McDermott International, Inc. is an engineering and construction company, with specialty manufacturing and service capabilities, focused on energy infrastructure. Our projects include steam generating and environmental equipment, offshore production facilities and pipelines, nuclear components and governmental services. McDermott’s customers include the leading participants in the power and energy industries, including the U.S. Department of Energy.

McDermott is **Diversified in Energy**

Representing our exposure to a variety of fuel sources, McDermott’s 2006 backlog of $7.6 billion was comprised of 54% offshore oil & gas, 29% commercial coal & nuclear power and 17% governmental nuclear projects.
It is a pleasure to share this year’s letter regarding the state of your company with each and every one of you. In 2006, McDermott International, Inc. (“McDermott” or the “Company”) successfully completed the multi-year turnaround that began before my tenure commenced. The hurdles our team overcame during this journey were substantial. For this reason and many others, 2006 proved to be the most gratifying 12-month period I’ve enjoyed since becoming CEO of your Company. As we turn the page to a new chapter in this Company’s distinguished history, “McDermott is…” my way to articulate our identity, accomplishments and vision.

McDermott is…

... Unique among our E&C Peers
McDermott is an engineering and construction company, with specialty manufacturing and service capabilities. A distinguishing characteristic of McDermott, compared to our peers, is that all of our activities are focused on energy markets. We also perform more of the work in-house, with less subcontracting. Our projects cover the energy spectrum – coal, nuclear, oil and natural gas. McDermott’s customers primarily consist of North American utilities and other power generators; the super-major, major and national oil companies operating offshore across the globe; and the United States Government, primarily the U.S. Department of Energy (“DOE”).

... French is name operations
For each of the energy markets we serve, McDermott operates through subsidiaries that have earned reputations for excellence, safety, innovation and industry leadership. Our primary operating subsidiaries are:

• The Babcock & Wilcox Company (“B&W”) in power generation systems,
• J. Ray McDermott, S.A. (“J. Ray”) in offshore oil and gas construction, and
• BWX Technologies, Inc. (“BWXT”) in government operations.

The enviable status that our subsidiaries have earned with their respective customers took decades to build. We view the strength of our brands as one of McDermott’s great assets, and therefore we continue utilizing these franchise names today to conduct our business.

... Together again
On February 22, 2006, a transformational event occurred when B&W emerged from its six-year asbestos-related reorganization and was reconsolidated with McDermott. To me, this event was the crowning achievement of McDermott’s turnaround. Due to the significance of this milestone, let me share some of the background.

When I joined McDermott in 2000, B&W had already filed for Chapter 11 bankruptcy as its comprehensive approach to resolving the increasing number of non-employee asbestos claims filed against it and the escalating amount these claimants sought in compensation. As B&W’s case progressed in the courts, it became more and more likely that the ultimate conclusion of the bankruptcy would involve McDermott losing ownership of B&W and incurring substantial expenses in addition. Fortunately, we refused to let this scenario materialize.

With dimming prospects of federal asbestos legislation and the slow progress of B&W’s previously proposed settlement, McDermott reached a revised settlement in August 2005 that became effective in February 2006. This new settlement allowed the Company to continue its ownership of B&W, and instead use cash to fund a trust for all asbestos claimants. During the course of 2006, McDermott and B&W paid all of the financial obligations under the settlement to the trust – a combined $955 million of cash – and assigned about $1.15 billion of insurance rights. As a result, B&W has settled all current and future asbestos claims against it. Of the amount paid, McDermott expects approximately $270 million will return to the Company in the form of a tax refund, likely in late 2007 or early 2008.

B&W literally wrote the book on Steam in 1875. BWXT was part of the Manhattan Project in 1945. J. Ray was a pioneer in offshore oil & gas construction in the 1940s. McDermott’s leadership in each of the industries it serves continues today.
Resolving the B&W reorganization was an essential critical path item for the additional value-creating restructuring that followed, such as:

- In September 2006, we announced that BWXT and B&W would be combined under a common management structure to *Capture the Value* associated with these strong businesses. This combination, effective January 1, 2007, will strengthen our presence in the emerging commercial nuclear market, enhance our service offerings to existing and future customers and produce synergies as the businesses come together. John Fees has been elected President and Chief Executive Officer of the combined entity, The Babcock & Wilcox Companies.

- In December 2006, McDermott consolidated its two groups of U.S. legal entities into a single consolidated group. There are numerous benefits to this transaction, including administrative efficiencies, increased flexibility in our financial structure, returning to a more tax-efficient legal structure and the ability to utilize at least $275 million of net operating losses against future taxable income.

Keeping B&W within McDermott ensures that the Company will be a leader across the energy E&C universe for the foreseeable future and it enables the realization of other synergistic opportunities. As I indicated earlier, it was a true crowning achievement.

**...DELIVERING RESULTS**

The foundation of any successful year begins with financial performance. I am pleased to report that McDermott truly excelled in that regard during 2006. McDermott’s financial health is strong and improving. Revenues exceeded $4.1 billion, clearly the highest level in recent memory. Operating income was about 9.4 percent of revenue, or $387 million, both at the high end of our E&C peer group. And although it’s not a perfect comparison, 2006 reported earnings of $3.01 per diluted share were 66 percent higher than in 2005.

Our success in 2006 is further evidence that McDermott is on the right track and is building momentum. Additional data points demonstrating progress include:

- J. Ray’s strong cash flow enabled it to retire its $200 million, 11% notes in June becoming essentially debt-free in our Offshore Oil & Gas Construction segment.
- Company-wide backlog grew to $7.6 billion, more than 1.8 times 2006 consolidated revenue. J. Ray alone increased backlog by almost $2.4 billion from year-end 2005.
- McDermott ended the year with cash, restricted cash, investments and equivalents totaling in excess of $1.0 billion, a substantial amount considering approximately $950 million was used during 2006 for B&W’s settlement and J. Ray’s debt retirement.
- After almost a decade in dispute, settlement agreements were reached in several of our long-standing legal proceedings.
- In continuing our focus on growth, McDermott spent $146 million on capital expenditures to increase capacity, enhance service offerings, acquire new facilities and maintain our capabilities.

To shareholders, of course, there is one metric that’s probably more important than all the others – stock price performance. In 2006, McDermott shares appreciated 71 percent, well above our peer group average. McDermott ended the year with a market capitalization of $5.6 billion, approximately $2.5 billion greater than year-end 2005. During 2006, McDermott announced and completed a 3-for-2 stock split, which provides additional liquidity for our shares, lowers the entry point for new investors, and reflected the Board’s confidence in the Company’s long-term outlook.

The entire management team at McDermott understands that shareholders are truly the owners of our Company, and I am pleased that McDermott rewarded your ongoing trust and investment.

**McDermott is Customer Focused**

In our businesses, McDermott rarely has a “new” customer, therefore repeat business is essential. The fact that year-end backlog at J. Ray and B&W ascended to recent records is evidence that our customer focus is warranted and rewarded.
OFFSHORE OIL & GAS CONSTRUCTION

From the beginning of oil exploration in the Gulf of Mexico, McDermott has been an industry pioneer. Our Offshore Oil & Gas Construction segment today provides engineering, construction, installation and project management services for the major and national oil companies through our subsidiary, J. Ray McDermott.

During 2006, investing for growth became a major priority for this segment, with notable accomplishments. J. Ray increased capacity in the Middle East and Asia Pacific fabrication facilities, enhanced the marine fleet, and commenced construction on a new facility in Mexico.

These initiatives enabled year-end backlog to reach a record $4.1 billion, an increase of $2.4 billion compared to last year. As demand for our offshore construction services grew, J. Ray was able to provide solutions for customers by demonstrating the strength of our global network.

An example of this global capability is the Reliance Industries project. Destined for Indian waters, this schedule-driven project will draw upon our Houston-based engineering division, the construction facilities in both Louisiana and the United Arab Emirates, and will be installed by our in-house marine fleet.

The Offshore Oil & Gas Construction segment has achieved strong backlog, revenue and earnings growth in recent years and will carry this momentum into 2007.
The Power Generation Systems segment represents our position as a leading supplier of fossil-fired steam generating systems, replacement nuclear steam generators, environmental equipment, replacement parts and related services to the power industry.

Key activities include the design, engineering, manufacturing, construction and related services associated with large utility and industrial power generation systems. This segment is anchored by our subsidiary, The Babcock & Wilcox Company, a leader in the industry since 1867.

In February 2006, B&W emerged from its six-year, asbestos-related restructuring and entered into a plan of reorganization, enabling the reconsolidation of B&W’s financial results. With the bankruptcy proceedings concluded, we are in position to support a growing market.

Backlog ended 2006 at $2.2 billion, bolstered by environmental equipment orders, driven by state and federal clean air regulations, and increased demand for new coal-fired power plants in the United States.

A technology leader, B&W is addressing concerns about greenhouse gas emissions. In 2006, we became a significant participant in SaskPower’s Clean Coal Project. The proposed 300-megawatt pulverized coal plant would capture over 90% of the carbon dioxide emissions, becoming the first commercial-scale coal plant to capture and sequester CO₂ emissions in North America. Our efforts represent our ongoing commitment to research and development in the power industry.
...Setting New Metrics to Define Success

With McDermott’s turnaround declared complete, B&W back in the family and the Company performing well, the question became “now what?” Our management team and the employees of your Company are never satisfied with the status quo. We saw McDermott through its most challenging time, and we are now intensely focused on the next mission: achievement of our 2010 targets.

During 2006, the management team and Board of Directors determined these longer-range goals, the achievement of which we would define as success. While we may reach some of the targets earlier, we set 2010 as the measurement year for the following key goals:

More than double 2005 operating income and other financial targets
One of the keys to our definition of success is to achieve more consistent earnings growth in what are admittedly cyclical markets. We believe that by obtaining an average growth rate of 15 percent from a preset 2005 base level, McDermott will reach at least $600 million of operating income by 2010. This growth rate would more than double 2005 operating income, which was already at a solid level. Other financial targets include maintaining our peer-leading operating margins – an indicator that we deliver more from a dollar of sales to our shareholders than other E&C competitors. We also stated our intention to limit McDermott’s debt-to-book capitalization ratio to below 30 percent.

Enhance existing assets to exploit current business cycle
Probably the highest returning investment a company can make is spending modest amounts of money to increase the capacity of a business that is already succeeding. During 2006, we increased our capital expenditures to prepare for growth. At J. Ray, we invested to increase capacity at two of our construction facilities and in our marine assets. B&W spent money to improve its research and development capabilities during a time when climate-change concerns, the need for new power generating capacity and the desire for U.S. energy independence are all hot topics. BWXT plans to extend the nuclear component manufacturing it currently provides governmental customers, to prepare to serve the commercial nuclear industry as well.

Expand geographic presence to meet client needs
Similar to the preceding goal, taking what a company currently does well to a new geographic region is also a lower-risk growth strategy. It also can leverage our existing customer relationships. In 2006, we announced that BWXT would pursue facilities management and operations in the United Kingdom similar to what we do in the United States for the DOE. Likewise, J. Ray announced plans to open a new fabrication facility in Kazakhstan and began groundbreaking for a new facility in Altamira, Mexico.

Re-enter U.S. commercial nuclear market
A number of initiatives already discussed form the foundation for McDermott’s objective to re-enter the commercial nuclear market in the United States. The combination of B&W and BWXT under common leadership was driven primarily to present a unified offering to commercial nuclear clients, by bringing together what these businesses already provide separately. B&W has been a leader in replacement steam generators and services in the Canadian market for years, while BWXT recently renewed its ASME certifications to provide commercial components in the United States and formed an agreement with AREVA NP. McDermott’s belief is that the United States will return to nuclear power as a primary source for new electricity generation. We are preparing for that future today.

McDermott is Leading Technology

McDermott solves industry problems. By securing over 5,300 U.S. patents in our power businesses and more than 1,000 worldwide patents in offshore construction, McDermott has consistently provided technological solutions to the energy markets we serve.
Pursue acquisitions to expand product offering
McDermott participates in large and growing markets. Coal & nuclear power, production of oil & gas and working with the Department of Energy are strong, core businesses. We have a solid foundation in each of these areas, and are well positioned to add to these strengths. McDermott has also generated strong cash flow. With our turnaround complete, we formed a business development group to explore potential partners and candidates for acquisitions. I have said numerous times, “there are no must-have deals” for McDermott – but if you’re not looking, you’ll never find the perfect opportunistic transaction. If we can generate favorable returns by acquiring a complementary business or partnering with a peer, expect us to do so.

Earn appropriate after-tax returns on all initiatives
Achieving growth would be a lot easier for all companies if the needed capital didn’t have a cost associated with it; however, McDermott competes for capital daily, including for your investment in us. With McDermott’s current credit ratings, the money we borrow isn’t inexpensive and we all know there is no source of capital requiring a higher return than our shareholders’ equity. Because we understand these facts, you can be assured that the capital we invest will be subjected to rigorous analysis and will seek returns worthy of your investment.

These six macro objectives are the guidelines by which we intend to measure ourselves and be judged by the financial community in the coming years. We believe the attainment of these objectives will represent another chapter in your Company’s history: the return of long-term disciplined and profitable growth. Since our opportunities are large, our competition is strong. This Company embraces the challenge. We are proud of our accomplishments but clearly are not satisfied. We look forward to executing on our strategy.

...McDermott is more than you think
I regularly hear or read someone’s description of what they believe McDermott to be. In reality, McDermott is almost always much more than they understand and articulate.

For instance, McDermott is strong in North America, but our reach spans the globe. We’re a market leader in power generation, but equally recognized in oil & gas and government operations. Engineering & construction is our industry, but we also have a solid parts and service business as well as specialty manufacturing operations. Just about any way we can be described, there’s more that can be added.

Probably the best description of who “McDermott is” would be my 27,800-plus co-workers, each of whom I proudly call my colleague. In a competitive marketplace, these men and women chose to be with McDermott during our difficult times and they represent why I am so confident we will be successful going forward.

Best regards,

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

McDermott is a Talented, Global Workforce
Based in Houston, Texas, McDermott’s operations and its 27,800-plus employees across the country and around the globe, help support the world’s energy needs.
GOVERNMENT OPERATIONS

Since the 1940s, our activities within the Government Operations segment have provided industry leadership in nuclear technologies, products and services. We continue that legacy today by delivering our unique design engineering and manufacturing capabilities to the marketplace. Conducted through our subsidiary, BWX Technologies, our primary activities include supplying nuclear components to the U.S. Government and providing various services, including uranium processing, environmental restoration, and management and operations (“M&O”) of government sites.

During 2006, we undertook several strategic initiatives to leverage strengths, pursue growth and enhance market position. BWXT announced plans to re-enter the commercial nuclear market and received nuclear accreditation from the American Society of Mechanical Engineers to do so. As the only so-qualified U.S. manufacturer of large, heavy nuclear components, BWXT announced a partnership with AREVA NP and then was awarded a commercial contract to supply components to the Diablo Canyon nuclear plant. We also entered the United Kingdom to pursue opportunities with that country’s Nuclear Decommissioning Authority and its Atomic Weapons Establishment. In its ongoing effort to reduce costs, BWXT also combined its two manufacturing divisions into one.

Going forward, we expect to remain the premier manager of complex, high-consequence nuclear and national security operations while pursuing expansion in other key markets.
BOARD OF DIRECTORS

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

John F. Bookout, III
Former Director,
McKinsey & Company

Roger A. Brown
Vice President, Strategic Initiatives
Smith International, Inc.

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)

Robert W. Goldman
Former Senior Vice President and
Chief Financial Officer,
Conoco Inc.

Robert L. Howard
Former Vice President,
Shell Oil Company

Oliver D. Kingsley, Jr.
Former President and
Chief Operating Officer,
Exelon Corporation

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

Thomas C. Schievelbein
Former President,
Northrop Grumman Newport News

1 Audit Committee
2 Compensation Committee
3 Governance Committee
4 Finance Committee
5 Lead Director

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,
Chief Administrative and Legal Officer

Louis J. Sannino
Executive Vice President,
Human Resources

James R. Easter
Vice President,
Corporate Development and Strategic Planning

Thomas A. Henzler
Vice President and
Corporate Compliance Officer

Liane K. Hinrichs
Vice President, General Counsel and Corporate Secretary

James C. Lewis
Vice President and Treasurer

John E. Roueche, III
Vice President, Investor Relations and Corporate Communications

Michael S. Taff
Vice President and
Chief Accounting Officer

THE BABCOCK & WILCOX COMPANIES

John A. Fees
President and Chief Executive Officer

Richard E. Reimels
President,
Commercial Nuclear, Inc.

David S. Black
Vice President and Controller

The Babcock & Wilcox Company

Brandon C. Bethards
President,
Fossil Power Group

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

Richard L. Killion
Vice President and General Manager,
Fossil Power Division

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

Michael G. Morash
Vice President and General Manager,
Babcock & Wilcox Construction Company

BWX Technologies, Inc.

S. Robert Cochran
President,
BWXT Services, Inc.

Winfred D. Nash
President,
BWXT Nuclear Operations Division

Rhonnie L. Smith
President,
BWXT Nuclear Services, (U.K.) Ltd.

J. RAY MCDERMOTT, S.A.

Robert A. Deason
President and Chief Operating Officer

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

John T. McCormack
Senior Vice President,
Project Services,
Engineering and Americas

William R. Robinson
Senior Vice President,
Sales, Marketing and Strategic Planning

Louis W. Burkart
Vice President and Controller

Daniel M. Houser
Vice President and General Manager,
Caspian Operations

F. Rickey Oehrlein
Vice President,
Special Projects

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

William L. Soester
Vice President,
Engineering
In 2006, the annual meeting of shareholders of McDermott International, Inc., will be held at 757 N. Eldridge Parkway, 14th floor, Houston, Texas 77079, on Friday, May 4, 2007, at 9:30 a.m. local time.

Investor Contacts

Questions concerning McDermott’s operating and financial performance, or requests for additional information about the company, should be directed to:

Jay Roueche or Robby Bellamy
Investor Relations
(281) 870-5011

Copies of the annual report and Form 10-K are available and may be obtained by contacting:

McDermott International, Inc.
c/o Investor Relations
777 N. Eldridge Parkway
Houston, Texas 77079-4425
(281) 870-5011 or online at www.mcdermott.com

Stockholder Inquiries

Inquiries regarding stockholder account matters should be addressed to:

Computershare Trust Company, N.A.
P.O. Box 43069
Providence, Rhode Island 02940-3069
(877) 282-1168

Stock Exchange

The company’s Common Stock is listed on the New York Stock Exchange. Symbol: MDR

Unless the context otherwise requires, the use in this report (other than the Form 10-K) of the term McDermott International or McDermott refers to the consolidated enterprise. The use of such terms as company, segments, units, division, groups, organization, joint venture, we, us, our or it, when referring either to McDermott or to its subsidiaries and affiliates, either individually or collectively, is only for convenience and is not intended to describe legal relationships. For a listing of McDermott International Inc.’s significant subsidiaries, please refer to its annual report on Form 10-K for the year ended December 31, 2006.

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, including statements relating to our backlogs, the extent to which changes in the industries in which we operate may vary materially from those expected. For a complete discussion of information about these and other risk factors, see McDermott’s annual report on Form 10-K for the year ended December 31, 2006, filed with the Securities and Exchange Commission.

Corporate Governance

Copies of McDermott’s Corporate Governance Guidelines, Code of Business Conduct, charters for the committees of the Board of Directors and other corporate governance materials are available on our website, www.mcdermott.com, at “Corporate Governance” and are available in printed form to any stockholder who requests a copy in writing to McDermott International, Inc., Corporate Secretary’s Office, 777 N. Eldridge Pkwy., Houston, Texas 77079. Information on how stockholders or other interested parties can contact McDermott’s nonmanagement directors is also available on our website at “Corporate Governance – Board Committees.”