

ODYSSEY MARINE EXPLORATION INC

Form 10-Q

November 12, 2013

[Table of Contents](#)

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013**

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 001-31895

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.)

(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer: Accelerated filer:

Non-accelerated filer: (Do not check if a smaller Reporting company) Smaller reporting company:

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 25, 2013 was 83,587,243.

Table of Contents

	Page No.
Part I: <u>Financial Information</u>	
Item 1. <u>Financial Statements:</u>	
<u>Consolidated Balance Sheets</u>	3
<u>Consolidated Statements of Operations</u>	4
<u>Consolidated Statements of Cash Flows</u>	5
<u>Notes to the Consolidated Financial Statements</u>	6 25
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26 35
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	35
Item 4. <u>Controls and Procedures</u>	35
Part II: <u>Other Information</u>	
Item 1. <u>Legal Proceedings</u>	36
Item 1A. <u>Risk Factors</u>	36
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	36
Item 6. <u>Exhibits</u>	36
<u>Signatures</u>	37

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

	(Unaudited) September 30, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 11,173,036	\$ 10,096,414
Restricted cash	561,245	276,906
Accounts receivable and other, net	6,681,697	2,101,941
Inventory	342,694	418,926
Other current assets	1,166,907	874,115
Total current assets	19,925,579	13,768,302
PROPERTY AND EQUIPMENT		
Equipment and office fixtures	20,782,719	16,781,671
Building and land	4,750,360	4,708,091
Accumulated depreciation	(16,434,827)	(15,038,811)
Total property and equipment	9,098,252	6,450,951
NON-CURRENT ASSETS		
Inventory	5,216,957	5,574,841
Other non-current assets	1,268,544	1,102,730
Total other assets	6,485,501	6,677,571
Total assets	\$ 35,509,332	\$ 26,896,824
LIABILITIES AND STOCKHOLDERS DEFICIT		
CURRENT LIABILITIES		
Accounts payable	\$ 2,410,686	\$ 1,948,555
Accrued expenses and other	4,406,753	14,050,840
Deferred revenue	2,835,522	2,835,522
Derivative liabilities	3,149,561	5,356,203
Mortgage and loans payable	20,832,052	14,809,737

Total current liabilities	33,634,574	39,000,857
LONG-TERM LIABILITIES		
Mortgage and loans payable	1,700,787	4,010,946
Deferred income from revenue participation rights	4,643,750	4,643,750
Total long-term liabilities	6,344,537	8,654,696
Total liabilities	39,979,111	47,655,553
Commitments and contingencies (Note H)		
STOCKHOLDERS DEFICIT		
Preferred stock \$.0001 par value; 9,675,200 and 9,361,200 shares authorized, respectively; none outstanding		
Preferred stock series D convertible \$.0001 par value; 134,800 and 448,800 shares authorized, respectively; 32,400 and 206,400 issued and outstanding, respectively	3	21
Common stock \$.0001 par value; 150,000,000 shares authorized; 81,484,779 and 75,416,203 issued and outstanding, respectively	8,148	7,542
Additional paid-in capital	185,134,331	144,446,574
Accumulated deficit	(186,705,615)	(165,212,866)
Total stockholders deficit before non-controlling interest	(1,563,133)	(20,758,729)
Non-controlling interest	(2,906,646)	
Total stockholders deficit	(4,469,779)	(20,758,729)
Total liabilities and stockholders deficit	\$ 35,509,332	\$ 26,896,824

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

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
REVENUE				
Artifact sales and other	\$ 5,534,933	\$ 712,628	\$ 6,565,579	\$ 900,034
Exhibit	19,527	50,000	100,218	150,000
Expedition		183,469	5,480	4,222,446
Total revenue	5,554,460	946,097	6,671,277	5,272,480
OPERATING EXPENSES				
Cost of sales artifacts and other	169,573	54,237	410,357	178,318
Marketing, general and administrative	4,670,196	2,985,664	10,390,087	7,825,582
Operations and research	4,159,412	(3,017,253)	19,403,757	11,689,145
Total operating expenses	8,999,181	22,648	30,204,201	19,693,045
INCOME (LOSS) FROM OPERATIONS	(3,444,721)	923,449	(23,532,924)	(14,420,565)
OTHER INCOME (EXPENSE)				
Interest income	4,074	573	6,829	23,711
Interest expense	(894,076)	(1,930,783)	(2,883,617)	(4,595,983)
Change in derivative liabilities fair value	870,453	4,801,862	2,206,642	1,712,030
Other	114,980	7,882	139,667	11,641
Total other income (expense)	95,431	2,879,534	(530,479)	(2,848,601)
INCOME (LOSS) BEFORE INCOME TAXES	(3,349,290)	3,802,983	(24,063,403)	(17,269,166)
Income tax benefit (provision)	(235,249)		(335,991)	
NET INCOME (LOSS) BEFORE NON-CONTROLLING INTEREST	(3,584,539)	3,802,983	(24,399,394)	(17,269,166)
Non-controlling interest	2,653,146		2,906,646	
NET INCOME (LOSS)	\$ (931,393)	\$ 3,802,983	\$ (21,492,748)	\$ (17,269,166)
NET INCOME (LOSS) PER SHARE				
Basic and diluted (See NOTE B)	\$ (.01)	\$.05	\$ (.27)	\$ (.24)

Weighted average number of common shares outstanding with participating securities per the two-class method				
Basic	80,252,203	78,544,391	78,991,192	73,498,034
Diluted	80,252,203	81,440,848	78,991,192	73,498,034

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

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

	Nine Months Ended	
	September 30, 2013	September 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss before non-controlling interest	\$ (24,399,394)	\$ (17,269,166)
Adjustments to reconcile net loss to net cash (used) by operating activities:		
Depreciation and amortization	1,398,541	1,186,550
Investment in consolidated entity	(301,093)	
Loan fee amortization	160,154	334,850
Change in derivatives liabilities fair value	(2,206,642)	(1,712,030)
Note payable interest accretion	1,641,325	2,992,354
Senior debt interest settled with common stock	489,961	
Settlement of vendor payable with subsidiary stock	625,000	
Share-based compensation	2,123,706	1,298,231
(Increase) decrease in:		
Restricted cash	(284,339)	(284,421)
Accounts receivable	(4,682,426)	(15,257,444)
Inventory	434,116	123,587
Other assets	(506,055)	(263,938)
Increase (decrease) in:		
Accounts payable	453,770	1,352,298
Accrued expenses and other	(9,719,353)	3,350,753
Deferred revenue		(629,561)
NET CASH (USED) BY OPERATING ACTIVITIES	(34,772,729)	(24,777,937)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(3,286,521)	(853,929)
Investment in consolidated entity	(1,250,000)	
NET CASH (USED) BY INVESTING ACTIVITIES	(4,536,521)	(853,929)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	6,039,905	738,982
Proceeds from sale of subsidiary stock	25,000,000	
Proceeds from issuance of loan payable	10,000,000	19,994,483
Broker commissions and fees on capital raises		(400,000)
Repayment of mortgage and loans payable	(654,033)	(515,043)
Dividends		(10,000)
NET CASH PROVIDED BY FINANCING ACTIVITIES	40,385,872	19,808,422

NET INCREASE (DECREASE) IN CASH	1,076,622	(5,823,444)
CASH AT BEGINNING OF PERIOD	10,096,414	7,971,794
CASH AT END OF PERIOD	\$ 11,173,036	\$ 2,148,350
SUPPLEMENTARY INFORMATION:		
Interest paid	\$ 392,719	\$ 887,872
Income taxes paid	\$	\$
NON-CASH TRANSACTIONS:		
Accrued compensation paid by equity instruments	\$ 165,748	\$ 347,528
Equipment purchased with financing	\$ 756,795	\$ 588,499
Debt repayment with common shares	\$ 7,826,086	\$ 2,347,826
Series G Preferred Stock conversion	\$	\$ 250,000

Summary of Significant Non-Cash Transactions

During the period we transferred 500,000 shares of Oceanica Resources, S.R. L. held by our wholly owned subsidiary Odyssey Marine Enterprises, Ltd. for \$625,000 of marine services. The shares were valued based on the two most recent transactions in Oceanica shares at \$1.25 per share.

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

Table of Contents

ODYSSEY MARINE EXPLORATION, INC. AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTE A - BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Odyssey Marine Exploration, Inc. and subsidiaries (the Company, Odyssey, us, we or our) have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission and the instructions to Form 10-Q and, therefore, do not include all information and footnotes normally included in financial statements prepared in accordance with generally accepted accounting principles. These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

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, 2013, and the results of operations and cash flows for the interim periods presented. Operating results for the three-month period ended September 30, 2013, 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 direct and indirect wholly owned subsidiaries, Odyssey Marine Services, Inc., OVH, Inc., Odyssey Retriever, Inc., Odyssey Marine Entertainment, Inc., Odyssey Marine Enterprises, Ltd., Odyssey Marine Management, Ltd., Oceanica Marine Operations, S.R.L., and majority interest in Oceanica Resources, S.R.L. and Exploraciones Oceanicas, S. De R.L. De C.V. Equity investments in which we exercise significant influence but do not control and of which we are not the primary beneficiary are accounted for using the equity method. All significant inter-company and intra-company transactions and balances have been eliminated. The results of operations attributable to the non-controlling interest are presented within equity and net income, and are shown separately from the Company's equity and net income attributable to the Company.

During the nine-months ended September 2013, our wholly owned subsidiary, Odyssey Marine Enterprises, Ltd., sold 23 million cuotas (shares) of its position in Oceanica Resources, S.R.L. for \$25 million in cash to a third-party investment group. According to the Accounting Standards Codification (ASC) 810 *Consolidation*, paragraph 810-10-45-23, we have accounted for this transaction as an equity transaction. Therefore, no gain or loss has been recognized in consolidated net income or comprehensive income.

Use of Estimates

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

Revenue Recognition and Accounts Receivable

In accordance with Topic A.1. in SAB 13: Revenue Recognition, exhibit and expedition charter revenue is recognized ratably when realized and earned as time passes throughout the contract period as defined by the terms of the agreement. Expenses related to the exhibit and expedition charter revenue are recorded as incurred and presented under the caption "Operations and research" on our Consolidated Statements of Income.

Artifact sales and other may also consist of revenues related to the recovery of bulk silver bullion from the *Gairsoppa* project that exceeds the directly related operating and recovery expenses. We recognize revenue when we complete our contractual obligation to deliver the silver bullion to the refining agent, the amount of revenue is reasonably assured based on the London Bullion Market rates and the bullion is in a format ready for sale into the market. Operating and recovery expenses incurred in connection with the *Gairsoppa* contract consist of vessel-related expenses (ships' crew, provisions, port fees and charter expenses), fuel, specialized equipment and administrative expenses. These expenses are charged to the Consolidated Statements of Income as incurred and subsequently reimbursed per our contract and recorded as a benefit (credit to expense) in the period we are assured of recoupment.

Table of Contents

Artifact sales and other is where we recognize deferred revenue related to revenue participation rights we previously sold to an investor. Upon receipt of funds payable to the investor for their revenue participation rights, we recognized revenue based upon the percent of investor-related proceeds from the sale of silver as a percentage of total proceeds that investor could earn under the revenue participation agreement.

Under our agreement with the United Kingdom Government for the *Gairsoppa* project, any proceeds from the recovery of the government-owned silver cargo are first applied as a reimbursement to us for search and recovery expenses related to the project. Any remaining net proceeds from the silver owned by the United Kingdom Government are then split 20/80 between the government and us, respectively. In 2012 and 2013 the proceeds from the silver sales were sufficient to fully reimburse our expenses and to provide net proceeds that were split between the two parties. The *Gairsoppa* project revenue recognized by us in 2012 and 2013 resulted from our share of the net proceeds from the sale of the recovered silver bullion that belonged to the United Kingdom Government. The United Kingdom Government reimburses us for all of the expenses incurred by us to recover their silver. Accordingly, we applied the expense reimbursement credit against our search and recovery expenses in our respective years Consolidated Statement of Income under the caption Operating Expenses: Operations and Research.

Bad debts are recorded as identified and, from time to time, a specific reserve allowance will be established when required. A return allowance is established for sales that have a right of return. Accounts receivable is stated net of any recorded allowances.

Cash, Cash Equivalents and Restricted Cash

Cash, cash equivalents and restricted cash 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.

Inventory

Our inventory consists of artifacts recovered from the SS *Republic* shipwreck, general branded merchandise and related packaging material. Inventoried costs of recovered artifacts include the costs of recovery, conservation and administrative costs to obtain legal title to the artifacts. Administrative costs are generally legal fees or insurance settlements required in order to obtain clear title. The capitalized recovery costs include direct costs such as vessel and related equipment operations and maintenance, crew and technical labor, fuel, provisions, supplies, port fees and depreciation. Conservation costs include fees paid to conservators for cleaning and preserving the artifacts. We continually monitor the recorded aggregate costs of the artifacts in inventory to ensure these costs do not exceed the net realizable value. Historical sales, publications or available public market data are used to assess market value.

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

Costs associated with the above noted items are the costs included in our costs of goods. Vessel costs associated with expedition revenue as well as exhibit costs are not included in cost of goods sold. Vessel costs include, but are not limited to, charter costs, fuel, crew and port fees. Vessel and exhibit costs are included in Operations and research in the Consolidated Statements of Operations. In the case of revenues associated with the *Gairsoppa* project, the United Kingdom owned the silver we sold into the London Bullion Market on their behalf, therefore, there was no associated cost of goods.

Long-Lived Assets

Our policy is to recognize impairment losses relating to long-lived assets in accordance with the ASC topic for Property, Plant and Equipment. Decisions are based on several factors, including, but not limited to, management's plans for future operations, recent operating results and projected cash flows.

Comprehensive Income

Securities 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, 2013, we did not own securities 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 three and ten years. Leasehold improvements are amortized over their estimated useful lives or lease term, if shorter. Major overhaul items (such as engines or generators) that enhance or extend the useful life of vessel-related assets qualify to be capitalized and depreciated over the useful life or remaining life of that

Table of Contents

asset, whichever is shorter. Certain major repair items required by industry standards to ensure a vessel's seaworthiness also qualify to be capitalized and depreciated over the period of time until the next scheduled planned major maintenance for that item. All other repairs and maintenance are accounted for under the direct-expensing method and are expensed when incurred.

Earnings Per Share

Basic earnings per share (EPS) is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. In periods when the Company generates income, the Company calculates basic earnings per share using the two-class method pursuant to ASC 260 *Earnings Per Share*. The two-class method was required effective with the issuance of the Senior Convertible Note disclosed in Note I because the note qualifies as a participating security, giving the holder the right to receive dividends should dividends be declared on common stock. Under the two-class method, earnings for the period are allocated on a pro-rata basis to the common stockholders and to the holders of Convertible Notes based on the weighted average number of common shares outstanding and number of shares that could be converted. The Company does not use the two-class method in periods when it generates a loss as the holder of the Convertible Notes do not participate in losses.

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 if-converted method to compute potential common shares from Preferred Stock, Convertible Notes or other convertible securities. As it relates solely to the Senior Convertible Note, for diluted earnings per share, the Company uses the more dilutive of the if-converted method or two-class method. When a net loss occurs, potential common shares have an anti-dilutive effect on earnings per share and such shares are excluded from the Diluted EPS calculation.

At September 30, 2013 and 2012, weighted average common shares outstanding year-to-date were 78,991,192 and 73,498,034, respectively. For the periods ended September 30, 2013 and 2012, 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 following tables represent potential common shares calculated using the treasury stock method from outstanding options, stock awards and warrants that were excluded from the calculation of diluted EPS:

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
Average market price during the period	\$ 3.28	\$ 3.72	\$ 3.18	\$ 3.32
In the money potential common shares from options excluded	360,340		297,197	321,755
In the money potential common shares from warrants excluded	576,218		523,586	1,270,508

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
Out of the money options and warrants excluded:				
Stock options with an exercise price of \$3.25 per share			100,000	
Stock options with an exercise price of \$3.40 per share	100,000		100,000	
Stock options with an exercise price of \$3.43 per share	40,000		40,000	
Stock options with an exercise price of \$3.50 per share	345,000		345,000	245,000
Stock options with an exercise price of \$3.51 per share	959,500		959,500	984,670
Stock options with an exercise price of \$3.53 per share	191,700		191,700	204,500
Stock options with an exercise price of \$3.90 per share	20,000	20,000	20,000	20,000
Stock options with an exercise price of \$4.00 per share	52,500	52,500	52,500	52,500
Stock options with an exercise price of \$5.00 per share	100,000	300,000	100,000	300,000
Stock options with an exercise price of \$7.00 per share	100,000	100,000	100,000	100,000
Warrants with an exercise price of \$3.60 per share	1,562,500		1,562,500	1,562,500
Warrants with an exercise price of \$5.25 per share		100,000		100,000
Total anti-dilutive warrants and options excluded from EPS	3,471,200	572,500	3,571,200	3,569,170

Table of Contents

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
Potential common shares from Convertible Preferred Stock excluded from EPS	32,400		32,400	206,400

The weighted average equivalent common shares relating to our unvested restricted stock awards that were excluded from potential common shares in the earning per share calculation due to having an anti-dilutive effect are:

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
Potential common shares from unvested restricted stock awards excluded from EPS	441,495		434,066	464,554

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

	Three Months Ended		Nine Months Ended	
	September 30,	September 30,	September 30,	September 30,
	2013	2012	2013	2012
Net income (loss)	\$ (931,393)	\$ 3,802,983	\$ (21,492,748)	\$ (17,269,166)
Cumulative dividends on Series G Preferred Stock				(10,000)
Numerator, basic and diluted net income (loss) available to stockholders	\$ (931,393)	\$ 3,802,983	\$ (21,492,748)	\$ (17,279,166)
Denominator:				
Shares used in computation basic:				
Weighted average common shares outstanding	80,252,203	74,087,794	78,991,192	73,498,034
Additional shares from participating securities per the two-class method		4,456,597		

Common shares outstanding for basic	80,252,203	78,544,391	78,991,192	73,498,034
Shares used in computation diluted:				
Common shares outstanding for basic	80,252,203	78,544,391	78,991,192	73,498,034
Dilutive effect of potential common shares outstanding		2,896,457		
Shares used in computing diluted net income per share	80,252,203	81,440,848	78,991,192	73,498,034
Net income (loss) per share basic	\$ (0.01)	\$ 0.05	\$ (0.27)	\$ (0.24)
Net income (loss) per share diluted	\$ (0.01)	\$ 0.05	\$ (0.27)	\$ (0.24)

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.

Stock-based Compensation

Our stock-based compensation is recorded in accordance with the guidance in the ASC topic for Stock-Based Compensation (See NOTE J).

Table of Contents**Fair Value of Financial Instruments**

Financial instruments consist of cash, evidence of ownership in an entity, and contracts that both (i) impose on one entity a contractual obligation to deliver cash or another financial instrument to a second entity, or to exchange other financial instruments on potentially unfavorable terms with the second entity, and (ii) conveys to that second entity a contractual right (a) to receive cash or another financial instrument from the first entity, or (b) to exchange other financial instruments on potentially favorable terms with the first entity. Accordingly, our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, derivative financial instruments, mortgage and loans payable, and redeemable preferred stock. We carry cash and cash equivalents, accounts payable and accrued liabilities, and mortgage and loans payable at the approximate fair market value, and, accordingly, these estimates are not necessarily indicative of the amounts that we could realize in a current market exchange. We carry derivative financial instruments at fair value as is required under current accounting standards. We carry redeemable preferred stock at historical cost and accrete carrying values to estimated redemption values over the term of the financial instrument.

Derivative financial instruments consist of financial instruments or other contracts that contain a notional amount and one or more underlying variables (e.g., interest rate, security price or other variable), require no initial net investment and permit net settlement. Derivative financial instruments may be free-standing or embedded in other financial instruments. Further, derivative financial instruments are initially, and subsequently, measured at fair value and recorded as liabilities or, in rare instances, assets (See NOTE M for additional information). We generally do not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks. However, we have entered into certain other financial instruments and contracts, such as our sale and issuance of redeemable preferred stock and freestanding warrants during October 2010 with features that are either (i) not afforded equity classification, (ii) embody risks not clearly and closely related to host contracts, or (iii) may be net-cash settled by the counterparty. As required by ASC 815 *Derivatives and Hedging*, these instruments are required to be carried as derivative liabilities, at fair value, in our financial statements with changes in fair value reflected in our income.

Fair Value Hierarchy

The three levels of inputs that may be used to measure fair value are as follows:

Level 1. Quoted prices in active markets for identical assets or liabilities.

Level 2. Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets with insufficient volume or infrequent transactions (less active markets), or model-derived valuations in which all significant inputs are observable or can be derived principally from or corroborated with observable market data for substantially the full term of the assets or liabilities. Level 2 inputs also include non-binding market consensus prices that can be corroborated with observable market data, as well as quoted prices that were adjusted for security-specific restrictions.

Level 3. Unobservable inputs to the valuation methodology are significant to the measurement of the fair value of assets or liabilities. Level 3 inputs also include non-binding market consensus prices or non-binding broker quotes that we were unable to corroborate with observable market data.

Redeemable Preferred Stock

Redeemable preferred stock (and, if ever, any other redeemable financial instrument we may enter into) is initially evaluated for possible classification as a liability in instances where redemption is certain to occur pursuant to ASC

480 *Distinguishing Liabilities from Equity*. Redeemable preferred stock classified as a liability is recorded and carried at fair value. Redeemable preferred stock that does not, in its entirety, require liability classification is evaluated for embedded features that may require bifurcation and separate classification as derivative liabilities. In all instances, the classification of the redeemable preferred stock host contract that does not require liability classification is evaluated for equity classification or mezzanine classification based upon the nature of the redemption features. Generally, mandatory redemption requirements or any feature that could require cash redemption for matters not within our control, irrespective of probability of the event occurring, requires classification outside of stockholders' equity. Redeemable preferred stock that is recorded in the mezzanine section is accreted to its redemption value through charges to stockholders' equity when redemption is probable using the effective interest method. See NOTE O for further disclosures about our redeemable preferred stock.

Subsequent Events

We have evaluated subsequent events for recognition or disclosure through the date this Form 10-Q is filed with the Securities and Exchange Commission.

Table of Contents**NOTE C RESTRICTED CASH**

As required by the original mortgage loan entered into with Fifth Third Bank (the Bank) on July 11, 2008 (see NOTE I), \$500,000 was deposited into an additional interest-bearing account from which principal and interest payments are made. On each anniversary of the mortgage, we were required to deposit into the account an amount sufficient to ensure a balance of \$500,000 for principal and interest payments for the subsequent year of the mortgage. This mortgage loan matured and was extended during July 2013. This new loan calls for a restricted cash balance of \$400,000 to be funded annually. The balance in the restricted cash account is held as additional collateral by the Bank and is not available for operations. The balance in this account at September 30, 2013, was \$150,491.

During July 2013, we entered into a \$10.0 million project term loan with the Bank (see NOTE I). This loan matures in July 2014. Per the agreement, we deposited, from the loan proceeds, \$500,000 into a restricted bank account to cover principal and interest payments. This account balance is also pledged as additional security for the loan. There is no requirement to fund this account in the future.

NOTE D ACCOUNTS RECEIVABLE

The accounts receivable balances at September 30, 2013 and December 31, 2012 were \$6,681,697 and \$2,101,941, respectively, which are net of reserves of \$4,631,593 and \$4,820,593, respectively. As described in NOTE F, Neptune Minerals, Inc. (NMI) completed a 2011 share exchange with Dorado Ocean Resources, Ltd. (DOR) shareholders which resulted in an executed assignment and assumption agreement, whereby NMI assumed \$8,227,675 of the outstanding debt of DOR owed to us. The full reserve at September 30, 2013 and the full reserve at December 31, 2012 are for the remaining Neptune Minerals, Inc. (NMI) accounts receivable assumed from DOR as discussed in NOTE F. Also included in our September 30, 2013 balance is \$500,000 that is for a loan made to NMI. See NOTE F.

During the three-month period ended September 30, 2013, we recorded an accounts receivable of \$14,444,948 representing proceeds to be received from the sale of silver from the *Gairsoppa* project which included \$9,226,398 for the contractual cost recoupment of previously expensed search and recovery costs related to the *Gairsoppa* project. The cost recoupment total consists of \$26,749 of costs expensed to Marketing, general and administrative and \$9,199,649 expensed to Operations and research. Within this period, we recovered approximately 61 tons of silver bullion from the wreck of the SS *Gairsoppa* and commenced the refining process which allows us to sell silver into London's bullion market on behalf of United Kingdom Government. There are no cost of goods associated with this transaction since we do not own the silver bullion being sold, and we are acting only as an agent for the United Kingdom Government. The *Gairsoppa* project is discussed at length in ITEM 2 of this Form 10-Q. The balance remaining of this receivable at September 30, 2013 was \$5,805,543. This entire remaining *Gairsoppa* related accounts receivable at September 30, 2013 was paid in full during the subsequent month.

NOTE E INVENTORY

Our inventory consisted of the following:

	September 30, 2013	December 31, 2012
Artifacts	\$ 5,446,668	\$ 5,743,915
Packaging	87,000	131,641
Merchandise	397,315	485,769

Merchandise reserve	(371,332)	(367,558)
Total inventory	\$ 5,559,651	\$ 5,993,767

Of these amounts, \$5,216,957 and \$5,574,841 are classified as non-current as of September 30, 2013 and December 31, 2012, respectively.

NOTE F INVESTMENTS IN UNCONSOLIDATED ENTITIES

Neptune Minerals, Inc.

During the quarter ended December 31, 2009, we invested \$500,000 for a 25% interest (five membership units) in SMM Project, LLC (SMM) to pursue opportunities in the exploration of deep-ocean gold and copper deposits. SMM purchased a majority interest in Bluewater Metals Pty, Ltd. (Bluewater), an Australian company with licenses for mineral exploration of approximately 150,000 square kilometers of ocean floor in territorial waters controlled by four different countries in the South Pacific. In April 2010, SMM was acquired by Dorado Ocean Resources, Ltd. (DOR) through a share exchange. At that time, DOR also acquired the remaining interest in Bluewater. We were issued 450 DOR shares in exchange for our surrendered units in SMM. We also acquired an additional 1,200 shares of DOR valued at \$2,000,000 that resulted in a 41.25% ownership of DOR.

Table of Contents

Under the terms of the Share Subscription Agreement, we had the option to pay for this investment in cash, provide marine services to DOR over a three-year period commencing April 2010, or exercise our contractual right to offset against the \$2,000,000 marine services accounts receivable owed to us. During 2011, we exercised our contractual right and offset these two amounts. The focus of DOR was on the exploration and monetization of gold- and copper-rich Seafloor Massive Sulfide (SMS) deposits.

During 2011, we were engaged by Neptune Minerals, Inc. (NMI) and its affiliates to perform marine services relating to deep-sea mining. The agreements provided for payments in cash and shares of Class B non-voting common stock of NMI. In 2011, we earned 2,066,600 shares of the Class B non-voting common stock from these engagements. During this same period, NMI completed a share exchange with DOR shareholders whereby each one outstanding share of DOR was exchanged for 1,000 shares of NMI Class B non-voting common stock. We received 1,650,000 shares of NMI Class B non-voting common stock for our 1,650 DOR shares pursuant to the share exchange. In connection with this share exchange, NMI executed an assignment and assumption agreement, whereby NMI assumed \$8,227,675 of the outstanding debt DOR owed to us. Additionally in 2011, we executed a debt conversion agreement with NMI, whereby we converted \$2,500,000 of the debt owed to us for 2,500,000 shares of NMI Class B non-voting common stock. At September 30, 2013, we have a net share position in NMI of 6,216,600 shares, which represents an approximate 30% ownership before any further dilution of the NMI stock.

Regarding the debt conversion noted in the preceding paragraph, NMI s shares were valued at \$1.00 based on their most recent capital raise at the time when we executed the debt conversion agreement. Pursuant to that agreement, we converted \$2,500,000 of the debt owed to us for 2,500,000 shares of NMI Class B non-voting common stock. All the \$8,227,675 receivable was fully reserved for in 2010. Thus the \$2,500,000 portion of the debt owed to us had a book basis of zero. When we received the 2,500,000 shares as settlement of this accounts receivable, we took the position that the shares received had a carryover basis of zero until we could convert the shares to cash. Accordingly, no gain or loss was recognized in our financial statements in connection with this transaction.

At September 30, 2013, our share of unrecognized DOR (NMI) losses is \$14.7 million. We have not recognized the accumulated \$14.7 million in our income statement because these losses exceed our investment in DOR (NMI). Our investment has a carrying value of zero as a result of the recognition of our share of prior losses incurred by NMI under the equity method of accounting. Based on the NMI and DOR transactions described above, we believe it is appropriate to allocate this loss carryforward of \$14.7 million to any incremental NMI investment that may be recognized on our balance sheet in excess of zero. The aforementioned loss carryforward is based on NMI s last audited financial statements as of June 30, 2013. We do not have any guaranteed obligations to NMI, nor are we otherwise committed to provide financial support. Even though we were not obligated, during the three-months ended September 30, 2013, we, along with a second creditor, loaned funds to NMI of which our share is \$500,000, and this indebtedness is evidenced by a convertible note. This note carries an interest rate of 6% per annum and has a maturity date of April 26, 2014. The note includes a conversion option under which, at any time prior to the payment in full of the principal amount, we may elect to convert all or any portion of the unpaid principal and accrued and unpaid interest into NMI s Class-A voting shares. The conversion price is \$20.00 per share if this option is elected. If the note remains unpaid at maturity, there is a mandatory conversion clause that sets the conversion share price at \$12.00 per share.

Chatham Rock Phosphate, Ltd.

During the period ended June 30, 2012, we performed deep-sea mining exploratory services for Chatham Rock Phosphate, Ltd. (CRP) valued at \$1,680,000. As payment for these services, CRP issued 9,320,348 of ordinary shares to us. The shares currently represent a 6.9% equity stake in CRP. With CRP being a thinly traded stock on the New Zealand Stock Exchange and guidance per ASC 320: *Debt and Equity Securities* regarding readily determinable fair

value, we believe it was appropriate to not recognize this amount as an asset nor as revenue during that period.

NOTE G INCOME TAXES

As of September 30, 2013, the Company had consolidated income tax net operating loss (NOL) carryforwards for federal tax purposes of approximately \$117 million and net operating loss carryforwards for foreign income tax purposes of approximately \$11 million. The federal NOL carryforwards from 1998 forward will expire in various years beginning in 2018 and ending through the year 2032. From 2018 through 2022, approximately \$3.2 million of the NOL will expire, from 2023 through 2027, approximately \$59.9 million of the NOL will expire, and from 2028 through 2032, approximately \$65.9 million of the NOL will expire.

As of September 30, 2013 we utilized \$16 million of the federal NOL carryforwards for taxable income resulting from our sale of partial ownership interest in a subsidiary. For Alternative Minimum Tax (AMT) purposes, a limitation is imposed on the allowable amount of the NOL carryforward, this limitation resulted in a current federal tax expense. The AMT rate applied is 20%.

Table of Contents

The components of the provision for income tax (benefits) are attributable to continuing operations as follows:

	September 30, 2013	September 30, 2012	September 30, 2011
Current			
Federal	\$ 320,991	\$	\$
State	15,000		
	\$ 335,991	\$	\$
Deferred			
Federal	\$	\$	\$
State			
	\$ 335,991	\$	\$

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 tax credit carryforwards	\$ 45,757,210
Capital loss carryforward	395,844
Accrued expenses	64,406
Deferred revenue	1,020,246
Reserve for accounts receivable	2,078,681
Reserve for inventory	133,608
Start-up costs	110,118
Excess of book over tax depreciation	1,304,151
Stock option and restricted stock award expense	1,942,747
Investment in unconsolidated entity	3,800,697
Less: valuation allowance	(56,412,435)
	\$ 195,273
Deferred tax liability:	
Property and equipment basis	\$ 124,044
Prepaid expenses	71,229
	\$ 195,273
Net deferred tax asset	\$

Edgar Filing: ODYSSEY MARINE EXPLORATION INC - Form 10-Q

As reflected above, we have recorded a net deferred tax asset of \$0 at September 30, 2013. As required by the Accounting for Income Taxes topic in the ASC, 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 realized without the recovery and rights of ownership or salvage rights of high-value shipwrecks or other forms of taxable income, thus a valuation allowance has been recorded as of September 30, 2013.

The decrease in the valuation allowance as of September 30, 2013 is due to the utilization of \$16 million of our net operating loss carryforward.

The change in the valuation allowance is as follows:

September 30, 2013	\$ 56,412,435
December 31, 2012	57,901,529
Change in valuation allowance	\$ (1,489,094)

Income taxes for the nine-month periods ended September 30, 2013 and 2012 differ from the amounts computed by applying the effective federal income tax rate of 34.0% to income (loss) before income taxes as a result of the following:

	September 30, 2013	September 30, 2012
Expected (benefit)	\$ (7,193,297)	\$ (5,871,516)
U.S. income tax expense at the AMT 20% rate	335,991	
State income taxes net of federal benefits	77,409	(167,562)
Nondeductible expense	23,010	14,166

Table of Contents

	September 30, 2013	September 30, 2012
Stock options and restricted stock awards	214,670	242,390
Gain on sale of subsidiary stock	8,454,148	
Derivatives	(137,755)	521,008
Change in valuation allowance	(1,489,094)	5,067,370
Effects of:		
Change in apportionment estimate	400,072	(40,826)
Change in net operating loss estimate	2,240	612,353
Change in capital loss carryover estimate		(374,051)
Change in AMT credit	(320,991)	
Other, net	(30,412)	(3,332)
	\$ 335,991	\$

During the nine-month periods ended September 30, 2013 and 2012, the Company recognized certain tax benefits and (liabilities), prior to any valuation allowances, related to stock option plans in the amounts of \$214,670 and \$249,423, respectively. If we did not have a full valuation allowance, such benefits would be recorded as an increase to the deferred tax asset and increase in additional paid in capital.

We have not recognized a material adjustment in the liability for unrecognized tax benefits and have not recorded any provisions for accrued interest and penalties related to uncertain tax positions.

The earliest tax year still subject to examination by a major taxing jurisdiction is 2010.

NOTE H COMMITMENTS AND CONTINGENCIES**Legal Proceedings**

On April 16, 2012, the Kingdom of Spain filed a motion with the district court for an award of attorney's fees and costs related to the *Black Swan* case claiming in excess of \$3,000,000. On November 15, 2012, the Magistrate Judge entered a Report and Recommendation recommending Spain recover fees and costs, but only those incurred after dismissal of the case from February 10, 2012 to March 20, 2012, related to the transfer of artifacts held in Gibraltar. This amounted to approximately \$130,000 of which the full amount was reserved in 2012. Failing to adopt the Report and Recommendation, on September 26, 2013 the District Court Judge entered an Order assessing \$1,072,979 related to attorney's fees. Payment was made on October 11, 2013, and a Satisfaction of Judgment was executed and filed on October 21, 2013. The difference between the \$1,072,979 and \$130,000 of \$942,979 was expensed in entirety in the Marketing, general and administrative line of our Consolidated Statement of Operations.

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

Trends and Uncertainties

Our current 2013 business plan estimates positive cash flow from the sum of operating and financing activities. The plan contains assumptions which include that several of our planned projects are funded through project recoveries

(Gairsoppa) and other financings, syndications or other partnership opportunities. The 2013 business plan expenses included a 90-day charter agreement which we executed with a company that provided a ship and equipment to conduct recovery operations on the *Gairsoppa* and *Mantola* projects similar to the work performed in 2012 when we monetized over \$37 million of silver. In 2013 we estimate to monetize at least \$30 million from the 2013 *Gairsoppa* project. Based upon our current expectations, we believe our cash position will be sufficient to fund operating cash flows throughout the rest of 2013 and 2014 taking into account our beginning cash balance, current cash flow expectations and revenues from multiple sources, including projected sales from recoveries, syndicated projects and other potential financing opportunities. We renewed our term and mortgage loans with Fifth