Building (bild-ing) n.-v.t. 1. form or establish, develop
2. establish on a foundation, base 3. increasing or having
the power to increase especially in size, amount or degree;
4. rising progressively.

In 2003, building was a common theme for McDermott. By definition, we do not claim to have completed or finished the job, but the 12 months of the year were spent solidifying a foundation from which a stronger, lasting enterprise can grow and flourish.

This annual report to shareholders describes the building that has taken place and the impact on the businesses we operate. There remain challenges ahead, but the work accomplished in 2003 better positions McDermott to meet them.

McDermott International is a leading global energy services company whose customers include major and independent oil and gas producers, hydrocarbon processors, electric utilities and the United States government. The company operates around the world through subsidiaries with some of the best-known names in their industries: J. Ray McDermott in the marine construction industry; BWX Technologies in government operations; and Babcock & Wilcox in the power generation industry.

Utilizing its worldwide project management offices, marine construction fleet and fabrication facilities, J. Ray McDermott designs, engineers, fabricates, transports and installs fixed and floating platforms, pipelines and subsea systems for the production of oil and natural gas.

BWX Technologies is at the forefront of the defense industry in the lifecycle management of complex, high consequence nuclear and national security operations, projects and programs. BWXT is a leader in technology development, engineering and component manufacturing for these operations.

Bruce W. Wilkinson
Chairman of the Board and Chief Executive Officer
As I look back on 2003, McDermott International, Inc. ("McDermott") recognized a combination of important achievements, familiar challenges as well as signs of promise that we’re building an improved future together. For 2004 and beyond, our goals have not changed from what I’ve articulated in the past: we seek to build sustainable profitability around our three “franchise name” businesses, improve our liquidity and strengthen the balance sheet, and continue to simplify our corporate structure.

McDermott consists of three different operating subsidiaries. BWX Technologies ("BWXT") is our government operations segment in the defense industry. J. Ray McDermott ("J. Ray") comprises our marine construction segment. Together, BWXT and J. Ray are the segments contained in McDermott’s consolidated financial results shown in the attached Form 10-K. The third business is The Babcock and Wilcox Company ("B&W"), a leading supplier in the power generation industry. B&W has not been consolidated in McDermott’s financial statements since it filed for bankruptcy in early 2000. B&W’s insolvency was not related to its operations, but rather to the insurmountable number of legal claims filed against it related to asbestos. Condensed results of B&W are included in Note 20 in the attached Form 10-K.

**Achievements, challenges and signs of promise**

Key achievements during the year included:
- The substantial refinancing of the company’s capital structure
- BWXT’s record setting financial performance and backlog
- Resolution of some significant legal challenges facing the company, and good progress on others
- Improvement to the leadership throughout the company

“For 2004 and beyond, our goals have not changed from what I’ve articulated in the past: we seek to build sustainable profitability around our three ‘franchise name’ businesses, improve our liquidity and strengthen the balance sheet, and continue to simplify our corporate structure.”
Perhaps the greatest challenge facing McDermott as it entered 2003 was to obtain a financial structure that would support the company over the longer term. At the beginning of 2003, we faced a February expiration of our credit facility combined with expected cash losses from operations. We signed a new one-year bank facility in February, but with our weakened credit profile, the facility had neither the capacity nor the flexibility needed to operate our businesses long term. The finance organization set out to obtain more permanent financing at the operating subsidiaries. That was largely accomplished in December with the issuance of $200 million of J. Ray’s 11 percent, senior secured notes, the signing of a $135 million, three-year revolving credit facility at BWXT and the extension of B&W’s debtor-in-possession credit facility. The final component is for J. Ray to complete negotiations on a new letter-of-credit (LC) facility. Once an LC facility is signed, these new securities and facilities will provide McDermott’s major subsidiaries with the capital needed to operate their business and will reduce the liquidity concerns surrounding our subsidiaries, positioning them for growth. I appreciate the confidence our new lenders and investors have displayed in the future of our businesses.

Under the first full year of leadership by John Fees, BWXT achieved record levels of profitability and backlog. As a leading participant in the lifecycle management of complex, high consequence nuclear and national security operations, BWXT attained segment income of $86.7 million during 2003, an improvement of 46 percent versus the prior year. In addition, BWXT completed the year with a record backlog of $1.8 billion.

We made significant strides in resolving many of the various legal proceedings to which McDermott or its subsidiaries were a participant. In particular, our legal staff resolved significant aspects of the Petronius dispute which began in 1999. In addition, we resolved almost all of the remaining anti-trust claims filed against J. Ray between 1998 and 2000.

Familiar Challenges at McDermott

The challenges facing the company today are not new. They include:

• Realizing sustainable profitability at J. Ray
• Emerging from the four-year-old B&W bankruptcy
• Managing the liability associated with our defined benefit pension plans

The best signal we can give shareholders that our financial performance has turned the corner is to achieve sustainable financial results. We are not there yet, due to inconsistency at J. Ray. In 2003, J. Ray produced two quarters of segment income, but for the year it realized a segment loss of $45.9 million. J. Ray’s performance was largely muted by $119.6 million in losses associated with fixed price, first-of-a-kind contracts whose risk/reward profiles were skewed and the execution was flawed. Two of these projects, the Medusa and Devils Tower spars, are now substantially complete. The three remaining, Carina Aries (a pipelay project in Argentina), the Belanak FPSO in Indonesia and a third spar, Front Runner, will be finished in 2004. While all of these loss-generating contracts were entered into by previous J. Ray management, the current team is responsible for their completion. J. Ray has implemented improved financial discipline...
and risk management to prevent these types of contracts in the future. The new challenge at J. Ray is to build a pipeline of sufficient, profitable work. While the second half of 2003 saw a reasonable level of bidding activity for new projects, there was an industry-wide slowdown in awards. This will challenge J. Ray’s performance in the first half of 2004 as the capacity and the costs of our facilities may exceed the work we have in backlog. J. Ray is working diligently, but overall it is not yet at the consistent profitability level required.

B&W is the single biggest unknown associated with McDermott’s future. As I mentioned earlier, B&W filed for bankruptcy due to the use of asbestos in its products prior to McDermott’s acquisition of B&W in 1978 and the hundreds of thousands of claims which followed alleging exposure, mostly from claimants who display no ill-effects of asbestos exposure.

There are only two outcomes available to emerge B&W from its bankruptcy, and we are pursuing both simultaneously. The first alternative is through a negotiated settlement with the asbestos claimants and their lawyers. This plan involves giving to the plaintiff’s trust 100 percent of the stock of B&W and its subsidiaries, issuing a $92 million note from McDermott Incorporated and delivering 4.75 million new shares of McDermott stock with certain price guarantees. Additionally, rights to over a billion dollars of insurance coverage would be assigned to the trust.

The second and preferred alternative for B&W relates to the proposed national legislative solution currently being discussed in the U.S. Senate. This solution involves the creation of a national trust for all the victims of asbestos exposure. This trust would be publicly administered but privately funded by companies like B&W and its insurers. I fully believe this legislative solution is the best alternative, not only for McDermott and our shareholders, but for the victims of asbestos exposure and for our national economy.

At December’s special shareholders meeting, the board of directors was given the authority to consider approving the negotiated settlement when the plan is ready to become effective. The asbestos claimants also approved the plan. The material question is whether your Senators and representatives in Washington will approve a bill creating a legislative solution prior to the settlement becoming effective.

I urge our shareholders to contact their Senators and congressional representatives and ask them to pass asbestos resolution legislation, and do so immediately. Everyone at McDermott is sympathetic to the victims of asbestos exposure and wants a system in place to compensate the sick in a fair, timely fashion. The approach of massive lawsuits, largely from claimants displaying no signs of illness, is not working. A national trust seems to be the only approach that will keep companies solvent, compensate the sick, clear our courts and improve the prospects for labor in our country.

The final challenge we face is the liability associated with McDermott’s defined benefit pension plan. In 2003, we charged $89 million against the income statement related to pensions. The vast majority of that amount was non-cash, qualified corporate pension expense ($76 million), but the amount represents a substantial burden to our earnings nonetheless. We have taken

“B&W is the single biggest unknown associated with McDermott’s future. I urge our shareholders to contact their Senators and congressional representatives and ask them to pass asbestos resolution legislation and do so immediately.”
action to minimize the future cost of these plans. In March 2003, J. Ray froze its pension plan to existing participants while increasing its contribution to employees’ 401(k)s. Decisions like this are difficult ones to make. We plan to fulfill the pension promises that were made in the past, but we must continue to ensure that promises we make going forward are those that we can afford. In 2004, non-cash, qualified corporate pension expense is expected to decline to approximately $63 million.

Promising Signs
By no means is our work completed or the turnaround date known, but our 16,000 McDermott employees are working to create the consistently profitable company that rewards your investment. Some of the promising signs I see are:

- McDermott’s stock price increased during the year 173 percent from December 31, 2002
- A resolution of the B&W bankruptcy by legislation or settlement could occur in 2004 or 2005
- Our three franchise named businesses maintained leadership in their respective industry sectors

My colleagues and I are a shareholder-focused management team. McDermott shares were volatile during the year as choppy financial results, liquidity concerns and the ebb and flow of asbestos legislation impacted our trading. In addition, McDermott was removed from the S&P 500 index during 2003 which forced most of the tracking index funds to sell. We are pleased that despite the volatility, your stock’s value improved year-over-year. During 2003, we met with the majority of our shareholder base in meetings and at conferences. We will continue to be open and forthright with you in good times and bad. I appreciate the trust and confidence that you have placed in us and will work diligently to improve the long-term value of your company.

There are no quick fixes but we are working to build a better company each and every day.

In this letter, my intent was to discuss frankly with you the major issues in our business. I encourage you to read thoroughly the attached Form 10-K to familiarize yourself with our financial results and other matters. To provide a brief summary of our financials, McDermott’s revenues increased 35 percent versus 2002 to $2.3 billion, but we realized a net loss of $95.2 million. The net loss includes pretax amounts of $14.5 million related to a non-cash mark-to-market expense associated with the proposed B&W asbestos settlement, $89.2 million of pension expenses and $119.6 million of losses at J. Ray related to the five projects previously discussed. Even though the end is in sight on the J. Ray projects, we are not satisfied with this level of performance. I expect that 2004 will continue to be a turnaround year at J. Ray, but we are building the foundation from which a prosperous future can be attained.

If I sound optimistic about our company, it’s because I am. McDermott has endured its most challenging period in its history and we are dedicated to building a better future. I thank you for your continued trust and support.

Bruce W. Wilkinson
Chairman of the Board and
Chief Executive Officer
March 2004
Building The Management Team

We are building a world-class leadership team. Bob Deason was hired as president at J. Ray in 2003 and quickly assembled his team, including four new hires.

John Fees, a 24-year company veteran, completed his first full year as BWXT president with record operating income. In 2003, our CFO and treasurer completed their first full year with a major refinancing project.

Building Customer Solutions

A common operating goal for McDermott’s businesses is to be the preferred solutions provider for our customers’ needs. Whether the need is for propulsion components for the U.S. Navy, engineering a project for an oil and gas client offshore or providing environmental services for a utility customer, McDermott builds customer solutions.

Building The Capital Structure

Financial flexibility, liquidity concerns, adequate capacity and acceptable covenants. These issues faced the finance organization entering 2003. To help mitigate these concerns, J. Ray completed a $200 million issuance of 11%, 10-year notes. BWXT entered into a three-year, $135 million credit facility and B&W renewed its credit facility. J. Ray is currently negotiating a letter-of-credit facility and once complete, our segments will be positioned for growth.

Building A Better McDermott

Around the globe, McDermott’s 16,000 employees spend their days working in specialties as diverse as our people, from accounting to welding, nuclear engineering to human resources, lawyer to project manager, and everything in between. The roles vary, but the mission is the same: All our efforts are for building a better McDermott.
Building Our Country’s Defenses

BWXT Technologies and its joint ventures ("BWXT") conduct McDermott’s government operations business, through two critical venues:

- BWXT manufactures, and is the premier supplier of, nuclear components for the U.S. Navy; and
- BWXT manages and operates certain facilities and sites for the Department of Energy.

BWXT has been involved with every aspect of the nuclear industry since its inception. It was part of the Manhattan Project in the beginning of nuclear power and now assists our nation’s nonproliferation goals through downblending weapons grade materials.

In manufacturing, BWXT provides the critical skills and resources that produce propulsion systems for the U.S. Navy. To date, BWXT nuclear components have assisted U.S. Navy vessels to safely steam over 124 million miles. Plans for the future include developing space nuclear power as well as the next generation of fuel cells.

In the management and operation of certain Department of Energy facilities, BWXT employees participate at 12 sites through joint ventures in either facilities management or remediation and restoration. Notable sites managed include two nuclear weapons assembly/disassembly facilities as well as our nation’s strategic petroleum reserves.

In 2003, BWXT produced segment income of $86.7 million, its best year ever, on a revenue base of $531 million. With a record year-end backlog of $1.8 billion, BWXT will continue to be the premier manager of complex, high-consequence nuclear and national security operations.
Building Offshore

Ray McDemott ("J. Ray") provides offshore solutions to the oil and gas industry with engineering offices, fabrication facilities and marine operations in the Americas, Middle East, Caspian and Asia Pacific. Its primary focus is on delivering the technical capability, experience and physical capacity to provide a range of solutions to customers. J. Ray’s EPIC and project management services include design, fabrication, transportation and installation of offshore facilities for its customers.

Meaningful strides were taken in 2003 to upgrade J. Ray’s organization on all levels and across all functional operations. Under the new leadership of Bob Deason, who joined the company in March 2003, J. Ray has focused on identifying and adopting best practices in all areas with particular attention to project execution, financial performance, sales, marketing and employee development. J. Ray is strategically focusing its resources to deliver premier performance in its target markets.

In 2003, J. Ray’s revenue was $1.8 billion, an increase of 59% versus 2002, but produced a segment loss of $45.9 million. The revenue growth resulted from increased activity on fabrication and marine installation projects in all geographic areas where J. Ray operates other than the Gulf of Mexico. J. Ray ended 2003 with a backlog of $1.4 billion and anticipates additional bookings in the first half of 2004, indicating that despite recent project challenges, the company is building for the future.
Executive Management

Board of Directors

Bruce W. Wilkinson
Chairman of the Board and
Chief Executive Officer of
McDermott International, Inc.

Philip J. Burguieres
Chief Executive Officer,
EMC Holdings, LLC;
Vice Chairman, Houston Texans

Ronald C. Cambre
Former Chairman of the Board and
Chief Executive Officer,
Newmont Mining Corporation

Bruce DeMars
Partner, RSD, LLC; Admiral,
United States Navy (Retired)

Joe B. Foster
Non-Executive Chairman of the Board,
Newfield Exploration Company;
Former Interim Chairman of the Board,
President and Chief Executive Officer,
Baker Hughes Incorporated

Robert L. Howard
Former Vice President,
Shell Oil Company

John W. Johnstone, Jr.
Former Chairman of the Board and
Chief Executive Officer,
Olin Corporation

D. Bradley McWilliams
Former Senior Vice President and
Chief Financial Officer, Cooper Industries Ltd.

Thomas C. Schievelbein
President,
Northrup Grumman Newport News

Richard E. Woolbert
Former Executive Vice President and
Chief Administrative Officer,
McDermott International, Inc.

Corporate Staff

Bruce W. Wilkinson
Chairman of the Board and
Chief Executive Officer

Francis S. Kalman
Executive Vice President and
Chief Financial Officer

John T. Nesser, III
Executive Vice President,
General Counsel and Corporate Secretary

Louis J. Sannino
Senior Vice President, Human Resources
and Corporate Compliance Officer

James R. Easter
Vice President, Finance and Treasurer

Thomas A. Henzer
Vice President and Corporate Controller

Babcock & Wilcox

David L. Keller
President and Chief Operating Officer

Brandon C. Bethards
Vice President and General Manager,
Fossil Power Division

Eileen M. Competti
President, Diamond Power International, Inc.

James L. Kulig
Vice President and General Manager,
B&W Service Company

Michael G. Morash
Vice President and General Manager,
B&W Construction Company

Richard E. Reimels
Vice President; President,
Babcock & Wilcox Canada

J. Ray McDermott
Robert A. Deason
President and Chief Operating Officer

Hafez K. Aghili
Vice President and General Manager,
Middle East and Caspian Operations

Louis W. Burkart
Vice President, Controller

Kurt S. Nelson
Senior Vice President

Sales, Marketing and Strategic Planning

F. Rickey Oehrlein
Vice President and General Manager,
Caspian Operations

Steven W. Roll
Vice President and General Manager,
Southeast Asia Operations

BWX Technologies

John A. Fees
President and Chief Operating Officer

Douglas L. Garlock
Vice President and General Manager,
Nuclear Equipment Division

Winfred D. Nash
Vice President and General Manager,
Nuclear Products Division

Dennis R. Ruddy
Vice President; President and
General Manager, BWXT Y-12

Rhonnie L. Smith
Vice President; President and
General Manager, BWXT Services, Inc.

J. Rod Woolsey
Senior Vice President, Operational Assurance

1 Audit Committee
2 Compensation Committee
3 Governance Committee
4 Lead Director
Investor Contact
Questions concerning McDermott's operating and financial performance, or requests for additional information about the company, should be directed to:
Jay Roueche,
Director of Investor Relations and Corporate Communications
(281) 870-5462.
Copies of the annual report and Form 10-K are available and may be obtained by contacting:
Investor Relations
McDermott International, Inc.
757 N. Eldridge Parkway
Houston, Texas 77079-4526
(281) 870-5011
or online at www.mcdermott.com

Caution Concerning Forward-Looking Statements
This document includes certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. McDermott cautions that statements in this document which are forward-looking and which provide other than historical information, involve risks and uncertainties that may impact the company’s actual results of operations. Although McDermott’s management believes that the expectations reflected in those forward-looking statements are reasonable, McDermott can give no assurance that those expectations will prove to have been correct. Those statements are made by using various underlying assumptions and are subject to numerous uncertainties and risks. If one or more of these risks materialize, or if underlying assumptions prove incorrect, actual results may vary materially from those expected. For a more complete discussion of information about these risks factors, see McDermott’s annual and quarterly reports filed with the Securities and Exchange Commission.

Corporate Governance
McDermott has posted to its website, www.mcdermott.com in the Investor Relations section, important information on its corporate governance. Information included is McDermott’s Corporate Governance Guidelines, Code of Ethics for the Chief Executive Officer and other Senior Financial Officers, and charters for the Audit, Governance and Compensation Committees of the Board of Directors. Information on McDermott’s independent board members and on how interested parties can contact them is also available on the website.