

Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

Sovereign Exploration Associates International, Inc.  
Form 10-Q  
November 21, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 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: 333-29903

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.

-----  
(Exact Name of Registrant as Specified in Its Charter)

Utah

30-0123229

-----  
(State or Other Jurisdiction of Incorporation or Organization) (I.R.S. Employer Identification No.)

503 East Washington Avenue, Suite 2D, Newtown, Pennsylvania 18940

-----  
(Address of Principal Executive Offices) (Zip Code)

(215) 968-0200

-----  
(Registrant's Telephone Number, Including Area Code)

N/A

-----  
(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  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):

# Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

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 shares of the issuer's common stock, \$0.001 par value, outstanding as of November 21, 2006, was 26,203,166.

## PART I - FINANCIAL INFORMATION

### Item 1. Financial Statements

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
(F/K/A - CALI Holdings, Inc.)  
CONSOLIDATED BALANCE SHEETS  
SEPTEMBER 30, 2006 AND JUNE 30, 2006

	September 30, 2006 UNAUDITED	June 30, RESTAT
<hr style="border-top: 1px dashed black;"/>		
Assets		
Cash and cash equivalents	\$ 2,115	
<hr style="border-top: 1px dashed black;"/>		
Total current assets	2,115	
<hr style="border-top: 1px dashed black;"/>		
Other assets		
Investments, net of allowance of \$173,868	-	
Notes receivable, net of allowance of \$832,849	-	
Capitalized costs and permits	2,694,394	
<hr style="border-top: 1px dashed black;"/>		
Total other assets	2,694,394	
<hr style="border-top: 1px dashed black;"/>		
Total assets	\$ 2,696,509	
<hr style="border-top: 3px double black;"/>		
Liabilities and Shareholders' Equity (Deficit)		
Current liabilities		
Accounts payable and accrued expenses	\$ 577,298	
Due to related parties	797,856	
Notes payable	124,182	
<hr style="border-top: 1px dashed black;"/>		
Total current liabilities	1,499,336	
<hr style="border-top: 1px dashed black;"/>		
Long-term liabilities		

Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

Related party note payables	1,130,897
Notes payable, convertible debt	800,000
	-----
Total long-term liabilities	1,930,897
	-----
Total liabilities	3,430,233
	-----
Commitments and contingencies	-
Shareholders' equity (deficit)	
Common stock, \$.001 par value, 250,000,000,000 shares authorized and 26,203,166 issued and outstanding at 6/30/06, and 250,000,000 shares authorized and 26,203,166 issued and outstanding at 9/30/06	26,203
Additional paid-in capital	19,864,067
Minority interest	(803,530)
Accumulated deficit	(19,820,464)
	-----
Total shareholders' equity (deficit)	(733,724)
	-----
Total liabilities and shareholders' equity (deficit)	\$ 2,696,509
	=====

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
(F/K/A - CALI Holdings, Inc.)  
CONSOLIDATED STATEMENT OF OPERATIONS  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006  
UNAUDITED

	-----
	9/30/2006
	-----
REVENUE	\$ -
	-----
OPERATING EXPENSES	
Salaries and wages	61,013
General and administrative	86,033
Professional fees	87,849
	-----
Total operating expenses	234,895
	-----
OTHER INCOME (EXPENSE)	
Interest expense	(14,342)
	-----
Total other income (expense)	(14,342)

Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

OPERATING LOSS BEFORE INCOME TAXES	(249,237)
Provision for income taxes	-
LOSS BEFORE DEPRECIATION ON INVESTMENTS	(249,237)
Net unrealized depreciation on investments	-
NET LOSS	\$ (249,237)
NET OPERATING LOSS PER COMMON SHARE:	
Basic	\$ (0.0095)
Diluted	\$ (0.0092)
NET LOSS PER COMMON SHARE	
Basic	\$ (0.0095)
Diluted	\$ (0.0092)
WEIGHTED AVERAGE SHARES OF COMMON STOCK OUTSTANDING:	
Basic	26,203,166
Diluted	27,113,166
DIVIDENDS DECLARED PER COMMON SHARE	\$ -

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
(F/K/A - CALI Holdings, Inc.)  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006  
UNAUDITED

	Common Stock Shares	Par Value	Additional paid-in capital (1)	Minority Interest	Ac
BALANCE, JUNE 30, 2006, Restated	26,203,166	\$ 26,203	\$ 19,864,067	\$ (803,530)	\$
Net loss	-	-	-		
BALANCE, SEPTEMBER 30, 2006	26,203,166	\$ 26,203	\$ 19,864,067	\$ (803,530)	\$

(1) - Capital in excess of par value as of June 30, 2006 and includes the

# Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

Company and subsidiaries

(2) - Accumulated undistributed net income (loss) as of June 30, 2006

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
(F/K/A - CALI Holdings, Inc.)  
STATEMENT OF CASH FLOWS  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2006  
UNAUDITED

	09/30/2006
Operating activities:	
Net loss	\$ (249,237)
Adjustments to reconcile net loss from operations to net cash (used in) operating activities:	
Capitalized costs and permits	(326,182)
Increase (decrease) in:	
Accounts payable and accrued expenses	229,770
Due to related parties	(20,073)
Net cash (used in) operating activities	(365,722)
Financing activities:	
Proceeds from related party notes payable	500,000
Payments on related party notes payable	(132,733)
Net cash provided by financing activities	367,267
Net increase in cash and cash equivalents	1,545
Cash, beginning of period	570
Cash, end of period	\$ 2,115
Supplemental disclosure of cash flow information:	
Interest paid	\$ -
Taxes paid	-

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
(F/K/A - CALI Holdings, Inc.)  
NOTES TO FINANCIAL STATEMENTS  
SEPTEMBER 30, 2006  
UNAUDITED

NOTE A - NATURE OF ORGANIZATION

Sovereign Exploration Associates International, Inc. (the "Company") was incorporated in the state of Utah in 1980. The company was formerly known as

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

CALI Holdings, Inc. On October 26, 2005 the Company changed its name from CALI Holdings, Inc. to Sovereign Exploration Associates International, Inc.

On January 13, 2004 the Company filed Form N-54A with the United States Securities and Exchange Commission ("SEC") to become a business development company ("BDC") pursuant to Section 54 of the Investment Company Act of 1940 (the "1940 Act"). As a result, the Company operated as an investment company and acquired investments designed to build an investment portfolio to enhance the Company's shareholder value. As a BDC, the Company was, in effect, a publicly traded private equity fund, where stockholders provided public capital in a regulated environment for private investment in smaller companies. Congressional intent behind the creation of BDCs was to encourage the flow of public capital to private and smaller public companies.

On September 8, 2006 the Company filed a definitive proxy statement (Schedule 14A) with the SEC indicating that the Company's shareholders were to vote on a proposal to withdraw the Company's election to be a BDC under the 1940 Act by filing Form N-54C with the SEC. The proposal was approved at a special meeting of the Company's shareholders on September 20, 2006.

On September 22, 2006, the Company filed a notification of withdrawal of business development company election on Form N-54C notifying the SEC that, pursuant to the provisions of Section 54(c) of the 1940 Act, the Company withdrew its election to be subject to Sections 55 through 65 of the 1940 Act. Accordingly, the Company is no longer subject to the 1940 Act but will continue as an operating reporting public company subject to the Securities Exchange Act of 1934.

The net effect, as of June 30, 2006, of the Company's election to withdraw our business development company status pursuant to the Investment Company Act of 1940 was as follows:

Additional paid in capital	\$ (550,705)
Deficit	(425,068)
Unrealized depreciation on investments	1,015,273
	-----
Net adjustments	\$ 39,500
	=====

As a result of the change in accounting principle because of the Company's election to withdraw its business development company election, the Company restated its June 30, 2006 Balance Sheet which is included in these financial statements.

### NOTE B - BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and pursuant to the rules and regulations of the SEC. The accompanying financial statements for the interim periods are unaudited and reflect all adjustments (consisting only of normal recurring adjustments) which are, in the opinion of management, necessary for a fair presentation of the financial position and operating results for the quarterly period presented. These financial statements should be read in conjunction with the Company's financial statements for the years ended June 30, 2006 and 2005 and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended June 30, 2006 as filed with the SEC. See discussion of change in accounting principle below.

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

The results of operations for the three months ended September 30, 2006 are not necessarily indicative of the results of operations to be achieved for the full fiscal year ending June 30, 2007.

The election to withdraw the Company as a BDC under the 1940 Act has resulted in a significant change in the Company's required method of accounting. BDC financial statement presentation and accounting utilizes the fair value method of accounting used by investment companies, which allows BDCs to recognize income and value their investments at market value as opposed to historical cost.

In addition, majority-owned subsidiaries are not consolidated and instead, investments in those subsidiaries are reflected on the balance sheet as an investment in and advances to affiliates, at fair value. As an operating company, the required financial statement presentation and accounting for securities held by the Company utilize either fair value or historical cost methods of accounting, depending on the classification of the investment and the Company's intent with respect to the period of time it intends to hold the investment, and the Company and its subsidiaries are reflected for financial accounting purposes as a consolidated entity. The change in accounting due to the conversion to an operating company from a BDC is considered a change in accounting principle.

As an operating company, the Company consolidates its financial statements with subsidiaries, thus eliminating the investment in and advances to affiliates account that was reflected on the Company's balance sheet as of June 30, 2006 and 2005, respectively.

Management has determined that with the lack of information available from prior management of the Company, and because the Company no longer owns any of the portfolio companies that were divested as a result of the Exchange Agreement effective October 17, 2005 except for Gulf Coast Records, LLC, it is impractical to comply with the retroactive application of prior periods being presented on an operating and consolidated basis in accordance with Statement of Financial Accounting Standards No. 154, Accounting for Changes and Error Corrections ("FAS #154").

Pursuant to paragraph 11 of FAS #154: The Company has deemed it impracticable to apply the effects of a change in accounting principle retroactively because the following conditions apply as of September 30, 2006:

1. The Company has made every reasonable effort to apply the requirement; however, we are unable to do.
2. Retrospective application of the change in accounting principle requires assumptions about prior management's intent in prior periods that cannot now be independently substantiated.
3. Retrospective application of the change in accounting principle requires significant estimates of amounts, and at this time it is impossible to distinguish objectively information about those estimates that: (a) provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application, and (b) would have been available when the financial statements for that prior period were issued.

See Note Q for explanation of prior period financial statement presentation.

As of September 30, 2006, the Company's subsidiaries were development stage enterprises, except for Gulf Coast Records, LLC, which is accounted for on the

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

equity method of accounting as described in Investments under Note B.

The Company's subsidiaries are development stage enterprises engaged in ocean explorations and archaeologically sensitive recoveries of artifacts, treasure trove and/or cargo from shipwrecks under various licenses.

Statement of Financial Accounting Standards No. 7, Accounting and Reporting by Development Stage Enterprises, defines a development stage enterprise as one that is devoting substantially all of its efforts to establishing a new business and either planned principal operations have not commenced or planned principal operations have commenced but there has been no significant revenue. Several artifacts have been recovered, but for the three month period ended September 30, 2006, there was no revenue.

The accompanying financial statements have been prepared on a going-concern basis, which contemplates the continuation of operations, realization of assets and liquidation of liabilities in the ordinary course of business. The Company's subsidiaries have capitalized all of their ocean explorations and archaeologically sensitive recoveries of artifacts, treasure trove and/or cargo from shipwrecks costs to-date. The Company plans to obtain additional financing through the sale of publicly traded stock, limited liability company member units of its subsidiaries, and/or debt financing. There is no assurance these efforts will be successful. The financial statements do not include any adjustments relating to the recoverability and classifications of reported asset amounts or the amounts of liabilities that might result from the outcome of that uncertainty. See Subsequent Events under Note O.

### Principles of Consolidation

The accompanying consolidated financial statements, as presented herein, are prepared on the accrual basis of accounting under the principles of consolidation consisting of the accounts of the Company and its subsidiaries.

As of September 30, 2006, the Company's subsidiaries and the related equity ownership are as follows:

#### Historic Discoveries, Inc.

Historic Discoveries is the Company's primary subsidiary and is wholly-owned by the Company. Historic Discoveries has two wholly-owned subsidiaries, Artifact Recovery & Conservation, Inc. ("ARC") and Sea Research, Inc. ("SRI").

#### Artifact Recovery & Conservation, Inc.

ARC is the managing member of Fantome Cove Treasure Trove 150, LLC, of which it owns a 97.05% equity interest. ARC is also the managing member of Interspace Exploration, LLC, of which it owns a 74% equity interest.

As of September 30, 2006, the minority interest in both of these entities is \$803,530.

The Company owns a 100% equity interest in Sovereign Exploration Associates International of Spain, Inc.

### Investments

The Company accounts for investments, where the Company holds from 20% up to 50% of the common stock of an investee, using the equity method. The investment is initially recorded at cost and the carrying amount is adjusted to recognize the Company's proportionate share of the earnings or losses of the investee after the date of acquisition. The amount of the adjustment is included in the determination of net income or loss of the Company in the period of the



## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

adjustment. Any dividends received from the investee reduce the carrying value of the investment.

As of June 30, 2006, the Company determined its 49% equity investment in Gulf Coast Records, LLC was fully impaired. During the fiscal year ended June 30, 2006, the Company had provided for a write-down of the investment in and advances to this company of \$1,015,273 to zero.

### Revenue Recognition

The Company recognizes revenue using the accrual method of accounting wherein revenue is recognized when earned and expenses and costs are recognized when incurred.

### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Accordingly, actual results could differ from those estimates.

### Consolidated Statement of Cash Flows

For the purpose of the Consolidated Statement of Cash Flows, the Company considers cash equivalents to be all highly liquid securities with an original maturity date of three months or less.

### Net (Loss) Per Common Share

Net (Loss) per common share is computed using the weighted average of shares outstanding during the periods presented in accordance with Statement of Financial Accounting Standards No. 128, Earnings Per Share.

The fully diluted weighted average number of common shares outstanding as of June 30, 2006 includes the 910,000 common shares that the Company has agreed to issue pursuant to the Settlement Agreement effective June 30, 2006. As of September 30, 2006, these common shares, which are subject to a Leak-Out Agreement, have yet to be issued.

### Segments

The Company operates as one segment as defined by the Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information.

### Foreign Currency Translation

The accompanying financial statements are stated in United States Dollars (USD).

### NOTE C - FIXED ASSETS

Fixed assets are stated at cost. The cost of equipment is charged against income over its estimated useful life, using the straight-line method of depreciation. Repairs and maintenance which are considered betterments and do not extend the useful life of equipment are charged to expense as incurred. When property or equipment is retired or otherwise disposed of, the asset and accumulated depreciation is removed from the accounts and the resulting profit and loss are reflected in income.

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

### NOTE D - CAPITALIZED COSTS

As of September 30, 2006, the Company accounted for its ocean exploration and archaeologically sensitive recoveries of artifacts, treasure trove and/or cargo from shipwrecks costs incurred to-date as capitalized costs.

### NOTE E - STOCK ISSUED FOR SERVICES

During the three months ended September 30, 2006 and the year ended June 30, 2006, the Company did not issue any stock for services.

### NOTE F- INCOME TAXES

Pursuant to the Exchange Agreement dated October 17, 2005, substantial ownership of the Company was transferred and according to provisions of the Internal Revenue Code, this transaction eliminated all of the loss carryforwards for federal income tax purposes starting with the fiscal year that ended June 30, 2006.

### NOTE G - LEASE ARRANGEMENTS

The Company maintains shared office space in Pennsylvania and Massachusetts with unrelated companies controlled by certain officers of the Company. These companies sublet space to the Company on a month-to-month basis with monthly rent of \$4,010, with no formal subleases.

Rent expense for the three months ended September 30, 2006 was \$12,030.

### NOTE H - NOTES PAYABLE

The following are convertible debentures as of September 30, 2006:

8% convertible debenture to an individual dated May 27, 2005 with an initial principal balance of \$21,000 due no later than May 27, 2006; outstanding principal and interest. This convertible debenture is currently in dispute.	\$ 24,087
5.25% convertible debenture to a company dated June 29, 2005 with an initial principal balance of \$40,000 due no later than June 29, 2008; outstanding principal and interest. This convertible debenture is currently in dispute.	\$ 89,988
8% convertible debenture to an individual dated May 18, 2005 with an initial principal balance of \$35,000 due no later than May 18, 2006; outstanding principal and interest. This convertible debenture is currently in dispute.	\$ 10,107 -----
Total notes payable	\$124,182 =====

The Company incurred interest expense on these convertible debentures of \$2,342 for the three months ended September 30, 2006.

### NOTE I - OPERATING AGREEMENTS

Prior to the Exchange Agreement of October 17, 2005, there is a Revenue Agreement as outlined in Exhibit B of the Exchange Agreement, that requires 20% revenue participation payable to the original owners of the permits from the net recovery of the shipwrecks for the permits that have been assigned to the subsidiaries of one of the Company's subsidiaries, Historic Discoveries, Inc.

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

The 20% revenue participation allows Historic Discoveries, Inc. to defer permit transfer fees and align site permit cost with revenue generation, eliminating the exposure associated with sites that do not produce a material number of artifacts.

Historic Discoveries, Inc. is only required to pay the 20% revenue participation when sites produce net revenue. The 20% revenue participation also provides Historic Discoveries, Inc. the right of first refusal on future sites, creating a mechanism for Historic Discoveries, Inc. and its operating companies to build site inventory while deferring the associated cost and reducing financial risk.

The Revenue Agreement with the original owners was executed prior to October 17, 2005. The original owners of these permits are the beneficial owners of the controlling interest in the stock received in the Exchange Agreement. Additionally, officers and directors of the Company hold certain executive positions in Historic Discoveries, Inc. and its subsidiaries.

The Fantome project (Fantome Cove Treasure Trove License 150, LLC, a subsidiary of ARC) sold a 2.05% equity interest for a capital investment of \$411,530, and the LeChameau project (Interspace Explorations, LLC, a subsidiary of ARC) sold a 26.0% ownership interest and 40% profit participation interest for \$392,000.

Management intends to assess the Company's liability under these agreements on a periodic basis. No liability has been recorded for these agreements as of September 30, 2006.

### NOTE J - SETTLEMENT AGREEMENT AND GENERAL RELEASE

The Company on June 30, 2006, entered into a Settlement Agreement and General Release (the "Settlement Agreement") with Former Management, KMA Capital Partners, Inc., and CF Holdings, LLC (collectively, the "Settlement Agreement Parties") in order to reach a comprehensive resolution of their disputes. The Settlement Agreement provides that the Settlement Agreement Parties release all claims that they may have against the Company, its parents, subsidiaries, affiliates, predecessors, successors, assigns, partners, agents, representatives, and attorneys (collectively, "affiliated parties") and that the Company releases all claims it may have against the Settlement Agreement Parties and their respective affiliated parties.

The Company has agreed to issue the Settlement Agreement Parties 910,000 common shares subject to a Leak-Out Agreement; however, as of September 30, 2006, these common shares had yet to be issued.

### NOTE K - SHAREHOLDERS' EQUITY

As of September 30, 2006, the authorized capital of the Company was 250,000,000 shares of common stock (with voting rights), par value \$.001.

The Company is also authorized to issue up to 100,000,000 shares of Preferred Stock, par value \$.001, in one or more series, with the terms and rights of each such series to be as determined by the Board; no such series have been authorized by the Board to date.

### NOTE L - ISSUANCE OF STOCK

For the three months ended September 30, 2006, the Company did not issue any stock for any securities transactions.

### NOTE M - CONCENTRATION OF CREDIT RISK

Financial instruments, which potentially expose the Company to concentrations of credit risk, consist principally of cash. As of September 30, 2006, the Company

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

maintains its cash accounts with financial institutions located in Pennsylvania and Canada. The Federal Deposit Insurance Corporation (FDIC) guarantees the Company's deposits in US-based financial institutions up to \$100,000 per account.

The Company's deposits with financial institutions that exceeded federally insured guarantees amounted to \$0 as of September 30, 2006. Historically, the Company has not experienced any losses on its deposits in excess of federally insured guarantees.

As of September 30, 2006, the Company accounts for its investment in Gulf Coast Records, LLC on the equity method of accounting. The amount of \$832,849 was offset by an allowance to reduce the market value of this note and investment to zero from Gulf Coast Records as of June 30, 2006. Current management is reviewing its options regarding this company and whether it wants to maintain its position or divest its holdings in the future, while actively negotiating with the management of Gulf Coast Records, LLC regarding the recovery of the Company's investment. Prior to June 30, 2006, the Company received information from the management of Gulf Coast Records, LLC that has caused the Company to reduce the fair market value to zero.

### NOTE N - RELATED PARTY TRANSACTIONS

#### ACCRUED PAYROLL AND EXPENSES; DUE TO RELATED PARTIES

As of September 30, 2006, \$797,856 was owed to certain officers of the Company for accrued payroll and unreimbursed expenses.

#### RELATED PARTY NOTE PAYABLE

In connection with the Exchange Agreement on October 17, 2005, Historic Discoveries, Inc. agreed to pay an aggregate of \$600,000 to the Company's former management in partial consideration for the termination of executive management contracts and a consulting contract with the Company. Sea Hunt, Inc., a related party to the Company, advanced \$300,000 at the closing of the Exchange Agreement and Venture Planning, Inc. provided, and subsequently paid, a note for the remaining \$300,000. Both Sea Hunt, Inc. and Venture Planning Inc. are controlled by the Company's Chairman, Peter Knollenberg. Because the underlying prior executive management and consulting contracts were obligations of the Company, the Company has agreed to repay the full \$600,000 plus accrued interest to Sea Hunt, Inc. and Venture Planning Inc.

Effective July 10, 2006, the President of the Company advanced \$500,000 to the Company for working capital purposes. The loan is due on demand and the interest requirements and stated rate are a direct pass-through from Nova Savings Bank.

### OFFICERS AND DIRECTORS OF THE COMPANY

Certain officers and directors of the Company hold certain executive positions in Historic Discoveries, Inc. and Sea Hunt, Inc. and their respective subsidiaries.

### NOTE O - SUBSEQUENT EVENTS

Effective November 15, 2006, the Chairman of the Company advanced the Company \$160,000 under a note agreement that requires an interest rate of the lesser of 0.9% or the legal rate under Texas law and is due, in full, with principal and interest on November 15, 2007.

Effective November 15, 2006, the \$600,000 note, as described in Note O under Related Party Notes Payable due to Sea Hunt, Inc. and Venture Planning, Inc., related parties to the Chairman of the Company, was renegotiated with a new due

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

date of November 15, 2007 along with an interest rate of the lesser of 0.9% or the legal rate under Texas law and is due, in full, with principal and interest on November 15, 2007.

### NOTE P - PRIOR PERIOD FINANCIAL STATEMENT PRESENTATION

Pursuant to paragraph 11 of FAS #154, the Company has deemed it impracticable to apply the effects of a change in accounting principle retroactively because certain conditions apply as of September 30, 2006. See Note B.

Since the Company does not possess the information necessary to restate the financial statements as of September 30, 2005 as an operating company, the following are the financial statements and corresponding footnotes for the Company, as of September 30, 2005 and for the three months then ended, presented as on the basis of accounting utilized by BDCs:

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
F/K/A CALI HOLDINGS INC.  
BALANCE SHEET  
SEPTEMBER 30, 2005  
UNAUDITED

ASSETS	09/30/05
Cash	\$ 33,397
Investments, at fair value	1,112,800
Accounts receivable	25,057
Other assets	129,372
Fixed assets, net of accumulated depreciation	9,023
Goodwill	489,000
Notes receivable	1,580,437
Security deposit	5,572
<b>TOTAL ASSETS</b>	<b>\$ 3,384,658</b>
LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY	
LIABILITIES	
Accounts payable and accrued expenses	\$ 214,610
Notes payable	281,700
<b>TOTAL LIABILITIES</b>	<b>496,310</b>
STOCKHOLDERS' EQUITY	
Class A - Preferred stock, no par value, 10,000,000 shares authorized, 3,725,000 issued and outstanding	-
Class B - Preferred stock, no par value, 10,000,000 shares authorized, none issued and outstanding	-
Class C - Convertible Preferred stock, \$.001 par value, 10,000,000 shares issued and outstanding	10,000
Class D - Preferred stock, no par value, 10,000,000 shares authorized, none issued and outstanding	-
Common stock, \$.001 par value, 2,000,000,000 shares authorized; 622,030,283 and 53,430,283 issued; and 472,030,283 and 53,430,283 outstanding respectively	472,030
Additional paid-in capital	17,377,563
Stock subscription receivable	25,240
Accumulated deficit	(14,996,485)
<b>TOTAL STOCKHOLDERS' EQUITY</b>	<b>2,888,348</b>

Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	3,384,658
--	----	-----------

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
F/K/A CALI HOLDINGS INC.  
STATEMENT OF OPERATIONS  
FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2005  
UNAUDITED

		9/30/2005
		-----
REVENUES	\$	396,366
OPERATING EXPENSES		
Depreciation and amortization		615
Professional fees		48,746
General and administrative		206,884
		-----
		256,245
		-----
NET OPERATING INCOME (LOSS)		140,121
		-----
NET UNREALIZED DEPRECIATION ON INVESTMENTS		(199,600)
		-----
OTHER INCOME (EXPENSE)		
Interest income		23,515
Interest expense		(931)
Realized loss on sale of investment		(94,843)
Other		24,114
		-----
		(48,145)
		-----
INCOME (LOSS) BEFORE INCOME TAX		(107,623)
DEFERRED INCOME TAX (EXPENSE)		-
		-----
NET (LOSS)	\$	(107,623)
		-----
NET (LOSS) PER SHARE BASIC AND FULLY DILUTED	\$	NIL
		-----
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING		239,140,609
		-----

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
F/K/A CALI HOLDINGS INC.  
STATEMENT OF CHANGES IN STOCKHOLDERS' (DEFICIT) EQUITY  
SEPTEMBER 30, 2005 AND JUNE 30, 2005

Preferred Stock Par	Common Stock Par	Additional paid-in	Stock Subscription
------------------------	---------------------	-----------------------	-----------------------

Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

	Shares	Value	Shares	Value	capital	receivable
BALANCE JUNE 30, 2005	10,000,000	\$ 10,000	53,430,283	\$ 53,430	\$ 17,262,963	\$ (4,760)
STOCK ISSUED FOR DEBENTURES	-	-	418,600,000	418,600	114,600	
STOCK SUBSCRIPTION RECEIVABLE	-	-	-	-	-	30,000
NET LOSS	-	-	-	-	-	-
BALANCE SEPTEMBER 30, 2005	10,000,000	\$ 10,000	472,030,283	\$ 472,030	\$ 17,377,563	\$ 25,240

SOVEREIGN EXPLORATION ASSOCIATES INTERNATIONAL, INC.  
F/K/A CALI HOLDINGS INC.  
STATEMENT OF CASH FLOWS  
SEPTEMBER 30, 2005  
UNAUDITED

CASH FLOWS FROM OPERATING ACTIVITIES:	9/30/2005
NET INCOME (LOSS)	\$ (107,623)
RECONCILIATION OF NET INCOME (LOSS) TO CASH FLOWS (USED IN) PROVIDED BY OPERATING ACTIVITIES	
Depreciation and amortization	615
Stock issued for services	-
Unrealized depreciation on investments	199,600
Loss on sale of investments	94,843
Loss on disposal of asset	444
Investments received in lieu of cash	(345,000)
(Increase) decrease in receivables	(21,368)
(Increase) decrease in other assets	135,292
Increase in accounts payable and accrued expenses	136,623
CASH FLOWS (USED IN) OPERATING ACTIVITIES	93,426
CASH FLOWS FROM INVESTING ACTIVITIES:	
Increase in notes receivable	(439,339)
Disposition of property and equipment	-
Purchase of property and equipment	(424)
Sale (purchase) of investments	3,700
CASH FLOWS (USED IN) PROVIDED BY INVESTING ACTIVITIES	(436,063)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from note payable	315,000
Proceeds from stock subscription	30,000
Issuance of common stock	-
CASH FLOWS PROVIDED BY FINANCING ACTIVITIES	345,000
NET INCREASE (DECREASE) IN CASH	2,363

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

CASH, BEGINNING OF THE PERIOD	31,034
	-----
CASH, END OF THE PERIOD	\$ 33,397
	=====
Supplementary Disclosure of Cash Flow Information:	
Cash paid during the period for:	
Interest	\$ 10
	=====

### Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our financial statements and notes thereto appearing elsewhere in this report.

#### CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

This Form 10-Q for the quarter ended September 30, 2006 contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended ("Exchange Act"). Forward-looking statements may be identified by the use of forward-looking terminology, such as "may," "shall," "could," "expect," "estimate," "anticipate," "predict," "probable," "possible," "should," "continue," or similar terms, variations of those terms or the negative of those terms. The forward-looking statements specified in the following information have been compiled by our management on the basis of assumptions made by management and are considered by management to be reasonable. Our future operating results, however, are impossible to predict and no representation, guaranty, or warranty is to be inferred from those forward-looking statements.

The assumptions used for purposes of the forward-looking statements specified in the following information represent estimates of future events and are subject to uncertainty as to possible changes in economic, legislative, industry, and other circumstances. As a result, the identification and interpretation of data and other information and their use in developing and selecting assumptions from and among reasonable alternatives require the exercise of judgment. To the extent that the assumed events do not occur, the outcome may vary substantially from anticipated or projected results, and, accordingly, no opinion is expressed on the achievability of those forward-looking statements. No assurance can be given that any of the assumptions relating to the forward-looking statements specified in the following information are accurate, and we assume no obligation to update any such forward-looking statements.

The reader of this discussion, the related financial statements and notes thereto, and other recent Company filings should understand that the portfolio companies, the senior management team, the Board of Directors, and the Company's method of accounting upon its withdrawal of its election to be treated as a business development company ("BDC") under the Investment Company Act of 1940 ("1940 Act"), have all materially changed.

#### RECENT DEVELOPMENTS

##### REASONS FOR CEASING TO BE A BUSINESS DEVELOPMENT COMPANY

Following the change in control of Sovereign Exploration Associates International, Inc. (the "Company") on October 17, 2005, we determined that many of the regulatory, financial reporting and other requirements imposed by the 1940 Act were too restrictive and prevented the Company from operating in the manner in which it desires. Among these restrictions are the following:



## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

- o A BDC is an investment company and is engaged in the business of investing, reinvesting, owning, holding, or trading in securities. We instead intend to carry on our marine recovery and explorations business through subsidiaries and controlled companies.
- o In carrying on our business, from time to time we expect to enter into joint venture and other transactions with affiliates, subject to the oversight and approval of the Board of Directors. BDCs generally are unable to enter into such transactions without the approval of the Securities and Exchange Commission (the "SEC"), and such approvals generally cannot be obtained without undue time and expense.
- o BDCs are subject to restrictions in the 1940 Act on the type and amount of securities, other than Common Stock, that they can issue. We believe that the Company would be better served by greater flexibility in our capital structure.
- o The closely regulated nature of BDCs causes them to be subject to greater legal and accounting expenses.
- o Because of restrictions on the Company's ability to issue stock, we were unable to comply with the Settlement Agreement effective June 30, 2006, while the Company was a BDC. We believe that the comprehensive settlement embodied in the Settlement Agreement is in the Company's best interests.

The Company's Board of Directors agreed with our assessment and determined that it was no longer feasible for the Company to operate as a BDC. The appropriate course of action was to withdraw the Company's election to be regulated as a BDC by filing a Form N-54C with the SEC. Following the withdrawal of the election, the Company will continue to be a reporting company under the Exchange Act, but will be managed so that it will not be subject to the provisions of the 1940 Act.

### EFFECT ON SHAREHOLDERS

Upon the Company's withdrawal of its election to be treated as a BDC, the Company will no longer be subject to regulation under the 1940 Act, which is designed to protect the interests of investors in investment companies. Specifically, our shareholders will no longer have the following protections of the 1940 Act:

- o We will no longer be subject to the requirement in Section 61 of the 1940 Act that we maintain a ratio of assets to senior securities (such as senior debt or preferred stock) of at least 200%.
- o We will no longer be prohibited from protecting any director or officer against any liability to the Company or our shareholders arising from willful malfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of that person's office.
- o We will no longer be required to provide and maintain a bond issued by a reputable fidelity insurance company to protect the Company against larceny and embezzlement.
- o We will no longer be required to ensure that a majority of our directors are persons who are not "interested persons," as that term is defined in section 56 of the Investment Company Act, and certain persons that would be prevented from serving on our board if we were a BDC (such as investment bankers) would be able to serve on our board.

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

- o We will no longer be subject to provisions of the 1940 Act regulating transactions between BDCs and certain affiliates.
- o We will no longer be subject to provisions of the 1940 Act restricting our ability to issue shares, warrants and options.
- o We will be able to change the nature of our business and fundamental investment policies without having to obtain the approval of our shareholders.

### EFFECT ON FINANCIAL STATEMENTS AND TAX STATUS

The election to withdraw the Company as a BDC under the 1940 Act results in a significant change in the Company's required method of accounting. BDC financial statement presentation and accounting utilizes the value method of accounting used by investment companies, which allows BDCs to recognize income and value their investments at market value as opposed to historical cost.

Operating companies use either the fair-value or historical-cost methods of accounting for financial statement presentation and accounting for securities held, depending on how the investment is classified and how long the company intends to hold the investment. Because of an absence of reliable market data as to the value of its assets, the Company has used historical cost as a proxy for fair value, mitigating the immediate impact of the change from fair-value to historical-cost accounting. In the future, however, changing our method of accounting could reduce the market value of our investments in privately held companies by eliminating our ability to report an increase in value of our holdings as they occur. Also, as an operating company, we will have to consolidate our financial statements with subsidiaries, thus eliminating the portfolio company reporting benefits available to BDCs.

We do not believe that the withdrawal of the Company's election to be treated as a BDC will have any impact on its federal income tax status, since we never elected to be treated as a regulated investment company under Subchapter M of the Internal Revenue Code. (Electing treatment as a regulated investment company under Subchapter M generally allows a qualified investment company to avoid paying corporate level federal income tax on income it distributes to its shareholders.) Instead, we have always been subject to corporate level federal income tax on our income (without regard to any distributions we make to our shareholders) as a "regular" corporation under Subchapter C of the Code.

### CHANGE IN ACCOUNTING PRINCIPLE

The Company's financial statements for the quarter ended September 30, 2005, as presented herein, were prepared using the method of accounting applicable to investment companies, while our financial statements, as presented herein, for the three months ended September 30, 2006, are prepared using the method of accounting applicable to operating companies. Our financial statements for these periods are not comparable. We have determined it is impractical to comply with the retroactive application of prior periods being presented on an operating and consolidated basis in accordance with Statement of Financial Accounting Standards No. 154, Accounting for Changes and Error Corrections ("FAS #154").

Pursuant to paragraph 11 of FAS #154, we have deemed it impracticable to apply the effects of a change in accounting principle retroactively because the following conditions apply as of September 30, 2006:

1. We have made every reasonable effort to apply the requirement, but are unable to do.
2. Retrospective application of the change in accounting principle requires assumptions about prior management's intent in prior periods

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

that cannot now be independently substantiated.

3. Retrospective application of the change in accounting principle requires significant estimates of amounts, and at this time it is impossible to distinguish objectively information about those estimates that: (a) provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application, and (b) would have been available when the financial statements for that prior period were issued.

### REVENUES

Revenue for the three months ended September 30, 2006 was \$0.

### OPERATING AND OTHER EXPENSES

Operating expenses for the three months ended September 30, 2006 was \$249,237, consisting of salaries and wages, general and administrative expenses, and professional fees. All of our employees, including officers, have agreed to a 50% reduction in their respective salaries and wages effective July 1, 2006.

### CAPITALIZED COSTS

The Company's subsidiaries are development stage enterprises engaged in ocean explorations and archaeologically sensitive recoveries of artifacts, treasure trove and/or cargo from shipwrecks under various licenses. FAS #7 defines a development stage enterprise as one that is devoting substantially all of its efforts to establishing a new business and either planned principal operations have not commenced or planned principal operations have commenced but there has been no significant revenue.

As of September 30, 2006, the Company accounted for \$2,344,394 of its ocean exploration and archaeologically sensitive recoveries of artifacts, treasure trove and/or cargo from shipwrecks costs incurred to-date as capitalized costs.

### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2006, we had an accumulated deficit of \$19,820,464.

Each year diving operations for ocean explorations and archaeologically sensitive recoveries of artifacts, treasure trove and/or cargo from shipwrecks must be funded. In order to fund the 2006 diving operations which ran from July through October 2006, the President of the Company advanced the Company \$500,000, of which \$265,000 was directly used for diving operations in Nova Scotia. The remaining funds of approximately \$235,000 were used for working capital purposes of the Company, primarily for legal and professional fees as an SEC registrant.

The net effect, as of June 30, 2006, of the Company's election to withdraw our business development company status pursuant to the Investment Company Act of 1940 was as follows:

Additional paid in capital	\$	(550,705)
Deficit		(425,068)
Unrealized depreciation on investments		1,015,273
		-----
Net adjustments	\$	39,500

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

=====

As a result of the change in accounting principle because of the Company's election to withdraw its BDC election, the Company restated its June 30, 2006 Balance Sheet, which is included in the accompanying financial statements.

In October 2006, the Company prepared a private placement memorandum for Fantome Cove Treasure Trove 150, LLC under which the Company is seeking to raise \$4 million in equity investments from accredited investors. The Company, through the efforts of management, is actively pursuing potential private investors. The securities offered will not be registered under the Securities Act of 1933 and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

Effective November 15, 2006, the Chairman of the Company advanced the Company \$160,000 under a note agreement that requires an interest rate of the lesser of 0.9% or the legal rate under Texas law and is due, in full, with principal and interest on November 15, 2007.

Effective November 15, 2006, the \$600,000 note due to Sea Hunt, Inc. and Venture Planning, Inc., related parties to the Chairman of the Company, was renegotiated with a new due date of November 15, 2007 along with an interest rate of the lesser of 0.9% or the legal rate under Texas law and is due, in full, with principal and interest on November 15, 2007.

### NOTES PAYABLE

The convertible debentures as outlined in Note H of the accompanying financial statements continue to be in dispute. We have no additional information regarding the resolution to these disputed convertible debentures which were entered into by prior management before October 17, 2005.

### COMMITMENTS AND CONTINGENCIES:

Prior to the Exchange Agreement, there is a Revenue Agreement as outlined in Exhibit B of the Exchange Agreement, that requires 20% revenue participation payable to the original owners of the permits from the net recovery of the shipwrecks for the permits that have been assigned to the subsidiaries of the Company's portfolio company, Historic Discoveries, Inc. The 20% revenue participation allows Historic Discoveries, Inc. to defer permit transfer fees and align site permit cost with revenue generation, eliminating the exposure associated with sites that do not produce a material number of artifacts. Historic Discoveries, Inc. is only required to pay the 20% revenue participation when sites produce net revenue. The 20% revenue participation also provides Historic Discoveries, Inc. the right of first refusal on future sites, creating a mechanism for Historic Discoveries, Inc. and its operating companies to build site inventory while deferring the associated cost and reducing financial risk. The Revenue Agreement with the original owners was executed prior to October 17, 2005.

As of September 30, 2006, we have determined that no liability exists under this agreement.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

As of September 30, 2006, the Company did not have any off-balance sheet investments or hedging investments.

The Company does not believe that its business was materially affected by inflation, other than the impact inflation may have on the securities markets, the valuations of business enterprises, and the relationship of such valuation to underlying earnings, all of which will influence the value of the Company's

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

assets.

### Item 4. Controls and Procedures

As required by SEC rules, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures at the end of the period covered by this report. This evaluation was carried out under the supervision and with the participation of our management, including our principal executive and principal financial officer. Based on this evaluation, this officer has concluded that the design and operation of our disclosure controls and procedures are effective. In addition, there were no changes in our internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file under the Exchange Act is accumulated and communicated to our management, including our principal executive and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure.

## Part II. Other Information

### Item 1. Legal Proceedings

Not applicable.

### Item 1A. Risk Factors

An investment in our common stock is highly speculative, involves a high degree of risk, and should be considered only by those persons who are able to bear the economic risk of their investment for an indefinite period. In addition to other information in this Quarterly Report on Form 10-Q, you should carefully consider the risks described below before investing in our publicly-traded securities. The risks described below are not the only ones facing us. Our business is also subject to the risks that affect many other companies, such as competition, technological obsolescence, labor relations, general economic conditions and geopolitical changes. Additional risks not currently known to us or that we currently believe are immaterial also may impair our business operations and our liquidity.

#### Our Business Is Inherently Risky and Speculative

Our business of historic shipwreck exploration and recovery is inherently risky, and the risks predominate at each step of the Corporation's business model.

The value of the Company is largely dependent on permits giving to us, through our subsidiaries and controlled companies, the exclusive right to exploration for historical shipwrecks in specified areas. The value of these permits is dependent, to a substantial degree, upon our research and data assembled indicating that a historical shipwreck is likely to be in the area. Although we have access to a substantial amount of research and data, which has been compiled during various projects, all such research and data regarding shipwrecks is imprecise, incomplete and unreliable, as it is often composed of, or affected by, numerous assumptions, rumors, "legends," historical and scientific inaccuracies, and inaccurate interpretations that have become a part of such research and data over time. The shipwrecks we seek generally have long

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

disintegrated, and confirming their locations is difficult. Even if the shipwrecks are accurately located in waters covered by our permits, the shipwrecks may have been salvaged or may not have had anything of value on board at the time of the sinking.

Underwater recovery operations are inherently difficult and dangerous and may be delayed or suspended by weather, sea conditions or other natural hazards. Further, such operations may be undertaken more safely during certain months of the year than during others. These risks are particularly great in the waters off Nova Scotia, where many of the shipwrecks we seek are believed to be located. There can be no assurances that we will be able to conduct search and/or recovery operations only during such favorable periods. In addition, even though sea conditions in a particular search location may be somewhat predictable, the possibility exists that unexpected conditions in a search area may occur and that such unexpected conditions might adversely affect operations. Further, it is possible that natural hazards may prevent or significantly delay search and recovery operations.

From time to time, it will be necessary to contract with third parties for additional equipment and/or labor necessary for the location and recovery of wreck sites. There can be no assurance that third party contracts will be available to us. The availability of specialized recovery equipment may present a problem, and the cost of obtaining the use of such equipment to conduct recovery operations is uncertain and will depend on, in part, the location and condition of the wreckage to be recovered.

Persons and entities other than the Company and its affiliates may claim title to the shipwrecks. Even if we are successful in locating and recovering shipwrecks, there is no assurance of establishing the rights to property recovered as against governmental entities, prior owners, or other attempted salvors claiming an interest therein. There is also a risk of theft of valuable items at sea, both before and after their recovery, by pirates or poachers and while in transit to a safe destination.

Even after the location of a historical shipwreck has been confirmed, it may require a period of years before we can realize revenue from salvage operations. We generally must obtain a recovery permit before we can make any substantial recoveries from the site.

Salvage operations generally require a substantial period of time to complete. Recovered items must be carefully examined by our science team. We then must negotiate with applicable government authorities, which generally are entitled to retain a portion of the recovered items. The issuance of recovery permits and negotiations with governmental authorities may result in delays, particularly if there is public sentiment against salvage, there are multiple governmental claims to the shipwreck, or the recovered items are especially valuable or historically significant.

Even if valuable items can be located and recovered, it is difficult to predict the price that may be realized for these items. The items may have been damaged by salt water or by natural sea conditions. The value of the recovered items will fluctuate with a precious metals market that has been highly volatile in recent years. Moreover, the entrance into the market of a large supply of similar items from shipwrecks, including those we have located and recovered, could itself depress the market for these items. The methods and channels that may be used in the disposition of the recovered items are uncertain at present and may include one or a combination of several alternatives. Ready access to buyers for disposition of any artifacts or other valuable items recovered cannot be assured and delays in the disposition of such items are very possible.

You May Be Diluted by Future Issuances of Equity or Debt Securities

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

In the future, we may attempt to increase our capital resources by making additional public offerings or private placements of equity or debt securities, including medium-term notes, senior or subordinated notes, one or more classes of preferred stock, additional common stock, warrants, or equity or debt securities convertible into common stock. Additional equity offerings by us reduce the value of our common stock. Any preferred stock we may issue would have a preference on distributions that could limit our ability to make distributions to the holders of our common stock. Upon our liquidation, holders of our debt securities, if any, and shares of preferred stock, if any, and lenders with respect to other borrowings, if any, will receive a distribution of our available assets prior to the holders of our common stock. Because our decision to issue securities in any future offering will depend on market conditions and other factors beyond our control, we cannot predict or estimate the amount, timing or nature of our future offerings. Thus, our shareholders bear the risk of our future offerings reducing the market price of our common stock and diluting their stock holdings in the Company.

### Need for Additional Capital

Although we have recovered a number of valuable items in our salvage operations to-date, we have not yet realized any revenues from these salvage operations, and any revenues we realize in the near future are unlikely to be sufficient to fund our operations. In addition, we have minimal financial resources. Accordingly, we can continue our operations only if we can raise additional working capital.

### Legal and Political Risks

Historical shipwreck recovery is highly regulated and can be a high-profile political issue, due to jurisdictional disputes, public concern over historically significant shipwrecks, and archaeological and environmental concerns.

A localized group in Nova Scotia has forwarded the idea to repeal the Nova Scotia Treasure Trove Act. This action remains on the horizon. However, our legal representation in Nova Scotia indicates the likelihood that it will not move forward and if it does that we may be "grandfathered" for a period of time.

The United Kingdom has filed a formal notice on the H.M.S. Fantome that could represent a challenge to our plans for a recovery in Fantome Cove. Our subsidiary ARC was notified on August 31, 2006, by the Nova Scotia Department of Tourism, Culture & Heritage that its application for a Class B recovery permit for the Fantome Cove treasure trove site has not been approved. A Class B permit is required before ARC can make any substantial recoveries from the site. The Department has recommended that permission be secured from the United Kingdom. We are considering our options.

Increasing international interest in the protection of underwater cultural heritage has been indicated by the United Nations Educational, Scientific and Cultural Organization (UNESCO) Convention on the Protection of the Underwater Cultural Heritage. The Convention generally would raise standards in terms of conduct of exploration and salvage and focus on improving science and archeology efforts. The Convention was adopted by UNESCO in 2001 but has not yet been widely adopted by the nations of the world, including Canada or the United States, and has not yet entered into force with respect to the nations that have adopted it. We believe that we will be able to comply with the Convention if it comes into force, although compliance may increase our costs.

### Legal Exposure

In the period leading up to the change in control of the Company on October 17, 2005, the Company, under its prior management, disposed of a number of its

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

assets for aggregate consideration of \$20 and issued 800,000,000 shares (800,000 shares on a split-adjusted basis) for consideration the receipt of which the Company's present management has been unable to confirm. In addition, in the period from October 17, 2005, to September 22, 2006, although we had elected treatment as a business development company under the 1940 Act, we may not have met all of the requirements for treatment as a business development company, and some of our activities or those of our affiliates raised questions under the 1940 Act. We accordingly could face legal exposure in the event of either private litigation or a SEC enforcement action with respect to events either before or after the change in control. Neither the SEC nor any private litigant has expressed a present intention of bringing such an action against us.

### Dependence on Key Personnel

Our success will depend largely on the skills of our key management personnel, who currently function without employment contacts. The loss of one or more of our key management personnel may materially and adversely affect our business and results of operations. We cannot guarantee that we will be able to replace any key management personnel in the event that their services become unavailable.

### Loss of Certain Protections Because of Non-BDC Status

When the Company ceased to be a BDC regulated under the Investment Company Act of 1940 ("1940 Act") in September 2006, the shareholders lost certain protections, including, but not limited to, the following:

- o The Company is no longer be subject to the requirement that it maintain a ratio of assets to senior securities of at least 200%.
- o The Company is no longer prohibited from protecting any director or officer against any liability to the Company or the Company's shareholders arising from willful malfeasance, bad faith, gross negligence, or reckless disregard of the duties involved in the conduct of that person's office.
- o The Company is no longer required to ensure that a majority of the directors are persons who are not "interested persons," as that term is defined in section 56 of the 1940 Act, and certain persons that would be prevented from serving on the Company's board if it were a BDC (such as investment bankers) will be able to serve on the Company's board.
- o The Company is no longer subject to provisions of the 1940 Act regulating transactions between BDCs and certain affiliates and restricting the Company's ability to issue warrants and options.
- o The Company is no longer obligated to subject a material change in its fundamental investment policies to the approval of its shareholders.
- o The Company is no longer subject to provisions of the 1940 Act prohibiting the issuance of securities at below net asset value.
- o The withdrawal of the Company's election to be regulated as a BDC results in a change in its method of accounting. BDC financial statement presentation and accounting uses the value method of accounting used by investment companies, which allows BDCs to recognize income and value their investments at market value as opposed to historical cost. Operating companies use either the fair-value or historical-cost methods of accounting for financial statement presentation and accounting for securities held, depending on how the investment is classified and how long the company intends



## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

to hold the investment. Changing the Company's method of accounting could reduce the market value of its investments in privately held companies by eliminating the Company's ability to report an increase in value of its holdings as they occur.

- o Because the Company's securities are not registered under Section 12 of the Exchange Act, it is not subject to the obligation to provide investors with proxy or information statements, and its insiders are not required to report their trades and holdings. However, the Company continues to be a reporting company and files periodic and current reports on Form 10-K, Form 10-Q, and Form 8-K. The Company's Board of Directors is still subject to customary principles of fiduciary duty with respect to the Company and its shareholders, and investors will benefit from a number of protections and corporate governance requirements under the Sarbanes-Oxley Act of 2002.

### OTC Bulletin Board

Our common stock is quoted on the OTC Bulletin Board ("OTCBB"). The OTCBB is an inter-dealer, over-the-counter market that provides significantly less liquidity than the NASDAQ Stock Market or national or regional exchanges. Securities traded on the OTCBB are typically thinly traded, highly volatile, have fewer markets and are not followed by analysts. The SEC's order handling rules, which apply to NASDAQ-listed securities, do not apply to securities quoted on the OTCBB. Quotes for stocks included on the OTCBB are not listed in newspapers, although they are available on the Internet.

### Penny Stock Rules

Trading in our securities will be subject to the "penny stock" rules for the foreseeable future. The SEC has adopted regulations that generally define a penny stock to be any equity security that has a market price of less than \$5.00 per share, subject to certain exceptions. These rules require that any broker-dealer who recommends our securities to persons other than prior customers and accredited investors must, prior to the sale, make a special written suitability determination for the purchaser and receive the purchaser's written agreement to execute the transaction. Unless an exception is available, the regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the risks associated with trading in the penny stock market. In addition, broker-dealers must disclose commissions payable to both the broker-dealer and the registered representative and current quotations for the securities they offer. The additional burdens imposed upon broker-dealers by such requirements may discourage broker-dealers from recommending transactions in our securities, which could severely limit the liquidity of our common stock and consequently adversely affect the market price of our common stock.

### No Dividends

Holders of our securities will only be entitled to dividends when, as and if declared by our Board of Directors. The Company has never paid dividends, and we do not expect to have profits or a cash surplus available for dividends in the foreseeable future.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Not applicable.

### Item 3. Defaults Upon Senior Securities

Not applicable.

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

### Item 4. Submission of Matters to a Vote of Security Holders

The Company held a special meeting of its shareholders on September 20, 2006, to consider a proposal for the company to withdraw its election to be a business development company under the 1940 Act. The withdrawal was approved by a vote of 91.33% of the company's outstanding common stock, with 23,931,879 shares voted in favor, 20,665 shares voted against, and 252 abstentions.

### Item 5. Other Information

Not applicable.

### ITEM 6. EXHIBITS

#### Exhibits

1. Articles of Incorporation are incorporated by reference to Exhibit 3(i) of Form 10-K as filed electronically with the SEC on October 13, 2006.
2. By-Laws are incorporated by reference to Exhibit 3(ii) of Form 10-K as filed electronically with the SEC on October 13, 2006.
3. Exchange Agreement is incorporated by reference to Exhibit 10.1 of Form 10-K as filed electronically with the SEC on October 13, 2006.
4. Settlement Agreement is incorporated by reference to Exhibit 10.2 of Form 10-K as filed electronically with the SEC on October 13, 2006.
5. Letter re: Change in Accounting Principles is filed herewith as EX-18.
6. Section 302 CEO and CFO Certification is filed herewith as EX-31.1.
7. Section 906 CEO and CFO Certification is filed herewith as EX-32.1.

#### SIGNATURE

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.

Sovereign Exploration Associates  
International, Inc.

Date: November 21, 2006

By: /s/Robert D. Baca  
Robert D. Baca  
President, Chief Executive Officer,  
and Chief Financial Officer

## Edgar Filing: Sovereign Exploration Associates International, Inc. - Form 10-Q

### Exhibit Index

Exhibit No.	Description
EX-18	Letter regarding Change in Accounting Principles
EX-31.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) Certification, as adopted pursuant to Section 302 of the Sarbanes Oxley Act of 2002
EX-32.1	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002