ODYSSEY MARINE EXPLORATION INC
Form 10-Q
November 07, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2007

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

ODYSSEY MARINE EXPLORATION, INC.

(Exact name of registrant as specified in its charter)

Nevada	**84-1018684**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

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)

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 x 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: x 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 x

The number of outstanding shares of the registrant s Common Stock, $.0001 par value, as of November 1, 2007 was 47,338,773.

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PART I: FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2007	December 31, 2006
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 11,881,858	$ 2,415,842
Accounts receivable, net	616,835	443,523
Inventory	2,527,453	2,263,078
Other current assets	450,306	359,665
Total current assets	15,476,452	5,482,108
PROPERTY AND EQUIPMENT		
Equipment and office fixtures	13,482,724	12,764,389
Building and land	3,709,873	3,709,873
Accumulated depreciation	(6,263,841)	(4,539,855)
Total property and equipment	10,928,756	11,934,407
OTHER ASSETS		
Inventory (non current)	6,041,171	7,353,159
Attraction development	928,247	1,261,573
Other non current assets	1,150,340	1,176,606
Total other assets	8,119,758	9,791,338
Total assets	$ 34,524,966	$ 27,207,853
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 513,113	$ 498,482
Accrued expenses	2,131,939	1,947,082
Mortgage and loans payable	3,447,898	3,443,605
Deposits	12,304	11,979
Total current liabilities	6,105,254	5,901,148
LONG TERM LIABILITIES		
Mortgage and loans payable	2,712,924	3,053,485
Deferred income from Revenue Participation Certificates	887,500	887,500
Total long term liabilities	3,600,424	3,940,985
Total liabilities	9,705,678	9,842,133

STOCKHOLDERS EQUITY		
Preferred stock $.0001 par value; 2,469,980 shares authorized; none outstanding		
Preferred stock series D convertible $.0001 par value; 7,340,000 shares authorized; 6,900,000 and 2,500,000 issued and outstanding, respectively	690	250
Preferred stock series E convertible $.0001 par value; 20 shares authorized; 13 issued and outstanding		
Common stock $.0001 par value; 100,000,000 shares authorized; 47,237,106 and 46,785,254 issued and outstanding	4,724	4,678
Additional paid-in capital	78,767,947	55,437,954
Accumulated deficit	(53,954,073)	(38,077,162)
Total stockholders equity	24,819,288	17,365,720
Total liabilities and stockholders equity	$ 34,524,966	$ 27,207,853

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

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ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS Unaudited

	Three Months Ended	
	September 30, 2007	September 30, 2006
REVENUE	$ 1,314,248	$ 586,778
OPERATING EXPENSES		
Cost of sales	406,425	303,189
Marketing, general and administrative	2,843,352	1,320,404
Operations and research	3,483,606	5,099,625
Total operating expenses	6,733,383	6,723,218
LOSS FROM OPERATIONS	(5,419,135)	(6,136,440)
OTHER INCOME (EXPENSE)		
Interest income	113,966	20,517
Interest expense	(124,978)	(86,179)
Other	18,512	11,325
Total other income (expense)	7,500	(54,337)
LOSS BEFORE INCOME TAXES	(5,411,635)	(6,190,777)
Income tax benefit (provision)		
NET LOSS	(5,411,635)	(6,190,777)
LOSS PER SHARE		
Basic and diluted	$ (.11)	$ (.13)
Weighted average number of common shares outstanding		
Basic and diluted	47,204,133	46,127,678

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

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ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS Unaudited

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
REVENUE	$ 5,195,793	$ 3,409,790
OPERATING EXPENSES		
Cost of sales	1,418,394	677,126
Marketing, general and administrative	8,533,813	5,904,750
Operations and research	10,698,541	11,101,612
Total operating expenses	20,650,748	17,683,488
LOSS FROM OPERATIONS	(15,454,955)	(14,273,698)
OTHER INCOME (EXPENSE)		
Interest income	226,379	90,377
Interest expense	(372,163)	(164,376)
Other	61,326	36,792
Total other income (expense)	(84,458)	(37,207)
LOSS BEFORE INCOME TAXES	(15,539,413)	(14,310,905)
Income tax benefit (provision)		
NET LOSS	(15,539,413)	(14,310,905)
LOSS PER SHARE		
Basic and diluted	$ (.34)	$ (.31)
Weighted average number of common shares outstanding		
Basic and diluted	47,033,938	46,066,563

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

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ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS Unaudited

	Nine Months Ended September 30, 2007	September 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net Loss	$ (15,539,413)	$ (14,310,905)
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	1,986,063	2,329,004
Loss (Gain) on disposal of equipment	18,576	(252,396)
Share-based compensation	869,929	425,260
(Increase) decrease in:		
Accounts receivable	(173,312)	434,245
Inventory	1,047,613	606,884
Other assets	(70,933)	109,420
Increase (decrease) in:		
Accounts payable	14,631	(38,221)
Customer deposits		(82,979)
Accrued expenses	374,577	(718,401)
NET CASH (USED) IN OPERATING ACTIVITIES	(11,472,269)	(11,498,089)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(659,105)	(2,141,016)
Proceeds from sale of equipment		550,000
Attraction development		(72,776)
NET CASH (USED) IN INVESTING ACTIVITIES	(659,105)	(1,663,792)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	723,655	413,068
Proceeds from issuance of preferred stock	21,255,000	8,750,000
Broker commission and fees on private offering	(45,000)	(45,000)
Proceeds from mortgage and loans payable		3,694,583
Repayment of mortgage and loans payable	(336,265)	(1,573,076)
NET CASH PROVIDED BY FINANCING ACTIVITIES	21,597,390	11,239,575
NET INCREASE (DECREASE) IN CASH	9,466,016	(1,922,306)
CASH AT BEGINNING OF PERIOD	2,415,842	3,283,331
CASH AT END OF PERIOD	$ 11,881,858	$ 1,361,025
SUPPLEMENTARY INFORMATION:		
Interest paid	$ 361,732	$ 155,425
Income taxes paid	$	$
NON CASH TRANSACTIONS:		
Beneficial conversion option related to preferred stock issuance	$ 337,498	$

Settlement of accounts receivable with accounts payable	$		$	53,539
Equipment purchased with financing	$		$	1,120,000
Accrued compensation paid by common stock	$	189,395	$	

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Summary of Significant Non-Cash Transactions

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.

During the period ended September 30, 2007, $327,341 of Attraction Development assets were activated and transferred into Property and Equipment.

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

The accompanying unaudited consolidated financial statements of Odyssey Marine Exploration, Inc. and subsidiaries (the Company , Odyssey , us , we or our) 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 Annual Report on Form 10-K for the year ended December 31, 2006.

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 September 30, 2007, and the results of operations, and cash flows for the interim periods presented. Operating results for the three-month period ended September 30, 2007 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 organized 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 used 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.

Advertising Costs

Advertising costs are expensed as incurred. Advertising costs for the three-month periods ended September 30, 2007 and 2006 were $309,906 and $90,783, respectively, and for the nine-month periods ended September 30, 2007 and 2006 were $1,101,476 and $539,260, respectively.

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 and Cash Equivalents

Cash and 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.

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.

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Inventory

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

The value of the SS *Republic* shipwreck artifacts in inventory includes the costs of recovery and conservation. The recovery costs also include the fee paid to an insurer to relinquish the insurer s claim to the artifacts recovered from the shipwreck. 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. Due to the closing of the themed attraction in New Orleans during 2006, we accelerated the estimated useful lives of certain fixed assets and leasehold improvements to a life ending on or before December 31, 2006. This resulted in additional depreciation and amortization of $874,434 for the year ended December 31, 2006.

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 September 30, 2007, 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.

Earnings Per Share

Basic earnings per share (EPS) is computed by dividing income available to common stockholders 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.

At September 30, 2007 and 2006 weighted average common shares outstanding year-to-date were 47,033,938 and 46,066,563, respectively. For the periods ended September 30, 2007 and 2006 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.

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The potential common shares, in the table following, represent potential common shares calculated using the treasury stock method from outstanding options and warrants that were excluded from the calculation of Diluted EPS:

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006
Average market price during the period	$ 4.76	$ 2.98	$ 5.93	$ 2.46
In the money potential common shares excluded	893,073	356,743	1,507,892	227,595

Potential common shares from out of the money options and warrants were also excluded from the computation of diluted earnings per share because calculation of the associated potential common shares has an anti-dilutive effect on EPS. The following table lists options and warrants that were excluded from diluted EPS:

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006
Out of the money options and warrants excluded:				
Stock Options with an exercise price of $2.50 per share				535,875
Stock Options with an exercise price of $3.50 per share		695,000		695,000
Stock Options with an exercise price of $4.00 per share		387,250		387,250
Stock Options with an exercise price of $5.00 per share	1,125,000	495,000		495,000
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		100,000
Total anti-dilutive warrants and options excluded from EPS	1,225,000	4,847,250		5,383,125

Weighted average potential common shares from outstanding Convertible Preferred Stock calculated on an as-if-converted basis having an anti-dilutive effect on diluted earnings per share were excluded from potential common shares as follows:

	Nine Months Ended September 30 2007	Nine Months Ended September 30, 2006	Three Months Ended September 30 2007	Three Months Ended September 30, 2006
Weighted average potential common shares from Preferred Stock excluded from computation of diluted earnings per share	5,825,275	1,831,502	7,157,143	2,500,000

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

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006
Net income	$ (15,539,413)	$ (14,310,905)	$ (5,411,635)	$ (6,190,777)
Beneficial conversion option on preferred stock issuance	(337,498)			
Numerator, basic and diluted net income available to stockholders	$ (15,876,911)	$ (14,310,905)	$ (5,411,635)	$ (6,190,777)
Denominator:				
Shares used in computation basic:				
Weighted average common shares outstanding	47,033,938	46,066,563	47,204,133	46,127,678
Shares used in computation diluted:				
Weighted average common shares outstanding	47,033,938	46,066,563	47,204,133	46,127,678
Dilutive effect of options and warrants outstanding				
Shares used in computing diluted net income per share	47,033,938	46,066,563	47,204,133	46,127,678
Net income per share basic	$ (0.34)	$ (0.31)	$ (0.11)	$ (0.13)
Net income per share diluted	$ (0.34)	$ (0.31)	$ (0.11)	$ (0.13)

Stock-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. As share-based compensation expense recognized in the statement of operations is based on awards ultimately expected to vest, it will be reduced for 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. The share based compensation charged against income for the nine-month periods ended September 30, 2007 and 2006 was $869,929 and $425,260, respectively, and for the three-month periods ended September 30, 2007 and 2006 was $208,143 and $114,715, respectively.

The weighted average estimated fair value of stock options granted during the three-month period ended September 30, 2006 was $0.96. We did not grant options during the three-month period ended September 30, 2007. These amounts were 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 for stock options granted in the three-month periods ended September 30, 2007 and 2006:

	September 30, 2007	September 30, 2006
Risk-free interest rate		5.1%
Expected volatility of common stock		60.4%
Dividend yield		0%
Expected life of options		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.

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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:

	September 30, 2007	December 31, 2006
Artifacts	$ 7,487,882	$ 8,488,258
Merchandise	674,380	583,318
Packaging	406,362	544,661
Total Inventory	$ 8,568,624	$ 9,616,237

Of these amounts, $6,041,171 and $7,353,159 are classified as non-current as of September 30, 2007 and December 31, 2006, respectively. In the event we secure ownership rights to the recently recovered artifacts of the *Black Swan* project, we will capitalize all related costs to recover and conserve these artifacts. To date we have identified approximately $2,000,000 of recovery and conservation costs that will be identified on the balance sheet when and if ownership rights are secured. Recovery costs include operating costs to recover, legal fees to defend and secure ownership rights and other costs associated with bringing the artifacts into an appropriate archeological state.

NOTE D INCOME TAXES

As of September 30, 2007, the Company had consolidated income tax net operating loss (NOL) carryforwards for federal tax purposes of approximately $60 million. The NOL will expire in various years ending through the year 2027.

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	$ 22,047,011
Accrued expenses	171,297
Reserve for accounts receivable	12,892
Reserve for inventory return	4,645
Start-up costs	108,833
Stock option expense	479,295
Less: valuation allowance	(20,755,805)
	$ 2,068,168
Deferred tax liability:	
Property and equipment basis	$ 70,398
Prepaid expenses	93,180
Inventory capitalization	1,864,349

Excess of tax over book depreciation		40,241
		2,068,168
Net deferred tax asset	$	

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As reflected above, we have recorded a net deferred tax asset of $0 at September 30, 2007. 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 and rights of ownership or salvage rights of high value shipwrecks and thus a valuation allowance has been recorded as of September 30, 2007. While we have recovered more than 17 tons of silver and hundreds of gold coins and other artifacts from the *Black Swan* project, we do not have the ability to immediately monetize the recovered cargo until we are awarded title or a salvage award by the U.S. District Court.

The change in the valuation allowance is as follows:

September 30, 2007	$ 20,755,805
December 31, 2006	14,857,487
Change in valuation allowance	$ 5,898,318

Income taxes for the nine-month periods ended September 30, 2007 and 2006 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:

	September 30, 2007	September 30, 2006
Expected provision (benefit)	$ (5,283,496)	$ (4,865,707)
State income taxes net of federal benefits	(261,147)	(184,419)
Nontaxable (income) expense	9,484	10,239
Stock options exercised	(417,443)	(214,659)
Change in valuation allowance	5,898,318	5,382,686
Change in estimate of net operating loss	560,545	
Inventory capitalization	(559,648)	
Effects of:		
Change in rate estimate	54,705	(118,363)
Other, net	(1,318)	(9,777)
	$	$

During the nine-month periods ended September 30, 2007 and 2006, the Company recognized certain tax benefits, prior to any valuation allowances, related to stock option plans in the amount of $162,034 and $72,614, 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.

Effective January 1, 2006, we are required to capitalize inventory costs under Internal Revenue Code Section 263A. This adjustment created a deferred tax liability in the amount of $3,314,407 on January 1, 2006 and will be recognized over the four year period beginning January 1, 2006. The remaining deferred tax liability as of September 30, 2007 is $1,864,349 and the current income tax effect is $594,172.

We adopted Financial Standards Board Interpretation No. 48, Accounting for Income Taxes (FIN 48), an interpretation of SFAS 109, on January 1, 2007. As a result of the adoption of FIN 48, we have not recognized a material adjustment in the liability for unrecognized tax benefits and have not recorded any provisions for accrued interest and penalties related to uncertain tax positions.

The Company s tax years 2004 through 2006 remain open to examination by the major taxing jurisdictions.

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 plaintiffs 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 court granted the Motion and dismissed the case for lack of personal jurisdiction on June 9, 2006. The Plaintiffs subsequently filed a Motion for Rehearing, and after further argument on the issues, the judge reversed his decision and entered an order denying the Defendants' motion to dismiss on February 27, 2007. The Defendants filed a Motion to Reconsider the order granting the Plaintiffs Motion for Reconsideration and denying Defendants Motion to Dismiss on March 12, 2007. On March 23, 2007, the Court denied that Motion. On June 25, 2007 Odyssey filed its appeal of the order denying its Motion to Dismiss with the South Carolina Court of Appeals. On October 15, 2007, the Appellate Court denied the appeal but ruled that determinations of fact in the trial court s order denying the Motion to Dismiss are not binding in future proceedings, and the case was remanded to the trial court. 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.

In addition to the lawsuit described above, the Company may be subject to a variety of claims and suits that arise from time to time in the ordinary course of business.

NOTE F MORTGAGE AND LOANS PAYABLE

The Company s consolidated mortgages and notes payable consisted of the following at September 30, 2007 and December 31, 2006:

	September 30, 2007	December 31, 2006
Revolving credit facility	$ 3,000,000	$ 3,000,000
Mortgage payable	2,424,822	2,473,090
Loan payable	736,000	1,024,000
	$ 6,160,822	$ 6,497,090

Revolving Credit Facility

On March 29, 2006, we entered into an Amended and Restated Revolving Credit Agreement (the Amended Credit Agreement) with Mercantile Bank. The Amended Credit Agreement replaced the Company s prior agreement with Mercantile Bank. The Amended Credit Agreement reduced the amount of the commitment from Mercantile 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 Credit 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 is also required to pay Mercantile 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 Mercantile Bank a first lien position on all corporate assets, including a provision not to pledge as collateral Company-owned vessels. The Company is required to comply with a number of covenants as stated in the Amended Credit Agreement.

Mortgage Payable

During June 2006, we entered into a mortgage loan in the principal amount of $2.5 million with Carolina First Bank for the refinancing of our corporate office building. This mortgage replaced 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, $63,898 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) for 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 as of September 30, 2007, was 8.13%. The first three months of the agreement required interest only payments followed by principal payments of $32,000 plus interest over the remaining life of the loan. Of the principal amount due on the loan,

$384,000 is classified as a current liability. The ROV is pledged as collateral for this loan.

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NOTE G PREFERRED STOCK

On September 13, 2007, the Company issued and sold 13 shares of its Series E Convertible Preferred Stock, par value $0.0001 per share ("Series E Preferred Stock"), at a price of $535,000 per share, for an aggregate purchase price of $6,955,000 in cash, pursuant to a Series E Convertible Preferred Stock Purchase Agreement between the Company and one institutional accredited investor. The Company expects to use the net proceeds of the transaction for general corporate purposes. The Series E Preferred Stock has no voting rights, except as required by Nevada law. Each share of Series E Preferred Stock is convertible into 100,000 shares of the Company's Common Stock. However, the Company shall not effect any conversion of the Series E Preferred Stock or any other preferred stock or warrant held by a holder of Series E Preferred Stock (a "Holder"), and no such Holder shall have the right to convert any Series E Preferred Stock or any other preferred stock or warrant held by such Holder, to the extent that after giving effect to such conversion, the beneficial owner of such shares (together with such beneficial owner's affiliates) would beneficially own in excess of 9.9% of the shares of the Company's Common Stock outstanding immediately after giving effect to such conversion or exercise. Holders of the Series E Preferred Stock have the right to participate in any dividends declared by the Company on the Company's Common Stock on an as-if-converted basis.

On May 2, 2007, we issued and sold an aggregate of 2,200,000 shares of Series D Convertible Preferred Stock at a price of $3.50 per share, for an aggregate purchase price of $7,700,000 in cash. The shares of Series D Preferred Stock were issued and sold upon the exercise of outstanding warrants, which were set to expire on May 15, 2007, to purchase the shares. The Series D Preferred Stock has no voting rights, except as required by Nevada law. Each share of Series D Preferred Stock is convertible into one share of the Company s Common Stock. However, no holder may convert any or all of the shares of Series D Preferred Stock held by such holder if and to the extent that such conversion would cause such holder to be a beneficial owner of more than nine and nine-tenths percent (9.9%) of the Common Stock, as determined under Rule 16a-1(a)(1) under the Securities Exchange Act of 1934, as amended. Holders of the Series D Preferred Stock have the right to participate in any dividends declared by us on our Common Stock on an as-if-converted basis.

On January 24, 2007, we issued and sold an aggregate of 2,200,000 shares of Series D Preferred Stock at a price of $3.00 per share, for an aggregate purchase price of $6,600,000 in cash, pursuant to a Series D Convertible Preferred Stock Purchase Agreement (the "Purchase Agreement"). In connection with the transaction, the Company issued the investors warrants to purchase an aggregate of 440,000 additional shares of Series D Preferred Stock with an exercise price of $4.00 per share and an expiration date of January 24, 2009. These warrants constituted a beneficial conversion option, which is a discount on the preferred stock offering, since they added value to the offering. The Black-Scholes valuation method was utilized in valuing these warrants. Since the related Series D Convertible Preferred Stock was immediately convertible, the entire discount on the preferred stock offering of $337,498 was amortized to retained earnings thus decreasing the income available to stockholders. We also issued to certain of the investors warrants to purchase an aggregate of 2,200,000 shares of Series D Preferred Stock with an exercise price of $3.50 per share and an expiration date of May 15, 2007, in exchange for the cancellation and surrender of warrants to purchase Common Stock held by such investors with an exercise price of $3.50 per share of Common Stock and an expiration date of March 9, 2007.

On March 13, 2006, the Company issued and sold an aggregate of 2,500,000 shares of non-voting Series D Convertible Preferred Stock, par value $0.0001 per share ("Series D Preferred Stock"), at a price of $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 share of Common Stock for every one share of Series D Preferred Stock. Proceeds of the private offering were $8,750,000.

NOTE H COMMON STOCK OPTIONS

We have two active stock incentive plans, the 1997 Stock Incentive Plan and the 2005 Stock Incentive Plan. The 1997 Stock Incentive Plan expired on August 17, 2007. As of that date, options can not be granted from that plan but any granted and unexercised options will continue to exist until exercised or they expire. The 2005 Stock Incentive Plan was adopted by our Board of Directors on August 3, 2005 and approved by our stockholders at the Annual Meeting of Stockholders on May 5, 2006. The 2005 Stock Incentive 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 I SEGMENT REPORTING

FAS 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

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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-ocean shipwrecks including the marketing, sales and distribution of recovered artifacts, replicas, merchandise and books through various retail and wholesale sales channels. The departments within this group include our marine operations, archaeology, conservation and research, sales and business development, and corporate administration.

Themed Attractions Our themed attractions segment is comprised of interactive attractions and exhibits that are designed to 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.

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 segment based upon revenues and operating income (loss) before taxes. Corporate overhead including legal, finance, human resources, information technology and real estate facilities is included within the shipwreck exploration segment and not allocated to themed attractions.

We opened our first themed attraction, *Odyssey s Shipwreck & Treasure Adventure*, in August 2005, in New Orleans. The attraction was closed early on the grand opening day due to Hurricane Katrina. We re-opened the attraction in February 2006 and closed it again in September 2006 because of market conditions in New Orleans. Odyssey received approximately $1.2 million in the fourth quarter 2006 as final insurance settlement on our claim for damages and business interruption due to the hurricane. As a result of our lease termination in New Orleans, we accelerated the estimated useful lives of certain assets and leasehold improvements in 2006. This acceleration resulted in additional expenses of $.9 million as of December 31, 2006. We relocated the attraction to the Museum of Science and Industry (MOSI) in Tampa, Florida, in May 2007. The new exhibit, *SHIPWRECK! Pirates & Treasure* opened to the public in June 2007 at MOSI and will run through February 2008.

(amounts in thousands)	**Shipwreck Exploration**	**Themed Attractions**	**Consolidated**
Segment Information			
Three months ended September 30, 2007			
Revenues from external customers	$ 1,070	$ 244	$ 1,314
Income (loss) before income taxes	$ (5,087)	$ (325)	$ (5,412)
Segment assets	$ 31,346	$ 3,179	$ 34,525
Three months ended September 30, 2006			
Revenues from external customers	$ 499	$ 88	$ 587
Income (loss) before income taxes	$ (5,052)	$ (1,139)	$ (6,191)
Segment assets	$ 23,791	$ 3,980	$ 27,771
Nine months ended September 30, 2007			
Revenues from external customers	$ 4,861	$ 335	$ 5,196
Income (loss) before income taxes	$ (14,399)	$ (1,140)	$ (15,539)
Segment assets	$ 31,346	$ 3,179	$ 34,525
Nine months ended September 30, 2006			
Revenues from external customers	$ 3,190	$ 220	$ 3,410
Income (loss) before income taxes	$ (11,971)	$ (2,340)	$ (14,311)
Segment assets	$ 23,791	$ 3,980	$ 27,771

NOTE J RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of an income tax position taken or expected to be taken in a tax return. This Interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Interpretation is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (FAS 157). FAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of FAS 157 is not expected to have a material impact on the Company s financial position, results of operations or cash flows.