ltd. reduced 1975 net income by approximately \$3,400,000, or \$.28 per share, including a provision for the capital gains tax on the sale.

Earnings in 1974, improved over 1973 earnings which were depressed by approximately \$.40 per share by a strike at the Barberton, Ohio plant. Earnings in 1974, however, were adversely impacted by fixed price fossil steam generating contracts, material shortages and high scrap costs. Price controls caused a cost-price squeeze on profit margins in 1972 and 1973, as B & W could not fully recover substantially higher costs of steel scrap and other material and labor cost increases."

ITEM 2. SUMMARY OF OPERATIONS

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES

CONSOLIDATED SUMMARY OF OPERATIONS

| | FOR FISCAL YEARS ENDED MARCH 31, | | | | |
|--|----------------------------------|------------------|-------------------|-------------------|-------------------|
| | 1974 | 1975 | 1976 | 1977 | 1978 |
| (In thousands of dollars except shares and per share amounts) | | | | | |
| Revenues | \$ 425,756 | \$ 742,825 | \$1,102,078 | \$1,223,841 | \$1,293,711 |
| Cost and expenses | 379,339 | 649,543 | 871,797 | 964,210 | 1,095,943 |
| Operating income | 46,417 | 93,282 | 230,281 | 259,631 | 197,768 |
| Other income (expense): | | | | | |
| Interest expense | (8,679) | (15,972) | (22,068) | (16,157) | (26,887) |
| Other | 9,461 | 13,354 | 13,488 | 18,152 | 69,206 |
| Income before provision for income taxes | 47,199 | 90,664 | 221,701 | 261,623 | 240,087 |
| Provision for income taxes | 12,178 | 14,217 | 66,427 | 70,116 | 80,995 |
| Income before extraordinary items and cumulative effect of accounting change | 35,021 | 76,447 | 155,274 | 191,510 | 159,092 |
| Extraordinary items | - | - | 4,910 | 132 | - |
| Cumulative effect of accounting change (net of taxes on income) | (3,023) | - | - | - | - |
| Net income | <u>\$ 31,998</u> | <u>\$ 76,447</u> | <u>\$ 160,184</u> | <u>\$ 191,642</u> | <u>\$ 159,092</u> |
| Earnings per common share: | | | | | |
| Primary earnings: | | | | | |
| Before extraordinary items and cumulative effect of accounting change | \$ 1.26 | \$ 2.47 | \$ 4.97 | \$ 6.11 | \$ 5.02 |
| Extraordinary items | - | - | .16 | - | - |
| Cumulative effect of accounting change (net of taxes on income) | (.11) | - | - | - | - |
| Net income | <u>\$ 1.15</u> | <u>\$ 2.47</u> | <u>\$ 5.13</u> | <u>\$ 6.11</u> | <u>\$ 5.02</u> |
| Fully diluted earnings: | | | | | |
| Before extraordinary items and cumulative effect of accounting change | \$ 1.13 | \$ 2.39 | \$ 4.80 | \$ 5.93 | \$ 4.92 |
| Extraordinary items | - | - | .15 | - | - |
| Cumulative effect of accounting change (net of taxes on income) | (.09) | - | - | - | - |
| Net income | <u>\$ 1.04</u> | <u>\$ 2.39</u> | <u>\$ 4.95</u> | <u>\$ 5.93</u> | <u>\$ 4.92</u> |
| Cash dividends per common share | \$.2625 | \$.30 | \$.425 | \$.575 | \$.90 |
| Average number of common shares outstanding | 27,852,508 | 30,891,736 | 31,247,192 | 31,342,492 | 31,670,923 |

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF THE CONSOLIDATED SUMMARY OF OPERATIONS

1978 Versus 1977

Revenues for the fiscal year ended March 31, 1978 increased \$69,870,000 (6%) as compared to the fiscal year ended March 31, 1977. This increase marks the culmination of five years of extraordinary growth of worldwide hydrocarbon development in offshore areas, peaking in the third quarter of this fiscal year. Compared with the prior fiscal year, domestic revenues increased to an all-time high, while foreign revenues decreased.

Costs and expenses (including depreciation and selling, general and administrative expenses) for the fiscal year ended March 31, 1978 were 85% of revenues as compared to 79% for the fiscal year ended March 31, 1977. This increase was attributable to lower utilization of Company-operated equipment, particularly in the North Sea, South East Asia and West Africa areas, resulting from a slowdown in offshore activity and increased competition in our foreign markets.

Interest expense has increased \$10,730,000 (66%), principally as a result of the additional borrowings related to the investment in The Babcock & Wilcox Company (B & W).

The increase in equity in earnings of affiliated companies in the current fiscal year is principally attributable to the Company's share of the earnings of B & W. The Company increased its investment to approximately 49% of B & W in September 1977, and its share of B & W's earnings has been accounted for on the equity method through March 31, 1978, at which time McDermott acquired the remaining interest in B & W. The Company has included its equity in the earnings of B & W as other income in the amount of \$20,364,000.

Additional increases in other income were attributable to an increase in interest income of \$12,300,000, consistent with changes in interest bearing investments as well as interest rates thereon, prevailing in the respective periods; further increases were attributable to a net gain on foreign currency translation of \$12,400,000 as well as workmen's compensation premium adjustments, gains and losses on disposal of assets, royalty income, bad debt recoveries and inventory adjustments.

Domestic operations accounted for a greater proportion of income before provision for income taxes during the current fiscal year than was the case in the prior fiscal year. United States investment tax credits for the current fiscal year are less than those for the prior fiscal year. Also, a greater proportion of income before taxes attributable to foreign operations is currently being generated in geopolitical areas subject to higher tax rates. Additionally, an income tax holiday applicable in the prior fiscal year was not applicable in the current fiscal year.

These combined factors increased the effective income tax rate for the fiscal year

ended March 31, 1978 to 34% as compared to 27% for the fiscal year ended March 31, 1977, producing provisions for income taxes of \$80,995,000 and \$70,116,000, respectively.

Net income was increased for the fiscal year ending March 31, 1977 by an extraordinary item of \$132,000 resulting from utilization of foreign tax benefits from an operating loss carryforward. There were no extraordinary items in the current fiscal year.

1977 Versus 1976

Revenues remained at a high level during 1977, increasing 11% over the prior year. Operating income was maintained at a corresponding level, increasing 13% over 1976. The Company was able to maintain its gross profit margins, despite increases in costs and expenses which included an increase in selling, general and administrative expenses. The increase in selling, general and administrative expense was principally due to the expenditure of \$1.9 million in connection with the SEC special investigation and \$2.3 million of increased research and development expense.

Other income in 1977 was \$4.7 million greater than in 1976. Such increase was due principally to greater interest income earned on a larger investment base, an increase in equity in earnings of affiliated companies and a decrease in foreign currency translation losses.

Investment tax credits in 1977 were \$4.9 million less than in 1976. However, net taxes were at a lower effective rate in 1977 versus 1976 due to more favorable rates of taxation applicable to the Company's operations during 1977 in various geographic areas of the world.

Net income in 1977 and 1976 was increased by an extraordinary item of \$0.1 and \$4.9 million, respectively, resulting from utilization of foreign tax benefits from an operating loss carryforward.

Item 4. PARENTS, SUBSIDIARIES AND AFFILIATES OF THE REGISTRANT

| <u>Name of Company</u> | <u>Organized Under The Laws Of</u> | <u>Percentage Of Voting Shares Owned</u> |
|------------------------------|--|--|
| J. Ray McDermott & Co., Inc. | Delaware | Parent |
| Oceanic Contractors, Inc. | Panama | 100 |
| The Babcock & Wilcox Company | Delaware | 100 |

The subsidiaries omitted from the foregoing list do not, considered in the aggregate, constitute a significant subsidiary.

Item 5. LEGAL PROCEEDINGS

In December 1976, the Company, among others, received a grand jury subpoena to produce certain documents pertaining to its domestic offshore pipeline and domestic structure fabrication and installation activities during the period from January 1, 1968 to the date of the subpoena. The grand jury's investigation appeared to be focused on possible antitrust violations, including possible price fixing and collusive bidding during the period covered by the subpoena. It now appears that the grand jury's investigation has been expanded to include foreign activities, and that it encompasses a substantial portion of the Company's activities. In connection with the investigation, substantial document production has been made and a number of individuals have been interviewed and called to testify, some -- including past and present officers and employees of the Company -- under grant of immunity from prosecution. As a result of the investigation criminal or civil proceedings may be brought against the Company, which is a target of the investigation, or against certain of its present or former officers and employees, some of whom are also targets of the investigation. The institution of any such action by the government could lead to private antitrust treble damage actions which could have a material adverse effect upon the Company.

The Intelligence Division of the Internal Revenue Service is conducting an investigation into possible violations of federal tax laws arising out of matters disclosed in the Audit Committee's Report with respect to questionable payments and accounting practices, which matters have been previously disclosed.

In August 1977 an action entitled Zeidman, et al. v. McDermott, et al., was filed by a former holder of common stock of The Babcock & Wilcox Company ("B&W") and a former holder of call options to purchase such common stock in the United States District Court for the Eastern District of Louisiana against the Company, certain of its officers, and Smith Barney, Harris Upham & Co. Incorporated ("Smith Barney"), the Company's financial advisor, alleging violations of federal securities laws prohibiting fraudulent and manipulative devices. The plaintiffs seek to represent all former holders of B&W common stock and all former holders of call options to purchase such common stock who sold such shares or call options during the period March 30, 1977 through August 14, 1977. They allege that the Company failed to disclose in a timely fashion that it and Smith Barney were engaged in a tender offer for the purpose of acquiring control of B&W and that the price received by members of the purported class was substantially below what they would have received had the defendants disclosed their actions and intentions in a timely fashion. Plaintiffs seek rescission of the sales of B&W securities made by the class prior to full disclosure by the Company of its tender offer, or in the alternative, damages in unspecified amounts suffered by the class, plus attorney's fees and costs. The defendants have denied the material allegation of the complaint and have moved to strike the plaintiffs' request for class action treatment.

In January 1978 a stockholder of B&W filed an alleged class action, Osofsky v. Zipf, et al., in the United States District Court for the Southern District of New York against the Company, B&W, the directors of B&W, Smith Barney and Morgan Stanley & Co. Incorporated ("Morgan Stanley"), B&W's financial advisor, alleging violations of federal securities laws and state common law in connection with the tender offer by the Company for B&W common stock (the "tender offer") and the subsequent merger of B&W into a wholly-owned subsidiary of the Company (the "merger"). The plaintiff alleges, among other things, that McDermott violated its

"promise" in the tender offer that the consideration to be received by B&W's stockholders in the merger would have to approximate the price paid pursuant to the tender offer (alleged to be \$65) by offering preferred stock in the merger which the plaintiff claims had a market value of \$61 or less. The Company has filed an answer denying the material allegations of the complaint and the case is proceeding to the discovery stage. Another stockholder of B&W filed a similar action, Udoff v. B&W, et al., against the Company and its directors and B&W and its directors in the same Court in March 1978. The Company has not yet answered the complaint. Counsel for the Company has stated, on the basis of counsel's present knowledge of the relevant facts, that in its opinion both of these suits are without merit.

In March 1978 a stockholder of the Company filed a derivative action, Lewis v. Graves, et al., in the United States District Court for the Southern District of New York against the Company, its directors, B&W, Smith Barney and Morgan Stanley alleging violations of federal securities laws and state common law in connection with the tender offer and the merger and in connection with the receipt by certain of the Company's directors of stock pursuant to the Company's Career Executive Stock Plans. The plaintiff alleges, among other things, that the price paid by the Company for B&W stock was excessive, that the proxy statement issued in connection with the merger failed to reveal certain alleged antitrust problems posed by the merger, and that certain of the Company's officers and directors failed to reveal their knowledge of or participation in certain questionable or illegal payments or practices in which the Company had been involved. The Company and all directors who were served have filed answers denying the material allegations of the complaint. In May 1978 another stockholder of the Company filed a similar action, Stein v. Aldrich, et al., in the same court against the Company and its directors, certain directors of B&W, Smith Barney and Morgan Stanley alleging violations of federal securities laws and state common law. The plaintiff alleges, among other things, that the Company's directors caused the Company to expend its funds for illegal purposes and thus committed waste of its assets, that the Company's 1968 and 1974 Career Executive Stock Plans should be cancelled because said directors concealed such activities, and that the amount paid by the Company for B&W shares was excessive. The Company and all named directors expect to either file an answer denying the material allegations of the complaint or to move to dismiss the complaint.

Upon the consummation of the merger of B & W into a wholly owned subsidiary of the Company, each stock option outstanding under the B & W 1972 Stock Option Plan became an option to purchase two shares of common stock of the Company at an option price equal to 100% of the option price of each share of B & W common stock under such stock option immediately prior to the effective date of the merger. On October 31, 1974, the board of directors of B & W amended all outstanding stock options under B & W's 1972 Stock Option Plan to reduce the purchase price to \$13.625 per share, including options covering 9,375 shares to Mr. George G. Zipf and 6,000 shares to Mr. R. J. Cantwell (formerly directors of B & W and now directors of the Company). The original option prices were from \$23.75 to \$26.625. A stockholder of B & W brought suit in February 1976, derivatively on behalf of B & W, in Supreme Court, New York County, State of New York, against all of the directors of B & W then serving, charging that the reduction of option prices violated the directors' fiduciary duty and was an improper amendment of the Plan without stockholder approval in violation of the Plan and the New Jersey Business Corporation Act. The suit seeks to have the named directors account to B & W for damages and to have the reduction in option exercise prices cancelled. On appeal of a lower court's dismissal of the complaint, the New York Court of Appeals affirmed the dismissal of the complaint with respect to allegations of violation of the Plan and New Jersey law and has allowed discovery in connection with the allegations of breach of fiduciary duty. The directors are vigorously defending the suit.

Item 6. INCREASES AND DECREASES IN OUTSTANDING SECURITIES AND INDEBTEDNESS

(a) Included below is information concerning changes in outstanding securities during the fiscal year ended March 31, 1978:

1. Common Stock Par Value \$1 Per Share:

| | |
|--|--------------------------|
| Shares outstanding, April 1, 1977 | 15,877,948 |
| Add: | |
| Shares issued upon conversion of 4-3/4% convertible subordinated debentures: | |
| May 5, 1977 | 149 |
| May 9, 1977 | 2,537 |
| May 17, 1977 | 298 |
| May 18, 1977 | 1,492 |
| May 23, 1977 | 4,477 |
| May 25, 1977 | 5,671 |
| May 27, 1977 | 895 |
| June 9, 1977 | 656 |
| June 13, 1977 | 1,492 |
| June 14, 1977 | 2,985 |
| July 5, 1977 | 746 |
| July 11, 1977 | 29 |
| July 25, 1977 | 2,477 |
| August 9, 1977 | 1,343 |
| October 19, 1977 | 41,819 |
| October 25, 1977 | 10,447 |
| October 26, 1977 | 100,000 |
| November 3, 1977 | 4,507 |
| November 14, 1977 | 746 |
| November 22, 1977 | 1,492 |
| November 28, 1977 | 4,477 |
| December 2, 1977 | 2,686 |
| December 7, 1977 | 1,194 |
| December 12, 1977 | 1,522 |
| December 13, 1977 | 597 |
| December 14, 1977 | 8,955 |
| December 15, 1977 | 24,567 |
| January 9, 1978 | 29,850 |
| January 13, 1978 | 32,059 |
| January 17, 1978 | 31,522 |
| February 10, 1978 | 1,133 |
| Shares issued upon two-for-one stock split | |
| December 15, 1977 | <u>16,106,204</u> |
| Shares outstanding March 31, 1978 | <u><u>32,306,972</u></u> |

Amounts shown above include 154,978 shares and 316,672 shares in treasury as of April 1, 1977 and March 31, 1978, respectively.

2. Series A \$2.20 Cumulative Convertible Preferred Stock:
Shares issued March 31, 1978, in exchange for outstanding
shares of B & W (See Note 9 to notes to consolidated financial
statements)

Shares outstanding, March 31, 1978,

Redemption Value \$197,423,281

6,317,545

3. Series B \$2.60 Cumulative Preferred Stock:

Shares issued March 31, 1978, in exchange for outstanding
shares of B & W (See Note 9 to notes to consolidated financial
statements)

Shares outstanding March 31, 1978,

Redemption Value \$197,423,282

6,317,545

- (b) Included below is information concerning changes in outstanding
indebtedness during the fiscal year ended March 31, 1978
(See Note 7 to notes to consolidated financial statements)

1. 4-3/4% Convertible Subordinated Debentures due 1987:

Debentures outstanding (principal amount) April 1, 1977 \$16,191,000

Deduct - Debentures converted into common stock par
value \$1 per share:

| | | |
|-------------------|------------------|---------------|
| May 5, 1977 | (149 shares) | 5,000 |
| May 9, 1977 | (2,537 shares) | 85,000 |
| May 17, 1977 | (298 shares) | 10,000 |
| May 18, 1977 | (1,492 shares) | 50,000 |
| May 23, 1977 | (4,477 shares) | 150,000 |
| May 25, 1977 | (5,671 shares) | 190,000 |
| May 27, 1977 | (895 shares) | 30,000 |
| June 9, 1977 | (656 shares) | 22,000 |
| June 13, 1977 | (1,492 shares) | 50,000 |
| June 14, 1977 | (2,985 shares) | 100,000 |
| July 5, 1977 | (746 shares) | 25,000 |
| July 11, 1977 | (29 shares) | 1,000 |
| July 25, 1977 | (2,477 shares) | 83,000 |
| August 9, 1977 | (1,343 shares) | 45,000 |
| October 19, 1977 | (41,819 shares) | 1,401,000 |
| October 25, 1977 | (10,447 shares) | 350,000 |
| October 26, 1977 | (100,000 shares) | 3,350,000 |
| November 3, 1977 | (4,507 shares) | 151,000 |
| November 14, 1977 | (746 shares) | 25,000 |
| November 22, 1977 | (1,492 shares) | 50,000 |
| November 28, 1977 | (4,477 shares) | 150,000 |
| December 2, 1977 | (2,686 shares) | 90,000 |
| December 7, 1977 | (1,194 shares) | 40,000 |
| December 12, 1977 | (1,522 shares) | 51,000 |
| December 13, 1977 | (597 shares) | 20,000 |
| December 14, 1977 | (8,955 shares) | 300,000 |
| December 15, 1977 | (24,567 shares) | 823,000 |
| January 9, 1978 | (29,850 shares) | 500,000 |
| January 13, 1978 | (32,059 shares) | 537,000 |
| January 17, 1978 | (31,522 shares) | 528,000 |
| February 10, 1978 | (1,133 shares) | <u>19,000</u> |

Debentures outstanding (principal amount) March 31, 1978

\$6,960,000

2. 8-1/2% Notes Payable due in equal annual installments of \$3,960,000 commencing January, 1983 to maturity January, 1997

Notes Payable outstanding (principal amount) March 31, 1978

\$ 60,000,000

3. 9% Notes Payable due in equal annual installments of \$1,650,000 commencing December, 1982 to maturity December, 1996

Notes Payable outstanding (principal amount) March 31, 1978

\$ 25,000,000

4. 9% Notes Payable due in equal annual installments of \$3,300,000 commencing October, 1977 to maturity October, 1991

Notes Payable outstanding (principal amount) March 31, 1978

\$ 46,700,000

5. Notes payable to certain banks under a revolving credit and term loan agreement dated August 12, 1977, payable commencing November 15, 1980 in twenty equal quarterly installments, such notes bearing interest and commitment fees at varying percentages of prime.

Notes Payable outstanding (principal amount) March 31, 1978

\$177,000,000

Item 7. CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES

- (a) Not applicable
- (b) Incorporated by reference to provisions of Article Fourth of the Certificate of Incorporation of J. Ray McDermott & Co., Inc. and of the resolutions of the Board of Directors designating the Series A \$2.20 Cumulative Convertible Preferred Stock, \$1 par value, and the Series B \$2.60 Cumulative Preferred Stock, \$1 par value (incorporated by reference to Appendices B, C and D, respectively, to the Joint Proxy Statement of J. Ray McDermott & Co., Inc. and The Babcock & Wilcox Company dated February 22, 1978, copies of which are exhibits hereto).

Item 8. DEFAULTS UPON SENIOR SECURITIES

Not applicable

Item 9. APPROXIMATE NUMBER OF EQUITY SECURITY HOLDERS

| <u>TITLE OF CLASS</u> | <u>NUMBER OF RECORD HOLDERS</u> |
|--|-------------------------------------|
| Common stock, par value \$1 per share | 9,477 |
| 4-3/4% Convertible Subordinated Debentures due 1987 | 6,960* |
| Series A \$2.20 Cumulative Convertible Preferred Stock, redemption value \$31.2 | 15,287 |
| Series B \$2.60 Cumulative Preferred Stock, redemption value \$31.25 | 15,287 |

* In bearer coupon form; determined in
accordance with SEC rules - 12(G) 5-1(5)

Item 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

- (a) A Special Meeting of Stockholders of the Company was held in New Orleans, Louisiana on March 30, 1978.
- (b) Directors elected at the March 30, 1978 Special Meeting of Stockholders:

W. O. Baker
R. J. Cantwell
Walter B. Shaw
William L. Wearly
George G. Zipf

On May 18, 1978 Mr. Baker submitted his resignation to the Board of Directors, to become effective upon the election of his successor, and on June 13, 1978 the Board of Directors elected Mr. William T. Seawell as a director to fill the vacancy created by Mr. Baker's resignation.

Directors whose term of office as director continued after the March 30, 1978 Special Meeting of Stockholders:

H. W. Bailey
G. W. Douglas Carver
J. E. Cunningham
Charles L. Davis
W. E. Earles
C. L. Graves
James A. Hunt
Graham D. Mattison
John A. Morgan
Robert K. Richie
John D. Ritchie
John B. Tweedy

- (c) Proposal to amend Certificate of Incorporation to create a class of 25,000,000 shares of preferred stock issuable in series, and increase the number of shares of authorized common stock from 36,000,000 to 60,000,000 shares (the affirmative vote of the holders of a majority of all shares entitled to vote was required for approval):

| | |
|------------------------------|------------|
| Affirmative Votes | 24,565,049 |
| Negative or Abstaining Votes | 7,429,790 |

Proposal to take action upon the Agreement and Plan of Reorganization for the merger of The Babcock & Wilcox Company into a wholly-owned subsidiary of the Company (the affirmative vote of the holders of a majority of all shares entitled to vote was required for approval):

| | |
|------------------------------|------------|
| Affirmative Votes | 24,824,585 |
| Negative or Abstaining Votes | 7,170,253 |

Proposal to amend the By-Laws of the Company to permit a majority of the Board of Directors to change the number of members constituting the Board (the affirmative vote of the holders of 66 2/3% of all shares entitled to vote was required for approval):

| | |
|------------------------------|------------|
| Affirmative Votes | 21,972.031 |
| Negative or Abstaining Votes | 10,022,808 |

Item 11. EXECUTIVE OFFICERS OF THE REGISTRANT

The following lists the executive officers of the registrant, their ages, positions presently held with the Company, and their business experience for the past five years:

C. L. Graves, 62, elected Chairman of the Board in August, 1974; Chief Executive Officer in February, 1972; held the title of President from January, 1972 until February, 1978. Formerly, he was Senior Executive Vice President and Executive Vice President.

J. E. Cunningham, 55, elected Vice Chairman of the Board - Finance and Administration; held the title of Executive Vice President from August, 1968, until February, 1978; formerly held title of Treasurer.

George G. Zipf, 57, elected Vice Chairman of the Board and Chief Operating Officer of The Babcock & Wilcox Operating Unit effective in March, 1978; prior to this, he was Chairman of the Board, President and Chief Executive Officer of The Babcock & Wilcox Company for more than five years.

R. K. Richie, 47, elected President and Chief Operating Officer of the McDermott Operating Unit in February, 1978; prior to this, he was President of Oceanic Contractors, Inc., a wholly-owned subsidiary of the Company, for more than the last five years.

H. W. Bailey, 55, elected Executive Vice President in charge of the McDermott Operating Unit's Domestic Operations in January, 1972; formerly held the title of Vice President and General Manager of the Morgan City Division Group.

V. J. LeBlanc, 58, elected Group Vice President in November, 1972, in charge of the McDermott Shipyard Group; held the title of Senior Division Manager of the Division from February, 1972. Formerly, he was Division Manager of the Division.

W. E. Earles, 50, elected Group Vice President in November, 1972, in charge of McDermott Structural Group; held the title of Division Manager of the Division from February, 1972. Formerly, he was Division Manager of the Division.

H. R. Reeves, 40, elected Group Vice President, Harvey Group, in charge of marine pipeline, diving, Harvey fabrication, dredging and inland service divisions; formerly Division Manager, Marine Pipeline Division.

G. C. Lee, 51, elected Group Vice President, Engineering, in February, 1975; formerly directed all structural, marine and architectural engineering along with computer section activities.

L. B. Smith, 47, elected Group Vice President in charge of the Hudson Engineering Group in May, 1978; prior to this, he was Vice President and then a Group Vice President of Oceanic Contractors, Inc., a wholly-owned subsidiary of the Company, for more than the last five years.

I. R. Foster, Jr., 48, elected Group Vice President, and Assistant to the President, in May, 1978; prior to this, he served as a Vice President of Oceanic Contractors, Inc., a wholly-owned subsidiary of the Company for more than the last five years.

J. L. Bates, 56, elected Senior Vice President responsible for McDermott Hudson Engineering-New Orleans in May, 1978; prior to this, he was Vice President of Oceanic Contractors, Inc., a wholly-owned subsidiary of the Company, since February, 1975; formerly was Division Manager of Oceanic Contractors, Inc.'s Engineering Office in London, England.

E. J. Dressel, 53, elected Vice President responsible for applied research and equipment development and construction in February, 1975; formerly Manager, Equipment and Machinery Development.

J. D. Dupy, 51, elected Vice President-Administration in August, 1974; formerly held the title of Corporate Treasurer and Corporate Secretary.

K. J. Gilly, 52, elected Vice President and General Counsel in November, 1977; prior to joining the Company in October, 1977 he was engaged in the practice of law as an attorney and partner with a New Orleans based law firm.

R. R. Striekert, Jr., 48, elected Vice President of the Company responsible for sales in May, 1978; prior to this, he was a Vice President of Oceanic Contractors, Inc., a wholly-owned subsidiary of the Company, for more than the last five years.

C. E. Young, 50, elected Vice President of the Company in May, 1978; prior to this, he served the Company as the Engineering Special Projects Manager for more than the last five years.

J. A. Lynott, 42, elected Treasurer in August, 1974; formerly Cash Manager of the Company since 1973; prior to joining the Company, he served as Assistant Treasurer of the Mead Corporation.

L. V. Sierra, 57, elected Corporate Secretary in November, 1972; formerly held titles of Assistant Secretary, and Office Manager of the Harvey Division Group.

There are no family relationships between the executive officers of the Company. Messrs. Graves, Cunningham, Zipf, Richie, Bailey and Earles also serve the Company as directors.

The executive officers of the Registrant listed above will hold their offices listed until the next Annual Meeting of Shareholders (in the case of directors) and the next meeting of the Board of Directors (in the case of officers) both of which are scheduled for August 8, 1978.

Item 12. INDEMNIFICATION OF DIRECTORS AND OFFICERS

The Company's By-Laws provide for the indemnification of directors and officers against expenses and liabilities incurred in connection with defending actions brought against them for negligence or misconduct in their official capacities. The following is a description of the provisions:

1. Provision is made for the indemnification of the directors and officers of the Company who serve as directors, officers, employees or agents of other corporations, partnerships, joint ventures, trusts of other enterprises at the request of the Company.
2. The provision explicitly applies to civil, criminal, administrative and investigative claims, actions, suits and proceedings, whether actual or threatened.
3. Under the provision, if the director or officer is wholly successful on the merits or otherwise with respect to the claim, suit or proceeding, he is automatically entitled to be indemnified by the Company.
4. In all other cases (including settlements and cases which terminate with a judgement against or conviction of the director or officer,, the director or officer is entitled to be indemnified by the Company if a court or independent legal counsel or the disinterested members of the Board of Directors find that the director or officer acted in good faith in a manner he reasonably believed to be in or not opposed to the best interests of the Company, and, in addition, with respect to any criminal action or proceeding, had no reasonable cause to believe that his conduct was unlawful. If it is thus determined that the required standard of conduct was met, the director or officer is entitled to be indemnified for his reasonable expense in connection with the claim, action, suit or proceeding and for any amounts paid under any judgement or fine or any settlement.

The provision permits the Company to advance litigation expenses to directors or officers prior to final disposition of claim, action, suit or proceeding if the recipient undertakes to repay the advance unless it is ultimately determined that he is entitled to indemnification.

The Company carries officers' and directors' liability insurance which provides all officers and directors liability coverage of 95% of liability up to a limit of \$1,000,000, 100% of all liability in excess of \$1,000,000 up to an aggregate of \$25,000,000 subject to a deduction on the liability portion of \$10,000 for each and every loss of each and every director with a \$75,000 annual aggregate for all directors.

Item 13. FINANCIAL STATEMENTS AND EXHIBITS FILED

(a) 1. Index to Financial Statements covered by Reports of Certified Public Accountants

| | |
|--|-------------|
| J. Ray McDermott & Co., Inc. & Subsidiaries | <u>Page</u> |
| Consolidated balance sheet at March 31, 1977 and 1978 | 44 |
| Consolidated statement of income and retained earnings for the fiscal years ended March 31, 1977 and 1978 | 45 |
| Consolidated statement of changes in financial position for the fiscal years ended March 31, 1977 and 1978 | 46 |
| Notes to consolidated financial statements | 47-64 |
| Supplementary information | 65 |
| Schedules supporting the financial statements for the fiscal years ended March 31, 1977 and 1978 | |
| V Property, plant and equipment | 66-67 |
| VI Accumulated depreciation | 68-69 |
| VII Intangible assets | 70 |
| XII Reserves | 71 |
| XVI Supplementary income statement information | 72 |

All other schedules have been omitted since the required information is not present or is not present in amounts sufficient to require submission of the schedule or because the information required is included in the respective financial statements, notes thereto or supplementary information.

The separate financial statements and schedules of J. Ray McDermott & Co., Inc. (not consolidated) are omitted since the Company is primarily an operating company and all of its subsidiaries are deemed to be totally-held as the total of minority interest and debt not guaranteed do not exceed five percent of the total assets as shown by the most recent year-end consolidated balance sheet.

2. Exhibits

Exhibit I - Calculation of earnings per common share assuming full dilution for the five fiscal years ended March 31, 1978.

Exhibit II - Article Fourth of the Certificate of Incorporation of J. Ray McDermott & Co., Inc.

Exhibit III - Resolutions of the Board of Directors designating the Series A \$2.20 Cumulative Convertible Preferred Stock, \$1 par value.

Exhibit IV - Resolutions of the Board of Directors designating the Series B \$2.60 Cumulative Preferred Stock, \$1 par value.

(b) Reports on Form 8-K

Not applicable

Items 14 through 18, inclusive, are not stated or answered herein since the registrant will file with the Securities and Exchange Commission, within 120 days after March 31, 1978, a definitive proxy statement pursuant to Regulation 14-A under the Securities Exchange Act of 1934.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized.

J. RAY McDERMOTT & CO., INC
(REGISTRANT)

Date June 26, 1978

By /s/ J. E. Cunningham
J. E. Cunningham, Vice Chairman of the
Board - Finance and Administration

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

The Board of Directors
J. Ray McDermott & Co., Inc.

We have examined the consolidated financial statements of J. Ray McDermott & Co., Inc. and subsidiaries listed in the accompanying index to financial statements at March 31, 1978 and for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. The financial statements of J. Ray McDermott & Co., Inc. and subsidiaries for the year ended March 31, 1977 were examined by other auditors whose opinion, as reissued and dated May 31, 1977 and November 10, 1977, was qualified as being subject to the effects of such adjustments, if any, as might have been required had the outcome of the grand jury investigation discussed in Note 8 to the financial statements been known.

As discussed in Note 8 to the financial statements, the Company is the subject of a grand jury investigation which appears to be focused on possible antitrust violations. The ultimate outcome of this investigation is not presently known, and no provision for liability, if any, that might result from such investigation has been made in the financial statements.

In our opinion, subject to the effects, if any, on the financial statements of the ultimate resolution of the matter discussed in the preceding paragraph, the financial statements listed in the accompanying index to financial statements present fairly the consolidated financial position of J. Ray McDermott & Co., Inc. and subsidiaries at March 31, 1978 and the consolidated results of operations and changes in consolidated financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ARTHUR YOUNG & COMPANY

New Orleans, Louisiana
May 31, 1978

REPORT OF CERTIFIED PUBLIC ACCOUNTANTS

To the Shareholders and Board of Directors of
J. Ray McDermott & Co., Inc.

We have examined the consolidated balance sheet of J. Ray McDermott & Co., Inc. and subsidiaries as of March 31, 1977 and the related consolidated statements of income and retained earnings and changes in financial position for the year then ended and supplementary information and supporting schedules. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As more fully described in the first paragraph of Note 8 to the Consolidated Financial Statements, J. Ray McDermott & Co., Inc. is the subject of a grand jury investigation which appears to be focused on possible antitrust violations. Since the outcome of this investigation is not presently known, no provision for liability, if any, which may result has been made in the financial statements.

In our opinion, subject to the effects, if any, of the ultimate resolution of the matter discussed in the preceding paragraph, the accompanying consolidated financial statements referred to above and supplementary information and supporting schedules present fairly the financial position of J. Ray McDermott & Co., Inc. and subsidiaries at March 31, 1977 and the results of their operations and changes in their financial position for the year then ended and the supplementary information and supporting schedules present fairly the information required to be set forth therein, all in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

MATTISON AND RIQUELMY

Houston, Texas

May 31, 1977 except as to the first paragraph of Note 8, to which the date is November 10, 1977.

CONSOLIDATED BALANCE SHEET

J. Ray McDermott & Co., Inc. and Subsidiaries/March 31, 1977 and 1978

ASSETS

| | 1977 | 1978 |
|---|---------------------------|---------------------------|
| | (In thousands of dollars) | (In thousands of dollars) |
| Current Assets: | | |
| Cash | \$ 5,231 | \$ 22,842 |
| Temporary investments, at cost which approximates market | 527,291 | 595,150 |
| Accounts and notes receivable (Note 3) | 257,652 | 535,281 |
| Marketable securities, at cost (market \$17,056 in 1978 and \$14,277 in 1977) | 9,231 | 9,231 |
| Contracts in progress (Note 3) | 32,250 | 324,126 |
| Inventories (Note 4) | 50,969 | 332,030 |
| Prepaid expenses | 5,789 | 12,354 |
| Total Current Assets | <u>888,413</u> | <u>1,831,014</u> |
| Investments in Affiliated Companies, at Equity | <u>11,912</u> | <u>18,689</u> |
| Property, Plant and Equipment, at Cost: (Schedule V) | | |
| Land | 11,544 | 36,077 |
| Buildings | 57,582 | 174,390 |
| Machinery and equipment | 664,223 | 931,226 |
| Property under construction | 21,440 | 97,114 |
| | <u>754,789</u> | <u>1,238,807</u> |
| Less accumulated depreciation and amortization (Schedule VI) | <u>288,640</u> | <u>347,226</u> |
| Net Property, Plant and Equipment | <u>466,149</u> | <u>891,581</u> |
| Excess of Cost Over Fair Value of Net Assets of Purchased Businesses | | |
| Less Amortization (Note 2) (Schedule VII) | <u>6,252</u> | <u>403,320</u> |
| Other Assets (Schedule VII) | <u>3,279</u> | <u>38,203</u> |
| Total | <u>\$1,376,005</u> | <u>\$3,182,807</u> |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | 1977 | 1978 |
|--|---------------------------|---------------------------|
| | (In thousands of dollars) | (In thousands of dollars) |
| Current Liabilities: | | |
| Notes payable to banks and current maturities of long-term debt (Note 7) | \$ 2,328 | \$ 12,508 |
| Accounts payable | 60,149 | 255,534 |
| Accrued liabilities | 93,705 | 256,744 |
| Advance billings on contracts (Note 3) | 173,991 | 278,557 |
| Provision for warranty expense | -- | 79,390 |
| U.S. and foreign income taxes | 89,006 | 425,739 |
| Dividends payable | 6,289 | 7,999 |
| Total Current Liabilities | <u>425,468</u> | <u>1,316,944</u> |
| Deferred Income Taxes | <u>57,586</u> | <u>68,050</u> |
| Long-Term Debt (Note 7) | <u>166,078</u> | <u>479,432</u> |
| Other Liabilities (Schedule XII) | <u>31,431</u> | <u>87,842</u> |
| Contingencies and Commitments (Note 8) | | |
| Stockholders' Equity (Note 9): | | |
| Preferred stock | -- | 394,847 |
| Common stock | 15,878 | 32,307 |
| Capital in excess of par value | 136,762 | 129,505 |
| Retained earnings (Notes 6 & 7) | <u>553,832</u> | <u>684,353</u> |
| | <u>706,472</u> | <u>1,241,012</u> |
| Less: Cost of common stock in treasury | <u>2,517</u> | <u>2,681</u> |
| Unamortized deferred career executive stock plan expense | <u>8,513</u> | <u>6,892</u> |
| Total Stockholders' Equity | <u>695,442</u> | <u>1,231,439</u> |
| Total | <u>\$1,376,005</u> | <u>\$3,182,807</u> |

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

J. Ray McDermott & Co., Inc. and Subsidiaries/for the Fiscal Years Ended March 31, 1977 and 1978

| | 1977 (In thousands of dollars except per share amounts) | 1978 |
|---|---|--------------------|
| Revenues | <u>\$1,223,841</u> | <u>\$1,293,711</u> |
| Costs and Expenses: | | |
| Cost of operations | 793,928 | 901,696 |
| Depreciation | 63,004 | 67,342 |
| Selling, general and administrative expenses | <u>107,278</u> | <u>126,905</u> |
| | <u>964,210</u> | <u>1,095,943</u> |
| Operating Income | <u>259,631</u> | <u>197,768</u> |
| Other Income (Expense): | | |
| Interest income | 21,824 | 34,124 |
| Interest expense | (16,157) | (26,887) |
| Equity in earnings of affiliated companies - Babcock & Wilcox (Note 2) | - | 20,364 |
| - Other | 2,275 | 3,554 |
| Other | <u>(5,947)</u> | <u>11,164</u> |
| | <u>1,995</u> | <u>42,319</u> |
| Income Before Provision for Income Taxes and Extraordinary Gain | <u>261,626</u> | <u>240,087</u> |
| Provision for Income Taxes (Note 6): | | |
| Current | 51,544 | 68,290 |
| Deferred | <u>18,572</u> | <u>12,705</u> |
| | <u>70,116</u> | <u>80,995</u> |
| Income Before Extraordinary Gain | 191,510 | 159,092 |
| Extraordinary Gain (Foreign tax benefit from operating loss carryforward) | <u>132</u> | <u>-</u> |
| Net Income | <u>191,642</u> | <u>159,092</u> |
| Retained Earnings, Beginning of Year | 380,228 | 553,832 |
| Deduct: | | |
| Cash dividends (\$0.90 in 1978 and \$0.575 in 1977, per share) | <u>18,038</u> | <u>28,571</u> |
| Retained Earnings, End of Year (Note 7) | <u>\$ 553,832</u> | <u>\$ 684,353</u> |
| Earnings Per Common Share: | | |
| Primary | <u>\$6.11</u> | <u>\$5.02</u> |
| Fully diluted | <u>\$5.93</u> | <u>\$4.92</u> |

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

J. Ray McDermott & Co., Inc. and Subsidiaries/for the Fiscal Years Ended
March 31, 1977 and 1978

| | 1977 | 1978 |
|--|---------------------------|---------------------------|
| | (In thousands of dollars) | (In thousands of dollars) |
| SOURCE OF FUNDS: | | |
| Operations: | | |
| Income before extraordinary gain | \$ 191,510 | \$ 159,092 |
| Charges not requiring current outlays of working capital: | | |
| Depreciation of property, plant and equipment | 63,004 | 67,342 |
| Deferred income taxes - noncurrent | 21,812 | 10,464 |
| Equity in earnings of affiliated companies | (2,275) | (23,918) |
| Other | 12,680 | 14,440 |
| Working capital provided from operations exclusive of extraordinary gain | 286,731 | 227,420 |
| Extraordinary gain | 132 | - |
| Issuance of common stock | 2,833 | 9,172 |
| Issuance of preferred stock | - | 394,847 |
| Noncurrent liabilities of B & W, principally long-term debt | - | 190,610 |
| Long-term borrowing (including fluctuations under the revolving credit agreement) | 23,522 | 275,000 |
| Other - net | (956) | 3,563 |
| | <u>312,262</u> | <u>1,100,612</u> |
| APPLICATION OF FUNDS: | | |
| Noncurrent assets of B & W: | | |
| Property, plant and equipment | - | 410,412 |
| Investments | - | 2,390 |
| Other assets | - | 34,890 |
| Equity in earnings of B & W prior to merger | - | (21,017) |
| Excess of cost over fair value of net assets of B & W | - | 399,764 |
| Additions to property, plant and equipment | 63,657 | 84,975 |
| Payments of long-term debt (including fluctuations under the revolving credit agreement) | 26,704 | 108,602 |
| Cash dividends | 18,038 | 28,571 |
| | <u>108,399</u> | <u>1,048,587</u> |
| Net increase in working capital | <u>\$ 203,863</u> | <u>\$ 52,025</u> |
| Changes in components of working capital: | | |
| Increase (decrease) in current assets: | | |
| Cash and temporary investments | \$ 315,126 | \$ 85,400 |
| Accounts and notes receivable | (28,368) | 277,629 |
| Contracts in progress | (8,246) | 291,876 |
| Inventories | (26,035) | 281,061 |
| Prepaid expenses | (59) | 6,565 |
| | <u>252,418</u> | <u>942,601</u> |
| Increase (decrease) in current liabilities: | | |
| Notes and accounts payable and accrued liabilities | (766) | 568,204 |
| Advance billings on contracts | 21,664 | 104,539 |
| Provision for warranty expense | - | 79,390 |
| Accrued income taxes | 25,279 | 336,733 |
| Dividends payable | 2,378 | 1,710 |
| | <u>48,555</u> | <u>890,576</u> |
| Net increase in working capital | <u>\$ 203,863</u> | <u>\$ 52,025</u> |

See accompanying notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES/ MARCH 31, 1977 AND 1978

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and all significant subsidiaries. The assets and liabilities of B & W have been consolidated with the Company's at March 31, 1978. The Company's share of B & W's earnings for 1978 is reflected on an equity basis in the consolidated statement of income. Investments in affiliated (20% to 50% owned) companies are accounted for on the equity method. All significant intercompany transactions and accounts have been eliminated.

Certain amounts previously reported in the consolidated financial statements of March 31, 1977 have been reclassified to conform with the presentation at March 31, 1978.

Marine and Onshore Construction Contracts

Revenues from marine and onshore construction contracts are generally recognized as contractual obligations are completed. Revenues are recognized on certain contracts containing identifiable separate projects when such projects are completed and accepted by the customer. Revenues from time or day rate basis contracts are recognized as earned. General and administrative costs are included in contract costs. Contract costs in excess of related billings are classified as current assets under contracts in progress. Billings in excess of related costs are classified as current liabilities under advance billings on contracts. Current provisions are made for all known or anticipated losses on contracts which have not been completed.

Foreign Currency Translation

The accounts of foreign subsidiaries maintained in foreign currencies are translated into U.S. Dollars based on current exchange rates at the end of the fiscal year for assets and liabilities except for inventories, prepaid expenses, property, plant and equipment, and stockholders' equity for which historical exchange rates are used. Average exchange rates prevailing during the fiscal years are used for revenues and expenses other than depreciation and prepaid expenses. Exchange gains and losses are recognized in the year of occurrence. Included in other income are gains of \$3,460,000 for the fiscal year ended March 31, 1978 and losses of \$3,914,000 for the fiscal year ended March 31, 1977.

Depreciation, Maintenance and Repairs

Property, plant and equipment is depreciated by the straight line method, using estimated useful lives of 8 to 30 years for buildings and 2 to 20 years for machinery and equipment.

Maintenance, repairs and renewals which do not materially prolong the useful life of an asset, are expensed as incurred except for drydocking costs for the Company's marine fleet. Under the accounting method for accrual of drydocking costs, estimated costs are provided and charged to operations currently. When expenditures are made for these costs, the reserve for drydocking is charged with the amounts paid.

Gains or losses on disposition of property, plant and equipment are included in income as realized.

Amortization of Excess of Cost Over Fair Value of Net Assets of Purchased Businesses

The excess of the Company's investment in B & W over the fair value of net assets acquired is being amortized on a straight line basis over forty years. Excess cost arising from business combinations prior to 1971 is not being amortized because, in the opinion of management, there has been no diminution in value.

Earnings Per Share

Primary earnings per share are based on the weighted average number of common shares outstanding during the year. Fully diluted earnings per share are computed assuming the conversion of the convertible subordinated debentures. All per share data have been restated to give effect to the two-for-one common stock split effective December 15, 1977.

NOTE 2 - ACQUISITION OF THE BABCOCK & WILCOX COMPANY

In September 1977, the Company acquired approximately 4,800,000 common shares of The Babcock & Wilcox Company (B & W) for \$62.50 per share pursuant to a tender offer. An additional 1,205,600 shares had been acquired previously in open market transactions. These acquisitions represented approximately 49% of the B & W shares outstanding. On March 31, 1978, the Company acquired the remaining outstanding shares of B & W in exchange for 6,317,545 shares of Series A \$2.20 Cumulative Convertible Preferred Stock and 6,317,545 shares of Series B \$2.60 Cumulative Preferred Stock. The total cost of the acquisition, which has been accounted for as a purchase, was approximately \$748,000,000, including expenses.

The assets and liabilities of B & W have been consolidated with the Company's at March 31, 1978. The Company's share of B & W's earnings for 1978 is reflected on an equity basis in the consolidated statement of income.

The excess of the Company's investment in B & W over the fair value of net assets acquired is being amortized on a straight line basis over forty years.

The following summary represents the consolidated results of the Company on a pro forma unaudited basis as if B & W had been combined with the Company throughout the respective periods:

| | Year Ended March 31, | |
|------------------------------|--|--------------|
| | 1977 | 1978 |
| | (In thousands of dollars except per share amounts) | |
| Revenues | \$ 2,924,000 | \$ 3,216,000 |
| Net income | \$ 227,000 | \$ 193,000 |
| Net income per common share: | | |
| Primary | \$6.22 | \$5.09 |
| Fully diluted | \$5.41 | \$4.53 |

NOTE 3 - CONTRACTS IN PROGRESS

Contracts in progress and advance billings on contracts at March 31 consist of the following:

| Contracts in Progress | | Advance Billings on Contracts | |
|---------------------------|------|----------------------------------|------|
| 1977 | 1978 | 1977 | 1978 |
| (In thousands of dollars) | | | |

Marine and onshore
construction contracts:

| | | | | |
|-------------------------------|-----------|------------|------------|------------|
| Cost of uncompleted contracts | \$ 71,381 | \$ 120,346 | \$ 389,433 | \$ 183,904 |
| Billings to customers | 39,131 | 84,608 | 563,424 | 263,749 |
| | 32,250 | 35,738 | 173,991 | 79,845 |

B & W contracts:

| | | | | |
|--------------------------|-----------|------------|------------|------------|
| Unbilled revenues | - | 207,268 | - | - |
| Cost of work in progress | - | 175,846 | - | - |
| | - | 383,114 | - | - |
| Billings to customers | - | 94,726 | - | 198,685 |
| | - | 288,388 | - | 198,685 |
| | \$ 32,250 | \$ 324,126 | \$ 173,991 | \$ 278,530 |

The amounts of general and administrative expenses remaining in the cost of uncompleted marine and onshore construction contracts at March 31, 1978 and 1977 were \$37,337,000 and \$34,435,000, respectively.

B & W contract revenues and related costs are recognized principally by a percentage of completion method related principally to physical shipments and direct labor or cost incurred, as applicable to the product or the activity

involved. Revenues so recorded are included in unbilled revenues until invoiced to customers under terms of the contracts. Costs of contract revenues on uncompleted contracts are based upon estimates to complete. Revisions to contract price and cost estimates are recognized in the period in which they are determined.

Unbilled revenues on contracts include \$39,000,000 not expected to be collected until after one year.

Included in accounts and notes receivable are amounts representing retainages on contracts as follows:

| | <u>1977</u> | <u>1978</u> |
|---|---------------------------|------------------|
| | (In thousands of dollars) | |
| Retainages | <u>\$ 20,781</u> | <u>\$ 31,839</u> |
| Retainages not expected to be collected until after one year | <u>\$ -</u> | <u>\$ 2,015</u> |

NOTE 4 - INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined on an average cost basis for raw materials and supplies except for certain domestic and foreign construction materials inventories, for which the last-in, first-out (LIFO) method is used. Work in progress and the majority of finished goods inventories were acquired in connection with the acquisition of B & W and are stated at fair market value at the date thereof. Approximately 11% and 63% of total inventories were valued using the LIFO method at March 31, 1978 and 1977, respectively.

Consolidated inventories at March 31, 1977 and 1978 are summarized below:

| | <u>1977</u> | <u>1978</u> |
|----------------------------|---------------------------|------------------|
| | (In thousands of dollars) | |
| Raw Materials and Supplies | \$41,592 | \$179,631 |
| Work in Progress | — | 104,365 |
| Finished Goods | <u>9,377</u> | <u>48,034</u> |
| | <u>\$50,969</u> | <u>\$332,030</u> |

Inventories used in the computation of costs and expenses were \$54,920,000, \$50,969,000 and \$77,004,000 at March 31, 1978, 1977 and 1976, respectively.

NOTE 5 - PENSION AND SUPPLEMENTAL COMPENSATION PLANS

Pension Plans - The Company has several pension plans covering substantially all employees except non-resident alien employees of foreign subsidiaries who do not earn income in the United States. Unfunded prior service costs based on the latest actuarial valuation was approximately \$275,000,000 including amounts attributable to B & W pension plans. The Company's policy has been to fund pension cost accrued. The total value of the pension funds and balance sheet accruals less deferred charges was in excess of the actuarially computed value of vested benefits for all plans. Total pension expense included in costs and expenses was \$8,709,000 in fiscal 1978 and \$8,061,000 in fiscal 1977, and includes amortization of prior service costs over thirty years.

Supplemental Compensation Plan - The Company accrues annually an amount equal to 4% of the amount by which consolidated income (as defined in the plan) exceeds an amount equal to 10% of capital employed in the business (as defined in the plan) from which supplemental compensation awards may be made to eligible managerial and other key employees. The aggregate amount of an award may not exceed 50% of the recipient's aggregate compensation for the year for which the award is made. Awards are payable in equal amounts over a five year period. Amounts charged to income under the plan amounted to \$6,919,000 and \$8,637,000 in 1978 and 1977, respectively.

NOTE 6 - INCOME TAXES

The provision for income taxes consists of:

| | 1977 | | 1978 | |
|-----------------|---------------------------|------------------|------------------|------------------|
| | <u>Current</u> | <u>Deferred</u> | <u>Current</u> | <u>Deferred</u> |
| | (In thousands of dollars) | | | |
| Federal | \$ 12,722 | \$ 16,540 | \$ 30,808 | \$ 12,829 |
| Foreign | 38,016 | 2,032 | 35,397 | (124) |
| State and local | 806 | - | 2,085 | - |
| | <u>\$ 51,544</u> | <u>\$ 18,572</u> | <u>\$ 68,290</u> | <u>\$ 12,705</u> |

Investment tax credits, accounted for on a flow through method, and utilized in fiscal 1978 and fiscal 1977, were \$1,609,000 and \$6,857,000, respectively.

The effective income tax rate is reconciled to the statutory federal income tax rate of 48% as follows:

| | <u>1977</u> | <u>1978</u> |
|---|-------------|-------------|
| | Percent | Percent |
| Statutory federal tax rate | 48.0 | 48.0 |
| Increases (reductions) in income tax rate resulting from: | | |
| Foreign operations | (19.0) | (10.3) |
| Earnings of affiliates | (.4) | (4.4) |
| Investment tax credits | (2.6) | (.7) |
| Other | <u>.8</u> | <u>1.1</u> |
| Effective tax rate | <u>26.8</u> | <u>33.7</u> |

Deferred income taxes provided in 1978 and 1977 result principally from the use of accelerated depreciation for income tax purposes and straight line depreciation for

financial reporting.

Undistributed income of foreign subsidiaries included in consolidated retained earnings at March 31, 1978 amounted to approximately \$538,000,000. Under present law, such amount would be subject to United States income taxes at prevailing tax rates less foreign tax credits if remitted to the parent company; no provision for such taxes has been made in the consolidated financial statements as it is the Company's intention to indefinitely reinvest said undistributed earnings in the foreign subsidiaries.

The Internal Revenue Service is currently examining the Company's income tax returns for the four fiscal years ended March 31, 1975 on the basis of a civil and fraud investigation. The Company has not received a report from the Internal Revenue Service; however, in the opinion of management the results of the investigation will not have a material effect on reported results of operations.

The Company's consolidated Federal Income tax returns for the eight fiscal years ended March 31, 1971 have been examined. The Company and the Internal Revenue Service have reached tentative agreement in connection with certain deficiencies. In the opinion of management, the deficiencies will not have a material effect on the results of operations.

An income tax holiday in a foreign country reduced the provision for income taxes by approximately \$16,000,000 (\$.51 per share primary earnings; \$.49 per share fully diluted earnings) in fiscal 1977. Such tax holiday expired in fiscal 1977.

NOTE 7 - LONG AND SHORT-TERM DEBT

Long-term debt consists of:

| | March 31, | |
|---|---------------------------|------------------|
| | 1977 | 1978 |
| | (In thousands of dollars) | |
| <u>Unsecured Debt:</u> | | |
| Notes payable to banks under a revolving credit and term loan agreement..... | \$ - | \$177,000 |
| 7.30% Note payable \$3,000,000 annually beginning in 1979..... | 60,000 | 60,000 |
| 9.70% Sinking fund debentures due December, 1999 with annual sinking fund installments of \$2,500,000 beginning 1981..... | 50,000 | 50,000 |
| 8.90% Notes due December, 1984..... | 35,000 | 35,000 |
| 4-3/4% Convertible (at \$16.75 per share) subordinated debentures due October, 1987..... | 16,191 | 6,960 |
| Prior unsecured debt of B & W: | | |
| 8-1/2% Notes payable \$3,960,000 annually to 1997 beginning in 1983..... | - | 60,000 |
| 9% Notes payable \$3,300,000 annually to 1991..... | - | 46,700 |
| 9% Notes payable \$1,650,000 annually to 1996 beginning 1982..... | - | 25,000 |
| <u>Partially Secured Debt:</u> | | |
| Other notes payable through 1994 and capitalized lease obligations..... | 6,267 | 27,226 |
| | 167,458 | 487,886 |
| Less due within one year..... | 1,380 | 8,454 |
| | <u>\$166,078</u> | <u>\$479,432</u> |

The revolving credit and term loan agreement, under which the notes payable to banks were issued, permits the borrowing of an aggregate of \$325,000,000 at 109.5% of the prime rate until August 1979 and then 112% of prime until August

1980, at which time all outstanding borrowings will convert to a term loan payable in twenty equal quarterly installments to maturity at August 15, 1985 at interest rates from 115% to 118% of prime. The Company pays a commitment fee at the rate of 1/2 of 1% and a fee of 7.5% of prime per annum on the unused portion.

Maturities of long-term debt during the five fiscal years subsequent to March 31, 1978 are as follows: 1979 - \$8,454,000; 1980 - \$10,479,000; 1981 - \$27,537,000; 1982 - \$47,682,000; and 1983 - \$53,134,000.

Certain of the Company's debt agreements contain, among other things, requirements as to maintenance of working capital and limitations on the payment of dividends and incurrence of future borrowings. Under the most restrictive covenants of these agreements at March 31, 1978, dividends were restricted to approximately \$200,000,000.

At March 31, 1978 and 1977 the Company had borrowings outstanding of \$3,654,000 and \$948,000 under short-term lines of credit which aggregated \$67,554,000 and \$64,760,000, respectively. Interest rates on the lines of credit ranged from 8% to 11-1/2% at March 31, 1978 and 6-1/4% to 10-7/8% at March 31, 1977. Informal arrangements with the banks require maintenance of compensating balances which are not legally restricted by such banks. For the fiscal years ended March 31, 1978 and March 31, 1977, the maximum amounts of borrowings under these lines of credit were \$12,707,000 and \$23,432,000, respectively. The weighted average interest rate was 8.34% for the 1978 fiscal year and 11.84% for the 1977 fiscal year on weighted average borrowings of \$5,253,000 and \$10,377,000, respectively. The weighted average interest rates were computed by dividing the actual interest incurred on the short-term borrowings by the average short-term borrowings.

NOTE 8 - CONTINGENCIES AND COMMITMENTS

Antitrust Investigation - In December 1976, the Company, among others, received a grand jury subpoena to produce certain documents pertaining to its domestic offshore pipeline and domestic structure fabrication and installation activities during the period from January 1, 1968 to the date of the subpoena. The grand jury's investigation appeared to be focused on possible antitrust violations, including possible price fixing and collusive bidding during the period covered by the subpoena. It now appears that the grand jury's investigation has been expanded to include foreign activities, and that it encompasses a substantial portion of the Company's activities. In connection with the investigation, substantial document production has been made and a number of individuals has been interviewed and called to testify, some, including past and present officers and employees of the Company, under grant of immunity from prosecution. As a result of the investigation, criminal or civil proceedings may be brought against the Company, which is a target of the investigation, or against certain of its present or former officers and employees, some of whom are also targets of the investigation. The institution of any such action by the government could lead to private antitrust treble damage actions which could have a material adverse effect upon the Company.

Litigation - The Company and certain of its officers, directors and subsidiaries are defendants in several legal proceedings claiming amounts significant in the aggregate, alleging, among other things, violations of federal securities laws in the acquisition of B & W. It is the opinion of management and of general counsel that the outcome of these litigations will not materially affect the financial position or operations of the Company.

During fiscal 1978, the Company entered into a settlement with respect to charges brought by the government arising out of a special investigation into questionable

payments and accounting practices. Pursuant to the settlement the Company paid \$1,000,000 to the United States Government consisting of a forfeiture of \$897,000 and aggregate penalties of \$103,000.

Operating Leases - The following is a schedule of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year at March 31, 1978:

Years ending March 31:

(In thousands of dollars)

| | |
|---------------------------------|------------------|
| 1979 | \$ 15,246 |
| 1980 | 9,773 |
| 1981 | 6,963 |
| 1982 | 5,309 |
| 1983 | 4,354 |
| After 1983 | <u>13,142</u> |
| Total minimum payments required | <u>\$ 54,787</u> |

Total rental expense attributable to operating leases for fiscal 1978 and 1977, was \$84,619,000 and \$71,793,000, respectively. These expense figures include contingent rentals and are net of sublease income, both of which are not material.

Firm and contemplated commitments for capital expenditures amounted to \$162,000,000 at March 31, 1978.

NOTE 9 - CAPITAL STOCK

Preferred Stock - At March 31, 1978, 25,000,000 shares of \$1 par value preferred stock were authorized, 6,600,00 shares were designated Series A \$2.20 Cumulative Convertible Preferred Stock and 6,600,000 shares were designated Series B \$2.60 Cumulative Preferred Stock. Each series had 6,317,545 shares issued and outstanding and is entitled to \$31.25 per share in liquidation. The outstanding shares were issued in connection with the acquisition of B & W and are stated at the mandatory redemption value which approximated market value of the shares issued. Both series of preferred stock are entitled to general voting rights of one-half vote for each share. The Board of Directors may authorize additional series of preferred stock and may set the terms of each new series except that the Company cannot create any series of stock senior to the existing Series A and Series B Preferred Stock without the consent of the holders of at least 50% of the shares of such preferred stock.

Each share of the outstanding Series A Preferred Stock is convertible into one common share. The shares are redeemable at the option of the Company on or after March 31, 1983 at the following prices plus accrued dividends: 1983 - \$33.45; 1984 - \$33.09; 1985 - \$32.72; 1986 - \$32.35; 1987 - \$31.97; and 1988 - \$31.62; and 1989 through 2008 - \$31.25. On March 31, 1989 and each subsequent year through March 31, 2008, the Company is obligated to redeem, at a redemption price of \$31.25 plus

accrued dividends, 5% of the number of shares which are outstanding at December 31, 1988.

Series B Preferred Stock is redeemable at the option of the Company on or after March 31, 1983 at the following prices plus accrued dividends: 1983 - \$32.25; 1984 - \$32.00; 1985 - \$31.75; 1986 - \$31.50; and 1987 through 2008 - \$31.25. For the periods March 31, 1986 through March 31, 1995, March 31, 1996 through March 31, 2006 and March 31, 2007 through March 31, 2008, the Company is obligated to redeem during each year shares of Series B Preferred Stock equal to 5%, 4% and 3%, respectively, of the number of shares which are outstanding at December 31, 1985.

Additional shares of Series A or Series B Preferred Stock, equal to the number of shares the Company is obligated to redeem may be redeemed on each redemption date by the Company, on a non-cumulative basis. The Company may apply to the mandatory sinking fund obligations any Series A or B Preferred Stock owned, previously redeemed or surrendered for conversion which have not been previously credited against the mandatory sinking fund obligation.

Common Stock - On March 31, 1978 the number of shares of \$1 par value common stock authorized was increased from 36,000,000 to 60,000,000. Changes in common stock during the two years ended March 31, 1978 are summarized as follows:

| | <u>Shares</u> (In thousands of | <u>Amount</u> dollars except | Capital in Excess of <u>Par Value</u> share data) |
|--|-----------------------------------|---------------------------------|--|
| Balance, March 31, 1976 | 15,795,530 | \$ 15,796 | \$ 134,011 |
| Conversion of 4-3/4% convertible subordi- nated debentures | 78,618 | 79 | 2,499 |
| Shares issued under Career Executive Stock Plan (net of forfeitures) | <u>3,800</u> | <u>3</u> | <u>252</u> |
| Balance, March 31, 1977 | 15,877,948 | 15,878 | 136,762 |
| Conversion of 4-3/4% convertible subordi- nated debentures | 322,820 | 323 | 8,728 |
| Issuance of shares to effect stock split | 16,106,204 | 16,106 | (16,106) |
| Forfeitures under Career Executive Stock Plan | <u>-</u> | <u>-</u> | <u>121</u> |
| Balance, March 31, 1978 | <u>32,306,972</u> | <u>\$ 32,307</u> | <u>\$ 129,505</u> |

At March 31, 1978 and 1977, 316,672 and 309,956 shares, respectively, were in treasury. At March 31, 1978, 7,331,145 shares were reserved for issuance in connection with the 1974 Career Executive Stock Plan, exercise of stock options, and conversion of the 4-3/4% Convertible Subordinated Debentures, and Series A Cumulative Convertible Preferred Stock.

Stock Options - In connection with the acquisition of B & W, options granted under a B & W stock option plan became options to purchase two shares of the Company's common stock. All options outstanding under this plan are non-qualified stock options and no additional options will be granted under the plan. At March 31, 1978, there were outstanding options to purchase 470,482 shares of common stock as follows:

| <u>Number of Shares</u> | <u>Price</u> | <u>Date Options Expire</u> |
|-------------------------|--------------|----------------------------|
| 18,622 | \$ 6.8125 | December 28, 1982 |
| 28,150 | 6.8125 | January 24, 1983 |
| 114,960 | 6.8125 | April 23, 1984 |
| 1,800 | 6.3125 | December 19, 1984 |
| 306,950 | 9.6875 | November 22, 1985 |

Career Executive Stock Plan- The plan, which was adopted in 1974, authorized 600,000 shares of common stock to be issued to eligible employees in consideration of their services. Employees granted stock under the plan pay \$1.00 per share as the option price. Shares may be issued pursuant to the plan until June 30, 1984. Restrictions with respect to issued shares lapse in approximately equal amounts on the second through tenth anniversary dates of the date of issuance. The cost of the plan, based on fair market value on the date of issuance of common stock, is amortized over a ten year period following the date of issuance. Upon forfeiture of stock by employees, previous expense attributable to unvested stock is credited to income. Forfeited shares under the plan returned to the Company amounted to 6,716 shares during 1978, and 5,280 shares during 1977. As of March 31, 1978, 131,596 shares of common stock are available for grant to eligible employees pursuant to the terms of the plan. Amounts charged to income under the plan and its predecessor plan amounted to \$1,541,000 and \$1,535,000 in fiscal 1978 and fiscal 1977, respectively.

NOTE 10 - FOREIGN SUBSIDIARIES

Summarized financial information with respect to consolidated foreign subsidiaries is as follows:

| | <u>March 31,</u> | |
|---|----------------------------------|-------------------|
| | <u>1977</u> | <u>1978</u> |
| | <u>(In thousands of dollars)</u> | |
| Assets (including cash and temporary investments of \$467,597,000 and \$537,456,000 at March 31, 1977 and 1978, respectively) | \$ 765,940 | \$ 923,602 |
| Liabilities | <u>307,033</u> | <u>338,985</u> |
| Net assets | <u>\$ 458,907</u> | <u>\$ 584,617</u> |
| Net income | <u>\$ 147,333</u> | <u>\$ 89,392</u> |

NOTE 11 - CERTAIN PAYMENTS

During fiscal 1978 and 1977, the Company made facilitating payments from regular corporate funds, minor in amount, to low level foreign government officials to expedite necessary action to which the Company was otherwise entitled. Commissions to foreign sales agents pursuant to written agreements were made during fiscal 1978 and fiscal 1977. The Company continued its practice of making modest seasonal gifts to governmental officials and employees of customers.

NOTE 12 - SEGMENT REPORTING

The Company has operated, prior to the acquisition of B & W, principally in two industry segments, Marine Construction Services and Onshore Construction Services. Marine Construction Services primarily involve construction of specialized offshore platforms and marine pipelines used for development drilling, production and transportation of oil and gas. Onshore Construction Services primarily involve construction of land based oil, gas, chemical, petrochemical and mineral processing plants and manufacture of air-cooled heat exchangers.

Operating income is revenues less costs and expenses, exclusive of general corporate expenses.

Identifiable assets by industry segment are those assets that are used in the Company's operations in each segment. Corporate assets are principally cash, temporary investments and marketable securities.

The Company's share of B & W's earnings for fiscal 1978 is reflected on an equity basis in the consolidated statement of income. B & W's operations are principally in the United States and are not vertically integrated into the Company's industrial segments. The assets of B & W are included in the accompanying industry segment schedule as steam generating equipment, tubular products and other products.

Steam generating equipment includes individually engineered complete fossil fuel boilers, nuclear steam systems, nuclear fuel and nuclear fuel assemblies, and associated equipment for electric utility and marine applications as well as fossil fuel boilers for industrial processes and power generation.

Tubular products include stainless, alloy and carbon steel, seamless and welded tubes and pipe, tubular and solid shapes, extrusions, special metal tubes, welding fittings and flanges, and seamless rolled rings.

Transfers between geographic areas are accounted for at prices which are generally established by reference to similar transactions with unaffiliated customers or, in certain circumstances, by reference to provisions of the U.S. Internal Revenue Code.

Revenues attributable to Foreign governments were \$211,945,000 and to an individual company were \$175,037,000.

Revenues attributable to unconsolidated affiliated companies were \$104,338,000 (\$46,652,000 in fiscal 1977).

NOTE 12 - SEGMENT REPORTING (CONTINUED)

SEGMENT INFORMATION FOR THE FISCAL YEAR ENDED MARCH 31, 1978

1. Information about the Company's Operations in Different Industry Segments

| | MARINE CONSTRUCTION SERVICES | ONSHORE CONSTRUCTION SERVICES | CONSOLIDATED |
|---|------------------------------------|-------------------------------------|--------------|
| | (In thousands of dollars) | | |
| Revenues. | \$1,116,119 | \$177,592 | \$1,293,711 |
| Operating income. | \$ 205,559 | \$ 15,364 | \$ 220,923 |
| Equity in earnings of affiliated companies - B & W. | | | 20,364 |
| - Other. | \$ 3,554 | | 3,554 |
| General corporate expenses. | | | (23,155) |
| Interest expense. | | | (26,887) |
| Interest income. | | | 34,124 |
| Other income (expense). | | | 11,164 |
| Income before provision for income taxes. | | | \$ 240,087 |
| Capital expenditures. | \$ 61,642 | \$ 22,660 | \$ 84,302 |
| Corporate capital expenditures. | | | 673 |
| Total capital expenditures. | | | \$ 84,975 |
| Depreciation expense. | \$ 57,528 | \$ 8,954 | \$ 66,482 |
| Corporate depreciation expense. | | | 860 |
| Total depreciation expense. | | | \$ 67,342 |
| Identifiable assets at March 31, 1978 | | | |
| - The Company | \$ 777,147 | \$ 91,484 | \$ 868,631 |
| - B & W | | | |
| Steam generating equipment | | | \$ 800,400 |
| Tubular equipment. | | | 379,600 |
| Other products | | | 146,458 |
| Excess of cost over fair value of net assets of B & W not yet allocated. | | | 397,068 |
| Total B & W | | | \$1,723,526 |
| Total identifiable assets | | | \$2,592,157 |
| Investment in net assets of vertically integrated affiliated companies | | | |
| - The Company | \$16,299 | | 16,299 |
| - B & W | | | 2,390 |
| Corporate assets. | | | 571,961 |
| Total assets at March 31, 1978. | | | \$3,182,807 |

2. Information about the Company's Operations in Different Geographic Areas

| | UNITED STATES | FOREIGN | CONSOLIDATED |
|---|---------------------------|------------------|--------------------|
| | (In thousands of dollars) | | |
| Revenues | \$ 638,556 | \$655,155 | \$1,293,711 |
| Transfers between geographic areas | 28,560 | (28,560) | -- |
| Total revenues | <u>\$ 667,116</u> | <u>\$626,595</u> | <u>\$1,293,711</u> |
| Operating income | <u>\$ 128,260</u> | <u>\$ 92,663</u> | \$ 220,923 |
| Equity in earnings of affiliated companies | <u>\$ 20,364</u> | <u>\$ 3,554</u> | 23,918 |
| General corporate expenses | | | (23,155) |
| Interest expense | | | (26,887) |
| Interest income | | | 34,124 |
| Other income (expense) | | | <u>11,164</u> |
| Income before provision for income taxes | | | <u>\$ 240,087</u> |
| Identifiable assets at March 31, 1978 | | | |
| - The Company | \$ 340,026 | \$528,605 | \$ 868,631 |
| - B & W | <u>1,237,607</u> | <u>88,851</u> | <u>1,326,458</u> |
| | <u>\$1,577,633</u> | <u>\$617,456</u> | <u>\$2,195,089</u> |
| - Excess of cost over fair value of net assets of B & W not yet allocated. | | | <u>\$ 397,068</u> |
| Total identifiable assets. | | | \$2,592,157 |
| Investment in net assets of vertically integrated affiliated companies. | | <u>\$ 18,689</u> | 18,689 |
| Corporate assets | | | <u>571,961</u> |
| Total assets at March 31, 1978 | | | <u>\$3,182,807</u> |

NOTE 13 - QUARTERLY FINANCIAL DATA (Unaudited)

The following tables set forth selected quarterly financial information for the years ended March 31, 1978 and 1977:

| | 1978 | | | |
|----------------------------|--|-------------------|------------------|-------------------|
| | Quarter Ended | | | |
| | June 30, 1977 | Sept. 30, 1977 | Dec. 31, 1977 | March 31, 1978 |
| | (In thousands of dollars except per share amounts) | | | |
| Revenues | \$298,852 | \$324,972 | \$448,869 | \$221,018 |
| Operating income | 69,448 | 61,513 | 52,293 | 14,514 |
| Equity in earnings of B&W | - | 3,195 | 7,341 | 9,828 |
| Net income | 45,647 | 46,581 | 49,779 | 17,085 |
| Earnings per common share: | | | | |
| Primary | 1.45 | 1.48 | 1.57 | 0.53 |
| Fully diluted | 1.41 | 1.44 | 1.54 | 0.53 |

| | 1977 | | | |
|----------------------------|--|-------------------|------------------|-------------------|
| | Quarter Ended | | | |
| | June 30, 1976 | Sept. 30, 1976 | Dec. 31, 1976 | March 31, 1977 |
| | (In thousands of dollars except per share amounts) | | | |
| Revenues | \$267,735 | \$396,658 | \$301,676 | \$257,772 |
| Operating income | 53,881 | 78,023 | 72,989 | 54,738 |
| Net income | 37,097 | 56,249 | 58,049 | 40,247 |
| Earnings per common share: | | | | |
| Primary | 1.19 | 1.79 | 1.85 | 1.28 |
| Fully diluted | 1.15 | 1.74 | 1.79 | 1.24 |

NOTE 14 - REPLACEMENT COST DATA (Unaudited)

In compliance with Securities and Exchange Commission Accounting Series Release No. 190, the Company has estimated current replacement cost of plant and equipment, depreciation, and the consequent effects on depreciation expense and cost of sales. The Company has provided replacement cost data for all domestic and foreign operations. In the Company's view, the replacement cost data set forth below has been estimated in a reasonable manner; however, it is also management's opinion that these estimates are of limited value because of the subjectivity involved in

their development under the present guidelines.

Replacement cost information is based on the hypothetical assumption that the Company would replace its entire inventory and productive capacity at the end of the current year. This assumption requires management to contemplate many actions at each year end that normally would not be considered concurrently. Therefore, the reader should not infer that the Company actually has present plans to replace its productive capacity or that actual replacement would or could occur in the manner assumed. In the normal course of business, the Company replaces or improves its productive capacity over an extended period of time. Decisions concerning such replacements are made in light of conditions existing at the time such determinations are made and could differ substantially from the assumptions upon which the information included herein was based.

The Company also cautions that the following replacement cost information does not purport to represent the current fair market value of its existing facilities, nor is it indicative of the amounts for which assets could be sold.

The Company has provided replacement cost estimates for all of its productive capacity currently in service. In conformance with SEC instructions, replacement cost is not presented for land, or for construction in progress which was not productive capacity at March 31, 1977 or 1978.

Replacement cost for most buildings were derived by applying an estimated current cost per square foot based upon published construction cost data adjusted as necessary by experience from recent construction activity within the Company. Replacement cost for other buildings was derived using building cost indices. Exceptions to this approach were made for specially constructed buildings for which general construction cost information was not deemed to be appropriate. Replacement cost for these specially constructed buildings or special components thereof were derived generally by engineering estimates.

Replacement cost for machinery and equipment was estimated on the basis of quoted market prices, recent purchase experience, engineering estimates or historical cost adjusted for published price indices as considered appropriate in the circumstances.

Depreciation based on the replacement cost of productive capacity has been estimated on a straight line basis using the same estimates of useful life and salvage value utilized in preparing the historical cost financial statements. Average replacement cost of productive capacity at the beginning and end of the year was used in determining the basis upon which depreciation expense was computed.

The replacement cost of inventories has been based upon estimates of the current costs of the applicable material, labor, and overhead at March 31, 1977 and 1978.

Total cost and expenses includes cost of operations, depreciation and selling, general and administrative expenses. The Company designs, fabricates and constructs construction projects to customers' specifications and generally does not expend efforts until a contract is received from the customer. All costs included in historical cost of operations are by nature replacement cost at the time of the billing except for depreciation and materials charges from non-LIFO inventories.

The merger with B & W impacts March 31, 1978 historical and replacement cost asset totals. For historical cost purposes, B & W's assets were valued at fair market value at the date of acquisition. For replacement cost purposes, B & W's assets were valued in the manner previously described.

Replacement cost estimates with comparable historical totals are as follows:

March 31,

| | 1977 | | 1978 | |
|---|----------------------------|---|----------------------------|---|
| | <u>Historical Cost</u> | <u>Estimated Replace- ment Cost</u> (In millions of dollars) | <u>Historical Cost</u> | <u>Estimated Replace- ment Cost</u> |
| Property, plant & equipment: | | | | |
| Productive capacity for which replacement cost data are provided | \$ 722 | \$1,278 | \$1,106 | \$3,110 |
| Accumulated depreciation | <u>(289)</u> | <u>(618)</u> | <u>(347)</u> | <u>(1,857)</u> |
| | 433 | <u>\$ 660</u> | 759 | <u>\$1,253</u> |
| Construction in progress | 21 | | 97 | |
| Land | <u>12</u> | | <u>36</u> | |
| Net property, plant & equip- ment as shown in accompany- ing consolidated balance sheet | <u>\$ 466</u> | | <u>\$ 892</u> | |
| Inventories | <u>\$ 51</u> | <u>\$ 62</u> | <u>\$ 332</u> | <u>\$ 341</u> |
| Depreciation expense | <u>\$ 63</u> | <u>\$ 98</u> | <u>\$ 67</u> | <u>\$ 106</u> |
| Total cost and expenses | <u>\$ 964</u> | <u>\$ 999</u> | <u>\$1,096</u> | <u>\$1,135</u> |

The replacement cost information presented above does not reflect all the effects of inflation and other economic factors on the Company's current costs and expenses, and consideration of the effects on assets other than inventories and productive capacity is not required. It is not practicable to estimate related effects on other costs, compliance with environmental regulation, product quality or other factors which could result from total replacement of the Company's property. Furthermore, the above replacement cost information standing alone does not recognize the relationship between cost changes and changes in selling prices. Although, when replacing productive capacity, the Company has been subject to higher replacement costs and increased operating costs as a result of inflation, it has generally been able to compensate for such increases by increasing prices for its products and services. Competitive conditions permitting, the Company expects to

modify its selling prices to recognize future cost changes. Furthermore, while the replacement cost of productive assets has been increasing in recent years, there has been a corresponding decline in the purchasing power of the dollar used to repay the long-term obligations which were used to acquire assets. Because of these and other limitations the Company believes that the use of replacement cost information to determine an income effect on its operations could be misleading.

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
SUPPLEMENTARY INFORMATION
FOR THE FISCAL YEARS ENDED MARCH 31, 1977 AND 1978
IN THOUSANDS OF DOLLARS

| Temporary investments consist of: | <u>1977</u> | <u>1978</u> |
|-----------------------------------|------------------|------------------|
| Certificates of deposit | \$ 62,049 | \$ 41,248 |
| Commerical paper | 11,961 | - |
| Time deposits | 403,290 | 523,356 |
| Repurchase agreements | 46,083 | 17,966 |
| Deposit in call accounts | <u>3,908</u> | <u>12,580</u> |
| | <u>\$527,291</u> | <u>\$595,150</u> |

| Accrued liabilities consist of: | <u>1977</u> | <u>1978</u> |
|---|------------------|------------------|
| Employee benefits | \$ 17,631 | \$ 63,885 |
| Payroll | 6,244 | 17,451 |
| Equipment demobilization and drydocking | 20,927 | 16,115 |
| Interest | 6,060 | 12,739 |
| Taxes - other than income | 13,191 | 10,248 |
| Other | <u>29,652</u> | <u>136,306</u> |
| | <u>\$ 93,705</u> | <u>\$256,744</u> |

| Interest expense consists of: | <u>1977</u> | <u>1978</u> |
|-------------------------------|------------------|------------------|
| Long-term debt | \$ 14,615 | \$ 26,222 |
| Other | <u>1,542</u> | <u>665</u> |
| | <u>\$ 16,157</u> | <u>\$ 26,887</u> |

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 SCHEDULE V - PROPERTY, PLANT AND EQUIPMENT
 FOR THE FISCAL YEAR ENDED MARCH 31, 1977
 IN THOUSANDS OF DOLLARS

| <u>CLASSIFICATION</u> | <u>BALANCE BEGINNING OF YEAR</u> | <u>ADDITIONS</u> | <u>RETIREMENTS OR SALES</u> | <u>OTHER CHARGES</u> | <u>BALANCE END OF YEAR</u> |
|--------------------------------|--|------------------|---------------------------------|--------------------------|------------------------------------|
| Land | \$ 7,545 | \$ 3,999 | \$ -- | \$ -- | \$ 11,544 |
| Buildings | 52,628 | 6,022 | 97 | (971) | 57,582 |
| Machinery and equipment | 570,127 | 95,627 | 2,502 | 971 | 664,223 |
| Property under construction | <u>63,674</u> | <u>(41,991)</u> | <u>--</u> | <u>(243) (1)</u> | <u>21,440</u> |
| | <u>\$693,974</u> | <u>\$63,657</u> | <u>\$ 2,599</u> | <u>\$(243)</u> | <u>\$754,789</u> |

(1) Transfer of excess material to inventories.

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
SCHEDULE V - PROPERTY, PLANT AND EQUIPMENT
FOR THE FISCAL YEAR ENDED MARCH 31, 1978
IN THOUSANDS OF DOLLARS

| <u>CLASSIFICATION</u> | <u>BALANCE BEGINNING OF YEAR</u> | <u>ADDITIONS</u> | | <u>RETIREMENTS OR SALES</u> | <u>BALANCE END OF YEAR</u> |
|--------------------------------|--|------------------|---------------------------|---------------------------------|------------------------------------|
| | | <u>B & W</u> | <u>OTHERS AT COST</u> | | |
| Land | \$ 11,544 | \$ 24,533 | \$ -- | \$ -- | \$ 36,077 |
| Buildings | 57,582 | 111,712 | 5,154 | 58 | 174,390 |
| Machinery and equipment | 664,223 | 240,079 | 38,235 | 11,305 | 931,226 |
| Property under construction | <u>21,440</u> | <u>34,088</u> | <u>41,586</u> | <u>--</u> | <u>97,114</u> |
| | <u>\$754,789</u> | <u>\$410,412</u> | <u>\$84,975</u> | <u>\$11,363</u> | <u>\$1,238,807</u> |

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 SCHEDULE VI - ACCUMULATED DEPRECIATION
 FOR THE FISCAL YEAR ENDED MARCH 31, 1977
 IN THOUSANDS OF DOLLARS

| <u>CLASSIFICATION</u> | <u>BALANCE BEGINNING OF YEAR</u> | <u>ADDITIONS</u> | <u>RETIREMENTS OR SALES</u> | <u>OTHER CHARGES</u> | <u>BALANCE END OF YEAR</u> |
|-------------------------|--|------------------|---------------------------------|--------------------------|------------------------------------|
| Buildings | \$ 15,345 | \$ 5,904 | \$ 95 | \$ 408 | \$ 21,562 |
| Machinery and equipment | <u>212,666</u> | <u>57,100</u> | <u>2,280</u> | <u>(408)</u> | <u>267,078</u> |
| | <u>\$228,011</u> | <u>\$63,004</u> | <u>\$2,375</u> | <u>\$ --</u> | <u>\$288,640</u> |

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 SCHEDULE VI - ACCUMULATED DEPRECIATION
 FOR THE FISCAL YEAR ENDED MARCH 31, 1978
 IN THOUSANDS OF DOLLARS

| <u>CLASSIFICATION</u> | <u>BALANCE BEGINNING OF YEAR</u> | <u>ADDITIONS</u> | <u>RETIREMENTS OR SALES</u> | <u>BALANCE END OF YEAR</u> |
|-------------------------|--|------------------|---------------------------------|------------------------------------|
| Buildings | \$ 21,562 | \$ 3,728 | \$ 49 | \$ 25,241 |
| Machinery and equipment | <u>267,078</u> | <u>63,614</u> | <u>8,707</u> | <u>321,985</u> |
| | <u>\$288,640</u> | <u>\$67,342</u> | <u>\$8,756</u> | <u>\$347,226</u> |

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 SCHEDULE VII - INTANGIBLE ASSETS
 FOR THE FISCAL YEARS ENDED MARCH 31, 1977 AND 1978
 IN THOUSANDS OF DOLLARS

| <u>DESCRIPTION</u> | <u>BALANCE BEGINNING OF YEAR</u> | <u>ADDITIONS</u> | <u>DEDUCTIONS</u> | <u>BALANCE END OF YEAR</u> |
|---|--|-------------------|-------------------|------------------------------------|
| Fiscal Year Ended March 31, 1977: | | | | |
| Excess of cost over fair value of net assets of purchased business | \$ 6,252 | \$ - | \$ - | \$ 6,252 |
| Unamortized debt issuance costs (1) | <u>1,476</u> | <u>-</u> | <u>159</u> | <u>1,317</u> |
| | <u>\$ 7,728</u> | <u>\$ -</u> | <u>\$ 159</u> | <u>\$ 7,569</u> |
| Fiscal Year Ended March 31, 1978: | | | | |
| Excess of cost over fair value of net assets of purchased business | \$ 6,252 | \$ 399,764 (2) | \$ 2,696 (3) | \$ 403,320 |
| Unamortized debt issuance costs (1) | 1,317 | - | 272 | 1,045 |
| Patents (1) | - | 10,221 | - | 10,221 |
| Trademarks (1) | - | 3,350 | - | 3,350 |
| Licenses (1) | <u>-</u> | <u>11,183</u> | <u>-</u> | <u>11,183</u> |
| | <u>\$ 7,569</u> | <u>\$ 424,518</u> | <u>\$ 2,968</u> | <u>\$ 429,119</u> |

(1) Included in other assets in the consolidated balance sheet.

(2) Represents the excess cost over fair value of net assets acquired of B & W.

(3) Represents amortization of additions subsequent to October 1970.

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
SCHEDULE XII - RESERVES
FOR THE FISCAL YEARS ENDED MARCH 31, 1977 AND 1978
IN THOUSANDS OF DOLLARS

| DESCRIPTION | BALANCE BEGINNING OF YEAR | CHARGED TO COST & EXPENSES | DEDUCTIONS | BALANCE END OF YEAR |
|---|---------------------------------|----------------------------------|-----------------|---------------------------|
| Fiscal Year Ended March 31, 1977: | | | | |
| Equipment demobilization and drydocking reserve | \$ 17,656 | \$ 14,724 | \$ 8,134 | \$ 24,246 |
| Less amount in current liabilities | 14,385 | | | 20,927 (2) |
| | <u>\$ 3,271</u> | | | <u>\$ 3,319 (1)</u> |
| Accrued liabilities for losses and damages | <u>\$ 7,076</u> | <u>\$ 7,503</u> | <u>\$ 4,541</u> | <u>\$ 10,038 (1)</u> |
| Supplemental compensation plan | \$ 10,389 | \$ 8,635 | \$ 1,027 | \$ 17,998 |
| Less amount in current liabilities | 584 | | | 888 (2) |
| | <u>\$ 9,805</u> | | | <u>\$ 17,110 (1)</u> |
| Fiscal Year Ended March 31, 1978: | | | | |
| Equipment demobilization and drydocking reserve | \$ 24,246 | \$ 12,475 | \$ 16,478 | \$ 20,243 |
| Less amount in current liabilities | 20,927 | | | 16,115 (2) |
| | <u>\$ 3,319</u> | | | <u>\$ 4,128 (1)</u> |
| Accrued liabilities for losses and damages | \$ 10,038 | \$ 13,057 | \$ 3,632 | \$ 19,463 |
| Less amount in current liabilities | - | | | 3,500 (2) |
| | <u>\$ 10,038</u> | | | <u>\$ 15,963 (1)</u> |
| Supplemental compensation plan | \$ 17,998 | \$ 6,919 | \$ 1,319 | \$ 23,598 |
| Less amount in current liabilities | 888 | | | 1,347 (2) |
| | <u>\$ 17,110</u> | | | <u>\$ 22,251 (1)</u> |

(1) Included in other liabilities in the consolidated balance sheet.

(2) Included in accrued liabilities in the consolidated balance sheet.

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 SCHEDULE XVI - SUPPLEMENTARY INCOME STATEMENT INFORMATION
 FOR THE FISCAL YEARS ENDED MARCH 31, 1977 AND 1978
 IN THOUSANDS OF DOLLARS

| | <u>1977</u> | <u>1978</u> |
|--------------------------------|-----------------|-----------------|
| Maintenance and repairs | <u>\$60,834</u> | <u>\$56,012</u> |
| Taxes, other than income taxes | <u>\$14,912</u> | <u>\$ 7,706</u> |
| Rents | <u>\$71,793</u> | <u>\$84,619</u> |

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 CALCULATIONS OF EARNINGS PER COMMON SHARE ASSUMING FULL DILUTION (1)
 FOR THE FISCAL YEARS ENDED MARCH 31,
 IN THOUSANDS OF DOLLARS, EXCEPT PER SHARE AMOUNTS

| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
|---|------------------|------------------|------------------|------------------|------------------|
| Income before extraordinary items and cumulative effect of accounting change | \$ 35,021 | \$ 76,447 | \$155,274 | \$191,510 | \$159,092 |
| Adjustment of interest and amortization of debt issuance expense on 4-1/4% Convertible Subordinated Debentures (net of taxes on income) | 489 | -- | -- | -- | -- |
| Adjustment of interest and amortization of debt issuance expense on 4-3/4% Convertible Subordinated Debentures (net of taxes on income) | <u>632</u> | <u>501</u> | <u>475</u> | <u>444</u> | <u>304</u> |
| Income applicable to common stock before extraordinary items and cumulative effect of accounting change | 36,142 | 76,948 | 155,749 | 191,954 | 159,396 |
| Extraordinary items | | | 4,910 | 132 | |
| Cumulative effect of accounting change (net of taxes on income) | <u>(3,023)</u> | <u>--</u> | <u>--</u> | <u>--</u> | <u>--</u> |
| Income applicable to common stock | <u>\$ 33,119</u> | <u>\$ 76,948</u> | <u>\$160,659</u> | <u>\$192,086</u> | <u>\$159,396</u> |
| Earnings per common share - assuming full dilution: | | | | | |
| Before extraordinary items and cumulative effect of accounting change | \$ 1.13 | \$ 2.39 | \$ 4.80 | \$ 5.93 | \$ 4.92 |
| Extraordinary items | -- | -- | 0.15 | -- | -- |
| Cumulative effect of accounting change (net of taxes on income) | <u>(0.09)</u> | <u>--</u> | <u>--</u> | <u>--</u> | <u>--</u> |
| Net income | <u>\$ 1.04</u> | <u>\$ 2.39</u> | <u>\$ 4.95</u> | <u>\$ 5.93</u> | <u>\$ 4.92</u> |

Continued on following page

EXHIBIT I CONTINUED

J. RAY McDERMOTT & CO., INC. AND SUBSIDIARIES
 CALCULATIONS OF EARNINGS PER COMMON SHARE ASSUMING FULL DILUTION (1)
 FOR THE FISCAL YEARS ENDED MARCH 31,

| | <u>1974</u> | <u>1975</u> | <u>1976</u> | <u>1977</u> | <u>1978</u> |
|--|-------------------|-------------------|-------------------|-------------------|-------------------|
| Weighted average number of common shares outstanding during year | 27,852,508 | 30,891,736 | 31,247,192 | 31,342,492 | 31,670,106 |
| Common stock equivalents of stock options based on "treasury stock" method | <u>--</u> | <u>--</u> | <u>--</u> | <u>--</u> | <u>817</u> |
| Weighted average number of primary shares outstanding | 27,852,508 | 30,891,736 | 31,247,192 | 31,342,492 | 31,670,923 |
| Shares applicable to 4-1/4% Convertible Subordinated Debentures due 1997 issued August 31, 1972 | 2,502,048 | -- | -- | -- | -- |
| Shares applicable to 4-3/4% Convertible Subordinated Debentures due 1987 issued October 26, 1972 | 1,595,360 | 1,226,012 | 1,169,682 | 1,072,770 | 740,739 |
| Shares applicable to Series A \$2.20 Cumulative Convertible Preferred Stock | <u>--</u> | <u>--</u> | <u>--</u> | <u>--</u> | <u>17,309</u> |
| Weighted average number of shares outstanding - assuming full dilution | <u>31,949,916</u> | <u>32,117,748</u> | <u>32,416,874</u> | <u>32,415,262</u> | <u>32,428,971</u> |

(1) Earnings per share computations reflect two-for-one common stock splits on June 20, 1975 and December 15, 1977

J. RAY McDERMOTT & CO., INC.

AMENDMENT TO CERTIFICATE OF INCORPORATION

RESOLVED that it is advisable to amend ARTICLE FOURTH of the Corporation's Certificate of Incorporation for the purpose of effectuating an increase in the Corporation's authorized capital stock, said amendment to be effected by striking ARTICLE FOURTH in its entirety and inserting the following in its place:

FOURTH. The total number of shares of all classes of stock which the Corporation shall have authority to issue is 85,000,000 shares, of which 25,000,000 shares shall be Preferred Stock with a par value of \$1.00 per share and 60,000,000 shares shall be Common Stock with a par value of \$1.00 per share.

PART A. Provisions Relating to Preferred Stock.

1. The Preferred Stock may be issued from time to time in one or more series, each of such series to have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative, participating, optional or other special rights, and qualifications limitations or restrictions thereof, as are stated and expressed herein and in the resolution or resolutions providing for the issue of such series adopted by the Board of Directors as hereinafter provided.

2. Authority is hereby expressly granted to the Board of Directors, subject to the provisions of this Part A, to authorize the issue of one or more series of Preferred Stock and with respect to each series to fix by resolution or resolutions providing for the issue of such series:

(a) The number of shares to constitute such series and the distinctive designation thereof, provided that unless stated in any resolution or resolutions relating to such series, such number of shares may be increased or decreased by the Board of Directors in connection with any classification or reclassification of unissued shares of Preferred Stock;

(b) The annual dividend rate on the shares of such series and the date or dates from which dividends shall accumulate as herein provided;

(c) Whether or not the shares of such series shall be subject to redemption, the limitations and restrictions with respect to such redemption, if any, and the times of redemption of the shares of such series and the prices which the holders of such series shall be entitled to receive upon the redemption thereof, which prices may vary at different redemption dates and may also be different with respect to shares redeemed through the operation of any retirement or sinking fund than with respect to shares otherwise redeemed;

(d) The amount which the holders of such series shall be entitled to receive upon the voluntary or involuntary liquidation, dissolution or winding up of the Corporation;

(e) Whether or not the shares of such series shall be subject to the operation of a retirement or sinking fund, and, if so, the extent to and manner in which it shall be applied to the purchase or redemption of the shares of such series for retirement or to other corporate purposes and the terms and provisions relative to the operation thereof;

(f) Whether or not the shares of such series shall be convertible into, or exchangeable for, shares of stock of any other class or classes, or of any other series of the same class, and if so convertible or exchangeable, the price or prices or the rate or rates of conversion or exchange and the method, if any, of adjusting the same, and the other terms and conditions of such conversion or exchange;

(g) The voting rights, if any, of holders of shares of such series in addition to the voting rights provided for in this Part A and by applicable law;

(h) The limitations and restrictions, if any, in addition to those provided in paragraph 11(a) hereof, to be effective while any shares of such series are outstanding upon the payment of dividends or making of other distributions on, and upon the purchase, redemption or other acquisition by the Corporation of the Common Stock or any other class or classes of stock of the Corporation ranking junior to the shares of such series;

(i) The conditions or restrictions, if any, upon the creation of indebtedness of the Corporation or upon the issue of any additional stock (including additional shares of such series or of any other series or of any other class) ranking on a parity with or prior to the shares of such series as to dividends or upon liquidation; and

(j) Any other preferences and relative, participating, optional, or other special rights, and qualifications, limitations or restrictions thereof, as shall not be inconsistent with this Part A of Article Fourth.

3. All shares of any one series of Preferred Stock shall be identical with each other in all respects, except that shares of any one series issued at different times may differ as to the dates from which dividends thereon shall be cumulative; and all series shall rank equally and be identical in all respects, except as permitted by the foregoing provisions of paragraph 2 of this Part A.

4. Before any dividends or distribution in cash or other property (other than dividends payable in stock ranking junior to the Preferred Stock) on any class or classes of stock of the Corporation ranking junior to the Preferred Stock as to dividends or on liquidation shall be declared or paid or set apart for payment, the holders of shares of Preferred Stock of each series shall be entitled to receive cash dividends, when and as declared by the Board of Directors, at the annual rate, and no more, fixed in the resolution or resolutions adopted by the Board of Directors providing for the issue of such series, payable in each year on such dates as may be fixed in such resolution or resolutions to holders of record on the respective dates not exceeding sixty days preceding such dividend payment dates as may be determined by the Board of Directors in advance of the payment of each particular dividend. With respect to each series of the Preferred Stock such dividends shall be cumulative from the date or dates fixed in the resolution or resolutions adopted by the Board of Directors providing for the issue of such series, which date or dates shall in no instance be more than ninety days before or after the date of the issuance of the particular shares of such series then to be issued. No dividends shall be declared on any series of Preferred Stock in respect of any dividend period unless there shall likewise be or have been declared on all shares of Preferred Stock of each other series at the time outstanding like dividends for all dividend periods coinciding with or ending before such dividend period, ratably in proportion to the respective annual dividend rates per annum fixed therefor as hereinbefore provided. Accruals of dividends shall not bear interest.

5. In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Corporation, before any payment or distribution of the assets of the Corporation (whether capital or surplus) shall be made to or set apart for the holders of any class or classes of stock of the Corporation ranking junior to the Preferred Stock upon liquidation, the holders of the shares of each series of the Preferred Stock shall be entitled to receive payment of the amount payable upon such liquidation, dissolution or winding up as fixed in the resolution or resolutions adopted by the Board of Directors providing for the issue of such series for the shares of the respective series to the date of final distribution to such holders, but they shall be entitled to no further payment. If, upon any liquidation, dissolution or winding up of the Corporation, the assets of the Corporation, or proceeds thereof, distributable among the holders of the Preferred Stock shall be insufficient to pay

in full the preferential amount aforesaid, then such assets, or the proceeds thereof, shall be distributed among such holders ratably in accordance with the respective amounts which would be payable on such shares if all amounts payable thereon were paid in full. For the purposes of this paragraph 5, the voluntary sale, lease, exchange or transfer (for cash, shares of stock, securities, or other consideration) of all or substantially all of the property or assets of the Corporation to, or a consolidation or merger of the Corporation with, one or more corporations (whether or not the Corporation is the corporation surviving such consolidation or merger) shall not be deemed to be a liquidation, dissolution or winding up, voluntary or involuntary.

6. The Corporation, at the option of the Board of Directors, may, at any time permitted by the resolution or resolutions adopted by the Board of Directors providing for the issue of any series of the Preferred Stock and at the redemption price or prices stated in said resolution or resolutions, redeem the whole or any part of the shares of such series at the time outstanding (the total sum, including accrued dividends, so payable on any such redemption being herein referred to as the "redemption price"). Notice of every such redemption shall be mailed to the holders of record of the shares of Preferred Stock so to be redeemed at their respective addresses as the same shall appear on the books of the Corporation. Such notice shall be mailed at least 30 but not more than 90 days in advance of the date designated for such redemption to the holders of record of shares so to be redeemed. In case of the redemption of a part only of any series of Preferred Stock at the time outstanding, the shares of such series so to be redeemed shall be selected by lot or in such other manner as the Board of Directors may determine to be equitable.

7. If, on the redemption date specified in such notice, the funds necessary for such redemption shall have been set aside by the Corporation, separate and apart from its other funds, in trust for the pro rata benefit of the holders of the shares so called for redemption, then, notwithstanding that any certificates for shares of Preferred Stock so called for redemption shall not have been surrendered for cancellation, the shares represented thereby shall no longer be deemed outstanding, the right to receive dividends thereon shall cease to accrue from and after the date of redemption so designated and all rights of holders of the shares of Preferred Stock so called for redemption shall forthwith, after such redemption date, cease and terminate, excepting only the right of the holders thereof to receive the redemption price therefor but without interest. Any moneys so set aside by the Corporation and unclaimed at the end of four years from the date designated for such redemption shall revert to the general funds of the Corporation, after which reversion the holders of such shares so called for redemption shall look only to the Corporation for payment of the redemption price. Any interest accrued on funds so deposited shall be paid to the Corporation from time to time.

8. If, after the giving of such notice but before the redemption date specified therein, the Corporation shall deposit with a bank or trust company in the Borough of Manhattan, the City of New York, having a capital and surplus of at least \$50,000,000, in trust to be applied to the redemption of the shares of Preferred Stock so called for redemption, the funds necessary for such redemption, then from and after the date of such deposit all rights of the holders of the shares of Preferred Stock so called for redemption shall cease and terminate, excepting only the right to receive the redemption price therefor, but without interest, and the right to exercise on or before the date designated for redemption privileges of conversion or exchange, if any, not theretofore expired, and such shares shall not be deemed to be outstanding. Any funds so deposited which shall not be required for such redemption because of the exercise of any such right of conversion or exchange subsequent to the date of such deposit shall be returned to the Corporation. In case the holders of shares of Preferred Stock which shall have been called for redemption shall not, within four years after the date fixed for redemption, claim the amount deposited with respect to the redemption thereof, any such bank or trust company shall, to the extent permitted by applicable law, upon demand, pay over to the Corporation such unclaimed amounts and thereupon such bank or trust company shall be relieved of all responsibility in respect thereof to such holder and such holder shall look only to the Corporation

for the payment thereof. Any interest accrued on funds so deposited shall be paid to the Corporation from time to time.

9. Shares of Preferred Stock which have been issued and reacquired in any manner by the Corporation (excluding, until the Corporation elects to retire them, shares which are held as treasury shares but including shares redeemed, shares purchased and retired, whether through the operation of a retirement or sinking fund, or otherwise, and shares which, if convertible or exchangeable, have been converted into or exchanged for shares of stock of any other class or classes or series) may, subject to any applicable provisions of the laws of the State of Delaware, have the status of authorized and unissued shares of Preferred Stock and be reissued as a part of the series of which they were originally a part or be reclassified and reissued as part of a new series of Preferred Stock to be created by resolution or resolutions of the Board of Directors or as part of any other series of Preferred Stock, all subject to the conditions or restrictions on issuance set forth in any resolution or resolutions adopted by the Board of Directors providing for the issue of any series of Preferred Stock.

10. If at any time the Corporation shall have failed to pay dividends in full on the Preferred Stock, thereafter and until dividends in full, including all accrued and unpaid dividends on the Preferred Stock outstanding, shall have been declared and set apart for payment or paid, (a) the Corporation, without the affirmative vote or consent of the holders of at least 66 $\frac{2}{3}$ % in interest of the Preferred Stock at the time outstanding, regardless of series, given in person or by proxy, either in writing or by resolution adopted at an annual or special meeting called for the purpose, at which the holders of the Preferred Stock, regardless of series, shall vote separately as a class, shall not redeem less than all of the Preferred Stock at such time outstanding, other than in accordance with paragraph 16 hereof, and (b) the Corporation shall not purchase any Preferred Stock except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of Preferred Stock of all series upon such terms as the Board of Directors, in their sole discretion after consideration of the respective annual dividend rates and other relative rights and preferences of the respective series, shall determine (which determination shall be final and conclusive) will result in fair and equitable treatment among the respective series; provided, that (i) unless prohibited by the provisions applicable to any series, the Corporation, to meet the requirements of any retirement or sinking fund provisions with respect to any series, may use shares of such series acquired by it prior to such failure and then held by it as treasury stock and (ii) nothing shall prevent the Corporation from completing the purchase or redemption of shares of Preferred Stock for which a purchase contract was entered into for any retirement or sinking fund purposes, or the notice of redemption of which was initially published, prior to such default.

11. So long as any of the Preferred Stock is outstanding the Corporation will not

(a) Declare, or pay, or set apart for payment, any dividends (other than dividends payable in stock ranking junior to the Preferred Stock) or make any distribution on any other class or classes of stock of the Corporation ranking junior to the Preferred Stock either as to dividends or upon liquidation and will not redeem, purchase or otherwise acquire, any shares of any such junior class if at the time of making such declaration, payment, distribution, redemption, purchase or acquisition the Corporation shall be in default with respect to any dividend payable on, or any obligation to retire shares of, Preferred Stock, provided that, notwithstanding the foregoing, the Corporation may at any time redeem, purchase or otherwise acquire shares of stock of any such junior class in exchange for, or out of the net cash proceeds from the sale of, other shares of stock of any junior class;

(b) Without the affirmative vote or consent of the holders of at least 66 $\frac{2}{3}$ % of all the Preferred Stock at the time outstanding, regardless of series, given in person or by proxy, either in writing or by resolution adopted at an annual or special meeting called for the purpose, at which the holders of the Preferred Stock, regardless of series, shall vote separately as a class,

amend, alter or repeal any of the provisions of this Part A so as adversely to affect the preferences, rights, or powers of the Preferred Stock; provided, that the creation of any class of stock ranking prior to the Preferred Stock either as to dividends or upon liquidation or any increase in the authorized number of shares of any such class of stock shall not be deemed to adversely affect the preferences, rights or powers of the Preferred Stock within the meaning of this subparagraph (b);

(c) Without the affirmative vote or consent of the holders of at least 50% of all the Preferred Stock at the time outstanding, regardless of series, given in person or by proxy, either in writing or by resolution adopted at an annual or special meeting called for the purpose, at which the holders of the Preferred Stock, regardless of series, shall vote separately as a class, create any class or classes of stock ranking prior to the Preferred Stock either as to dividends or upon liquidation, or increase the authorized number of shares of any such class of stock; or

(d) Without the affirmative vote or consent of the holders of at least 66 $\frac{2}{3}$ % of any series of the Preferred Stock at the time outstanding, given in person or by proxy, either in writing or by resolution adopted at an annual or special meeting called for the purpose, at which the holders of such series of the Preferred Stock shall vote separately as a series, amend, alter or repeal any of the provisions in the resolution or resolutions adopted by the Board of Directors providing for the issue of such series so as adversely to affect the preferences, rights or powers of the Preferred Stock of such series;

provided, however, any vote or consent required by subparagraph (b) above may, to the extent permitted by applicable law, be given and made effective by the filing of an appropriate amendment of the Corporation's Certificate of Incorporation without obtaining the vote or consent of the holders of the Common Stock of the Corporation, the right to give such vote or consent being expressly waived, to the extent permitted by applicable law, by all holders of such Common Stock unless the action to be taken would substantially adversely affect the rights or powers of the Common Stock; and provided, further, any vote or consent required by subparagraph (d) above may, to the extent permitted by applicable law, be given and made effective by the filing of an appropriate amendment of the Corporation's Certificate of Incorporation without obtaining the vote or consent of the holders of any other series of Preferred Stock or of the holders of the Common Stock of the Corporation, the right to give such vote or consent being expressly waived, to the extent permitted by applicable law, by all holders of such other series of Preferred Stock and Common Stock, unless the action to be taken would substantially adversely affect the rights or powers of such other series of Preferred Stock or Common Stock, as the case may be.

12. Whenever dividends payable on the Preferred Stock shall be in default in an aggregate amount equivalent to six full quarterly dividends, the holders of the Preferred Stock shall have the exclusive and special right, voting separately as a class and without regard to series, to elect two directors of the Corporation. Such right shall be in addition to any rights which the holders of the Preferred Stock may have in the absence of such default to vote in the election of directors. Whenever such right of the holders of the Preferred Stock shall have vested such right may be exercised initially either at a special meeting of such holders of the Preferred Stock called as provided in paragraph 13, or at any annual meeting of stockholders, and thereafter at annual meetings of stockholders. The right of the holders of the Preferred Stock voting separately as a class to elect members of the Board of Directors of the Corporation as aforesaid shall continue until such time as all dividends accumulated on the Preferred Stock shall have been paid in full, at which time the special right of the holders of the Preferred Stock so to vote separately as a class for the election of directors shall terminate, subject to revesting in the event of each and every subsequent default in an aggregate amount equivalent to six full quarterly dividends.

13. At any time when such special voting power shall have vested in the holders of the Preferred Stock as provided in paragraph 12, a proper officer of the Corporation shall, upon the written request of the holders of record of at least 10% of the Preferred Stock then outstanding, regardless of series, addressed to the Secretary of the Corporation, call a special meeting of the holders of the Preferred Stock and of any other class or classes of stock having voting power, for the purpose of electing directors. Such meeting shall be held at the earliest practicable date at such place as may be specified in the notice of meeting. If such meeting shall not be called by the proper officers of the Corporation within twenty days after personal service of said written request upon the Secretary of the Corporation, or within twenty days after mailing the same within the United States of America, by registered or certified mail addressed to the Secretary of the Corporation at its principal office, then the holders of record of at least 10% of the Preferred Stock then outstanding, regardless of series, may designate in writing one of their number to call such meeting at the expense of the Corporation, and such meeting may be called by such person so designated upon the notice required for annual meetings of stockholders and shall be held at the place for the holding of annual meetings of stockholders of the Corporation. Any holder of Preferred Stock so designated shall have access to the stock books of the Corporation for the purpose of causing meetings of stockholders to be called pursuant to these provisions. Notwithstanding the provisions of this paragraph 13, no such special meeting shall be called during the period within ninety days immediately preceding the date fixed for the next annual meeting of stockholders.

14. At any meeting held for the purpose of electing directors at which the holders of the Preferred Stock shall have the special right, voting separately as a class, to elect directors as provided in paragraph 12, the presence, in person or by proxy, of the holders of 33 $\frac{1}{3}$ % of the Preferred Stock then outstanding shall be required to constitute a quorum of such class of the election of any director by the holders of the Preferred Stock as a class. At any such meeting or adjournment thereof, (a) the absence of a quorum of the Preferred Stock shall not prevent the election of directors other than those to be elected by the Preferred Stock voting as a class and the absence of a quorum for the election of such other directors shall not prevent the election of the directors to be elected by the Preferred Stock voting as a class, and (b) in the absence of either or both such quorums, a majority of the holders present in person or by proxy of the stock or stocks which lack a quorum shall have power to adjourn the meeting for the election of directors which they are entitled to elect from time to time without notice other than announcement at the meeting until a quorum shall be present.

15. During any period when the holders of the Preferred Stock have the right to vote as a class for directors as provided in paragraph 12, (a) the directors so elected by the holders of the Preferred Stock shall continue in office until the next annual meeting or until their successors shall have been elected by such holders or until termination of the right of the holders of the Preferred Stock to vote as a class for directors, and (b) any vacancies in the Board of Directors shall be filled only by vote of a majority (even if that be only a single director) of the remaining directors theretofore elected by the holders of the class or classes of stock which elected the director whose office shall have become vacant. To the extent permitted by applicable law, immediately upon any termination of the right of the holders of the Preferred Stock to vote as a class for directors as provided in paragraph 12, the term of office of the directors then in office so elected by the holders of the Preferred Stock shall terminate.

16. If in any case the amounts payable with respect to any obligations to retire shares of the Preferred Stock are not paid in full in the case of all series with respect to which such obligations exist, the number of shares of the various series to be retired shall be in proportion to the respective amounts which would be payable on account of such obligations if all amounts payable in respect of all such series were discharged in full.

17. No holder of Preferred Stock as such shall have any preemptive or preferential right to purchase or subscribe to stock, obligations, warrants, rights to subscribe to stock or other securities of the Corporation of any class, whether now or hereafter authorized or issued.

18. Except as may be required under the applicable statutory laws or may be set forth in the resolution or resolutions providing for the issue of any series adopted by the Board of Directors as hereinabove provided and except for the voting powers provided with respect to all shares of the Preferred Stock set forth above, no holder of Preferred Stock as such shall have any voting powers on any matters upon which stockholders of the Corporation have the right to vote.

19. For the purposes hereof and of any resolution of the Board of Directors providing for the classification or reclassification of any shares of Preferred Stock or for the purpose of any certificate filed with the Secretary of State of the State of Delaware (unless otherwise provided in any such resolution or certificate):

(a) The term "outstanding", when used in reference to shares of stock, shall mean issued shares, excluding shares held by the Corporation and shares called for redemption funds for the redemption of which shall have been deposited in trust;

(b) The amount of dividends "accrued" on any share of Preferred Stock of any series as at any dividend date shall be deemed to be the amount of any unpaid dividends accumulated thereon to and including such dividend date, whether or not earned or declared, and the amount of dividends "accrued" on any share of Preferred Stock of any series as at any date other than a dividend date shall be calculated as the amount of any unpaid dividends accumulated thereon to and including the last preceding dividend date, whether or not earned or declared, plus an amount equivalent to the pro rata portion of the periodic dividend with respect thereto at the annual dividend rate fixed for the shares of such series for the period after such last preceding dividend date to and including the date as of which the calculation is made;

(c) Any class or classes of stock of the Corporation shall be deemed to rank

(i) prior to the Preferred Stock either as to dividends or upon liquidation, if the holders of such class or classes shall be entitled to the receipt of dividends or of amounts distributable upon liquidation, dissolution or winding up, as the case may be, in preference or priority to the holders of the Preferred Stock;

(ii) on a parity with the Preferred Stock either as to dividends or upon liquidation, whether or not the dividend rates, dividend payment dates, or redemption or liquidation prices per share thereof be different from those of the Preferred Stock, if the holders of such class or classes of stock shall be entitled to the receipt of dividends or of amounts distributable upon liquidation, dissolution or winding up, as the case may be, in proportion to their respective dividend rates or liquidation prices, without preference or priority one over the other with respect to the holders of the Preferred Stock;

(iii) junior to the Preferred Stock either as to dividends or upon liquidation if the rights of the holders of such class or classes shall be subject or subordinate to the rights of the holders of the Preferred Stock in respect of the receipt of dividends or of amounts distributable upon liquidation, dissolution or winding up, as the case may be.

PART B. Provisions Relating to Common Stock

1. At all times (subject to the special voting rights of the Preferred Stock set forth above) each holder of Common Stock of the Corporation shall be entitled to one vote for each share of such stock outstanding in the name of such holder on the books of the Corporation on the record date designated for the purpose of such vote.

2. No holder of shares of Common Stock shall have, as such holder, any preemptive right to purchase or subscribe to stock, obligations, warrants, rights to subscribe to stock or other securities of the Corporation of any class, whether now or hereafter authorized or issued.

**RESOLUTIONS RELATING TO J. RAY McDERMOTT & CO., INC.
SERIES A \$2.20 CUMULATIVE CONVERTIBLE
PREFERRED STOCK**

RESOLVED, that subject to the amendment referred to above* becoming effective and subject to the approval of the Merger by the respective stockholders of the Corporation and B&W, pursuant to the authority vested in the Board of Directors by the provisions of the Corporation's Certificate of Incorporation, as then amended, the Board of Directors hereby authorizes the issue of a series of Preferred Stock of the Corporation and hereby fixes the designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereon in addition to those set forth in said Certificate of Incorporation as follows:

1. *Designation.* 6,600,000 shares of Preferred Stock of the Corporation are hereby constituted as a series of Preferred Stock designated as "Series A \$2.20 Cumulative Convertible Preferred Stock" (hereinafter called "Series A Preferred Stock").

2. *Dividends.* The dividend rate on the Series A Preferred Stock shall be \$2.20 per share per annum and dividends thereon shall be payable quarterly on the first day of January, April, July and October in each year, commencing on the first of such dates occurring more than 45 days after the original issuance of the Series A Preferred Stock. Dividends on the Series A Preferred Stock shall be cumulative from and after the date of original issuance thereof.

3. *Optional Redemption and Sinking Fund.* (a) On and after the fifth anniversary of the date on which the merger of The Babcock & Wilcox Company into McDermott Energy, Inc. becomes effective (the "Effective Date of the Merger"), the Series A Preferred Stock will be redeemable at the option of the Corporation at any time, either in whole or in part, at the redemption price per share set forth below for the date fixed for redemption (hereinafter together with any date upon which any redemptions are made pursuant to the sinking fund provided for in paragraph (b) of this Section 3 called a "Redemption Date") for such shares:

| Redemption Date During 12-month Period Beginning on the Anniversary of the Effective Date of the Merger | Redemption Price |
|--|---------------------|
| 1983 | \$33.45 |
| 1984 | 33.09 |
| 1985 | 32.72 |
| 1986 | 32.35 |
| 1987 | 31.97 |
| 1988 | 31.62 |
| 1989 (and thereafter) | 31.25 |

plus in each case a sum equal to all dividends on such shares accrued and unpaid thereon to the Redemption Date.

(b) On the eleventh anniversary of the Effective Date of the Merger and on each subsequent anniversary thereafter to and including the thirtieth anniversary thereafter, so long as any shares of the

* See amendment to McDermott's Certificate of Incorporation set forth as Appendix B to this Prospectus and Joint Proxy Statement.

Series A Preferred Stock remain outstanding, the Corporation will redeem pursuant to a mandatory sinking fund at a redemption price of \$31.25 per share plus a sum equal to all dividends accrued and unpaid thereon to the Redemption Date a number of shares of the Series A Preferred Stock equal to 5% of the number of shares of the Series A Preferred Stock which are issued as of the date which is 91 days prior to the eleventh anniversary of the Effective Date of the Merger (the "Termination Date"). In addition, the Corporation may redeem pursuant to an optional sinking fund on each Redemption Date on which it is obligated to make a redemption pursuant to the mandatory sinking fund, on a noncumulative basis, an additional number of shares of the Series A Preferred Stock not in excess of the number of shares it is then obligated to redeem pursuant to the mandatory sinking fund on the same terms as are applicable to mandatory sinking fund redemptions. The Corporation may apply to its mandatory sinking fund obligation any shares of the Series A Preferred Stock owned by it, any shares of the Series A Preferred Stock previously redeemed by it (otherwise than through the operation of the mandatory sinking fund) and any shares of Series A Preferred Stock surrendered for conversion, which have not been previously credited against a mandatory sinking fund obligation.

4. *Conversion Rights.* The holders of shares of the Series A Preferred Stock shall have the right, at their option, to convert shares of the Series A Preferred Stock into shares of Common Stock of the Corporation at any time on and subject to the following terms and conditions:

(a) The shares of the Series A Preferred Stock shall be convertible at the office of any transfer agent for the Series A Preferred Stock, and at such other office or offices, if any, as the Board of Directors of the Corporation may designate, into fully paid and non-assessable shares (calculated as to each conversion to the nearest 1/100th of a share) of Common Stock of the Corporation, at the conversion rate, determined as hereinafter provided, in effect at the time of conversion. The rate at which shares of Common Stock shall be delivered upon conversion shall be initially one share of Common Stock for each share of Series A Preferred Stock; provided, however, that such conversion rate shall be subject to adjustment from time to time in certain instances as hereinafter provided. The conversion rate in effect at any time is herein called the "conversion rate".

(b) In order to convert shares of the Series A Preferred Stock into Common Stock the holder thereof shall surrender at any office hereinabove mentioned the certificate or certificates therefor, duly endorsed to the Corporation or in blank, and give written notice to the Corporation at said office that he elects to convert such shares and the name or names in which the certificate or certificates for shares of Common Stock are to be issued. No payment or adjustment shall be made upon any conversion on account of any dividends accrued on the shares of the Series A Preferred Stock surrendered for conversion or on account of any dividends on the Common Stock issued upon such conversion. Shares of the Series A Preferred Stock shall be deemed to have been converted immediately prior to the close of business on the day of receipt of such notice and the surrender of such shares for conversion in accordance with the foregoing provisions, and the person or persons entitled to receive the Common Stock issuable upon such conversion shall be treated for all purposes as the record holder or holders of such Common Stock at such time. As promptly as practicable after the receipt of such notice and the surrender of such shares as aforesaid, the Corporation shall issue and shall deliver at said office a certificate or certificates for the number of full shares of Common Stock issuable upon such conversion, together with a cash payment in lieu of any fraction of any share, as hereinafter provided, to the person or persons entitled to receive the same. In case shares of the Series A Preferred Stock are called for redemption, the right to convert such shares shall cease and terminate at the close of business on the Redemption Date, unless default shall be made in payment of the redemption price.

(c) No fractional shares of Common Stock shall be issued upon conversion of shares of the Series A Preferred Stock but, in lieu of any fraction of a share of Common Stock which would

otherwise be issuable in respect of the aggregate number of shares of the Series A Preferred Stock surrendered for conversion at one time by the same holder, the Corporation shall pay in cash as an adjustment of such fraction an amount equal to the same fraction of the Closing Price of the Common Stock, on the date on which such shares of the Series A Preferred Stock were duly surrendered for conversion, or, if such date is not a Trading Date, on the next preceding date which was a Trading Date.

(d) the conversion rate shall be adjusted from time to time as follows:

(A) In case the Corporation shall (i) pay a dividend or make a distribution in shares of Common Stock, (ii) subdivide its outstanding shares of Common Stock, (iii) combine its outstanding shares of Common Stock into a smaller number of shares or (iv) issue by reclassification of its shares of Common Stock any shares of capital stock of the Corporation, the conversion rate shall be adjusted so that the holder of any shares of the Series A Preferred Stock surrendered for conversion after such time shall be entitled to receive the number of shares of Common Stock of the Corporation which he would have owned or been entitled to receive had such shares of the Series A Preferred Stock been converted immediately prior to such time. Such adjustment shall become effective at the opening of business on the business day next following the record date for determination of stockholders entitled to receive such dividend or distribution in the case of a dividend or distribution and shall become effective immediately after the effective date in case of a subdivision, combination or reclassification; and any shares of Common Stock issuable in payment of a dividend shall be deemed to have been issued immediately prior to the close of business on the record date for such dividend for purposes of calculating the number of outstanding shares of Common Stock under clauses (B) and (C) below.

(B) In case the Corporation shall issue rights or warrants to substantially all holders of its Common Stock entitling them (for a period not exceeding 45 days from the date of such issuance) to subscribe for or purchase shares of Common Stock at a price per share less than the current market price per share (as determined pursuant to clause (D) below) of the Common Stock on the record date mentioned below, then in each case the number of shares of Common Stock into which each share of Series A Preferred Stock shall thereafter be convertible shall be determined by multiplying the number of shares of Common Stock into which such share of Series A Preferred Stock was theretofore convertible by a fraction, of which the numerator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants, immediately prior to such issuance, plus the number of additional shares of Common Stock offered for subscription or purchase, and of which the denominator shall be the number of shares of Common Stock outstanding on the date of issuance of such rights or warrants, immediately prior to such issuance, plus the number of shares which the aggregate offering price of the total number of shares so offered for subscription or purchase would purchase at such current market price (determined by multiplying such total number of shares by the exercise price of such rights or warrants and dividing the product so obtained by such current market price). Such adjustment shall become effective at the opening of business on the business day next following the record date for the determination of stockholders entitled to receive such rights or warrants.

(C) In case the Corporation shall distribute to substantially all holders of its Common Stock evidences of its indebtedness or other assets (excluding any cash dividends or distributions and dividends referred to in clause (A) above), or shall distribute to substantially all holders of its Common Stock rights or warrants to subscribe for or purchase securities (other than those referred to in clause (B) above), then in each such case the number of shares of Common Stock into which each share of Series A Preferred Stock shall thereafter be convertible shall be determined by multiplying the number of shares of Common Stock

into which such share of Series A Preferred Stock was convertible immediately prior to the date of such distribution by a fraction, of which the numerator shall be the current market price per share of Common Stock (determined pursuant to clause (D) below) on the record date mentioned below, and of which the denominator shall be such current market price per share of Common Stock less the then fair market value (as determined by the Board of Directors of the Corporation, whose determination shall be conclusive) of the portion of the assets or evidences of indebtedness so distributed, or of such subscription rights or warrants, applicable to one share of Common Stock. Such adjustment shall become effective on the opening of business on the business day next following the record date for the determination of stockholders entitled to receive such distribution.

(D) For the purpose of any computation under clause (B) or (C) above, the current market price per share of Common Stock on any date shall be deemed to be the average of the daily Closing Prices for thirty consecutive Trading Dates commencing forty-five Trading Dates before the date in question.

(E) In any case in which this Section 4 shall require that an adjustment as a result of any event become effective at the opening of business on the business day next following a record date, the Corporation may elect to defer until after the occurrence of such event (i) issuing to the holder of any shares of the Series A Preferred Stock converted after such record date and before the occurrence of such event the additional shares of Common Stock issuable upon such conversion over and above the shares of Common Stock issuable upon such conversion on the basis of the conversion rate prior to adjustment and (ii) paying to such holder any amount in cash in lieu of a fractional share of Common Stock pursuant to paragraph (c) of this Section 4.

(F) No adjustment of the conversion rate shall be required unless such adjustment would require an increase or decrease of at least 1% in the number of shares into which each share of Series A Preferred Stock is then convertible, but in such case any adjustment that would otherwise be required then to be made shall be carried forward and shall be made at the time of and together with the next subsequent adjustment which, together with any adjustment so carried forward, shall amount to not less than 1% of such number; *provided, however*, if during a period of three years after an event which would have required adjustment of the conversion rate but for such 1% limitation the conversion rate shall not have been adjusted, the conversion rate shall be adjusted on the third anniversary of such event to reflect whatever adjustment would otherwise have been required by such event; and *provided further* that the Corporation shall be entitled to make such reductions in the conversion rate, in addition to those required by this clause (F), as it in its discretion shall determine to be advisable in order that any stock dividend hereafter made by the Corporation to its stockholders shall not be taxable.

(g) In case of any consolidation or merger of the Corporation as a result of which the holders of Common Stock shall be entitled to receive stock, other securities or other assets with respect to or in exchange for Common Stock or in case of any sale or conveyance of all or substantially all of the property or business of the Corporation as an entirety, the holder of a share of the Series A Preferred Stock shall have the right thereafter, so long as the conversion right hereunder shall exist, to convert such share into the kind and amount of shares of stock and other securities and properties receivable upon such consolidation, merger, sale or conveyance by a holder of the number of shares of Common Stock into which such share of the Series A Preferred Stock might have been converted immediately prior to such consolidation, merger, sale or conveyance and shall have no other conversion rights with regard to such share of this Series. In case securities or properties other than Common Stock shall be issuable or deliverable upon

conversion as aforesaid, then all reference in this Section 4 shall be deemed to apply, so far as appropriate and as nearly as may be, to such other securities or properties. The provisions of this paragraph (e) shall similarly apply to successive consolidations, mergers, sales or conveyances.

(f) Whenever the conversion rate is adjusted as herein provided:

(A) the Corporation shall compute the adjusted conversion rate in accordance with this Section 4 and shall prepare a certificate signed by the Treasurer or an Assistant Treasurer of the Corporation setting forth the adjusted conversion rate, and such certificate shall forthwith be filed with the transfer agent or agents for the Series A Preferred Stock; and

(B) a notice stating that the conversion rate has been adjusted and setting forth the adjusted conversion rate shall be mailed to the holders of record of the outstanding shares of the Series A Preferred Stock at or prior to the time the Corporation mails an interim statement to its stockholders covering the quarterly period during which the facts requiring such adjustment occurred, but in any event within 60 days of the end of such quarter.

(g) In case:

(A) the Corporation shall declare a dividend (or any other distribution) on its Common Stock payable otherwise than in cash; or

(B) the Corporation shall authorize the granting to the holders of its Common Stock of rights to subscribe for or purchase any shares of capital stock of any class or of any other rights; or

(C) of any reclassification of the capital stock of the Corporation (other than a subdivision or combination of its outstanding shares of Common Stock or a change in par value, or from par value to no par value, or from no par value to par value), or of any consolidation or merger to which the Corporation is a party and for which approval of any stockholders of the Corporation is required, or of the sale or transfer of all or substantially all of the assets of the Corporation, or of the voluntary or involuntary dissolution, liquidation or winding up of the Corporation;

then the Corporation shall cause to be mailed to the transfer agent or agents for the Series A Preferred Stock and to the holders of record of the outstanding shares of the Series A Preferred Stock, at least 20 days prior to the applicable record date hereinafter specified, a notice stating (x) the date on which a record is to be taken for the purpose of such dividend, distribution or rights, or, if a record is not to be taken, the date as of which the holders of Common Stock of record to be entitled to such dividend, distribution or rights are to be determined, or (y) the date on which such reclassification, consolidation, merger, sale, transfer, dissolution, liquidation or winding up is expected to become effective, and the date as of which it is expected that holders of Common Stock of record shall be entitled to exchange their shares of Common Stock for securities or other property deliverable upon such reclassification, consolidation, merger, sale, transfer, dissolution, liquidation or winding up.

(h) The Corporation shall at all times reserve and keep available, free from preemptive rights, out of its authorized but unissued Common Stock or out of shares of Common Stock held in its treasury, solely for the purpose of effecting the conversion of the shares of the Series A Preferred Stock, the full number of shares of Common Stock deliverable upon the conversion of all shares of Series A Preferred Stock from time to time outstanding.

(i) The Corporation will pay any and all documentary, stamp or similar taxes that may be payable in respect of the issuance or delivery of shares of Common Stock on conversion of shares of the Series A Preferred Stock pursuant hereto. The Corporation shall not, however, be required to pay any tax which may be payable in respect of any transfer involved in the issue and delivery of shares of Common Stock in a name other than that in which the shares of the Series A Preferred Stock so converted were registered, and no such issue or delivery shall be made unless and until the person requesting such issue has paid to the Corporation the amount of any such tax, or has established, to the satisfaction of the Corporation, that such tax has been paid or that no such tax is applicable.

(j) For the purposes of this Section 4 the term "Common Stock" means the Common Stock of the Corporation, \$1 par value, as the same exists as of the original date of issue of the Series A Preferred Stock or as such stock may be reconstituted from time to time.

(k) As used in this Section 4, the term "Closing Price" on any day shall mean the reported last sales price regular way on such day or, in case no such sale takes place on such day, the average of the reported closing bid and asked prices regular way, in each case on the New York Stock Exchange, or, if the Common Stock is not listed or admitted to trading on such Exchange, on the principal national securities exchange on which the Common Stock is listed or admitted to trading, or, if not listed or admitted to trading on any national securities exchange, the average of the closing bid and asked prices as furnished by any New York Stock Exchange member firm selected from time to time by the Board of Directors of the Corporation for that purpose; and the term "Trading Date" shall mean a date on which the New York Stock Exchange (or any successor to such Exchange) is open for the transaction of business.

5. *Voting Rights.* In addition to the special voting rights provided in Part A of the Certificate of Incorporation of the Corporation, each holder of shares of the Series A Preferred Stock shall be entitled to one-half vote for each share of the Series A Preferred Stock held of record with the same rights as holders of shares of Common Stock.

Without the affirmative vote or consent of the holders of at least 50% of the shares of the Series A Preferred Stock and the Series B \$2.60 Cumulative Preferred Stock of the Corporation at the time outstanding, given in person or by proxy, either in writing or by resolution adopted at an annual or special meeting, the holders of the Series A Preferred Stock and the Series B \$2.60 Cumulative Preferred Stock of the Corporation consenting or voting separately as a class, the Corporation will not create any class or series of stock ranking senior to such series either as to dividends or upon liquidation or increase the authorized number of shares of any such other class or series.

6. *Liquidation Rights.* Upon the dissolution, liquidation or winding up of the Corporation, whether voluntary or involuntary, the holders of the shares of the Series A Preferred Stock shall be entitled to receive out of the assets of the Corporation, before any payment or distribution shall be made on the Common Stock or on any other class of stock ranking junior to the Preferred Stock upon liquidation, cash in the amount of \$31.25 per share plus a sum equal to all dividends (whether or not earned or declared) on such shares accrued and unpaid thereon to the date of final distribution.

7. *Limitation on Issuance.* The Corporation shall not issue or reissue any shares of Series A Preferred Stock after the Termination Date but, subject to such limitation, the Corporation may issue shares of Series A Preferred Stock in connection with transactions unrelated to the Merger.

RESOLUTIONS RELATING TO J. RAY McDERMOTT & CO., INC.

SERIES B \$2.60 CUMULATIVE PREFERRED STOCK

RESOLVED, that subject to the amendment referred to above* becoming effective and subject to the approval of the Merger by the respective stockholders of the Corporation and B&W, pursuant to the authority vested in the Board of Directors by the provisions of the Corporation's Certificate of Incorporation, as then amended, the Board of Directors hereby authorizes the issue of a series of Preferred Stock of the Corporation and hereby fixes the designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereon in addition to those set forth in said Certificate of Incorporation as follows:

1. *Designation.* 6,600,000 shares of Preferred Stock of the Corporation are hereby constituted as a series of Preferred Stock designated as "Series B \$2.60 Cumulative Preferred Stock" (hereinafter called "Series B Preferred Stock").

2. *Dividends.* The dividend rate on the Series B Preferred Stock shall be \$2.60 per share per annum and dividends thereon shall be payable quarterly on the first day of January, April, July and October in each year, commencing on the first of such dates occurring more than 45 days after the original issuance of the Series B Preferred Stock. Dividends on the Series B Preferred Stock shall be cumulative from and after the date of original issuance thereof.

3. *Optional Redemption and Sinking Fund.* (a) On and after the fifth anniversary of the date on which the merger of The Babcock & Wilcox Company into McDermott Energy, Inc. becomes effective (the "Effective Date of the Merger"), the Series B Preferred Stock will be redeemable at the option of the Corporation at any time, either in whole or in part, at the redemption price per share set forth below for the date fixed for redemption (hereinafter together with any date upon which any redemptions are made pursuant to the sinking fund provided for in paragraph (b) of this Section 3 called a "Redemption Date") for such shares:

| <u>Redemption Date During 12-month Period Beginning on the Anniversary of the Effective Date of the Merger</u> | <u>Redemption Price</u> |
|--|-----------------------------|
| 1983 | \$32.25 |
| 1984 | 32.00 |
| 1985 | 31.75 |
| 1986 | 31.50 |
| 1987 (and thereafter) | 31.25 |

plus in each case a sum equal to all dividends on such Shares accrued and unpaid thereon to the Redemption Date.

(b) The Corporation will redeem pursuant to a mandatory sinking fund at a redemption price of \$31.25 per share plus a sum equal to all dividends accrued and unpaid thereon to the Redemption Date (i) on the 8th anniversary of the Effective Date of the Merger, and on each subsequent anniversary

* See amendment to McDermott's Certificate of Incorporation set forth as Appendix B to this Prospectus and Joint Proxy Statement.

thereafter to and including the 17th anniversary thereafter, a number of shares of Series B Preferred Stock equal to 5% of the number of shares of Series B Preferred Stock which are issued as of the date which is 91 days prior to the eighth anniversary of the Effective Date of the Merger (the "Termination Date"), (ii) on the 18th anniversary of the Effective Date of the Merger, and on each subsequent anniversary thereafter to and including the 28th anniversary thereafter, a number of shares of Series B Preferred Stock equal to 4% of the number of shares of Series B Preferred Stock issued as of the Termination Date, and (iii) on the 29th and 30th anniversary of the Effective Date of the Merger a number of shares of Series B Preferred Stock equal to 3% of the number of shares of Series B Preferred Stock issued as of the Termination Date. In addition, the Corporation may redeem pursuant to an optional sinking fund on each Redemption Date on which it is obligated to make a redemption pursuant to the mandatory sinking fund, on a noncumulative basis, an additional number of shares of the Series B Preferred Stock not in excess of the number of shares it is then obligated to redeem pursuant to the mandatory sinking fund on the same terms as are applicable to mandatory sinking fund redemptions. The Corporation may apply to its mandatory sinking fund obligation any shares of the Series B Preferred Stock owned by it and any shares of the Series B Preferred Stock previously redeemed by it (otherwise than through the operation of the mandatory sinking fund) which have not been previously credited against a mandatory sinking fund obligation.

4. *Voting Rights.* In addition to the special voting rights provided in Part A of the Certificate of Incorporation of the Corporation, each holder of shares of the Series B Preferred Stock shall be entitled to one-half vote for each share of the Series B Preferred Stock held of record with the same rights as holders of shares of Common Stock.

Without the affirmative vote or consent of the holders of at least 50% of the shares of the Series B Preferred Stock and the Series A \$2.20 Cumulative Convertible Preferred Stock of the Corporation at the time outstanding, given in person or by proxy, either in writing or by resolution adopted at an annual or special meeting, the holders of the Series B Preferred Stock and the Series A \$2.20 Cumulative Convertible Preferred Stock of the Corporation consenting or voting separately as a class, the Corporation will not create any class or series of stock ranking senior to such series either as to dividends or upon liquidation or increase the authorized number of shares of any such other class or series.

5. *Liquidation Rights.* Upon the dissolution, liquidation or winding up of the Corporation, whether voluntary or involuntary, the holders of the shares of the Series B Preferred Stock shall be entitled to receive out of the assets of the Corporation, before any payment or distribution shall be made on the Common Stock or on any other class of stock ranking junior to the Preferred Stock upon liquidation, cash in the amount of \$31.25 per share plus a sum equal to all dividends (whether or not earned or declared) on such shares accrued and unpaid thereon to the date of final distribution.

6. *Limitation on Issuance.* The Corporation shall not issue or reissue any shares of Series B Preferred Stock after the Termination Date but, subject to such limitation, the Corporation may issue shares of Series B Preferred Stock in connection with transactions unrelated to the Merger.