

ODYSSEY MARINE EXPLORATION INC
Form 10-Q
November 03, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 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 1-31895

ODYSSEY MARINE EXPLORATION, INC.

(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

5215 W. Laurel Street, Tampa, Florida 33607

(Address of principal executive offices) (Zip code)

(813) 876-1776

(Registrant's telephone number, including area code)

84-1018684
(I.R.S. Employer

Identification No.)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer:

Accelerated filer:

Non-accelerated filer:

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

The number of outstanding shares of the registrant's Common Stock, \$.0001 par value, as of October 20, 2006 was 46,146,408.

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

| | (Unaudited) | |
|---|----------------------|----------------------|
| | September 30, | December 31, |
| | 2006 | 2005 |
| ASSETS | | |
| CURRENT ASSETS | | |
| Cash and cash equivalents | \$ 1,361,025 | \$ 3,283,331 |
| Accounts receivable, net | 1,056,921 | 1,527,913 |
| Inventory | 2,639,393 | 4,728,394 |
| Other current assets | 358,262 | 729,678 |
| Total current assets | 5,415,601 | 10,269,316 |
| PROPERTY AND EQUIPMENT | | |
| Equipment and office fixtures | 12,989,725 | 10,745,738 |
| Building and land | 3,709,873 | 3,973,988 |
| Accumulated depreciation | (4,073,929) | (2,738,572) |
| Total property and equipment | 12,625,669 | 11,981,154 |
| OTHER ASSETS | | |
| Inventory (non current) | 7,322,031 | 5,839,914 |
| Attraction development | 1,245,252 | 1,172,475 |
| Other non current assets | 1,162,697 | 927,599 |
| Total other assets | 9,729,980 | 7,939,988 |
| Total assets | \$ 27,771,250 | \$ 30,190,458 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| CURRENT LIABILITIES | | |
| Accounts payable | \$ 562,905 | \$ 601,129 |
| Accrued expenses | 1,071,325 | 1,843,261 |
| Mortgage and loans payable | 1,947,412 | 111,433 |
| Deposits | 20,090 | 103,069 |
| Total current liabilities | 3,601,732 | 2,658,892 |
| LONG TERM LIABILITIES | | |
| Mortgage and loans payable | 3,163,861 | 1,758,333 |
| Deferred income from Revenue Participation Certificates | 887,500 | 887,500 |
| Total long term liabilities | 4,051,361 | 2,645,833 |
| Total liabilities | 7,653,093 | 5,304,725 |
| STOCKHOLDERS EQUITY | | |

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| | | |
|---|---------------|---------------|
| Preferred stock - \$.0001 par value; 6,800,000 and 9,300,000 shares authorized; none outstanding | | |
| Preferred stock series A convertible - \$.0001 par value; 510,000 shares authorized; none issued or outstanding | | |
| Preferred stock series D convertible - \$.0001 par value; 2,500,000 and 0 shares authorized, issued and outstanding | 250 | |
| Common stock - \$.0001 par value; 100,000,000 Shares authorized; 46,127,678 and 45,823,224 issued and outstanding | 4,613 | 4,582 |
| Additional paid-in capital | 53,413,275 | 43,870,228 |
| Accumulated deficit | (33,299,981) | (18,989,077) |
| Total stockholders' equity | 20,118,157 | 24,885,733 |
| Total liabilities and stockholders' equity | \$ 27,771,250 | \$ 30,190,458 |

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS - Unaudited

| | Three Months Ended | |
|--|--------------------|---------------|
| | September 30, | September 30, |
| | 2006 | 2005 |
| REVENUE | \$ 586,778 | \$ 986,682 |
| OPERATING EXPENSES | | |
| Cost of sales | 303,189 | 190,633 |
| Marketing, general & administrative | 1,320,404 | 2,335,420 |
| Operations & research | 5,099,625 | 3,808,427 |
| Total operating expenses | 6,723,218 | 6,334,480 |
| INCOME (LOSS) FROM OPERATIONS | (6,136,440) | (5,347,798) |
| OTHER INCOME (EXPENSE) | | |
| Interest income | 20,517 | 6,900 |
| Interest expense | (86,179) | (32,365) |
| Other | 11,325 | 13,127 |
| Total other income (expense) | (54,337) | (12,338) |
| INCOME (LOSS) BEFORE INCOME TAXES | (6,190,777) | (5,360,136) |
| Income tax benefit (provision) | | 2,239,053 |
| NET INCOME (LOSS) | (6,190,777) | (3,121,083) |
| EARNINGS (LOSS) PER SHARE | | |
| Basic and diluted | \$ (.13) | \$ (.07) |
| Weighted average number of common shares outstanding | | |
| Basic and diluted | 46,127,678 | 42,738,172 |

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS - Unaudited

| | Nine Months Ended | |
|--|-------------------|---------------|
| | September 30, | September 30, |
| | 2006 | 2005 |
| REVENUE | \$ 3,409,790 | \$ 8,162,016 |
| OPERATING EXPENSES | | |
| Cost of sales | 677,126 | 760,724 |
| Marketing, general & administrative | 5,904,750 | 6,539,865 |
| Operations & research | 11,101,612 | 7,961,558 |
| Total operating expenses | 17,683,488 | 15,262,147 |
| INCOME (LOSS) FROM OPERATIONS | (14,273,698) | (7,100,131) |
| OTHER INCOME (EXPENSE) | | |
| Interest income | 90,377 | 22,397 |
| Interest expense | (164,376) | (89,112) |
| Other | 36,792 | 54,950 |
| Total other income (expense) | (37,207) | (11,765) |
| INCOME (LOSS) BEFORE INCOME TAXES | (14,310,905) | (7,111,896) |
| Income tax benefit (provision) | | 2,898,241 |
| NET INCOME (LOSS) | (14,310,905) | (4,213,655) |
| EARNINGS (LOSS) PER SHARE | | |
| Basic and diluted | \$ (.31) | \$ (.10) |
| Weighted average number of common shares outstanding | | |
| Basic and diluted | 46,066,563 | 41,246,622 |

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS - Unaudited

| | Nine Months Ended | |
|---|---------------------|---------------------|
| | September 30, | September 30, |
| | 2006 | 2005 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Income (Loss) | \$ (14,310,905) | \$ (4,213,655) |
| Adjustments to reconcile net loss to net cash used by operating activity: | | |
| Deferred income taxes | | (3,351,351) |
| Depreciation and amortization | 2,329,004 | 971,282 |
| (Gain) Loss on disposal of equipment | (252,396) | 43,528 |
| Share-based compensation | 425,260 | |
| Tax benefit related to exercise of employee Stock options | | 453,110 |
| (Increase) decrease in: | | |
| Accounts receivable | 434,245 | 1,476,947 |
| Inventory | 606,884 | (853,724) |
| Other assets | 109,420 | (286,925) |
| Increase (decrease) in: | | |
| Accounts payable | (38,221) | 110,691 |
| Customer deposits | (82,979) | (2,695) |
| Accrued expenses | (718,401) | (490,311) |
| NET CASH (USED) IN OPERATING ACTIVITIES | (11,498,089) | (6,143,103) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of property and equipment | (2,141,016) | (4,083,865) |
| Proceeds from sale of equipment | 550,000 | 49,647 |
| Attraction development | (72,776) | (1,151,745) |
| Purchase of building improvements | | (245,803) |
| NET CASH (USED) IN INVESTING ACTIVITIES | (1,663,792) | (5,431,766) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from issuance of common stock | 413,068 | 13,547,062 |
| Proceeds from issuance of preferred stock | 8,750,000 | |
| Broker commission and fees on private offering | (45,000) | (445,000) |
| Proceeds from mortgage and loans payable | 3,694,583 | |
| Repayment of mortgage and loans payable | (1,573,076) | (137,267) |
| NET CASH PROVIDED BY FINANCING ACTIVITIES | 11,239,575 | 12,964,795 |
| NET INCREASE (DECREASE) IN CASH | (1,922,306) | 1,389,926 |
| CASH AT BEGINNING OF PERIOD | 3,283,331 | 3,050,721 |
| CASH AT END OF PERIOD | \$ 1,361,025 | \$ 4,440,647 |
| SUPPLEMENTARY INFORMATION: | | |
| Interest paid | \$ 155,425 | \$ 87,367 |
| Income taxes paid | \$ | \$ |
| NON CASH TRANSACTIONS: | | |
| Depreciation capitalized as inventory | \$ | \$ 72,912 |
| Accounts receivable paid by services | \$ 53,539 | \$ |

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| | | |
|---|--------------|------------|
| Accrued compensation paid by common stock | \$ | \$ 100,000 |
| Equipment purchased with financing | \$ 1,120,000 | \$ |

Summary of Significant Non-Cash Transactions

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

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

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - BASIS OF PRESENTATION

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

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

In the opinion of management, these financial statements reflect all adjustments, including normal recurring adjustments, necessary for a fair presentation of the financial position as of September 30, 2006, results of operations, and cash flows for the interim periods presented. Operating results for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for the full year.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

Principles of Consolidation

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

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

Use of Estimates

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

Revenue Recognition and Accounts Receivable

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

Cash Equivalents

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

Fair Value of Financial Instruments

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

Inventory

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

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

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

Long-Lived Assets

Our policy is to recognize impairment losses relating to long-lived assets in accordance with Financial Accounting Standards Board No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets based on several factors, including, but not limited to, management's plans for future operations, recent operating results and projected cash flows. Due to the closing of the themed attraction in the New Orleans market during the three months ended September 30, 2006, we accelerated the estimated useful lives of certain fixed assets and leasehold improvements to a life ending September 30, 2006. This resulted in additional depreciation and amortization of \$645,249 for the period ended September 30, 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, 2006, we did not own United States Treasury Bills with a maturity greater than three months.

Property and Equipment and Depreciation

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

Depreciation expense is summarized as follows:

Nine Months Ended

Three Months Ended

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| | September 30 2006 | September 30 2005 | September 30 2006 | September 30 2005 |
|--|----------------------|----------------------|----------------------|----------------------|
| Depreciation expense | \$ 2,318,715 | \$ 1,044,194 | \$ 1,256,487 | \$ 417,223 |
| Less depreciation capitalized to inventory | | 72,912 | | |
| Net depreciation expense | \$ 2,318,715 | \$ 971,282 | \$ 1,256,487 | \$ 417,223 |

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

Earnings Per Share

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

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

For the periods ending September 30, 2006 and 2005 in which net losses occurred, all potential common shares were excluded from diluted EPS because the effect of including such shares would be anti-dilutive. The potential common shares, in the table following, represent potential common shares from outstanding options and warrants that were excluded from the calculation of Diluted EPS:

| | Nine Months Ended | | Three Months Ended | |
|--|-------------------|---------------|--------------------|---------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Average market price during the period | \$ 2.98 | \$ 3.87 | \$ 2.46 | \$ 4.58 |
| In the money potential common shares excluded | 356,743 | 1,354,888 | 227,595 | 1,729,465 |
| Out of the money options 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 | 8,000 | 387,250 | |
| Stock Options with an exercise price of \$5.00 per share | 495,000 | 595,000 | 495,000 | 595,000 |
| Warrants with an exercise price of \$3.50 per share | 3,170,000 | | 3,170,000 | |
| Warrants with an exercise price of \$5.25 per share | 100,000 | 100,000 | 100,000 | 100,000 |
| Total Anti dilutive warrants and options excluded from EPS | 5,203,993 | 2,057,888 | 5,610,720 | 2,424,465 |

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

| | Nine Months Ended | | Three Months Ended | |
|--|-------------------|---------------|--------------------|---------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Weighted average potential common shares from Series D Preferred Stock excluded from computation | 1,831,502 | | 2,500,000 | |

of diluted earnings per share

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

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

| | Nine Months Ended | | Three Months Ended | |
|--|-------------------|----------------|--------------------|----------------|
| | September 30, | September 30, | September 30, | September 30, |
| | 2006 | 2005 | 2006 | 2005 |
| Numerator, basic and diluted net loss | \$ (14,310,905) | \$ (4,213,655) | \$ (6,190,777) | \$ (3,121,083) |
| Denominator: | | | | |
| Weighted average common shares outstanding basic | 46,066,563 | 41,246,622 | 46,127,678 | 42,738,172 |
| Effect of potential common shares | | | | |
| Weighted average common shares basic and diluted | 46,066,563 | 41,246,622 | 46,127,678 | 42,738,172 |
| Loss per share basic and diluted | \$ (.31) | \$ (.10) | \$ (.13) | \$ (.07) |

Share-Based Compensation

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

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

Share-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest. Share-based compensation expense recognized in the consolidated statement of operations during the nine-month period ended September 30, 2006 include compensation expense for the share-based compensation awards granted prior to December 31, 2005, based on the grant date fair value estimated in accordance with FAS 123(R). As share-based compensation expense recognized in the statement of operations is based on awards ultimately expected to vest, it will be reduced for estimated forfeitures. FAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

As a result of adopting FAS 123(R), \$114,715 and \$425,260 of share-based compensation was charged against income for the three and nine-month periods ended September 30, 2006. For the three and nine-month periods ended September 30, 2005, the following table illustrates the effect on net income and earnings per share had we applied the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, Accounting for Share-Based Compensation, to share-based employee compensation.

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES continued

| | Nine Months Ended | Three Months Ended |
|---|--------------------|--------------------|
| | September 30, 2005 | September 30, 2005 |
| Net income (loss): | | |
| As reported | \$ (4,213,655) | \$ (3,121,083) |
| Pro forma adjustment for compensation, net of tax | (1,261,027) | (812,518) |
| Pro forma | \$ (5,474,682) | \$ (3,933,601) |
| Basic income (loss) per share: | | |
| As reported | \$ (.10) | \$ (.07) |
| Pro forma | \$ (.13) | \$ (.09) |
| Diluted income (loss) per share: | | |
| As reported | \$ (.10) | \$ (.07) |
| Pro forma | \$ (.13) | \$ (.09) |

The weighted average estimated fair value of stock options granted during the three-month periods ended September 30, 2006 and 2005 was \$0.96 and \$2.04 respectively. The weighted average estimated fair value was determined using the Black-Scholes option-pricing model, which values options based on the stock price at the grant date, the expected life of the option, the estimated volatility of the stock, the expected dividend payments, and the risk-free interest rate over the life of the option. The assumptions used in the Black-Scholes model were as follows:

| | 3 Month Period Ended | |
|-------------------------------------|----------------------|---------------|
| | September 30, | September 30, |
| | 2006 | 2005 |
| Risk-free interest rate | 5.10% | 3.9% |
| Expected volatility of common stock | 60.4% | 62.4% |
| Dividend Yield | 0% | 0% |
| Expected life of options | 4 years | 4 years |

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

Income Taxes

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

NOTE C ACCOUNTS RECEIVABLE

Accounts receivable is comprised of the following:

September 30, December 31,

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| | 2006 | 2005 |
|------------------------------------|------------------|------------------|
| Accounts receivable - trade | \$ 793,690 | \$ 1,478,869 |
| Accounts receivable - other | 350,000 | 176,442 |
| Accounts receivable - reserve | (86,769) | (127,398) |
| Total Accounts receivable, net | \$ 1,056,921 | \$ 1,527,913 |

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE D - INVENTORY

Our inventory consisted of the following:

| | September 30, | December 31, |
|-----------------|---------------|---------------|
| | 2006 | 2005 |
| Artifacts | \$ 8,745,488 | \$ 9,320,343 |
| Merchandise | 629,326 | 634,558 |
| Packaging | 586,610 | 613,407 |
| Total Inventory | \$ 9,961,424 | \$ 10,568,308 |

Of these amounts \$7,322,031 and \$5,839,914 are classified as non-current as of September 30, 2006 and December 31, 2005, respectively.

NOTE E - INCOME TAXES

As of September 30, 2006, the Company had consolidated income tax net operating loss (NOL) carryforwards for federal tax purposes of approximately \$44 million. The NOL will expire in various years ending through the year 2026.

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

| | September 30, | September 30, |
|----------|---------------|----------------|
| | 2006 | 2005 |
| Current | | |
| Federal | \$ | \$ |
| State | | |
| | \$ | \$ |
| Deferred | | |
| Federal | \$ | \$ (2,655,875) |
| State | | (242,366) |
| | \$ | \$ (2,898,241) |

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 | \$ 16,447,484 |
| Accrued expenses | 79,277 |

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| | |
|--------------------------------------|--------------|
| Reserve for accounts receivable | 30,572 |
| Start-up costs | 107,833 |
| Stock option expense | 163,262 |
| Less: valuation allowance | (13,174,545) |
| | \$ 3,653,883 |
| Deferred tax liability: | |
| Property and equipment basis | \$ 69,751 |
| Prepaid expenses | 58,136 |
| Inventory reserve | 9,071 |
| Excess of tax over book depreciation | 385,731 |
| Artifacts recovery costs | 3,131,194 |
| | \$ 3,653,883 |
| Net deferred tax asset | \$ |

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

As reflected above, we have recorded a net deferred tax asset of \$0 at September 30, 2006. In accordance with SFAS No. 109, *Accounting for Income Taxes*, we have evaluated whether it is more likely than not that the deferred tax assets will be realized.

Based on the available evidence, we have concluded that it is more likely than not that those assets would not be realizable without the recovery of high value shipwrecks and thus a valuation allowance has been recorded as of September 30, 2006.

The change in the valuation allowance is as follows:

| | |
|-------------------------------|---------------|
| September 30, 2006 | \$ 13,174,545 |
| December 31, 2005 | \$ 7,791,859 |
| Change in valuation allowance | \$ 5,382,686 |

Income taxes for the nine month periods ended September 30, 2006 and 2005 differ from the amounts computed by applying the effective federal income tax rate of 34% to income before income taxes as a result of the following:

| | September 30, 2006 | September 30, 2005 |
|--|-----------------------|-----------------------|
| Expected provision (benefit) | \$ (4,865,707) | \$ (2,418,045) |
| State income taxes net of federal benefits | (184,419) | (167,966) |
| Nontaxable (income) expense | 10,239 | 19,922 |
| Stock options exercised | (214,659) | |
| Change in valuation allowance | 5,382,686 | (10,993) |
| Effects of: | | |
| Change in rate estimate | (118,363) | (334,898) |
| Other, net | (9,777) | 13,739 |
| | \$ | \$ (2,898,241) |

During the nine-month periods ended September 30, 2006 and 2005, the Company recognized certain tax benefits, prior to any valuation allowances, related to stock option plans in the amount of \$72,614 and \$453,110 respectively. If we did not have a full valuation allowance, such benefits would be recorded as an increase in the deferred tax asset and an increase in additional paid-in capital.

NOTE F - CONTINGENCIES

Legal Proceedings

On or about December 14, 2004 a complaint was filed against seven defendants including the Company in the Court of Common Pleas in the Ninth Judicial Circuit, County of Charleston, in the State of South Carolina. The complaint was filed by Republic & Eagle Associates, Inc. and Sea Miners, Inc. against John Morris, Greg Stemm, John Lawrence, John Balch, Daniel Bagley, Seahawk Deep Sea Technologies, Inc. (Seahawk) and the Company. The plaintiff's allegations included breach of fiduciary duty, civil conspiracy and breach of contract based primarily upon an alleged contract(s) between the plaintiffs and Seahawk dated May 16, 1995 dealing with the search for the SS *Republic*. The plaintiffs alleged that their research, which was provided to Seahawk, led to the discovery of the SS *Republic* and sought an unspecified amount of damages and public recognition of their contribution. On February 18, 2005, John Morris, Greg Stemm, Daniel Bagley, and the Company filed their Notice of Motion and Motion to Dismiss Defendants John Morris, Greg Stemm, Daniel Bagley and Odyssey Marine Exploration, Inc. (the Motion). In the Motion, the defendants alleged that the complaint should be dismissed because, among other things, the South Carolina

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court does not have jurisdiction over them, the action was filed in an improper venue, plaintiffs lack the capacity to maintain the action, and the action should be barred based on the Doctrine of Forum Non Conveniens. The final arguments on the Motion were heard by the South Carolina court on April 19, 2006. On June 9, 2006, the court granted in favor of the defendants and the plaintiff's complaint was dismissed. The Plaintiff's filed a Motion for Rehearing which was heard by the Court on September 6, 2006. The Court has not yet ruled on the rehearing.

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE G RELATED PARTY TRANSACTIONS

During the three and nine-months ended September 30, 2005, a construction company, owned by the stepson of an officer of the Company was paid for renovation services on our corporate headquarters building amounting to \$3,200 and \$103,675, respectively. Also, the spouse of a Company officer performed logo design services for the same nine month period amounting \$3,525.

NOTE H MORTGAGE AND LOANS PAYABLE

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

| | September 30, 2006 | December 31, 2005 |
|---------------------------|-----------------------|----------------------|
| Revolving credit facility | \$ 1,509,098 | \$ 11,433 |
| Mortgage payable | 2,482,175 | 1,858,333 |
| Loan payable | 1,120,000 | |
| | \$ 5,111,273 | \$ 1,869,766 |

Revolving Credit Facility

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

Mortgage Payable

During June 2006, we entered into a mortgage loan for \$2.5 million with Carolina First Bank for the refinancing of our corporate office building. This mortgage replaces the original mortgage held by the Bank of Tampa. The mortgage loan is due on June 1, 2009 with monthly payments based on a 20 year amortization schedule. Interest is at a fixed annual rate of 7.5%. Of the principal amount due on the mortgage \$59,075 is classified as a current liability. This debt is secured by the related mortgaged real property as well as being cross-collateralized with the coins used to secure the Amended and Restated Revolving Credit Agreement with Mercantile Bank.

Loan Payable

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

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE I - PREFERRED STOCK

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

NOTE J COMMON STOCK

During the quarter ended September 30, 2005, a total of 2,018,800 shares of common stock were issued for the exercise of warrants at an exercise price of \$2.50 per share. Proceeds of \$5,047,000 were realized from the exercise of the warrants which were due to expire on October 5, 2005.

During the quarter ended September 30, 2005 we issued 100,000 warrants having an exercise price of \$5.25 per share to a vendor for services relating to a marketing program. These warrants become vested and earned based upon future performance of the program, and may not be exercised until earned, therefore expense will not be recorded until the warrants are vested and earned.

NOTE K COMMON STOCK OPTIONS

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

NOTE L 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 financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Our chief operating decision maker is our Chief Executive Officer. The Company manages and evaluates the operating results of the business in two primary segments, shipwreck exploration and themed attractions.

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

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

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

We held the grand opening of our first themed attraction, *Odyssey's Shipwreck & Treasure Adventure*, on August 27, 2005, at the Jax Brewery complex in the French Quarter of New Orleans. The attraction was closed early on the grand opening day due to Hurricane Katrina. The Jax Brewery building in which the attraction was located remained closed until February 2006.

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The Odyssey attraction sustained minimal damage and we were able to safely remove all irreplaceable artifacts and valuables including coins and other high-value items. Odyssey carries \$4.5 million of insurance coverage for the attraction including property and business income. A preliminary insurance claim was filed in January 2006 and a revised claim in April 2006. We received a partial settlement from the insurance company of \$350,000 in October 2006. However, we presently cannot estimate the remaining amount of insurance proceeds we may receive or when we may receive them.

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE L SEGMENT REPORTING continued

On February 15, 2006, we re-opened *Odyssey's Shipwreck & Treasure Adventure* in New Orleans. Because the local tourist and resident markets had not yet recovered from the devastating impact of Hurricane Katrina, our attraction did not reach a breakeven attendance level after the re-opening. As a result, on July 28, 2006 we provided written notice to the landlord, in accordance with the provisions of our lease agreement, exercising our right to terminate the lease effective January 31, 2007. The attraction was subsequently closed in September 2006. As a result of this lease termination, we accelerated the estimated useful lives of certain fixed assets and leasehold improvements to September 30, 2006. This acceleration resulted in additional depreciation and amortization of approximately \$645,000 for the period ended September 30, 2006. We plan to relocate our attraction to another market in 2007 and continue to research alternatives. Completion of our second attraction, currently approximately 75% completed, has been suspended until we relocate our existing New Orleans attraction.

| (amounts in thousands) | Shipwreck Exploration | Themed Attractions | Consolidated |
|--|--------------------------|-----------------------|--------------|
| Segment Information | | | |
| <i>Three months ended September 30, 2006</i> | | | |
| 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 |
| <i>Three months ended September 30, 2005</i> | | | |
| Revenues from external customers | \$ 967 | \$ 20 | \$ 987 |
| Income (loss) before income taxes | \$ (4,379) | \$ (981) | \$ (5,360) |
| Segment assets | \$ 32,463 | \$ 4,909 | \$ 37,372 |
| <i>Nine months ended September 30, 2006</i> | | | |
| 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 |
| <i>Nine months ended September 30, 2005</i> | | | |
| Revenues from external customers | \$ 8,142 | \$ 20 | \$ 8,162 |
| Income (loss) before income taxes | \$ (5,633) | \$ (1,479) | \$ (7,112) |
| Segment assets | \$ 32,463 | \$ 4,909 | \$ 37,372 |

NOTE M TRENDS AND UNCERTAINTIES

We anticipate we will continue to incur net losses in the short term. Our ability to generate net income in future periods is dependent upon the success of our ability to recover and monetize high-value shipwrecks. We remain confident that we have several potential high-value shipwreck targets which could be recovered. However, we cannot guarantee that the sales of our products and other available cash sources will generate sufficient cash flow to meet our overall cash requirements remaining in 2006 and into 2007. If cash flow is not sufficient to meet our business requirements, we will be required to raise additional capital through other financing activities. While we have been successful in raising the necessary funds in the past, there can be no assurance we can continue to do so. If sufficient funds cannot be secured for our expected business plan, we would be forced to curtail our exploration and development efforts to a level for which funding can be secured.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

Overview

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

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

Business Segments

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

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

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

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

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

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

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

Themed Attractions Our themed attractions group is responsible for interactive attractions and exhibits that entertain and educate multi-generational audiences, and present Odyssey's unique shipwreck stories and artifacts. The exhibits showcase our proprietary technologies and the excitement of deep-ocean archeological shipwreck search and recovery.

We held the grand opening of our first themed attraction, *Odyssey's Shipwreck & Treasure Adventure*, on August 27, 2005, at the Jax Brewery complex in the French Quarter of New Orleans. The attraction was closed early on the grand opening day due to Hurricane Katrina. The Jax Brewery building in which the attraction was located remained closed until February 2006.

The Odyssey attraction sustained minimal damage and we were able to safely remove all irreplaceable artifacts and valuables including coins and other high-value items. Odyssey carries \$4.5 million of insurance coverage for the attraction including property and business income. A preliminary insurance claim was filed in January 2006 and a revised claim in April 2006. We received a partial settlement from the insurance company of \$350,000 in October 2006. However, we presently cannot estimate the remaining amount of insurance proceeds we may receive or when we may receive them.

| | Shipwreck | Themed | |
|--|-------------|-------------|--------------|
| (amounts in thousands) | Exploration | Attractions | Consolidated |
| Segment Information | | | |
| <i>Three months ended September 30, 2006</i> | | | |
| 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 |
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Operational Update

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

Atlas Project

Odyssey's primary operational focus of summer and fall 2006 has been seven search blocks of Odyssey's Atlas project, which encompass the area believed to contain the Atlas target of highest value, code-named Tripoli. These search blocks overlapped with other Atlas targets, but were designed to completely cover the area believed to hold the Tripoli.

The Company began search operations on the project during the 2005 season, and resumed operations in April 2006. During 2005, much of the area was searched with one pass with a high-resolution side-scan sonar. During 2006, a second pass of the area was completed which included acoustic (side-scan) data and also a magnetometer datastream which helped the Company create a large database of both acoustic and magnetic information. Overlaying all three layers provided an extremely high resolution map of these seven search blocks.

Once targets of interest were logged, additional high-resolution imagery and magnetometer surveys were utilized to further classify and map targets before Remotely Operated Vehicles (ROVs) were deployed to visually inspect and recover any artifacts deemed necessary for identification.

During the entire 2006 survey period, at least two ships were mobilized to engage in this search operation, and during part of the summer, three ships were utilized. After the side-scan mapping was completed, Odyssey released the leased vessel employed during the past two Atlas seasons and it has returned to its home port.

Following is a summary of the operations conducted in the Tripoli search area:

| | |
|--|-------|
| Anomalies detected | 1,873 |
| Anomalies selected for further inspections | 1,017 |
| Shipwrecks located | 161 |
| Modern/20 th Century Shipwrecks | 124 |
| 19 th Century Shipwrecks | 25 |
| 17 th 18 th Century Shipwrecks | 12 |

More targets may yet be discovered during the balance of this year's search operations, as Odyssey continues final anomaly inspections. These activities are anticipated to be completed in this area during November. These operations will also include photomosaics and preliminary excavations of sites of interest.

Odyssey filed a shipwreck arrest in the U.S. District Court for the Middle District of Florida in September 2006. On October 30, 2006 the U.S. District Court granted Odyssey's Motion for Preliminary Injunction appointing Odyssey as the exclusive finder-in-possession of the shipwrecked vessel, and prohibiting any interference with Odyssey's intended excavation of the site, believed to be a 17th century merchant vessel which is located outside the territorial waters of any country. However, until further ROV inspections and a preliminary archaeological excavation are completed on the arrested shipwreck site, the company is not prepared to confirm the identity or potential value.

The *Odyssey Explorer* is due in dry dock the first week of November for what is expected to be a relatively short class inspection and re-fitting of *ZEUS*. During that time, artifacts and data from the arrested site will be analyzed. The Company may return to the site again after the dry dock, depending on the *Sussex* project schedule and weather conditions.

The Sussex Project

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

In late 2005 and early 2006, Odyssey completed to the satisfaction of the Government of the United Kingdom all work detailed in Phase 1A of the *Sussex* archaeological project plan. The Company has also completed a portion of Phase 1B. (A public version of the project plan is available for viewing at www.shipwreck.net/sussexpp.html.) The Company temporarily halted operations on the project at the request of the Spanish Ministry of Foreign Affairs while issues relative to the archaeological plan for excavation of the site, territorial and cultural resource management issues were negotiated.

In March 2006, Odyssey submitted an archaeological plan to the Spanish Ministry of Foreign Affairs which addressed questions raised by the Government of the Autonomous Region of Andalusia in reference to the ongoing HMS *Sussex* project. As part of this proposed plan, Odyssey agreed with the British Government to undertake additional survey operations in the area and to provide Spain with a detailed assessment of the region's underwater cultural heritage in deep water, as well as assistance in developing a plan for managing and protecting those resources.

In August, additional clarifications and a response to additional questions were provided at a meeting in Seville arranged by the Spanish Ministry of Foreign Affairs with representatives of the Government of Andalusia through the offices of the Embassy of the United Kingdom. As a result of that meeting, the outstanding matters were narrowed to three issues relating to site mapping, positional information and formalization of the submission of the plan through the project archaeologists. Odyssey is working closely with the offices of the Embassy of the United Kingdom and the United Kingdom's Ministry of Defence to address these final issues and anticipates that they will be resolved in time to resume operations later this year.

Throughout the duration of this complicated multi-national situation, the Spanish Ministry of Foreign Affairs, the United Kingdom Foreign and Commonwealth Office and Ministry of Defence, the United States Department of State and representatives of the Autonomous Region of Andalusia have all contributed resources and attention to solving a complex series of issues relating to the *Sussex* project. While it has taken longer to resolve these issues than anticipated, we believe that the results will translate to goodwill between all the parties and serve to provide a platform for future cooperation in underwater exploration and management of deep ocean cultural heritage.

Critical Accounting Policies and Changes to Accounting Policies

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

Results of Operations

Three months ended September 30, 2006 compared to three months ended September 30, 2005

| | (Unaudited) (dollars in millions) | | | |
|-------------------------------------|-----------------------------------|--------|---------|-------|
| | 2006 | 2005 | \$ Var | % Var |
| Revenue | \$.6 | \$ 1.0 | \$ (.4) | (41)% |
| Cost of sales | .3 | .2 | .1 | 59% |
| Marketing, general & administrative | 1.3 | 2.3 | (1.0) | (43)% |
| Operations & research | 5.1 | 3.8 | 1.3 | 34% |
| Total cost and expenses | \$ 6.7 | \$ 6.3 | \$.4 | 6% |
| Revenue | | | | |

Revenues are generated primarily through the sale of gold and silver coins, but also include other artifacts and merchandise. Revenues for 2006 and 2005 were \$.6 million and \$1.0 million, respectively, representing sales volume of gold and silver coins of approximately 868 coins in 2006 and 198 coins in 2005. We charged \$.4 million against income to recognize the return of coins from an independent dealer who purchased them in a prior period. Exclusive of this return, actual sales for 2006 were \$1.0 million compared to \$1.0 million in 2005. While we continue to sell numismatic coins to independent coin dealers, there has been a significant shift beginning in the second quarter 2006 to our direct marketing sales efforts. Direct sales efforts (inbound and outbound call center and related infrastructure) were outsourced beginning in the second quarter 2006 to an experienced direct marketing partner. The majority of our coin sales in 2006 were silver coins sold through our direct marketing partner. We have been extremely pleased with the marketing programs and sales efforts of our direct marketing partner where our focus is selling our silver coin inventory directly to consumers at higher unit prices than we were receiving through our indirect wholesale channels. Another benefit of this outsourcing is we have significantly reduced our overhead costs associated with our direct sales organization. We have begun to test a variety of advertising methods and mediums that are beginning to show great promise and a positive return on our investment. We intend to increase our investment in the advertising programs that are demonstrating positive sales results.

In 2005, we sold a lower volume of coins, but they represented a greater mix of higher unit price gold coins sold through independent coin dealers and our company-operated direct sales call center. We expect sales of gold coins through our independent dealers will continue to decline as our focus shifts to direct silver coin sales and our gold coin availability continues to diminish. Of our remaining gold coin inventory, the majority represents \$10 Eagles which are not in as much demand by numismatic collectors as the higher-value numismatic \$20 Double Eagles. We anticipate the \$10 Eagle gold coin inventory will be sold over time to non-numismatic collectors through our direct marketing partner. Also, included in our revenue for 2006 was \$.1 million of admissions and merchandise sales from our themed attractions segment. All of our revenue for 2006 and 2005 is U.S. domestic-based.

Costs and Expenses

Cost of sales consists of shipwreck recovery costs, grading, conservation, packaging, and shipping costs associated with artifact, merchandise and book sales. Cost of sales as a percentage of revenue before returns for 2006 and 2005 was 32% and 19%, respectively. The higher cost of sales percentage in 2006 is attributable to a higher sales mix of silver versus gold coins.

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

Marketing, general and administrative expenses were \$1.3 million in 2006 as compared to \$2.3 million in 2005. The decrease of \$1.0 million is primarily related to lower marketing and employee costs attributed to the closing of our direct sales company-operated call center in May 2006 (\$.5 million) and other general corporate expense reductions.

Operations and research expenses were \$5.1 million in 2006, compared to \$3.8 million in 2005. Of the \$1.3 million increase, \$.9 million was due to vessel operating expenses primarily associated with our search and inspection vessel purchased in June 2006, and \$.4 million was due to operations costs of our themed attractions segment, primarily associated with our New Orleans attraction. As a result of our lease termination in New Orleans, we accelerated the estimated useful lives of certain fixed assets, leasehold improvements and future rent payments to September 30, 2006. This acceleration resulted in additional expenses of \$.7 million in September 2006 when it was closed.

Nine months ended September 30, 2006 compared to nine months ended September 30, 2005

| | (Unaudited) (dollars in millions) | | | |
|-------------------------------------|-----------------------------------|---------|-----------------------|-------|
| | 2006 | 2005 | Incr/(Decr) \$ Var | % Var |
| Revenue | \$ 3.4 | \$ 8.2 | \$ (4.8) | (58)% |
| Cost of sales | .7 | .8 | (.1) | (11)% |
| Marketing, general & administrative | 5.9 | 6.5 | (.6) | (10)% |
| Operations & research | 11.1 | 8.0 | 3.1 | 39% |
| Total cost and expenses | \$ 17.7 | \$ 15.3 | \$ 2.4 | 16% |
| Revenue | | | | |

Revenues are generated primarily through the sale of gold and silver coins, but also include other artifacts and merchandise. Revenues for 2006 and 2005 were \$3.4 million and \$8.2 million, respectively, representing sales volume of gold and silver coins of approximately 1,690 coins in 2006 and 1,502 coins in 2005. While we continue to sell numismatic coins to independent coin dealers, there has been a significant shift beginning in the second quarter 2006 to our direct marketing sales efforts. Direct sales efforts (inbound and outbound call center and related infrastructure) were outsourced beginning in the second quarter 2006 to an experienced direct marketing partner. The decrease of \$4.8 million in 2006 is primarily due to a lower availability of high-value numismatic gold coins, sales to fewer independent coin dealers and a shift to a higher volume of lower priced silver coins. The majority of our coin sales in 2006 were silver coins sold through our direct marketing partner. We have been extremely pleased with the marketing programs and sales efforts of our direct marketing partner where our focus is selling our silver coin inventory directly to consumers at higher unit prices than we were receiving through our indirect wholesale channels. Another benefit of this outsourcing is we have significantly reduced our overhead costs associated with our direct sales organization. We have begun to test a variety of advertising methods and mediums that are beginning to show great promise and a positive return on our investment. We intend to increase our investment in the advertising programs that are demonstrating positive sales results.

In 2005, we sold a lower volume of coins, but they represented a greater mix of higher unit price gold coins sold through independent coin dealers and our company-operated direct sales call center. We expect sales of gold coins through our independent dealers will continue to decline as our focus shifts to direct silver coin sales and our gold coin availability continues to diminish. Of our remaining gold coin inventory, the majority represents \$10 Eagles which are not in as much demand by numismatic collectors as the higher-value numismatic \$20 Double Eagles. We anticipate the \$10 Eagle gold coin inventory will be sold over time to non-numismatic collectors through our direct marketing partner. Also, included in our revenue for 2006 was \$.2 million of admissions and merchandise sales from our themed attractions segment. All of our revenue for 2006 and 2005 is U.S. domestic-based.

Costs and Expenses

Cost of sales consists of shipwreck recovery costs, grading, conservation, packaging, and shipping costs associated with artifact, merchandise and book sales. Cost of sales as a percentage of revenue before returns for 2006 and 2005 was 13% and 8%, respectively. The lower cost of sales percentage in 2005 is attributable to a high sales mix of gold versus silver coins.

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

Marketing, general and administrative expenses were \$5.9 million in 2006 as compared to \$6.5 million in 2005. The decrease of \$.6 million is primarily related to lower marketing and employee costs attributed to the closing of our direct sales company-operated call center in May 2006 (\$.6 million) and other general corporate expense reductions offset by an increase of \$.4 million related to higher shared-based compensation costs related to adoption of FASB 123R in 2006.

Operations and research expenses were \$11.1 million in 2006, compared to \$8.0 million in 2005. Of the \$3.1 million increase, \$2.0 million related to vessel operating expenses in our marine operations group, \$1.3 million of which was associated with our search and inspection vessel purchased in June 2006 and \$.6 million was due to vessel recovery costs not capitalized in 2006. The remaining \$1.1 million increase of operations and research expenses was due to operations costs of our themed attractions segment which was open for seven months in 2006 and one month in 2005. As a result of our lease termination in New Orleans, we accelerated the estimated useful lives of certain fixed assets, leasehold improvements and future rent payments to September 30, 2006. This acceleration resulted in additional expenses of \$.7 million in September 2006 when it was closed.

Liquidity and Capital Resources

Discussion of Cash Flows

Net cash used in operating activities in the first nine months of 2006 was \$11.5 million. This amount primarily reflected an operating loss of \$14.3 million offset by an increase in depreciation (\$2.3 million) and share based compensation (\$.4 million), a gain on the sale of the vessel RV *Odyssey* (\$.3 million), and a decrease in assets (\$1.2 million) offset by a decrease in current liabilities (\$.8 million). Net cash used in operating activities for 2005 of \$6.1 million represented an operating loss of \$4.2 million, an increase in the net deferred tax asset of \$3.4 million offset by a decrease in accounts receivable of \$1.5 million.

Cash flows used in investing activities were \$1.7 million and \$5.4 million for the first nine months in 2006 and 2005, respectively. Cash used in investing activities in 2006 primarily reflected purchase of property and equipment for our shipwreck exploration segment which included a remotely operated vehicle (ROV) and a search and inspection vessel offset by \$1.1 million of loan proceeds for financing the (ROV) purchase. Cash used in investing activities in 2005 primarily represented \$3.8 million for capital expenditures for our themed attractions segment including our New Orleans attraction, \$1.4 million for other property and equipment and \$.2 million for building improvements at our corporate facility.

Cash flows provided by financing activities were \$11.2 million and \$13.0 million for the first nine months of 2006 and 2005, respectively. In 2006, the cash provided by financing activities primarily included \$9.1 million from the sale of preferred and common stock and \$.7 million from refinancing our corporate office building and \$1.4 million net borrowings from our credit facility. Cash provided by financing activities in 2005 included \$13.5 million of proceeds received from the issuance of common stock offset by \$.4 million in brokerage commissions and fees on the private offering and a \$.1 million mortgage repayment.

General

At September 30, 2006, we had cash and cash equivalents of \$1.4 million, a decrease of \$1.9 million from the December 31, 2005 balance of \$3.3 million.

During March 2006, we received approximately \$8.8 million from the sale of 2.5 million shares of non-voting Series D Convertible Preferred Stock, par value \$0.0001 per share, at \$3.50 per share to five funds controlled by two institutional accredited investors pursuant to the terms of a purchase agreement. The Series D Preferred Stock is convertible into Common Stock at a ratio of one (1) share of Common Stock for every one (1) share of Series D Preferred Stock. The net proceeds from the preferred stock offering are being used for general corporate purposes and the purchase of marine property and equipment.

During March 2006, we entered into an Amended and Restated Revolving Credit Agreement with Mercantile Bank (the Bank). The Amended and Restated Credit Agreement replaces the Company's prior agreement with the Bank. The Amended and Restated Agreement reduced the amount of the commitment from the Bank from a \$6 million revolving credit facility to a \$3 million credit facility. The \$4 million of gold coins previously collateralized were removed from the amended agreement and silver coins collateralized and held by the custodian increased from 10,000 to 15,000 coins. The credit facility has a floating interest rate equal to the LIBOR 30-Day Index Rate plus two hundred sixty-five basis points (2.65%), requires monthly payments of interest only and is due in full on April 21, 2008. The Company will also be required to pay the Bank an unused line fee equal to 0.25% per annum of the unused portion of the credit line, payable quarterly. Additionally, the Company granted a first lien position on all corporate assets, including a provision not to pledge as collateral our Company-owned vessels. The Company is required to comply with a number of covenants including maintaining a minimum stockholders' equity of \$20,000,000, which would increase annually by an amount equal to fifty percent of any after-tax net income. At September 30, 2006, we had approximately \$1.5 million available credit remaining on the credit facility.

During June 2006, we entered into a mortgage loan for \$2.4 million with Carolina First Bank for the refinancing of our corporate office building. This mortgage replaces the original mortgage held by the Bank of Tampa which had an outstanding loan balance of \$1.7 million. The mortgage loan is due on June 1, 2009 and monthly payments are based on a 20 year amortization schedule. Interest is at a fixed annual rate of 7.5%.

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

During July 2006, we received net proceeds of \$.5 million from the sale of our smaller search and inspection vessel, the RV *Odyssey*. These proceeds were used to partially offset the June 2006 purchase of an additional ship similar in size to the *Odyssey Explorer*. In October 2006 we received a partial settlement from the insurance company of \$350,000 in regards to our outstanding Hurricane Katrina claim for our New Orleans attraction. However, we presently cannot estimate the remaining amount of insurance proceeds we may receive.

Material Trends and Uncertainties

We anticipate we will continue to incur net losses in the short term. Our ability to generate net income in future periods is dependent upon the success of our ability to recover and monetize high-value shipwrecks. We remain confident that we have several potential high-value shipwreck targets which could be recovered. However, we cannot guarantee that the sales of our products and other available cash sources will generate sufficient cash flow to meet our overall cash requirements remaining in 2006 and into 2007. If cash flow is not sufficient to meet our business requirements, we will be required to raise additional capital through other financing activities. While we have been successful in raising the necessary funds in the past, there can be no assurance we can continue to do so. If sufficient funds cannot be secured for our expected business plan, we would be forced to curtail our exploration and development efforts to a level for which funding can be secured.

Off Balance Sheet Requirements

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

New Accounting Pronouncements

Effective January 1, 2006, the Company adopted SFAS No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), which replaces SFAS No. 123 and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. SFAS No. 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair values. The Company adopted SFAS No. 123R using the modified-prospective method, which requires the Company, beginning January 1, 2006 and thereafter, to expense the grant date fair value of all share-based awards over their remaining vesting periods to the extent the awards were not fully vested as of the date of adoption and to expense the fair value of all share-based awards granted subsequent to December 31, 2005 over their requisite service periods. During the three and nine-month periods ended September 30, 2006, the Company recorded \$114,715 and \$425,261, respectively, of share-based compensation expense. Previous periods have not been restated. See Note B. for further details.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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

ITEM 4. CONTROLS AND PROCEDURES

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

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On or about December 14, 2004 a complaint was filed against seven defendants including the Company in the Court of Common Pleas in the Ninth Judicial Circuit, County of Charleston, in the State of South Carolina. The complaint was filed by Republic & Eagle Associates, Inc. and Sea Miners, Inc. against John Morris, Greg Stemm, John Lawrence, John Balch, Daniel Bagley, Seahawk Deep Sea Technologies, Inc. (Seahawk) and the Company. The plaintiff s allegations included breach of fiduciary duty, civil conspiracy and breach of contract based primarily upon an alleged contract(s) between the plaintiffs and Seahawk dated May 16, 1995 dealing with the search for the SS *Republic*. The plaintiffs alleged that their research, which was provided to Seahawk, led to the discovery of the SS *Republic* and sought an unspecified amount of damages and public recognition of their contribution. On February 18, 2005, John Morris, Greg Stemm, Daniel Bagley, and the Company filed their Notice of Motion and Motion to Dismiss Defendants John Morris, Greg Stemm, Daniel Bagley and Odyssey Marine Exploration, Inc. (the Motion). In the Motion, the defendants alleged that the complaint should be dismissed because, among other things, the South Carolina court does not have jurisdiction over them, the action was filed in an improper venue, plaintiffs lack the capacity to maintain the action, and the action should be barred based on the Doctrine of Forum Non Conveniens. The final arguments on the Motion were heard by the South Carolina court on April 19, 2006. On June 9, 2006, the court ruled in favor of the defendants and the complaint was dismissed. The Plaintiffs filed a Motion for Rehearing which was heard by the Court on September 6, 2006. The Court has not yet ruled on that motion.

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

ITEM 1A. Risk Factors

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

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

There were no unregistered sales of equity securities during the three months ended September 30, 2006, that have not been reported in a Current Report on Form 8-K.

ITEM 3. Defaults Upon Senior Securities

None.

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

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

| | | |
|------|--|-------------------------------|
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith electronically |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Filed herewith electronically |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350 | Filed herewith electronically |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350 | Filed herewith electronically |

SIGNATURES

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

ODYSSEY MARINE EXPLORATION, INC.

Date: November 3, 2006

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