MCDERMOTT INTERNATIONAL INC
Form 10-K
March 01, 2007

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from _____ to _____

Commission File Number 001-08430
McDERMOTT INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

REPUBLIC OF PANAMA	72-0593134
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
777 N. ELDRIDGE PKWY. HOUSTON, TEXAS	77079
(Address of Principal Executive Offices)	(Zip Code)

Registrant s Telephone Number, Including Area Code (281) 870-5901

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

Title of each class	Name of each Exchange on which registered
Common Stock, $1.00 par value	New York Stock Exchange
Rights to Purchase Preferred Stock (Currently Traded with Common Stock)	New York Stock Exchange

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

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

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

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

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

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

The aggregate market value of the registrant s common stock held by nonaffiliates of the registrant on the last business day of the registrant s most recently completed second fiscal quarter (based on the closing sales price on the New York Stock Exchange on June 30, 2006) was approximately $4,995,795,675.

The number of shares of the registrant s common stock outstanding at January 31, 2007 was 110,831,565.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A under the Securities Exchange Act of 1934 in connection with the registrant s 2007 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

Table of Contents

McDERMOTT INTERNATIONAL, INC.
INDEX FORM 10-K

Table of Contents

Table of Contents

Table of Contents

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

PART I

Item 1. BUSINESS

A. GENERAL

McDermott International, Inc. (MII), incorporated under the laws of the Republic of Panama in 1959, is an engineering and construction company with specialty manufacturing and service capabilities and is the parent company of the McDermott group of companies, which includes:

J. Ray McDermott, S.A., a Panamanian subsidiary of MII (JRMSA), and its consolidated subsidiaries;

McDermott Holdings, Inc., a Delaware subsidiary of MII (MHI), and its consolidated subsidiaries;

McDermott Incorporated, a Delaware subsidiary of MHI (MI), and its consolidated subsidiaries;

The Babcock & Wilcox Companies, a Delaware subsidiary of MI (B&WC);

BWX Technologies, Inc., a Delaware subsidiary of B&WC (BWXT), and its consolidated subsidiaries; and

The Babcock & Wilcox Company, a Delaware subsidiary of B&WC (B&W), and its consolidated subsidiaries.

In this Annual Report on Form 10-K, unless the context otherwise indicates, we, us and our mean MII and its consolidated subsidiaries.

We are a worldwide energy services company operating in three business segments:

Offshore Oil and Gas Construction, previously referred to as Marine Construction Services, includes the results of operations of JRMSA and its subsidiaries and JRMH and its subsidiaries, hereafter collectively referred to as JRM, which supply services primarily to offshore oil and gas field developments worldwide. This segment s principal activities include the front-end design and detailed engineering, fabrication and installation of offshore drilling and production facilities and installation of marine pipelines and subsea production systems. This segment operates in most major offshore oil and gas producing regions throughout the world, including the United States, Mexico, the Middle East, India, the Caspian Sea and Asia Pacific.

Government Operations includes the results of operations of BWXT and its subsidiaries. This segment supplies nuclear components and provides various services to the U.S. Government, including uranium processing, environmental site restoration services and management and operating services for various U.S. Government-owned facilities, primarily within the nuclear weapons complex of the U.S. Department of Energy (DOE).

Power Generation Systems includes the results of operations of B&W and its subsidiaries. This segment provides a variety of services, equipment and systems to generate steam and electric power at energy facilities worldwide. On February 22, 2006, B&W and three of its subsidiaries exited from Chapter 11 Bankruptcy proceedings. As a result of B&W s Chapter 11 proceedings, we did not consolidate the results of operations of B&W and its subsidiaries in our consolidated financial statements from February 22, 2000 through February 22, 2006. Amounts reported for this segment during that period reflect only the results of operations of several foreign subsidiaries not owned by B&W. See Note 20 to our consolidated financial statements included in this report for information on B&W and its subsidiaries.

The following tables summarize our revenues and operating income by business segment for the years ended December 31, 2006, 2005 and 2004. See Note 17 to our consolidated financial statements included in this report for

additional information about our business segments and operations in different geographic areas.

1

Table of Contents

	Year Ended December 31,		
	2006	*2005*	*2004*
		(In Millions)	
REVENUES			
Offshore Oil and Gas Construction	$1,610.3	$1,238.9	$1,357.8
Government Operations	630.1	601.0	555.1
Power Generation Systems	1,888.6		
Adjustments and Eliminations	(8.9)	(0.2)	
	$4,120.1	$1,839.7	$1,912.9
OPERATING INCOME:			
Segment Operating Income (Loss):			
Offshore Oil and Gas Construction	$ 209.9	$ 149.8	$ 53.8
Government Operations	82.8	68.0	76.7
Power Generation Systems	101.9	(0.9)	(0.9)
	$ 394.6	$ 216.9	$ 129.6
Gain (Loss) on Asset Disposals and Impairments Net:			
Offshore Oil and Gas Construction	$ (16.2)	$ 6.4	$ 30.3
Government Operations	1.1	0.1	0.6
Power Generation Systems	0.1		1.6
	$ (15.0)	$ 6.5	$ 32.5
Equity in Income (Loss) from Investees:			
Offshore Oil and Gas Construction	$ (2.9)	$ 2.8	$ 1.9
Government Operations	27.8	31.3	32.5
Power Generation Systems	12.5	6.4	1.2
	$ 37.4	$ 40.5	$ 35.6
Unallocated corporate[(1)]	(29.9)	(39.9)	(49.6)
	$ 387.1	$ 224.0	$ 148.1

(1) See Note 17 to our consolidated

financial statements included in this report for further information on unallocated corporate expenses.

B. OFFSHORE OIL AND GAS CONSTRUCTION

General

The Offshore Oil and Gas Construction segment s business involves the front-end design and detailed engineering, fabrication and installation of offshore drilling and production facilities and installation of marine pipelines and subsea production systems. This segment also provides comprehensive project management and procurement services. This segment operates in most major offshore oil and gas producing regions throughout the world, including the United States, Mexico, the Middle East, India, the Caspian Sea and Asia Pacific.

Offshore Oil and Gas Construction Vessels and Properties

We operate a fleet of marine vessels used in major offshore construction. We currently own or, through our ownership interest in a joint venture, operate one derrick vessel and six combination derrick-pipelaying vessels. We also operate a pipelay vessel and a dive support vessel for a subdivision of the state-owned oil company of Azerbaijan. The lifting capacities of our derrick and combination derrick-pipelaying vessels range from 660 to 4,400 tons. These vessels range in length from 350 to 497 feet and are fully equipped with revolving cranes, auxiliary cranes, welding equipment, pile-driving hammers, anchor winches and a variety of additional equipment. Four of our owned and operated vessels are self-propelled, with three also having dynamic positioning systems. We also have a substantial inventory of specialized support equipment for intermediate water and deepwater construction and

Table of Contents

pipelay. In addition, we own or lease a substantial number of other vessels, such as tugboats, utility boats, launch barges and cargo barges, to support the operations of our major marine construction vessels.

The following table sets forth certain information with respect to the major construction vessels utilized to conduct our Offshore Oil and Gas Construction business, including their location at December 31, 2006 (except where otherwise noted, each of the vessels is owned and operated by us):

Location and Vessel Name	Flag	Vessel Type	Year Entered Service/ Upgraded	Maximum Derrick Lift (tons)	Maximum Pipe Diameter (inches)
UNITED STATES					
DB 50 (a)	Panama	Pipelay/Derrick	1988	4,400	20
DB 16 (a)	U.S.A.	Pipelay/Derrick	1967/2000	860	30
Intermac 600 (b)	U.S.A.	Launch/Cargo Barge	1973		
MIDDLE EAST					
DB 27	Panama	Pipelay/Derrick	1974	2,400	60
DLB KP1	Panama	Pipelay/Derrick	1974	660	60
CASPIAN SEA					
Israfil Husseinov (c)	Azerbaijan	Pipelay	1997/2003		60
Akademik Tofiq Ismayilov (a)(c)	Azerbaijan	Dive Support Vessel	1987/2005		
ASIA PACIFIC					
DB 101	Panama	Semi-Submersible Derrick	1978/1984	3,500	
DB 30	Panama	Pipelay/Derrick	1975/1999	3,080	60
DB 26	Panama	Pipelay/Derrick	1975	900	60
Intermac 650 (d)	Panama	Launch/Cargo Barge	1980/2006		
Franklin III	Panama	Shallow Water Barge	1997		

(a) Vessel with dynamic positioning capability.

(b) The dimensions of this vessel are 500 x 120 x 33 .

(c) Operated by us for a subdivision of the State Oil Company of the Azerbaijan Republic.

(d) The overall dimensions of this vessel are 650 x 170 x 40 .

Governmental regulations, our insurance policies and some of our financing arrangements require us to maintain our vessels in accordance with standards of seaworthiness and safety set by governmental authorities or classification societies. We maintain our fleet to the standards for seaworthiness, safety and health set by the American Bureau of Shipping, Den Norske Veritas and other world-recognized classification societies.

Our principal fabrication facilities are located near Morgan City, Louisiana, in Indonesia on Batam Island and in Dubai, U.A.E., and we are currently developing a new fabrication facility on the east coast of Mexico in the Port of Altamira, for which we are targeting to begin operations in the third quarter of 2007. We also operate a portion of the Baku Deepwater Jacket Factory fabrication facility in Baku, Azerbaijan, which is owned by a subsidiary of the State Oil Company of the Azerbaijan Republic. Our fabrication facilities are equipped with a wide variety of heavy-duty construction and fabrication equipment, including cranes, welding equipment, machine tools and robotic and other automated equipment. We fabricate a full range of offshore structures, from conventional jacket-type fixed platforms to intermediate water and deepwater platform configurations employing Spar, compliant-tower and tension leg technologies, as well as floating, production, storage and offtake (FPSO) technology.

Table of Contents

Expiration dates, including renewal options, of leases covering land for JRM s fabrication facilities at December 31, 2006 were as follows:

Morgan City, Louisiana	Years 2008-2048
Dubai (Jebel Ali), U.A.E.	Year 2015
Batam Island, Indonesia	Years 2029-2038
Altamira, Mexico	Year 2036

As a result of renewal options on the various tracts comprising the Morgan City fabrication facility, we have the ability, within our sole discretion, to continue leasing almost all the land we are currently using for that facility until 2048.

Foreign Operations

JRM s revenues, net of intersegment revenues, and its segment income derived from operations located outside of the United States, as well as the approximate percentages to our total consolidated revenues and total consolidated segment income, respectively, for each of the last three years were as follows (dollars in thousands):

	Revenues		*Segment Income*	
	Amount	*Percent*	*Amount*	*Percent*
Year ended December 31, 2006	$1,378,339	33%	$214,822	52%
Year ended December 31, 2005	$1,051,547	57%	$204,474	77%
Year ended December 31, 2004	$ 832,722	44%	$ 84,914	43%

We participate in joint ventures involving operations in foreign countries that sometimes require majority ownership by local interests. See Note 17 to our consolidated financial statements included in this report for further information on the geographic distribution of our revenues.

Customers

JRM s customers are primarily oil and gas companies, including several foreign government-owned companies. JRM s five largest customers during 2006 were Azerbaijan International Operating Company, Aramco Overseas Company BV, Dolphin Energy Limited, Ras Laffan Liquified Natural Gas Company Limited and Conoco Indonesia, Inc., which accounted for 8.5%, 6.6%, 3.1%, 1.9% and 1.3% of our total consolidated revenues, respectively. JRM s five largest customers during 2005 were Azerbaijan International Operating Company, Ras Laffan Liquified Natural Gas Company Limited, BP Plc and its subsidiaries, Exxon Neftegas Limited and Apache Energy Limited, which accounted for 20.0%, 5.8%, 5.3%, 4.9% and 4.5% of our total consolidated revenues, respectively.

The level of engineering and construction services required by any one customer depends upon the amount of that customer s capital expenditure budget for offshore construction services in any single year. Consequently, customers that account for a significant portion of revenues in one year may represent an immaterial portion of revenues in subsequent years.

Contracts

We have historically performed work on a fixed-price, cost-plus or day-rate basis or a combination of these methods. Most of our long-term contracts have provisions for progress payments. We attempt to cover anticipated increases in costs of labor, material and service costs of our long-term contracts, either through an estimate of such charges, which is reflected in the original price, or through price escalation clauses.

We recognize our contract revenues and related costs on a percentage-of-completion basis. Accordingly, we review contract price and cost estimates periodically as the work progresses and reflect adjustments in income proportionate to the percentage of completion in the period when we revise those estimates. To the extent that these adjustments result in a reduction or an elimination of previously reported profits with respect to a project, we would recognize a charge against current earnings, which could be material.

Table of Contents

Our arrangements with customers frequently require us to provide letters of credit or bid and performance bonds to secure bids or performance under contracts for offshore construction services. While these letters of credit and bonds may involve significant dollar amounts, historically, there have been no material payments to our customers under these arrangements. These arrangements are typical in the industry for projects outside the U.S. Gulf of Mexico.

In the event of a contract deferral or cancellation, we are generally entitled to recover costs incurred, settlement expenses and profit on work completed prior to deferral or termination. While we have not generally experienced significant project cancellations, significant or numerous cancellations could adversely affect our business, financial condition and results of operations.

Backlog

As of December 31, 2006 and 2005, our Offshore Oil and Gas Construction segment s backlog amounted to approximately $4.1 billion and $1.8 billion, respectively. This represents approximately 54% and 50% of our total consolidated backlog at December 31, 2006 and 2005, respectively. Of our December 31, 2006 backlog in this segment, we expect to recognize revenues as follows (in approximate millions):

	Amount
Quarter Ended:	
March 31, 2007	$ 500
June 30, 2007	$ 490
September 30, 2007	$ 530
December 31, 2007	$ 600
Year Ended December 31, 2008	$1,550
Thereafter	$ 460

While fabrication projects are typically awarded substantially in advance of performance as a result of the required lead time for procurement, the offshore construction industry is highly seasonal in some geographic regions. Because of the more conducive weather conditions, most installation operations are conducted in the warmer months of the year in those areas, and many of these contracts are awarded with only a short period of time before the desired time of project performance. Projects in our backlog may be cancelled by customers.

Raw Materials

Our Offshore Oil and Gas Construction segment uses raw materials, such as carbon and alloy steels in various forms, welding gases, paint, fuels and lubricants, which are available from many sources. We generally purchase these raw materials and components as needed for individual contracts. Although shortages of some raw materials and fuels have existed from time to time, no serious shortage exists at the present time. Our Offshore Oil and Gas Construction segment does not depend on a single source of supply for any significant raw materials.

Competition

We believe we are among the few offshore construction contractors capable of providing a full range of services in major offshore oil and gas producing regions of the world. We believe that the substantial capital costs involved in becoming a full-service offshore construction contractor create a significant barrier to entry into the market as a global, fully integrated competitor. We do, however, face substantial competition from regional competitors and less integrated providers of offshore construction services, such as engineering firms, fabrication facilities, pipelaying companies and shipbuilders.

A number of companies compete with us in each of the separate marine pipelay and construction and fabrication phases in various parts of the world. These competitors include Allseas Marine Contractors S.A.; Daewoo Engineering & Construction Co., Ltd.; Global Industries, Ltd.; NPCC (Abu Dhabi); Heerema Group;

Table of Contents

Hyundai Heavy Industrial Co., Ltd.; Kiewit Offshore Services, Ltd.; Nippon Steel Corporation; Saipem S.p.A.; Acergy S.A.; and Technip S.A. Contracts are usually awarded on a competitive bid basis. Although we believe customers consider, among other things, the availability and technical capabilities of equipment and personnel, efficiency, condition of equipment, safety record and reputation, price competition is normally the primary factor in determining which qualified contractor with available equipment is awarded a contract. Major construction vessels have few alternative uses and, because of their nature and the environment in which they work, have relatively high maintenance costs whether or not they are operating. See the discussion in Item 1A, Risk Factors, for additional information on the competitive nature of our Offshore Oil and Gas Construction segment.

Factors Affecting Demand

Our Offshore Oil and Gas Construction segment s activity depends mainly on the capital expenditures for offshore construction services of oil and gas companies and foreign governments for construction of development projects. Numerous factors influence these expenditures, including:

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

See Item 1A, Risk Factors, for further information on factors affecting demand.

C. GOVERNMENT OPERATIONS

General

Our Government Operations segment consists of the operations of BWXT and its subsidiaries. Through this segment, we manage complex, high-consequence nuclear and national security operations, and we are a principal supplier of nuclear components and advanced energy products to the U.S. Government. Through our operation of this segment, we have over 50 years of experience in the ownership and operation of large nuclear development, production and reactor facilities, including 48 years of providing precision-manufactured components for the U.S. Navy. Principal areas of operation include:

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

BWXT conducts the operations of our Government Operations segment through two primary subsidiaries or divisions: BWXT Services, Inc. and its Nuclear Operations Division.

In 2006, BWXT formed its Nuclear Operations Division by consolidating its Nuclear Equipment Division and its Nuclear Products Division. We believe this consolidation will result in greater operating efficiencies, cost savings and synergies in BWXT s nuclear business.

Properties

BWXT s principal manufacturing facilities are located in:

Lynchburg, Virginia;

Barberton, Ohio; and

Mount Vernon, Indiana.

Each of these facilities is located on property we own.

Table of Contents

The Lynchburg, Virginia facility, which is BWXT s Nuclear Operations Division s primary manufacturing plant, is the nation s largest commercial high-enriched uranium processing facility. The facility resides on 437 acres with 870,000 square feet of manufacturing area and comprises approximately 60 buildings and trailers. The site is the recipient of the highest rating given by the Nuclear Regulatory Commission for license performance. The performance review determines the safe and secure conduct of operations of the facility. The site is also the largest commercial International Atomic Energy Agency-certified facility in the U.S.

Precision components and products ranging in size from a few grams to hundreds of tons can be accommodated in the Lynchburg facility. Modern multi-axis machining centers use computer controls with direct links to distributed computer-aided design and manufacturing networks. Computer-controlled electron beam, plasma and tungsten inert gas welding are used for joining a variety of special materials, including nuclear, refractory, superconducting alloys, stainless steel, inconel, titanium and aluminum. Other facility capabilities include:

advanced heat treatment to optimize material properties of components;

computerized real-time accept/reject dimensional inspection coordinate measuring systems for dimensional inspection, custom inspection gauging and calibration, destructive/nondestructive testing, dye check, Zyglo inspection, Cryogenic testing, ultrasonic inspection, magnetic particle inspection and computer or direct numerical control machining and inspection;

the design and development of advanced nuclear fuels systems for space, defense, research and commercial applications; and

the production of aluminum-clad uranium fuel elements of high and low enrichments for research and test reactors.

The other manufacturing facilities for BWXT s Nuclear Operations Division are the Barberton, Ohio and Mount Vernon, Indiana facilities. The Barberton facility includes 69 acres with 548,000 square feet of manufacturing area and 119,000 square feet of office area. The Mount Vernon facility, located on the Ohio River, includes 580,000 square feet of manufacturing space and 61,000 square feet of office space. The main manufacturing bay of the Mount Vernon facility is serviced by two 500-ton cranes, which extend over a barge dock on the Ohio River.

Both the Barberton and Mount Vernon facilities utilize multiple, full-contouring, computer numerical control horizontal and vertical machining centers; large gantry robotic welding centers; and state-of-the-art support equipment for machining and welding.

Operations

BWXT manages and operates complex, high-consequence nuclear and national security operations for the DOE and the National Nuclear Security Administration (NNSA), primarily through joint ventures, limited liability corporations and partnerships. In addition, BWXT provides a broad array of technical services in support of DOE and NNSA operations and facilities.

BWXT provides operations, management and technical services in support of the following U.S. Government facilities:

Idaho National Laboratory. The Idaho National Laboratory is an 890-square-mile DOE site near Idaho Falls, Idaho that serves nuclear, national security and scientific research purposes. Operations at the facility include processing and managing radioactive and hazardous materials and nuclear reactor design, demonstration and safety. BWXT manages the nuclear and national security operations of this site as a team member of the Battelle Energy Alliance, the operator of the site.

Savannah River Site. The Savannah River Site is a 310-square mile DOE industrial complex, located in Aiken, South Carolina, dedicated to the processing and storing of nuclear materials in support of the national defense and U.S. nuclear nonproliferation efforts. The site also develops and deploys technologies to improve the environment and treat nuclear and hazardous wastes. As an integrated contractor at this site, BWXT is responsible for nuclear materials management and the startup and operation of a facility to extract tritium, a

radioactive form of hydrogen necessary for the nation s nuclear weapons stockpile.

7

Table of Contents

Strategic Petroleum Reserve. The Strategic Petroleum Reserve provides emergency supply of crude oil stored at four sites in huge underground salt caverns along the Texas and Louisiana Gulf Coast. Since 1993, the facility has been managed and operated by DynMcDermott Petroleum Operations Company, a joint venture of DynCorp/CSC, McDermott International, Inc., International Matex Tank and Terminals and Jacobs Engineering. BWXT manages the contract for McDermott International, Inc.

Pantex Plant. The Pantex Plant is a 16,000-acre NNSA site located near Amarillo, Texas. Key operations at this facility include evaluating, retrofitting and repairing nuclear weapons; dismantling and sanitizing nuclear weapons components; developing, testing and fabricating high-explosive components; and handling and storing plutonium pits. BWXT, through a joint venture with Honeywell International Inc. and Bechtel National, Inc., manages and operates the facility.

Y-12 National Security Complex. The Y-12 facility is an 811-acre NNSA site located in Oak Ridge, Tennessee. Operations at the site focus on the production, refurbishment and dismantlement of nuclear weapons components, storage of nuclear material and the prevention of the proliferation of weapons of mass destruction. As the prime contractor, BWXT, through a joint venture with Bechtel National, Inc., manages the facility.

Los Alamos National Laboratory. The Los Alamos National Laboratory is located in New Mexico and is the DOE weapons laboratory with the largest number of defense facilities and weapons-related activities. It is the foremost site for the government s ongoing research and development on the measures necessary for certifying the safety and reliability of nuclear weapons without the use of nuclear testing. Since 2006, BWXT, as part of Los Alamos National Security, LLC, is the management and operations contractor for this facility. Previously, BWXT was a subcontractor to the University of California at this facility, providing Nuclear Facility Operations Assessment, Advisory and Technical Support Services.

Oak Ridge National Laboratory. The Oak Ridge National Laboratory is a multi-disciplined science and technology complex located on a 58-square mile site near Oak Ridge, Tennessee. This facility is managed and operated by UT-Battelle, LLC for the DOE. BWXT, as an integrated subcontractor to UT-Battelle, LLC, provides technical support in the areas of nuclear facility management and operation.

With manufacturing facilities located in Barberton, Ohio, Mount Vernon, Indiana, and Lynchburg, Virginia, BWXT s Nuclear Operations Division specializes in the design and manufacture of close-tolerance and high-quality equipment for nuclear applications. In addition, it is a leading manufacturer of critical nuclear components, fuels and assemblies for government and commercial uses. The division has supplied nuclear components for DOE programs since the 1950s. In addition, it is the largest domestic supplier of research reactor fuel elements for colleges, universities and national laboratories. BWXT s Nuclear Operations Division also provides uranium targets used for medical isotopes and converts or downblends high-enriched uranium into low-enriched fuel for use in commercial reactors to generate electricity. The division also has over 100 years of experience in supplying heavy fabrications for industrial use, including components for defense applications.

BWXT s Nuclear Operations Division works closely with the DOE supported non-proliferation program. Currently, it is assisting in the development of a high-density, low-enriched uranium fuel required for high-enriched uranium test reactor conversions. In addition, this division has been a leader in the receipt, storage, characterization, dissolution, recovery and purification of a variety of uranium-bearing materials. All phases of uranium downblending and uranium recovery are provided at the division s Lynchburg, Virginia site.

BWXT s Nuclear Operations Division has an experienced staff of design and manufacturing engineers capable of performing full scope, prototype design work coupled with manufacturing integration. Its engineering capabilities include:

steam separation equipment design and development;

thermal-hydraulic design of reactor plant components;

structural component design for precision manufacturing;

materials expertise in high-strength, low-alloy steels, nickel-based materials and others;

material procurement of tubing, forgings, weld wire; and

fully-equipped metallographic and chemical analysis laboratory facility.

Table of Contents

The Nuclear Operations Division also implements strong quality assurance programs for its products.

Customers

The U.S. Government is the primary customer of our Government Operations segment, comprising 97% of segment revenues for the year ended December 31, 2006 and 94% of segment revenues for the year ended December 31, 2005.

The U.S. Government accounted for approximately 15%, 31%, and 27% of our total consolidated revenues for the years ended December 31, 2006, 2005, and 2004, respectively, including 14%, 28%, and 26%, respectively, related to nuclear components.

Contracts

Our contracts with the federal government are subject to annual funding determinations. In addition, contracts with the federal government and its prime contractors usually contain standard provisions for termination at the convenience of the government or the prime contractor. Upon termination of such a contract, we are generally entitled to recover costs incurred, settlement expenses and profit on work completed prior to termination. While we have not generally experienced significant project cancellations, significant or numerous cancellations could adversely affect our business, financial condition and results of operations.

The contracts for the management and operation of U.S. Government facilities are generally structured as five-year contracts with five-year renewal options, which are exercisable by the customer. These are cost-reimbursement contracts with a U.S. Government credit line with little corporate-funded working capital. As a U.S. Government contractor, we are subject to federal regulations under which our right to receive future awards of new federal contracts may be unilaterally suspended or barred if we are convicted of a crime or indicted based on allegations of a violation of specific federal statutes.

Backlog

As of December 31, 2006 and 2005, our Government Operations segment s backlog amounted to approximately $1.3 billion and $1.8 billion, or approximately 17% and 50%, respectively, of our total consolidated backlog. Of our December 31, 2006 backlog in this segment, we expect to recognize revenues as follows (in approximate millions):

	Amount
Quarter Ended:	
March 31, 2007	$150
June 30, 2007	$120
September 30, 2007	$120
December 31, 2007	$110
Year Ended December 31, 2008	$310
Thereafter	$460

As of December 31, 2006, this segment s backlog with the U.S. Government was $1.3 billion (of which $25.1 million had not yet been funded), or approximately 15% of our total consolidated backlog. During the year ended December 31, 2006, the U.S. Government awarded new orders of approximately $94.3 million to this segment. Historically, this segment received a substantial amount of its backlog from the U.S. Government in the fourth quarter of each year. We are currently negotiating terms