

ODYSSEY MARINE EXPLORATION INC  
Form 10-Q  
August 07, 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 June 30, 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)

**84-1018684**  
(I.R.S. Employer

Identification No.)

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

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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 July 25, 2006 was 46,127,678.

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

	(Unaudited) June 30, 2006	December 31, 2005
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 3,880,641	\$ 3,283,331
Accounts receivable, net	1,501,183	1,527,913
Inventory	4,412,908	4,728,394
Other current assets	304,193	729,678
<b>Total current assets</b>	<b>10,098,925</b>	<b>10,269,316</b>
<b>PROPERTY AND EQUIPMENT</b>		
Equipment and office fixtures	13,828,938	10,745,738
Building and land	4,040,824	3,973,988
Accumulated depreciation	(3,800,981)	(2,738,572)
<b>Total property and equipment</b>	<b>14,068,781</b>	<b>11,981,154</b>
<b>OTHER ASSETS</b>		
Inventory (non current)	6,035,046	5,839,914
Attraction development	1,241,141	1,172,475
Other non current assets	917,141	927,599
<b>Total other assets</b>	<b>8,193,328</b>	<b>7,939,988</b>
<b>Total assets</b>	<b>\$ 32,361,034</b>	<b>\$ 30,190,458</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$ 478,337	\$ 601,129
Accrued expenses	1,139,228	1,843,261
Mortgage and loans payable	355,159	111,433
Deposits	32,652	103,069
<b>Total current liabilities</b>	<b>2,005,376</b>	<b>2,658,892</b>
<b>LONG TERM LIABILITIES</b>		
Mortgage and loans payable	3,273,939	1,758,333
Deferred income from Revenue Participation Certificates	887,500	887,500
<b>Total long term liabilities</b>	<b>4,161,439</b>	<b>2,645,833</b>
<b>Total liabilities</b>	<b>6,166,815</b>	<b>5,304,725</b>

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STOCKHOLDERS EQUITY

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; 46,127,678 and 45,823,224 issued and outstanding	4,613	4,582
Additional paid-in capital	53,298,560	43,870,228
Accumulated deficit	(27,109,204)	(18,989,077)
Total stockholders equity	26,194,219	24,885,733
Total liabilities and stockholders equity	\$ 32,361,034	\$ 30,190,458

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

**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS - Unaudited**

	<b>Three Months Ended</b>	
	<b>June 30,</b>	<b>June 30,</b>
	<b>2006</b>	<b>2005</b>
<b>REVENUE</b>	\$ 1,957,834	\$ 3,825,818
<b>OPERATING EXPENSES</b>		
Cost of sales	259,607	353,809
Marketing, general & administrative	2,182,985	2,386,394
Operations & research	3,737,932	2,737,795
Total operating expenses	6,180,524	5,477,998
<b>INCOME (LOSS) FROM OPERATIONS</b>	(4,222,690)	(1,652,180)
<b>OTHER INCOME (EXPENSE)</b>		
Interest income	56,158	6,969
Interest expense	(36,077)	(28,236)
Other	11,170	28,312
Total other income (expense)	31,251	7,045
<b>INCOME (LOSS) BEFORE INCOME TAXES</b>	(4,191,439)	(1,645,135)
Income tax benefit (provision)		564,468
<b>NET INCOME (LOSS)</b>	(4,191,439)	(1,080,667)
<b>EARNINGS (LOSS) PER SHARE</b>		
Basic and diluted	\$ (.09)	\$ (.03)
Weighted average number of common shares outstanding		
Basic and diluted	46,108,337	41,686,862

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

**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS - Unaudited**

	Six Months Ended	
	June 30,	June 30,
	2006	2005
REVENUE	\$ 2,823,013	\$ 7,175,334
OPERATING EXPENSES		
Cost of sales	373,937	570,097
Marketing, general & administrative	4,584,346	4,307,321
Operations & research	6,001,987	4,050,250
Total operating expenses	10,960,270	8,927,668
INCOME (LOSS) FROM OPERATIONS	(8,137,257)	(1,752,334)
OTHER INCOME (EXPENSE)		
Interest income	69,860	15,497
Interest expense	(78,197)	(56,746)
Other	25,467	41,823
Total other income (expense)	17,130	574
INCOME (LOSS) BEFORE INCOME TAXES	(8,120,127)	(1,751,760)
Income tax benefit (provision)		659,188
NET INCOME (LOSS)	(8,120,127)	(1,092,572)
EARNINGS (LOSS) PER SHARE		
Basic and diluted	\$ (.18)	\$ (.03)
Weighted average number of common shares outstanding		
Basic and diluted	46,035,499	40,488,485

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

**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS - Unaudited**

	Six Months Ended	
	June 30,	June 30,
	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net Income (Loss)	\$ (8,120,127)	\$ (1,092,572)
Adjustments to reconcile net loss to net cash used by operating activity:		
Deferred income taxes		(1,040,126)
Depreciation and amortization	1,068,726	554,058
(Gain) Loss on disposal of equipment		40,451
Share-based compensation	310,545	
Tax benefit related to exercise of employee Stock options		380,938
(Increase) decrease in:		
Accounts receivable	(10,017)	214,156
Inventory	120,354	(644,367)
Other assets	412,834	(11,050)
Increase (decrease) in:		
Accounts payable	(122,789)	134,967
Customer deposits	(70,417)	(10,518)
Accrued expenses	(650,497)	(1,111,883)
<b>NET CASH (USED) IN OPERATING ACTIVITIES</b>	<b>(7,061,388)</b>	<b>(2,585,946)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(3,150,036)	(1,018,169)
Proceeds from sale of equipment		49,647
Attraction development	(68,666)	(2,629,927)
Purchase of building improvements		(168,032)
<b>NET CASH (USED) IN INVESTING ACTIVITIES</b>	<b>(3,218,702)</b>	<b>(3,766,481)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from issuance of common stock	413,068	8,276,000
Proceeds from issuance of preferred stock	8,750,000	
Broker commission and fees on private offering	(45,000)	(445,000)
Proceeds from mortgage and loans payable	3,314,583	
Repayment of mortgage and loans payable	(1,555,251)	(112,267)
<b>NET CASH PROVIDED BY FINANCING ACTIVITIES</b>	<b>10,877,400</b>	<b>7,718,733</b>
<b>NET INCREASE IN CASH</b>	<b>597,310</b>	<b>1,366,306</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>\$ 3,880,641</b>	<b>\$ 4,417,027</b>
<b>SUPPLEMENTARY INFORMATION:</b>		
Interest paid	\$ 30,491	\$ 51,484
Income taxes paid	\$	\$
<b>NON CASH TRANSACTIONS:</b>		
Depreciation capitalized as inventory	\$	\$ 72,912



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Accounts receivable paid by services	\$	53,539	\$
Accrued compensation paid by common stock	\$		\$ 100,000

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**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.

During June 2006, we entered into a mortgage loan for \$2.5 million with Carolina First Bank for the refinancing of our corporate office building. At the closing of this loan, the outstanding amount of approximately \$1.8 million due on the original mortgage with Bank of Tampa was paid in full.

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

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**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 June 30, 2006, results of operations, and cash flows for the interim periods presented. Operating results for the three and six month periods ended June 30, 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 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.



**Table of Contents****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.

**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 June 30, 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 are 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:

<b>Six Months Ended</b>		<b>Three Months Ended</b>	
<b>June 30</b>		<b>June 30</b>	
<b>2006</b>	<b>June 30 2005</b>	<b>June 30 2006</b>	<b>June 30 2005</b>

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Depreciation expense	\$ 1,062,228	\$ 626,970	\$ 597,914	\$ 326,787
Less depreciation capitalized to inventory		72,912		
Net depreciation expense	\$ 1,062,228	\$ 554,058	\$ 567,914	\$ 326,787

**Table of Contents****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 June 30, 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:

	Six Months Ended		Three Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2006	2005	2006	2005
Average market price during the period	\$ 3.25	\$ 3.51	\$ 2.81	\$ 4.32
In the money potential common shares excluded	410,922	1,744,312	317,287	2,526,603
Out of the money options excluded:				
Stock Options with an exercise price of \$3.50 per share	665,000		665,000	
Stock Options with an exercise price of \$4.00 per share	402,000	5,000	402,000	
Stock Options with an exercise price of \$5.00 per share	495,000	595,000	495,000	595,000
Warrants with an exercise price of \$3.50 per share	3,170,000		3,170,000	
Warrants with an exercise price of \$5.25 per share	100,000		100,000	
Anti dilutive warrants and options excluded from EPS	5,242,922	2,344,312	5,149,287	3,121,603

Weighted average potential common shares having an anti-dilutive effect on diluted earnings per share from Series D Preferred Stock outstanding that were excluded from potential common shares are as follows:

	Six Months Ended		Three Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2006	2005	2006	2005
Weighted average potential common shares from Series D Preferred Stock excluded from computation of diluted earnings per share		1,491,713		2,500,000

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

	Six Months Ended		Three Months Ended	
	June 30,	June 30,	June 30,	June 30,
	2006	2005	2006	2005
Numerator, basic and diluted net loss	\$ (8,120,127)	\$ (1,092,572)	\$ (4,191,439)	\$ (1,080,667)
Denominator:				
Weighted average common shares outstanding basic	46,035,499	40,488,485	46,108,337	41,686,862
Effect of potential common shares				
Weighted average common shares basic and diluted	46,035,499	40,488,485	46,108,337	41,686,862
Loss per share basic and diluted	\$ (.18)	\$ (.03)	\$ (.09)	\$ (.03)

**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 for periods beginning on or after January 1, 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).

Share-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest. Share-based compensation expense recognized in the consolidated statement of operations during the three and six-month periods ended June 30, 2006 include compensation expense for the share-based compensation awards granted prior to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123(R). As share-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), \$269,037 and \$310,545 of share-based compensation was charged against income for the three and six-month periods ended June 30, 2006. During the three months ended March 31, 2006, we granted stock options from the 2005 Stock Incentive Plan which was approved at the annual Shareholder meeting on May 5, 2006. Therefore, since these instruments were granted from an unapproved plan as of March 31, 2006, in conformity with FAS 123(R), \$101,871 of compensation expense relating to the first quarter of 2006 was recorded during the three month period ended June 30, 2006, the period during which the Shareholders approved the 2005 Stock Incentive Plan. For the three and six-month periods ended June 30, 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.





**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued**

	Six Months Ended	Three Months Ended
	June 30,	June 30,
	2005	2005
Net income (loss):		
As reported	\$ (1,092,572)	\$ (1,080,667)
Pro forma adjustment for compensation, net of tax	(448,509)	(130,822)
Pro forma	\$ (1,541,081)	\$ (1,211,4889)
Basic income (loss) per share:		
As reported	\$ (.03)	\$ (.03)
Pro forma	\$ (.04)	\$ (.03)
Diluted income (loss) per share:		
As reported	\$ (.03)	\$ (.03)
Pro forma	\$ (.04)	\$ (.03)

The weighted average estimated fair value of stock options granted during the three-month periods ended June 30, 2006 and 2005 was \$1.52 and \$2.18 respectively. 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:

	3 Month Period Ended	
	June 30,	June 30,
	2006	2005
Risk-free interest rate	4.8-5.0%	3.7%
Expected volatility of common stock	60.4%	62.5%
Dividend Yield	0%	0%
Expected life of options	4-5 years	4 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:

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	June 30,	December 31,
	2006	2005
Artifacts	\$ 9,204,536	\$ 9,320,343
Merchandise	643,894	634,558
Packaging	599,524	613,407
 Total Inventory	 \$ 10,447,954	 \$ 10,568,308

Of these amounts \$6,035,046 and \$5,839,914 are classified as non-current as of June 30, 2006 and December 31, 2005, respectively.

**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****NOTE D - INCOME TAXES**

As of June 30, 2006, the Company had consolidated income tax net operating loss ( NOL ) carryforwards for federal tax purposes of approximately \$39 million. The NOL will expire in various years ending through the year 2026.

For the six-month periods ended June 30, 2006 and 2005, the components of the provision for income taxes (benefit) are attributable to continuing operations as follows:

	June 30, 2006	June 30, 2005
Current		
Federal	\$	\$
State		
	\$	\$
Deferred		
Federal	\$	\$ (562,841)
State		(96,347)
	\$	\$ (659,188)

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	\$ 14,495,479
Accrued expenses	94,479
Reserve for accounts receivable	92,748
Stock option expense	125,604
Less: valuation allowance	(10,942,170)
	\$ 3,866,140
Deferred tax liability:	
Property and equipment basis	\$ 71,319
Prepaid expenses	30,847
Inventory reserve	10,987
Excess of tax over book depreciation	476,255
Artifacts recovery costs	3,276,732
	\$ 3,866,140
Net deferred tax asset	\$

As reflected above, we have recorded a net deferred tax asset of \$0 at June 30, 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

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valuation allowance has been recorded as of June 30, 2006.

The change in the valuation allowance is as follows:

June 30, 2006	\$ 10,942,170
December 31, 2005	\$ 7,791,859
Change in valuation allowance	\$ 3,150,311

**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****NOTE D - INCOME TAXES - continued**

Income taxes for the six month periods ended June 30, 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:

	June 30, 2006	June 30, 2005
Expected provision (benefit)	\$ (2,760,843)	\$ (595,598)
State income taxes net of federal benefits	(177,164)	(100,241)
Nontaxable (income) expense	7,101	8,845
Stock options exercised	(214,659)	
Change in valuation allowance	3,150,311	(10,993)
Effects of:		
Change in rate estimate		39,099
Other, net	(4,746)	
	\$	\$ (659,188)

During the six-month periods ended June 30, 2006 and 2005, the Company recognized certain tax benefits, prior to any valuation allowances, related to stock option plans in the amount of \$105,586 and \$380,938 respectively. If we did not have a full valuation allowance, such benefits would be 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 included 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 alleged that their research, which was provided to Seahawk, led to the discovery of the SS *Republic* and sought 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 alleged 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 final arguments on the Motion were heard by the South Carolina court on April 19, 2006. On June 9, 2006, the court granted in favor of the defendants and the plaintiff's complaint was dismissed. The Plaintiff's filed a Motion for Rehearing which has been scheduled to be heard by the Court on September 2, 2006.

The Company may be subject to a variety of claims and suits that arise from time to time in the ordinary course of business. We currently believe these claims and suits are without merit and will not have a material adverse impact on our financial position or results of operations.

**NOTE F RELATED PARTY TRANSACTIONS**

During the three and six-months ended June 30, 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 \$23,314 and 100,475, respectively. Also, the spouse of a Company officer performed logo design services for the same periods amounting to \$1,725 and \$3,525, respectively.



**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****NOTE G MORTGAGE AND LOANS PAYABLE**

The Company's consolidated mortgages and notes payable consisted of the following at June 30, 2006 and December 31, 2005:

	June 30, 2006	December 31, 2005
Revolving credit facility	\$ 9,098	\$ 11,433
Mortgage payable	2,500,000	1,858,333
Loan payable	1,120,000	
	\$ 3,629,098	\$ 1,869,766

**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.

**Mortgage Payable**

During June 2006, we entered into a mortgage loan for \$2.5 million with Carolina First Bank for the refinancing of our corporate office building. This mortgage replaces the original mortgage held by the Bank of Tampa. The mortgage loan is due on June 1, 2009 with monthly payments based on a 20 year amortization schedule. Interest is at a fixed annual rate of 7.5%. Of the principal amount due on the mortgage \$58,061 is classified as a current liability. This debt is secured by the related mortgaged real property as well as being cross-collateralized with the coins used to secure the Amended and Restated Revolving Credit Agreement with Mercantile Bank.

**Loan Payable**

During June 2006, we entered into a loan agreement for \$1.12 million with Mercantile Bank for the purchase of a remotely operated vehicle (ROV) of which the purchase price was \$1.4 million. This loan has a maturity date of September 1, 2009 and bears a variable LIBOR interest rate that is adjusted monthly. The variable rate is calculated by dividing LIBOR by an amount equal to 1.00 minus the Libor Reserve Percentage, plus 3.0%. The interest rate in effect for the first payment period is 8.3%. The first three months of the agreement requires interest only payments followed by principle payments of \$32,000 plus interest over the remaining life of the loan. Mercantile Bank holds the ROV as collateral for this loan agreement.

**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 B. 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 share-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. The local tourist and resident markets have not yet recovered from the devastating impact of Hurricane Katrina. Our attraction has yet to reach a breakeven attendance level since the re-opening. As a result, on July 28, 2006 we provided written notice to the landlord, in accordance with the provisions of our lease agreement, exercising our right to terminate the lease effective January 31, 2007. We plan to relocate our attraction to another market in the latter part of 2006 and are currently researching alternatives. We continue to evaluate our business alternatives for our second attraction currently in development.

**Table of Contents****ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES****NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS****NOTE J SEGMENT REPORTING - continued**

(amounts in thousands)

	Shipwreck Exploration	Themed Attractions	Consolidated
<b>Segment Information</b>			
<i>Three months ended June 30, 2006</i>			
Revenues from external customers	\$ 1,873	\$ 85	\$ 1,958
Income (loss) before income taxes	\$ (3,614)	\$ (577)	\$ (4,191)
Segment assets	\$ 27,795	\$ 4,566	\$ 32,361
<i>Three months ended June 30, 2005</i>			
Revenues from external customers	\$ 3,826	\$	\$ 3,826
Income (loss) before income taxes	\$ (1,273)	\$ (372)	\$ (1,645)
Segment assets	\$ 35,406	\$ 276	\$ 35,682
<i>Six months ended June 30, 2006</i>			
Revenues from external customers	\$ 2,691	\$ 132	\$ 2,823
Income (loss) before income taxes	\$ (6,939)	\$ (1,181)	\$ (8,120)
Segment assets	\$ 27,795	\$ 4,566	\$ 32,361
<i>Six months ended June 30, 2005</i>			
Revenues from external customers	\$ 7,175	\$	\$ 7,175
Income (loss) before income taxes	\$ (1,254)	\$ (498)	\$ (1,752)
Segment assets	\$ 35,406	\$ 276	\$ 35,682

**NOTE K SUBSEQUENT EVENT**

On February 15, 2006, we re-opened *Odyssey's Shipwreck & Treasure Adventure* in New Orleans. The local tourist and resident markets have not yet recovered from the devastating impact of Hurricane Katrina. Our attraction has yet to reach a breakeven attendance level since the re-opening. As a result, on July 28, 2006 we provided written notice to the landlord, in accordance with the provisions of our lease agreement, exercising our right to terminate the lease effective January 31, 2007. The attraction is scheduled for closure during September, 2006. As a result of this lease termination, we will incur charges against income relating to the closure which will include the write off leasehold improvements of approximately \$.3 million.

**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.

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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.

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### **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.

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.

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.

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Income (loss) before income taxes	\$ (1,254)	\$ (498)	\$ (1,752)
Segment assets	\$ 35,406	\$ 276	\$ 35,682

**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.

For the first time in Odyssey's history, we have three large research ships (The Odyssey Explorer, a leased vessel, and Odyssey's newly purchased search vessel) working simultaneously on major shipwreck expeditions.

Odyssey's leased vessel continues to conduct side-scan and magnetometer search operations and anomaly inspections for the Atlas search project. The new search vessel recently purchased by the Company has also mobilized and at this time is conducting inspections on targets which have already been located.

Odyssey's 251' deep-ocean archaeological platform, the *Odyssey Explorer* is presently conducting operations. For security reasons, information relating to these operations may not be disclosed until completion of recovery operations if and when they occur.

This year's expansion of our search and excavation capabilities and operations reflects our focus and commitment to our core business - finding shipwrecks of significant value.

**HMS *Sussex***

In March 2006, we submitted an archaeological plan which addressed issues raised by the Autonomous Region of Andalucia and the central Spanish government in reference to the ongoing HMS *Sussex* project. In May 2006, a response was received from the Ministry of Foreign Affairs with several technical questions raised by the Junta of Andalucia. In early June, we provided clarification on these points to the Kingdom of Spain's Ministry of Foreign Affairs through the offices of the Embassy of the United Kingdom. As part of the archaeological plan, we have agreed to undertake additional survey operations in the area and to provide Andalucia with a detailed survey of the region's underwater cultural heritage in deep water, as well as assistance in developing a plan for managing those resources.

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Odyssey is continuing to work in a cooperative manner with the Junta of Andalucia and the central Spanish government and is awaiting final comments on the plan before resuming operations on the shipwreck believed to be HMS *Sussex*. Based on communications from the Spanish Government and other sources, we anticipate that the archaeological plan will be deemed acceptable and we plan to begin work on the *Sussex* project later in 2006 according to a schedule which allows us to continue work on one of our other projects until its weather window closes in the fall.

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.

Odyssey has completed to the satisfaction of the Government of the United Kingdom all work detailed in Phase 1A of the *Sussex* archaeological project plan. The Company has 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 June 30, 2006 compared to three months ended June 30, 2005**

	(Unaudited) (dollars in millions)			
	2006	2005	\$ Var	% Var
Revenue	\$ 2.0	\$ 3.8	\$ (1.8)	(49)%
Cost of sales	.3	.4	(.1)	(27)%
Marketing, general & administrative	2.2	2.3	(.1)	(4)%
Operations & research	3.7	2.8	.9	32%
Total cost and expenses	\$ 6.2	\$ 5.5	\$ .7	13%
<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 \$2.0 million and \$3.8 million, respectively, representing sales volume of gold and silver coins of approximately 640 coins in 2006 and 825 coins in 2005. We continue to sell numismatic coins to independent coin dealers. The decrease of \$1.8 million in 2006 is primarily due to a lower availability of high-value numismatic gold coins, sales to fewer independent coin dealers and a shift to a higher volume of lower priced silver coins. 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. Also, included in our revenue for 2006 was \$.1 million of admissions and merchandise sales from our themed attractions segment. All of our revenue for 2006 and 2005 is U.S. domestic-based.

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 indirect (wholesale) sales channels and joint venture opportunities. While the marketing programs associated with this restructuring are still ramping up, initial results are positive. Marketing channel tests currently underway - including direct mail, outbound telesales, financial newsletter inserts and catalog sales - are generating sales results at or above forecast levels. We plan to add additional channels to this mix in the near future.





**Table of Contents****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 9%, 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 \$2.2 million in 2006 as compared to \$2.3 million in 2005. The decrease of \$.1 million is primarily related to lower marketing expenses of \$.3 million offset by higher shared-based compensation costs related to adoption of FASB 123R in 2006.

Operations and research expenses were \$3.7 million in 2006, compared to \$2.8 million in 2005. Of the \$.9 million increase, \$.5 million was due to vessel operating expenses primarily due to additional usage of our leased vessel and mobilization expenses associated with our recently purchased vessel, and \$.4 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.

**Six months ended June 30, 2006 compared to six months ended June 30, 2005**

	(Unaudited) (dollars in millions)			
	2006	2005	\$ Var	% Var
Revenue	\$ 2.8	\$ 7.2	\$ (4.4)	(61)%
Cost of sales	.4	.6	(.2)	(34)%
Marketing, general & administrative	4.6	4.2	.4	9%
Operations & research	6.0	4.1	1.9	45%
Total cost and expenses	\$ 11.0	\$ 8.9	\$ 2.1	23%
<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 \$2.8 million and \$7.2 million, respectively, representing sales volume of gold and silver coins of approximately 825 coins in 2006 and 1,300 coins in 2005. We continue to sell numismatic coins to independent coin dealers. The decrease of \$4.4 million in 2006 is primarily due to a lower availability of high-value numismatic gold coins, sales to fewer independent coin dealers and a shift to a higher volume of lower priced silver coins. 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. Also, included in our revenue for 2006 was \$.1 million of admissions and merchandise sales from our themed attractions segment. All of our revenue for 2006 and 2005 is U.S. domestic-based.

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 indirect (wholesale) sales channels and joint venture opportunities. While the marketing programs associated with this restructuring are still ramping up, initial results are positive. Marketing channel tests currently underway - including direct mail, outbound telesales, financial newsletter inserts and catalog sales - are generating sales results at or above forecast levels. We plan to add additional channels to this mix in the near future.

**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 8%, respectively. The lower cost of sales percentage in

2005 is attributable to a high sales mix of gold versus silver coins.

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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 \$4.6 million in 2006 as compared to \$4.2 million in 2005. Of the \$.4 million increase, \$.3 million is related to higher shared-based compensation costs related to adoption of FASB 123R in 2006.

Operations and research expenses were \$6.0 million in 2006, compared to \$4.1 million in 2005. Of the \$1.9 million increase, \$.6 million was due to vessel recovery costs not capitalized in 2006, \$.6 million was due to vessel operating expenses primarily due to additional usage of our leased vessel and mobilization expenses associated with our recently purchased vessel in June 2006, \$.6 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, and \$.1 million was due to additional archeological expenses associated the HMS *Sussex* project.

## **Liquidity and Capital Resources**

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

Net cash used in operating activities in the first six months of 2006 was \$7.1 million. Cash used in operating activities for the first six months of 2006 primarily reflected an operating loss of \$8.1 million offset by an increase in depreciation (\$1.1 million), share based compensation (\$.3 million) and other assets (\$.4 million) and a decrease in current liabilities of \$.8 million. Net cash used in operating activities for 2005 of \$2.6 million represented an operating loss of \$1.1 million, a decrease in accrued expenses of \$1.1 million, and an increase in inventory of \$.5 million offset by a decrease in accounts receivable.

Cash flows used in investing activities were \$3.2 million and \$3.8 million for the first six months in 2006 and 2005, respectively. Cash used in investing activities for the first six months of 2006 primarily reflected purchase of property and equipment for our shipwreck exploration segment which included a remotely operated vehicle (ROV) and a search and inspection vessel. Cash used in investing activities in 2005 primarily represented \$2.6 million for attraction exhibits as part of our themed attractions segment and \$1.2 million for the purchase of property and equipment and building improvements for our shipwreck exploration segment.

Cash flows provided by financing activities were \$10.9 million and \$7.7 million for the first six months of 2006 and 2005, respectively. In 2006, the cash provided by financing activities primarily included \$9.1 million from the sale of preferred and common stock, \$1.1 million of loan proceeds for financing our remotely operated vehicle (ROV) purchase and \$.7 million from refinancing our corporate office building. Cash provided by financing activities in 2005 included \$8.2 million of proceeds received from the issuance of common stock offset by \$.4 million in brokerage commissions and fees on the private offering and a \$.1 million mortgage repayment.

### ***General***

At June 30, 2006, we had cash and cash equivalents of \$3.9 million, an increase of \$.6 million from the December 31, 2005 balance of \$3.3 million. Working capital and the ratio of current assets to current liabilities were \$8.1 million and 5.0 to 1, respectively at June 30, 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 are being used for general corporate purposes and the purchase of marine property and equipment.

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.

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During June 2006, we entered into a mortgage loan for \$2.5 million with Carolina First Bank for the refinancing of our corporate office building. This mortgage replaces the original mortgage held by the Bank of Tampa. The mortgage loan is due on June 1, 2009 and monthly payments are based on a 20 year amortization schedule. Interest is at a fixed annual rate of 7.5%.

During June 2006, we entered into a loan agreement for \$1.12 million with Mercantile Bank for the purchase of a remotely operated vehicle (ROV) of which the purchase price was \$1.4 million. This loan has a maturity date of September 1, 2009 and bears a variable LIBOR interest rate that is adjusted monthly. The variable rate is calculated by dividing LIBOR by an amount equal to 1.00 minus the Libor Reserve Percentage, plus 3.0%. The interest rate in effect for the first payment period is 8.3%. The first three months of the agreement requires interest only payments followed by principle payments of \$32,000 plus interest over the remaining life of the loan.

During July 2006, we received net proceeds of \$.5 million from the sale of our smaller search and inspection vessel, the RV *Odyssey*. These proceeds were used to offset the recent purchase of an additional ship similar in size to the *Odyssey Explorer*. This additional ship will be equipped with a state-of-the-art side-scan sonar system and a Remotely Operated Vehicle (ROV) to conduct search operations and target inspections.

Based upon current expectations, we believe our cash and cash equivalents, cash generated from operations, bank credit facility and proceeds from our equity offering should satisfy our working capital requirements for 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. However, we remain confident that we have several potential high-value shipwreck targets which could 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 in 2006.

## **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 and six-month periods ended June 30, 2006, the company recorded \$269,037 and \$310,545, respectively, 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 second quarter of 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



**Table of Contents****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 included 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 alleged that their research, which was provided to Seahawk, led to the discovery of the SS *Republic* and sought 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 alleged 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 final arguments on the Motion were heard by the South Carolina court on April 19, 2006. On June 9, 2006, the court granted in favor of the defendants and the plaintiff's complaint dismissed. The Plaintiff's filed a Motion for Rehearing which has been scheduled to be heard by the Court on September 2, 2006.

The Company may be subject to a variety of claims and suits that arise from time to time in the ordinary course of business. We currently believe these claims and suits are without merit and will not have a material adverse impact on our financial position or results of operations.

**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 June 30, 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**

On May 5, 2006, the Company held an Annual Meeting of Shareholders at which John Morris, Gregory Stemm, George Knutsson, David Saul, George Lackman, Jr. and David J. Bederman were each reelected to the Board of Directors. In addition, the Company's shareholders ratified the appointment of Ferlita, Walsh & Gonzalez, P.A., Certified Public Accountants, as the Company's auditors, and approved the Company's 2005 Stock Incentive Plan. The following table sets forth the votes cast for, against or withheld, as well as the number of abstentions, as to each of the matters presented at the meeting. Except for as noted, here were no broker non-votes.

Election of Directors:

Nominees	For	Withheld
John C. Morris	31,310,500	5,038,578
Gregory P. Stemm	31,306,838	5,042,240
George Knutsson	34,320,474	2,028,604
David J. Saul	33,561,036	2,788,042
George E. Lackman, Jr.	34,321,514	2,027,564
David J. Bederman	31,176,488	5,172,590

Appointment of Ferlita, Walsh & Gonzalez, P.A.:





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	<b>For</b>	<b>Against</b>	<b>Abstain</b>
The approval of the Company's 2005 Stock Incentive Plan	36,235,629	36,291	77,158

	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b>Broker Non-Votes</b>
<b>ITEM 5. Other Information</b>	17,481,738	1,456,432	416,253	16,994,655

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

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**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: August 7, 2006

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

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