

ODYSSEY MARINE EXPLORATION INC  
Form 10-Q  
May 10, 2006

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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 10-Q

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Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the quarterly period ended March 31, 2006

or

Transition report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-31895

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## ODYSSEY MARINE EXPLORATION, INC.

(Exact name of registrant as specified in its charter)

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Nevada  
(State or other jurisdiction of  
incorporation or organization)

5215 W. Laurel Street, Tampa, Florida 33607

(Address of principal executive offices) (Zip code)

(813) 876-1776

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

84-1018684  
(I.R.S. Employer

Identification No.)

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

Indicate by check mark whether the registrant 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 (Check one):

Large accelerated filer:  Accelerated filer:  Non-accelerated filer:

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

The number of outstanding shares of the registrant's Common Stock, \$.0001 par value, as of April 30, 2006 was 46,087,678.

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**PART I: FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

|                                                         | (Unaudited)          |                      |
|---------------------------------------------------------|----------------------|----------------------|
|                                                         | March 31,            | December 31,         |
|                                                         | 2006                 | 2005                 |
| <b>ASSETS</b>                                           |                      |                      |
| <b>CURRENT ASSETS</b>                                   |                      |                      |
| Cash and cash equivalents                               | \$ 8,088,341         | \$ 3,283,331         |
| Accounts receivable, net                                | 983,297              | 1,527,913            |
| Inventory                                               | 4,244,475            | 4,728,394            |
| Other current assets                                    | 640,417              | 729,678              |
| <b>Total current assets</b>                             | <b>13,956,530</b>    | <b>10,269,316</b>    |
| <b>PROPERTY AND EQUIPMENT</b>                           |                      |                      |
| Equipment and office fixtures                           | 10,909,569           | 10,745,738           |
| Building and land                                       | 4,021,323            | 3,973,988            |
| Accumulated depreciation                                | (3,232,886)          | (2,738,572)          |
| <b>Total property and equipment</b>                     | <b>11,698,006</b>    | <b>11,981,154</b>    |
| <b>OTHER ASSETS</b>                                     |                      |                      |
| Inventory (non current)                                 | 6,373,154            | 5,839,914            |
| Attraction development                                  | 1,172,475            | 1,172,475            |
| Other non current assets                                | 923,232              | 927,599              |
| <b>Total other assets</b>                               | <b>8,468,861</b>     | <b>7,939,988</b>     |
| <b>Total assets</b>                                     | <b>\$ 34,123,397</b> | <b>\$ 30,190,458</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>              |                      |                      |
| <b>CURRENT LIABILITIES</b>                              |                      |                      |
| Accounts payable                                        | \$ 359,116           | \$ 601,129           |
| Accrued expenses                                        | 834,173              | 1,843,261            |
| Mortgage and loans payable                              | 111,250              | 111,433              |
| Deposits                                                | 136,404              | 103,069              |
| <b>Total current liabilities</b>                        | <b>1,440,943</b>     | <b>2,658,892</b>     |
| <b>LONG TERM LIABILITIES</b>                            |                      |                      |
| Mortgage payable                                        | 1,733,333            | 1,758,333            |
| Deferred income from Revenue Participation Certificates | 887,500              | 887,500              |
| <b>Total long term liabilities</b>                      | <b>2,620,833</b>     | <b>2,645,833</b>     |
| <b>Total liabilities</b>                                | <b>4,061,776</b>     | <b>5,304,725</b>     |
| <b>STOCKHOLDERS EQUITY</b>                              |                      |                      |

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|                                                                                                                     |               |               |
|---------------------------------------------------------------------------------------------------------------------|---------------|---------------|
| Preferred stock - \$.0001 par value; 6,800,000 and 9,300,000 shares authorized; none outstanding                    |               |               |
| Preferred stock series A convertible - \$.0001 par value; 510,000 shares authorized; none issued or outstanding     |               |               |
| Preferred stock series D convertible - \$.0001 par value; 2,500,000 and 0 shares authorized, issued and outstanding | 250           |               |
| Common stock - \$.0001 par value; 100,000,000 Shares authorized; 46,087,678 and 45,823,224 issued and outstanding   | 4,609         | 4,582         |
| Additional paid-in capital                                                                                          | 52,974,527    | 43,870,228    |
| Accumulated deficit                                                                                                 | (22,917,765)  | (18,989,077)  |
| Total stockholders' equity                                                                                          | 30,061,621    | 24,885,733    |
| Total liabilities and stockholders' equity                                                                          | \$ 34,123,397 | \$ 30,190,458 |

The accompanying notes are an integral part of these financial statements.

## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF OPERATIONS - Unaudited

|                                                      | Three Months Ended |              |
|------------------------------------------------------|--------------------|--------------|
|                                                      | March 31,          | March 31,    |
|                                                      | 2006               | 2005         |
| REVENUE                                              | \$ 865,179         | \$ 3,349,516 |
| OPERATING EXPENSES                                   |                    |              |
| Cost of sales                                        | 114,330            | 216,282      |
| Marketing, general & administrative                  | 2,401,361          | 1,920,927    |
| Operations & research                                | 2,264,055          | 1,312,461    |
| Total operating expenses                             | 4,779,746          | 3,449,670    |
| INCOME (LOSS) FROM OPERATIONS                        | (3,914,567)        | (100,154)    |
| OTHER INCOME (EXPENSE)                               |                    |              |
| Interest income                                      | 13,703             | 8,528        |
| Interest expense                                     | (42,120)           | (28,511)     |
| Other                                                | 14,297             | 13,511       |
| Total other income (expense)                         | (14,120)           | (6,472)      |
| INCOME (LOSS) BEFORE INCOME TAXES                    | (3,928,687)        | (106,626)    |
| Income tax benefit (provision)                       |                    | 94,720       |
| NET INCOME (LOSS)                                    | (3,928,687)        | (11,906)     |
| EARNINGS (LOSS) PER SHARE                            |                    |              |
| Basic and diluted                                    | \$ (.09)           | \$ .00       |
| Weighted average number of common shares outstanding |                    |              |
| Basic and diluted                                    | 45,965,907         | 39,276,793   |

The accompanying notes are an integral part of these financial statements.

## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS - Unaudited

|                                                                           | Three Months Ended  |                     |
|---------------------------------------------------------------------------|---------------------|---------------------|
|                                                                           | March 31,           | March 31,           |
|                                                                           | 2006                | 2005                |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                              |                     |                     |
| Net Income (Loss)                                                         | \$ (3,928,687)      | \$ (11,906)         |
| Adjustments to reconcile net loss to net cash used by operating activity: |                     |                     |
| Deferred income taxes                                                     |                     | (116,922)           |
| Depreciation and amortization                                             | 496,841             | 227,271             |
| (Gain) Loss on disposal of equipment                                      |                     | (14,550)            |
| Share based compensation                                                  | 41,508              |                     |
| Tax benefit related to exercise of employee Stock options                 |                     | 22,202              |
| (Increase) decrease in:                                                   |                     |                     |
| Accounts receivable                                                       | 491,080             | (223,616)           |
| Inventory                                                                 | (49,322)            | (504,201)           |
| Other assets                                                              | 91,101              | (769,221)           |
| Increase (decrease) in:                                                   |                     |                     |
| Accounts payable                                                          | (242,010)           | 308,862             |
| Customer deposits                                                         | 33,334              | (3,065)             |
| Accrued expenses                                                          | (955,553)           | (933,656)           |
| <b>NET CASH (USED) IN OPERATING ACTIVITIES</b>                            | <b>(4,021,708)</b>  | <b>(2,018,802)</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                              |                     |                     |
| Purchase of property and equipment                                        | (211,167)           | (552,384)           |
| Proceeds from sale of equipment                                           |                     | 49,647              |
| Attraction development                                                    |                     | (1,677,360)         |
| Purchase of building improvements                                         |                     | (74,177)            |
| <b>NET CASH (USED) IN INVESTING ACTIVITIES</b>                            | <b>(211,167)</b>    | <b>(2,254,274)</b>  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                              |                     |                     |
| Proceeds from issuance of common stock                                    | 313,068             | 6,919,750           |
| Proceeds from issuance of preferred stock                                 | 8,750,000           |                     |
| Broker commission and fees on private offering                            |                     | (400,000)           |
| Loan payable                                                              | 1,511,250           |                     |
| Repayment of mortgage and loans payable                                   | (1,536,433)         | (25,000)            |
| <b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>                          | <b>9,037,885</b>    | <b>6,494,750</b>    |
| <b>NET INCREASE IN CASH</b>                                               | <b>4,805,010</b>    | <b>2,221,674</b>    |
| <b>CASH AT BEGINNING OF PERIOD</b>                                        | <b>3,283,331</b>    | <b>3,050,721</b>    |
| <b>CASH AT END OF PERIOD</b>                                              | <b>\$ 8,088,341</b> | <b>\$ 5,272,395</b> |
| <b>SUPPLEMENTARY INFORMATION:</b>                                         |                     |                     |
| Interest paid                                                             | \$ 34,045           | \$ 27,766           |
| Income taxes paid                                                         | \$                  | \$                  |
| <b>NON CASH TRANSACTIONS:</b>                                             |                     |                     |
| Depreciation reclassified as inventory                                    | \$                  | \$ 72,912           |
| Accounts receivable paid by services                                      | \$ 53,539           | \$                  |

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|                                           |    |            |
|-------------------------------------------|----|------------|
| Accrued compensation paid by common stock | \$ | \$ 100,000 |
|-------------------------------------------|----|------------|



**Summary of Significant Non-Cash Transactions**

During the quarter ended March 31, 2005, warrants to purchase a total of 470,000 shares were issued to two persons associated with the placement agent as part of the commission paid in connection with a private placement of securities during the period. These warrants are exercisable at a price of \$3.50 per share for a period of two years. The fair value of these warrants as computed by the Black-Scholes option pricing model was \$.72 per warrant, or \$336,504. Due to the high volatility of our stock, we do not believe that the Black-Scholes model provides a realistic fair value for the warrants. These warrants do not have the characteristics of traded warrants, therefore, the warrant valuation models do not necessarily provide a reliable measure of the fair value. By agreement between the parties at the time of the offering, the Company used a fair value of \$.50 per warrant, or \$235,000.

The accompanying notes are an integral part of these financial statements.

**ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE A - BASIS OF PRESENTATION**

Odyssey Marine Exploration, Inc. was incorporated March 5, 1986, as a Colorado corporation named Universal Capital Corporation, Inc. On August 8, 1997 Odyssey Marine Exploration, Inc. (the Company), completed the acquisition of 100% of the outstanding Common Stock of Remarc International, Inc., a Delaware corporation formed May 20, 1994, (Remarc) in exchange for the Company's Common Stock in a reverse acquisition. On September 7, 1997, we changed our domicile to Nevada and our name was changed to Odyssey Marine Exploration, Inc. Odyssey Marine Exploration, Inc., is engaged in the archaeologically sensitive exploration and recovery of deep-water shipwrecks and the marketing and sales of shipwreck-related items. The corporate headquarters are located in Tampa, Florida.

The accompanying unaudited consolidated financial statements of Odyssey Marine Exploration, Inc. and subsidiaries have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and the instructions to Form 10-Q and, therefore, do not include all information and footnotes normally included in financial statements prepared in accordance with generally accepted accounting principles. We suggest these interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Form 10-K for the year ended December 31, 2005.

In the opinion of management, these financial statements reflect all adjustments, including normal recurring adjustments, necessary for a fair presentation of the financial position as of March 31, 2006, results of operations, and cash flows for the interim periods presented. Operating results for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for the full year.

**NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

This summary of significant accounting policies of the Company is presented to assist in understanding our financial statements. The financial statements and notes are representations of the Company's management who are responsible for their integrity and objectivity and have prepared them in accordance with our customary accounting practices.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Odyssey Marine, Inc., Odyssey Marine Services, Inc., OVH, Inc, Odyssey Retriever, Inc. and Odyssey Marine Entertainment, Inc. All significant inter-company transactions and balances have been eliminated.

Shipwreck Heritage Press, LLC was created during 2005 to publish and distribute print media. The entity does not have activity and has not been capitalized, and therefore, it is not consolidated.

**Use of Estimates**

Management uses estimates and assumptions in preparing these financial statements in accordance with generally accepted accounting principles. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could vary from the estimates that were used.

**Revenue Recognition and Accounts Receivable**

Revenue from sales is recognized at the point of sale when legal title transfers. Legal title transfers when product is shipped or is available for shipment to customers. Bad debts are recorded as identified and no allowance for bad debts has been recorded. A return allowance is established for merchandise sales which have a right of return. Accounts receivable is stated net of any recorded allowance for returns.

**Cash Equivalents**

Cash equivalents include cash on hand and cash in banks. We also consider all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.



## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

**Fair Value of Financial Instruments**

The carrying value of cash and cash equivalents, accounts receivable, prepaid expense, accounts payable, accrued expense, loan payable and mortgage payable approximate fair value. Considerable judgment is necessarily required in interpreting market data to develop the estimates of fair value, and, accordingly, the estimates are not necessarily indicative of the amounts that we could realize in a current market exchange.

**Inventory**

Our inventory consists of artifacts recovered from the SS *Republic* shipwreck, related packaging material for the artifacts, and merchandise.

The SS *Republic* shipwreck artifacts are recorded in inventory at the costs of recovery and conservation. The recovery costs also include the fee paid to an insurer to relinquish the insurers claim to the artifacts recovered and the shipwreck. We started capitalizing costs in November 2003 after establishing the artifacts being recovered had a net realizable value exceeding the costs being capitalized. We continued to capitalize the recovery costs until the shipwreck site was completely excavated. The capitalized costs include direct costs of recovery such as vessel and related equipment operations and maintenance, crew and technical labor, fuel, provisions and supplies, port fees and depreciation. Conservation costs include fees paid to conservators for cleaning and preparing the artifacts for sale. We continually monitor the recorded aggregate costs of the artifacts in inventory to ensure these costs do not exceed the net realizable value. We use historical sales, publications or available public market data to assess market value.

The packaging materials and merchandise are recorded at average cost. We record our inventory at the lower of cost or market.

**Long-Lived Assets**

Our policy is to recognize impairment losses relating to long-lived assets in accordance with Financial Accounting Standards Board No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets based on several factors, including, but not limited to, management's plans for future operations, recent operating results and projected cash flows. To date, no such impairment has been indicated.

**Comprehensive Income**

United States Treasury bills with a maturity greater than three months from purchase date are deemed available-for-sale and carried at fair value. Unrealized gains and losses on these securities are excluded from earnings and reported as a separate component of stockholders' equity. At March 31, 2006, we did not own United States Treasury Bills with a maturity greater than three months.

**Property and Equipment and Depreciation**

Property and equipment is stated at historical cost. Depreciation is provided using the straight-line method at rates based on the assets' estimated useful lives which is normally between five and ten years. Leasehold improvements are amortized over their estimated useful lives or lease term, if shorter. Depreciation expense capitalized was directly related to our vessel *Odyssey Explorer* and supporting equipment during the SS *Republic* excavation.

Depreciation expense is summarized as follows:

|                                            | Three Months Ended |            |
|--------------------------------------------|--------------------|------------|
|                                            | March 31,          | March 31,  |
|                                            | 2006               | 2005       |
| Depreciation expense                       | \$ 494,314         | \$ 300,183 |
| Less depreciation capitalized to inventory |                    | 72,912     |

|                          |            |            |
|--------------------------|------------|------------|
| Net depreciation expense | \$ 494,314 | \$ 227,271 |
|--------------------------|------------|------------|

## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

## Earnings Per Share

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that would occur if dilutive securities and other contracts to issue Common Stock were exercised or converted into Common Stock or resulted in the issuance of Common Stock that then shared in our earnings. We use the treasury stock method to compute potential common shares from stock options and warrants and the as-if-converted method to compute potential common shares from Preferred Stock or other convertible securities.

When a net loss occurs, potential common shares have an anti-dilutive effect on earnings per share and such shares are excluded from the Diluted EPS calculation.

For the periods ending March 31, 2006 and 2005 in which net losses occurred, all potential common shares were excluded from diluted EPS because the effect of including such shares would be anti-dilutive. The potential common shares, in the table following, represent potential common shares from outstanding options and warrants that were excluded from the calculation of Diluted EPS:

|                                                          | Three Months Ended |           |
|----------------------------------------------------------|--------------------|-----------|
|                                                          | March 31,          | March 31, |
|                                                          | 2006               | 2005      |
| Average market price during the period                   | \$ 3.69            | \$ 2.64   |
| In the money potential common shares excluded            | 662,379            | 943,395   |
| Out of the money options excluded:                       |                    |           |
| Stock Options with an exercise price of \$4.00 per share | 60,500             |           |
| Stock Options with an exercise price of \$5.00 per share | 495,000            | 540,000   |
| Warrants with an exercise price of \$3.50 per share      |                    | 3,170,000 |
| Warrants with an exercise price of \$5.25 per share      | 100,000            |           |
| Anti dilutive warrants and options excluded from EPS     | 1,317,879          | 4,653,395 |

Also, a total of 472,222 and 0 weighted average potential common shares from Series D Preferred Stock outstanding were excluded from potential common shares for the period ended March 31, 2006 and 2005, respectively.

The following is a reconciliation of the numerators and denominators used in computing basic and diluted loss per share:

|                                                  | Three Months Ended |             |
|--------------------------------------------------|--------------------|-------------|
|                                                  | March 31,          | March 31,   |
|                                                  | 2006               | 2005        |
| Numerator, basic and diluted net loss            | \$ (3,928,687)     | \$ (11,906) |
| Denominator:                                     |                    |             |
| Weighted average common shares outstanding basic | 45,965,907         | 39,276,793  |
| Effect of potential common shares                |                    |             |
| Weighted average common shares basic and diluted | 45,965,907         | 39,276,793  |

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|                                  |    |        |    |        |
|----------------------------------|----|--------|----|--------|
| Loss per share basic and diluted | \$ | (0.09) | \$ | (0.00) |
|----------------------------------|----|--------|----|--------|

## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

## Share-Based Compensation

On January 1, 2006, we adopted Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123(R)), that addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for either equity instruments of the enterprise or liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. The statement eliminates the ability to account for share-based compensation transactions, as we formerly did, using the intrinsic value method as prescribed by Accounting Principles Board, or APB, Opinion No. 25, Accounting for Stock Issued to Employees, and generally requires that such transactions be accounted for using a fair-value-based method and recognized as expenses in our consolidated statement of operations.

We adopted FAS 123(R) using the modified prospective method which requires the application of the accounting standard as of January 1, 2006. Our consolidated financial statements as of and for the first quarter of 2006 reflect the impact of adopting FAS 123(R). In accordance with the modified prospective method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of FAS 123(R).

Stock-based compensation expense recognized during the period is based on the value of the portion of stock-based payment awards that is ultimately expected to vest. Stock-based compensation expense recognized in the consolidated statement of operations during the first quarter of 2006 included compensation expense for the stock-based payment awards granted prior to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123(R). As stock-based compensation expense recognized in the statement of operations is based on awards ultimately expected to vest, it will be reduced for estimated forfeitures. FAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

As a result of adopting FAS 123(R), \$41,508 of share-based compensation was charged against income for the three-month period ended March 31, 2006. For the three-month period ended March 31, 2005, the following table illustrates the effect on net income and earnings per share had we applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Share-Based Compensation, to share-based employee compensation.

|                                                   | March 31,    |
|---------------------------------------------------|--------------|
|                                                   | 2005         |
| Net income (loss):                                |              |
| As reported                                       | \$ (11,906)  |
| Pro forma adjustment for compensation, net of tax | (317,687)    |
| Pro forma                                         | \$ (329,593) |
| Basic income (loss) per share:                    |              |
| As reported                                       | \$ .00       |
| Pro forma                                         | \$ (.01)     |
| Diluted income (loss) per share:                  |              |
| As reported                                       | \$ .00       |
| Pro forma                                         | \$ (.01)     |

The weighted average estimated fair value of stock options granted during the three-month period ended March 31, 2005 was \$2.15. During the three months ended March 31, 2006, we granted stock options from the 2005 Stock Incentive Plan which was approved at the annual Shareholding meeting on May 5, 2006. Therefore, since these instruments were granted from an unapproved plan as of March 31, 2006, in conformity with SFAS 123(R), compensation expense has not been recorded for the quarter ended March 31, 2006. The weighted average estimated fair value was determined using the Black-Scholes option-pricing model, which values options based on the stock price at the grant date, the expected life of the option, the estimated volatility of the stock, the expected dividend payments, and the risk-free interest rate over the life of the option. The assumptions used in the Black-Scholes model were as follows:





## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - continued

|                                     | 3 Month Period Ended |           |
|-------------------------------------|----------------------|-----------|
|                                     | March 31,            | March 31, |
|                                     | 2006                 | 2005      |
| Risk-free interest rate             | N/A                  | 4.8%      |
| Expected volatility of common stock | N/A                  | 210%      |
| Dividend Yield                      | N/A                  | 0%        |
| Expected life of options            | N/A                  | 2-5 years |

The Black-Scholes option valuation model was developed for estimating the fair value of traded options that have no vesting restrictions and are fully transferable. Because option valuation models require the use of subjective assumptions, changes in these assumptions can materially affect the fair value of the options. Our options do not have the characteristics of traded options, therefore, the option valuation models do not necessarily provide a reliable measure of the fair value of our options.

**Income Taxes**

Income taxes are accounted for using an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. A valuation allowance is provided when it is more likely than not that some portion or the entire deferred tax asset will not be realized.

**NOTE C - INVENTORY**

Our inventory consisted of the following:

|                 | March 31,     | December 31,  |
|-----------------|---------------|---------------|
|                 | 2006          | 2005          |
| Artifacts       | \$ 9,378,661  | \$ 9,320,343  |
| Merchandise     | 622,938       | 634,558       |
| Packaging       | 616,030       | 613,407       |
| Total Inventory | \$ 10,617,629 | \$ 10,568,308 |

Of these amounts \$6,373,154 and \$5,839,914 are classified as non-current as of March 31, 2006 and December 31, 2005, respectively.

**NOTE D - INCOME TAXES**

As of March 31, 2006, the Company had consolidated income tax net operating loss ( NOL ) carryforwards for federal tax purposes of approximately \$35 million. The NOL will expire in various years ending through the year 2026.

For the three-month periods ended March 31, 2006 and 2005, the components of the provision for income taxes (benefit) are attributable to continuing operations as follows:

| March 31, | March 31, |
|-----------|-----------|
|-----------|-----------|

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|          | 2006 | 2005        |
|----------|------|-------------|
| Current  |      |             |
| Federal  | \$   | \$          |
| State    |      |             |
|          | \$   | \$          |
| Deferred |      |             |
| Federal  | \$   | \$ (88,856) |
| State    |      | (5,864)     |
|          | \$   | \$ (94,720) |

## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE D - INCOME TAXES - continued

Deferred income taxes reflect the net tax effects of the temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets and liabilities are as follows:

|                                                   |               |
|---------------------------------------------------|---------------|
| Deferred tax assets:                              |               |
| Net operating loss and capital loss carryforwards | \$ 13,288,066 |
| Accrued expenses                                  | 90,606        |
| Reserve for accounts receivable                   | 17,823        |
| Less: valuation allowance                         | (9,408,116)   |
|                                                   | \$ 3,988,379  |
| Deferred tax liability:                           |               |
| Property and equipment basis                      | \$ 71,319     |
| Prepaid expenses                                  | 72,484        |
| Inventory reserve                                 | (7,786)       |
| Excess of tax over book depreciation              | 517,312       |
| Artifacts recovery costs                          | 3,335,030     |
|                                                   | \$ 3,988,379  |
| Net deferred tax asset                            | \$            |

As reflected above, we have recorded a net deferred tax asset of \$0 at March 31, 2006. In accordance with SFAS No. 109, *Accounting for Income Taxes*, we have evaluated whether it is more likely than not that the deferred tax assets will be realized. Based on the available evidence, we have concluded that it is more likely than not that those assets would not be realizable without the recovery of high value shipwrecks and thus a valuation allowance has been recorded as of March 31, 2006.

The change in the valuation allowance is as follows:

|                               |              |
|-------------------------------|--------------|
| March 31, 2006                | \$ 9,408,116 |
| December 31, 2005             | \$ 7,791,859 |
| Change in valuation allowance | \$ 1,616,257 |

Income taxes for the three month periods ended March 31, 2006 and 2005 differ from the amounts computed by applying the effective federal income tax rate of 34% to income before income taxes as a result of the following:

|                                            | March 31,<br>2006 | March 31,<br>2005 |
|--------------------------------------------|-------------------|-------------------|
| Expected provision (benefit)               | \$ (1,335,754)    | \$ (36,253)       |
| State income taxes net of federal benefits | (90,908)          | (4,084)           |
| Nontaxable (income) expense                | 3,879             | (15,970)          |
| Stock options exercised                    | (200,411)         |                   |

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|                               |           |             |
|-------------------------------|-----------|-------------|
| Change in valuation allowance | 1,616,257 |             |
| Effects of:                   |           |             |
| Change in rate estimate       |           | (38,413)    |
| Other, net                    | 6,937     |             |
|                               | \$        | \$ (94,720) |

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**ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE D - INCOME TAXES - continued**

During the three-month periods ended March 31, 2006 and 2005, the Company recognized certain tax benefits related to stock option plans in the amount of \$0 and \$22,202 respectively. Such benefits were recorded as an increase in the deferred tax asset and an increase in additional paid-in capital.

**NOTE E - CONTINGENCIES**

**Legal Proceedings**

On or about December 14, 2004 a complaint was filed against seven defendants including the Company in the Court of Common Pleas in the Ninth Judicial Circuit, County of Charleston, in the State of South Carolina. The complaint was filed by Republic & Eagle Associates, Inc. and Sea Miners, Inc. against John Morris, Greg Stemm, John Lawrence, John Balch, Daniel Bagley, Seahawk Deep Sea Technologies, Inc. (Seahawk) and the Company. The plaintiff's allegations include breach of fiduciary duty, civil conspiracy and breach of contract based primarily upon an alleged contract(s) between the plaintiffs and Seahawk dated May 16, 1995 dealing with the search for the SS *Republic*. The plaintiffs allege that their research, which was provided to Seahawk, led to the discovery of the SS *Republic* and they seek an unspecified amount of damages and public recognition of their contribution. On February 18, 2005, John Morris, Greg Stemm, Daniel Bagley, and the Company filed their Notice of Motion and Motion to Dismiss Defendants John Morris, Greg Stemm, Daniel Bagley and Odyssey Marine Exploration, Inc. (the Motion). In the Motion, the defendants allege that the complaint should be dismissed because, among other things, the South Carolina court does not have jurisdiction over them, the action was filed in an improper venue, plaintiffs lack the capacity to maintain the action, and the action should be barred based on the Doctrine of Forum Non Conveniens. The parties continue to engage in discovery. On April 19, 2006, the South Carolina court heard arguments on the Motion, but as of yet has not issued a ruling. Management believes the lawsuit is without merit and intends to vigorously defend the action.

The Company may be subject to a variety of claims and suits that arise from time to time in the ordinary course of business. Management currently believes that these claims and suits will not have a material adverse impact on its financial position or its results of operations.

**NOTE F RELATED PARTY TRANSACTIONS**

During the three-month ended March 31, 2005, a construction company, owned by the stepson of an officer of the Company was paid for renovation services on our corporate headquarters building amounting to \$77,161. Also, the spouse of a Company officer was paid \$1,800 for logo design services for the three-months ended March 31, 2005.

**NOTE G LOAN PAYABLE**

**Revolving Credit Facility**

On March 29, 2006, we entered into an Amended and Restated Revolving Credit Agreement with Mercantile Bank. The Amended and Restated Credit Agreement replaces the Company's prior agreement with the Bank. The Amended and Restated Agreement reduced the amount of the commitment from the Bank from a \$6 million revolving credit facility to a \$3 million revolving credit facility. The \$4 million of gold coins previously collateralized were removed from the amended agreement and silver coins collateralized and held by the custodian increased from 10,000 to 15,000 coins. The credit facility has a floating interest rate equal to the LIBOR 30-Day Index Rate plus two hundred sixty five basis points (2.65%), requires monthly payments of interest only and is due in full on April 21, 2008. The Company will also be required to pay the Bank an unused line fee equal to 0.25% per annum of the unused portion of the credit line, payable quarterly. Additionally, the Company granted a first lien position on all corporate assets, including a provision not to pledge as collateral our Company-owned vessels. The Company is required to comply with a number of covenants including maintaining a minimum stockholders' equity of \$20,000,000, which amount may be increased after the first year.

**NOTE H - PREFERRED STOCK**

On March 13, 2006, the Company sold 2,500,000 shares of non-voting Series D Convertible Preferred Stock, par value \$0.0001 per share, at \$3.50 per share to two institutional accredited investors pursuant to the terms of a purchase agreement. The Series D Preferred Stock is convertible into Common Stock at a ratio of one (1) share of Common Stock for every one (1) share of Series D Preferred Stock. Proceeds of the private offering were \$8,750,000.



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**ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE I COMMON STOCK OPTIONS**

On August 3, 2005, our Board of Directors approved and adopted our 2005 Stock Incentive Plan. This plan was submitted to our shareholders and was ratified at the Annual Meeting of Stockholders on May 5, 2006. The plan provides for the grant of incentive stock options, non-qualified stock options, restricted stock awards, restricted stock units and stock appreciation rights. We have reserved 2,500,000 of our authorized but unissued shares of common stock for issuance under the plan and not more than 500,000 of these shares may be used for restricted stock awards and restricted stock units. Any incentive option and any non-qualified option granted under the plan must provide for an exercise price of not less than the fair market value of the underlying shares on the date of grant, but the exercise price of any incentive option granted to an eligible employee owning more than 10% of our outstanding common stock must not be less than 110% of fair market value on the date of the grant.

**NOTE J SEGMENT REPORTING**

SFAS 131, Disclosures about Segments of an Enterprise and Related information, establishes standards for reporting information about operating segments. Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our Chief Executive Officer. The Company manages and evaluates the operating results of the business in two primary segments, shipwreck exploration and themed attractions.

**Shipwreck Exploration** This segment includes all operating activities for exploration and recovery of deep-water shipwrecks including the marketing, promotion and distribution of recovered artifacts, related replicas, merchandise and books through various retail and wholesale sales channels.

**Themed Attractions** This segment is responsible for the development and operation of interactive attractions and exhibits which will entertain and educate multi-generational audiences, and present our unique shipwreck stories and artifacts.

The accounting policies of the business segments are the same as those described in the summary of significant accounting policies included in Note A. Management evaluates the operating results of each of its segments based upon revenues and operating income (loss) before taxes. Corporate overhead including legal, finance, human resources, information technology, real estate facilities, as well as stock-based compensation, is included within the shipwreck exploration segment and not allocated to themed attractions.

On June 8, 2005, we announced that a newly formed subsidiary, Odyssey Marine Entertainment, Inc., would open an interactive shipwreck and treasure attraction in the French Quarter of New Orleans, Louisiana. Located in the Jax Brewery, *Odyssey's Shipwreck & Treasure Adventure* appeals to the universal fascination with shipwrecks and sunken treasure. We held the grand opening on August 27, 2005, at the Jax Brewery complex in the French Quarter of New Orleans. The attraction was closed early on the grand opening day due to Hurricane Katrina. The Jax Brewery building in which the attraction resides remained closed until February 2006. The Odyssey attraction sustained minimal damage and we were able to safely remove all irreplaceable artifacts and valuables including coins and other high-value items. Odyssey carries \$4.5 million of insurance coverage for the attraction including property and business income. A preliminary insurance claim was filed in January 2006 and a revised claim in April 2006. However, we presently cannot estimate the amount of insurance proceeds we may receive. On February 15, 2006, we re-opened *Odyssey's Shipwreck & Treasure Adventure* in New Orleans. Unlike the rest of the city, the French Quarter escaped mostly intact and tourists are slowly returning to the area.



## ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## NOTE J SEGMENT REPORTING continued

| (amounts in thousands)                   | Shipwreck   | Themed      | Consolidated |
|------------------------------------------|-------------|-------------|--------------|
|                                          | Exploration | Attractions |              |
| <b>Segment Information</b>               |             |             |              |
| <i>Three months ended March 31, 2006</i> |             |             |              |
| Revenues from external customers         | \$ 818      | \$ 47       | \$ 865       |
| Income (loss) before income taxes        | \$ (3,324)  | \$ (605)    | \$ (3,929)   |
| Segment assets                           | \$ 29,317   | \$ 4,806    | \$ 34,123    |
| <i>Three months ended March 31, 2005</i> |             |             |              |
| Revenues from external customers         | \$ 3,350    | \$          | \$ 3,350     |
| Income (loss) before income taxes        | \$ 19       | \$ (126)    | \$ (107)     |
| Segment assets                           | \$ 34,867   | \$          | \$ 34,867    |

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following discussion will assist in the understanding of our financial position and results of operations. The information below should be read in conjunction with the financial statements, the related notes to the financial statements and our report on Form 10-K for the year ended December 31, 2005.

This discussion contains both historical and forward-looking information. We assess the risks and uncertainties about our business, long-term strategy, and financial condition before we make any forward-looking statements, but we cannot guarantee that our assessment is accurate or that our goals and projections can or will be met. Statements concerning results of future search operations, recovery operations, attraction openings, marketing strategies and similar events are forward-looking statements within the meaning of Securities laws and regulations.

**Overview**

Odyssey Marine Exploration, Inc. is engaged in the archaeologically sensitive exploration and recovery of deep-water shipwrecks throughout the world. We employ advanced state-of-the-art technology, including side scan sonar, remotely operated vehicles, or ROVs, and other advanced technology, that enables us to locate and recover shipwrecks at depths that were previously unreachable in an economically feasible manner. Odyssey continues to build on a foundation of shipwreck research, development of political relationships and advancement of techniques for deep-ocean search and recovery. Odyssey is a Nevada corporation formed on March 5, 1986.

Our vision is to become the world leader in deep-ocean shipwreck exploration, archeological excavation, education, entertainment, and marketing of shipwreck cargoes and related merchandise.

**Business Segments**

The Company manages and evaluates the operating results of the business in two primary segments: shipwreck exploration and themed attractions.

**Shipwreck Exploration** This segment includes all operating activities for exploration and recovery of deep-ocean shipwrecks including the marketing, promotion and distribution of recovered artifacts, replicas, merchandise and books through various retail and wholesale sales channels. The departments included within this group include our marine operations, archaeology, conservation and research, marketing, sales and corporate administration.

Marine operations is tasked with the discovery and recovery of deep-ocean shipwrecks utilizing state-of-the-art technology, including side scan sonar, remotely operated vehicles (ROVs), and other advanced technology. They oversee ships, offshore technology, and ship and technical crews. The marine operations team has also developed proprietary procedures, software and equipment to improve the quality and speed of deep-ocean shipwreck operations.

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Our archaeology, conservation and research department supports marine operations by providing target information as well as conducting historical research on artifacts recovered from shipwrecks. After recovered items are returned to shore, our conservation department stabilizes the artifacts and ultimately brings them to their final state of conservation. This department also provides the curation of company-owned artifacts.

Our marketing and sales department includes support functions for the promotion and distribution of products through both retail and wholesale channels.

Our shipwreck exploration segment continues to rely significantly on the recovered shipwreck cargoes as a primary source of raw materials. The availability of raw materials is primarily dependent on the success of finding intrinsically valuable cargoes from shipwrecks. If we are not successful in the exploration and recovery of shipwrecks, we may not have sufficient raw materials to sell.

Our corporate administrative department oversees all aspects of business management and reporting including compliance. The department is also responsible for public and investor relations, finance and accounting, information technology, legal and human resources.

**Themed Attractions** Our themed attractions group is responsible for interactive attractions and exhibits that entertain and educate multi-generational audiences, and present Odyssey's unique shipwreck stories and artifacts. The exhibits showcase our proprietary technologies and the excitement of deep-ocean archeological shipwreck search and recovery. On June 8, 2005, we announced that a newly formed subsidiary, Odyssey Marine Entertainment, Inc., would open an interactive shipwreck and treasure attraction in the French Quarter of New Orleans, Louisiana. Located in the Jax Brewery, *Odyssey's Shipwreck & Treasure Adventure* appeals to the universal fascination with shipwrecks and sunken treasure. The attraction tells the stories behind some of the world's most famous shipwrecks, their treasure and historical artifacts, and allows visitors to experience the adventure and excitement of deep-ocean shipwreck exploration through multiple hands-on interactive exhibits.

We held the grand opening of our first themed attraction, *Odyssey's Shipwreck & Treasure Adventure*, on August 27, 2005, at the Jax Brewery complex in the French Quarter of New Orleans. The attraction was closed early on the grand opening day due to Hurricane Katrina. The Jax Brewery building in which the attraction resides remained closed until February 2006. The Odyssey attraction sustained minimal damage and we were able to safely remove all irreplaceable artifacts and valuables including coins and other high-value items. Odyssey carries \$4.5 million of insurance coverage for the attraction including property and business income. A preliminary insurance claim was filed in January 2006 and a revised claim in April 2006. However, we presently cannot estimate the amount of insurance proceeds we may receive.

On February 15, 2006, we re-opened *Odyssey's Shipwreck & Treasure Adventure* in New Orleans. Unlike the rest of the city, the French Quarter escaped mostly intact and tourists are slowly returning to the area. We continue to evaluate our business alternatives for our second attraction currently in development.

|                                          | Shipwreck   | Themed      |              |
|------------------------------------------|-------------|-------------|--------------|
| (amounts in thousands)                   | Exploration | Attractions | Consolidated |
| <b>Segment Information</b>               |             |             |              |
| <i>Three months ended March 31, 2006</i> |             |             |              |
| Revenues from external customers         | \$ 818      | \$ 47       | \$ 865       |
| Income (loss) before income taxes        | \$ (3,324)  | \$ (605)    | \$ (3,929)   |
| Segment assets                           | \$ 29,317   | \$ 4,806    | \$ 34,123    |
| <i>Three months ended March 31, 2005</i> |             |             |              |
| Revenues from external customers         | \$ 3,350    | \$          | \$ 3,350     |
| Income (loss) before income taxes        | \$ 19       | \$ (126)    | \$ (107)     |
| Segment assets                           | \$ 34,867   | \$          | \$ 34,867    |

#### Operational Update

In the past, we have from time to time disclosed information concerning each of our existing and planned search operations. Also, we may have entered into agreements with parties who have provided information regarding specific targets. In order to protect the identities of the targets of our planned search operations, we have decided to defer disclosing specific information relating to our search targets or agreements until we have located the targeted shipwreck or shipwrecks and determined a course of action to protect our property rights.

We resumed search operations on the Atlas project in April utilizing a ship equipped with Odyssey's advanced side-scan, magnetometer and other proprietary technology. In addition, Odyssey's MaxRover ROV, nicknamed CLIO, has been relocated to the Atlas search area to be used for site inspections.

The 2005 search operations in the Atlas area resulted in the mapping of over 4,600 square miles of the search area. Results include the discovery of 2,421 anomalies on the sea floor using an advanced high-resolution side-scan sonar system. After post-processing data, over 1,100 of those anomalies were selected for possible further examination. Of those, 577 sites have been inspected and at least 180 are believed to be manmade or shipwreck sites.

Our research indicates that a minimum of five high-value shipwrecks are in the Atlas search area. (For reasons of security and strategic confidentiality, the Company does not disclose the location of the Atlas area.)

Odyssey's 251 deep-ocean archaeological platform, the *Odyssey Explorer* continues to work on deep-ocean projects in the Mediterranean. For security reasons, information relating to these projects may not be disclosed until completion of recovery operations.

### HMS *Sussex*

In March 2006, we submitted an archaeological plan which addressed all issues raised by the Autonomous Region of Andalusia and the central Spanish government in reference to the ongoing HMS *Sussex* project. We are awaiting final comments and approval of the plan before continuing operations on that shipwreck.

HMS *Sussex* was an 80-gun English warship lost in a severe storm in the western Mediterranean in 1694. Research suggests the *Sussex* was carrying a large cargo of coins when she sank. Odyssey believes it has located the shipwreck of HMS *Sussex* and has signed an exclusive partnering agreement with the legal owner of the shipwreck, the Government of the United Kingdom, for the archaeological excavation of the shipwreck.

We have completed to the satisfaction of the Government of the United Kingdom all work detailed Phase 1A of the *Sussex* archaeological project plan. We have also completed a portion of Phase 1B. (A public version of the project plan is available for viewing at [www.shipwreck.net](http://www.shipwreck.net).)

### Critical Accounting Policies and Changes to Accounting Policies

There have been no material changes in our critical accounting estimates since December 31, 2005, nor have we adopted any accounting policy that has or will have a material impact on our consolidated financial statements.

### Results of Operations

#### Three months ended March 31, 2006 compared to three months ended March 31, 2005

*The dollar values discussed below, except as otherwise indicated, are approximations to the nearest \$100,000.*

|                                     | (Unaudited) |        |             |       |
|-------------------------------------|-------------|--------|-------------|-------|
|                                     | 2006        | 2005   | Incr/(Decr) |       |
|                                     |             |        | \$ Var      | % Var |
| Revenue                             | \$ .9       | \$ 3.4 | \$ (2.5)    | (74)% |
| Cost of sales                       | .1          | .2     | (.1)        | (47)% |
| Marketing, general & administrative | 2.4         | 1.9    | .5          | 25%   |
| Operations & research               | 2.3         | 1.3    | 1.0         | 73%   |
| Total cost and expenses             | \$ 4.8      | \$ 3.4 | \$ 1.4      | 39%   |
| <b>Revenue</b>                      |             |        |             |       |

Revenues are generated primarily through the sale of gold and silver coins, but also include other artifacts and merchandise. Revenues for 2006 and 2005 were \$.9 million and \$3.4 million, respectively, representing sales volume of gold and silver coins of approximately 180 coins in 2006 and 480 coins in 2005. We continue to sell numismatic coins to independent coin dealers. The decrease of \$2.5 million in 2006 is primarily due to a lower availability of high-value numismatic gold coins and sales to fewer independent coin dealers. Our experience has shown that many of these independent dealers are primarily interested in higher quality numismatic gold coins. As our availability of these higher quality gold coins diminishes, we expect the number of independent dealers interested in our coins to be reduced. We are continuing to develop additional indirect

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sales channels to supplement our sales to independent coin dealers of our non-graded gold, shipwreck effect silver coins and for other merchandise. While significant revenue has not yet been realized from these new indirect sales channels, we are building additional distribution for Odyssey shipwreck products, which should begin producing revenue during 2006.

We continued to develop retail distribution of coins, artifacts and merchandise in our direct retail sales channels where our gross margins are higher. While these sales increased in the first quarter 2006 relative to 2005, our overall expectations have not yet been achieved. After investigating opportunities to increase revenue and reduce expenses without compromising the overall strategic business plan, we decided to restructure our business development and sales functions. Based on several favorable tests, direct sales (inbound and outbound call center and related infrastructure) have been outsourced to an experienced direct marketing call center partner so that the internal business development team can focus on business to business (wholesale) sales channels and joint venture opportunities.

### **Costs and Expenses**

Cost of sales consists of shipwreck recovery costs, grading, conservation, packaging, and shipping costs associated with artifact, merchandise and book sales. Cost of sales as a percentage of revenue for 2006 and 2005 was 13% and 6%, respectively. The lower cost of sales percentage in 2005 is attributable to a high sales mix of gold versus silver coins.

The major factors that contribute to cost of sales as a percentage of revenue include capitalized ship recovery costs, number of artifacts recovered, revenue per artifact sold and the cost of merchandise and books. Cost of sales as a percentage of revenue will change depending on the sales mix because of the significantly higher unit sales prices for gold than silver coins and other merchandise.

Marketing, general and administrative expenses were \$2.4 million in 2006 as compared to \$1.9 million in 2005. Of the \$.5 million increase, \$.2 million resulted from advertising expenses primarily associated with our direct sales effort. Additionally, \$.2 million related to our themed attractions segment for continuing and extra expenses of our closed New Orleans attraction, as a result of Hurricane Katrina, prior to re-opening on February 15, 2006. Also, \$.1 million was attributable to general and administration expenses, information technology and professional services.

Operations and research expenses were \$2.3 million in 2006, compared to \$1.3 million in 2005. Of the \$1.0 million increase, \$.7 million was due to vessel recovery costs not being capitalized during 2006, and \$.3 million was due to operations costs of our themed attractions segment, primarily associated with our New Orleans attraction which re-opened in February 2006 and was closed in 2005.

### **Liquidity and Capital Resources**

#### ***Source and Use of Funds***

Net cash used in operating activities in the first three months of 2006 was \$4.0 million. Cash used in operating activities for the first three months of 2006 primarily reflected an operating loss of \$3.9 million, a decrease of working capital of \$.6 million offset by depreciation of \$.5 million. Net cash used in operating activities for 2005 of \$2.0 million primarily represented a decrease in working capital consisting of an increase in inventory, accounts receivable and other assets and a decrease in accrued expenses.

Cash flows used in investing activities were \$.2 million and \$2.3 million for the first quarter in 2006 and 2005, respectively. Cash used in investing activities for the first three months of 2006 primarily reflected purchase of property and equipment for our shipwreck exploration segment. Cash used in investing activities in 2005 primarily reflected the purchase of property and equipment of \$.5 million, capital expenditures related to our themed attraction segment of \$1.7 million and other building improvements.

Cash flows provided by financing activities were \$9.0 million and \$6.5 million for the first quarter of 2006 and 2005, respectively. In 2006, the cash provided by financing activities primarily included \$8.8 million from the sale of Series D Convertible Preferred Stock and \$.3 million proceeds from the issuance of common stock related to the exercise of employee stock options. Cash provided by financing activities in 2005 included \$6.9 million of proceeds received from the issuance of common stock offset by \$.4 million in brokerage commissions on the private offering.

#### ***General***

At March 31, 2006, we had cash and cash equivalents of \$8.1 million, an increase of \$4.8 million from the December 31, 2005 balance of \$3.3 million. Working capital and the ratio of current assets to current liabilities were \$12.5 million and 9.7 to 1, respectively at March 31, 2006, compared with \$7.6 million and 3.9 to 1, respectively, at December 31, 2005.

During March 2006, we received approximately \$8.8 million from the sale of 2.5 million shares of non-voting Series D Convertible Preferred Stock, par value \$0.0001 per share, at \$3.50 per share to five funds controlled by two institutional



accredited investors pursuant to the terms of a purchase agreement. The Series D Preferred Stock is convertible into Common Stock at a ratio of one (1) share of Common Stock for every one (1) share of Series D Preferred Stock. The net proceeds from the preferred stock offering will be used for general corporate purposes.

During March 2006, we entered into an Amended and Restated Revolving Credit Agreement with Mercantile Bank (the "Bank"). The Amended and Restated Credit Agreement replaces the Company's prior agreement with the Bank. The Amended and Restated Agreement reduced the amount of the commitment from the Bank from a \$6 million revolving credit facility to a \$3 million credit facility. The \$4 million of gold coins previously collateralized were removed from the amended agreement and silver coins collateralized and held by the custodian increased from 10,000 to 15,000 coins. The credit facility has a floating interest rate equal to the LIBOR 30-Day Index Rate plus two hundred sixty-five basis points (2.65%), requires monthly payments of interest only and is due in full on April 21, 2008. The Company will also be required to pay the Bank an unused line fee equal to 0.25% per annum of the unused portion of the credit line, payable quarterly. Additionally, the Company granted a first lien position on all corporate assets, including a provision not to pledge as collateral our Company-owned vessels. The Company is required to comply with a number of covenants including maintaining a minimum stockholders' equity of \$20,000,000, which would increase annually by an amount equal to fifty percent of any after-tax net income.

Based upon current expectations, we believe our cash and cash equivalents, cash generated from operations, bank credit facility and proceeds from recent equity offering will satisfy our working capital requirements for at least 2006. However, we anticipate we will continue to incur net losses in 2006. Our ability to generate net income in future periods is dependent upon the success of our ability to recover and monetize high-value shipwrecks. We were optimistic our search and recovery efforts in 2005 would have been more successful than what we achieved. However, we remain confident that we have several potential high-value shipwreck targets which could be recovered in 2006. However, our current estimates do not include monetizing any assets for shipwrecks which may be recovered in 2006. We may be required to reduce budgeted expenses if sales estimates are not attained. However, we cannot guarantee that the sales of our products and other available cash sources will generate sufficient cash flow to meet our overall cash requirements. If cash flow is not sufficient to meet our business requirements, we may be required to raise additional capital through other financing activities.

#### **Off Balance Sheet Requirements**

We do not engage in off-balance sheet financing arrangements. In particular, we do not have any interest in so-called limited purpose entities, which include special purpose entities (SPEs) and structured finance entities.

#### **New Accounting Pronouncements**

Effective January 1, 2006, the company adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The company adopted SFAS No. 123R using the modified-prospective method, which requires the company, beginning January 1, 2006 and thereafter, to expense the grant date fair value of all share-based awards over their remaining vesting periods to the extent the awards were not fully vested as of the date of adoption and to expense the fair value of all share-based awards granted subsequent to December 31, 2005 over their requisite service periods. During the three months ended March 31, 2006, the company recorded \$41,508 of share-based compensation expense. Previous periods have not been restated. See Note B. for further details.

#### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Market risk is the exposure to loss resulting from changes in interest rates, foreign currency exchange rates, commodity prices and equity prices. We do not believe we have material market risk exposure and have not entered into any market risk sensitive instruments to mitigate these risks or for trading or speculative purposes.

#### **ITEM 4. CONTROLS AND PROCEDURES**

Odyssey maintains a set of disclosure controls and procedures designed to ensure that information required to be disclosed in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. As of the end of the period covered by this report, based on an evaluation carried out under the supervision and with the participation of Odyssey's management, including the chief executive officer (CEO) and chief financial officer (CFO), of the effectiveness of our disclosure controls and procedures, the CEO and CFO have concluded that Odyssey's disclosure controls and procedures are effective. There have been no significant changes in the Company's internal controls over financial reporting during the first quarter of 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial



reporting.

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**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

On or about December 14, 2004 a complaint was filed against seven defendants including the Company in the Court of Common Pleas in the Ninth Judicial Circuit, County of Charleston, in the State of South Carolina. The complaint was filed by Republic & Eagle Associates, Inc. and Sea Miners, Inc., against John Morris, Greg Stemm, John Lawrence, John Balch, Daniel Bagley, Seahawk Deep Sea Technologies, Inc. (Seahawk) and the Company. The plaintiff's allegations include breach of fiduciary duty, civil conspiracy and breach of contract based primarily upon an alleged contract(s) between the plaintiffs and Seahawk dated May 16, 1995 dealing with the search for the SS *Republic*. The plaintiffs allege that their research which was provided to Seahawk led to the discovery of the SS *Republic* and they seek an unspecified amount of damages and public recognition of their contribution. On February 18, 2005, John Morris, Greg Stemm, Daniel Bagley, and the Company filed their Notice of Motion and Motion to Dismiss Defendants John Morris, Greg Stemm, Daniel Bagley and Odyssey Marine Exploration, Inc. (the Motion). In the Motion, the defendants allege that the complaint should be dismissed because, among other things, the South Carolina court does not have jurisdiction over them, the action was filed in an improper venue, plaintiffs lack the capacity to maintain the action, and the action should be barred based on the Doctrine of Forum Non Conveniens. The parties continue to engage in discovery. On April 19, 2006, the South Carolina court heard arguments on the Motion, but as of yet has not issued a ruling. Management believes the lawsuit is without merit and intends to vigorously defend the action.

**ITEM 1A. Risk Factors**

For information regarding risk factors, please refer to Item 1A in the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

There were no unregistered sales of equity securities during the three months ended March 31, 2006, that have not been reported in a Current Report on Form 8-K.

**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

None.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

|      |                                                                                                    |                               |
|------|----------------------------------------------------------------------------------------------------|-------------------------------|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith electronically |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith electronically |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350                        | Filed herewith electronically |

32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350

Filed herewith electronically

**SIGNATURES**

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

ODYSSEY MARINE EXPLORATION, INC.

Date: May 10, 2006

By: /s/ Michael J. Holmes  
Michael J. Holmes, Chief Financial Officer and  
Authorized Officer

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