

# Odyssey Jettisons Lottery Ticket Upside With New HMS Victory Deal

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**Disclosure:** The author is short OMEX. (More...)

## Summary

- New HMS Victory deal with the MHF and UK MOD conforms to the UNESCO CPOCH Annex which prohibits commercial sale of recovered artifacts and requires the collection kept intact.
- Wessex Archeology report that it is “highly unlikely” that there is gold; speculation of “secret undocumented gold” based on a single unsourced Dutch newspaper clipping.
- Soonest excavation could begin is 3-5 months, still could be derailed: MMO may not approve; true Balchen descendants may demand judicial inquiry; OMEX cash balance perilously low.
- Former CEO’s GALT Resources still has an override claim for 50% of proceeds to OMEX up to \$15mm and a 7% royalty thereafter.
- New fee-for-service model and no "lottery ticket" upside highlights unviability of current business model with high debt load and corporate overhead.

We were surprised for a number of reasons to see Odyssey Marine Exploration (NASDAQ:[OMEX](#))'s announcement [Friday](#) about their planned go-ahead on the HMS Victory. Among other things, it seemed to be inconsistent with the stated change in strategy to focus on more "singles and doubles" rather than the homerun-or-nothing strategy that resulted in disasters such as the "Black Swan" case where after years of legal wrangling, they had to pay Spain's legal fees and lost all their treasure.

We did take advantage of the share price increase to increase our short position as there is a major misunderstanding about what this new deal means. We question how it's possible for someone to write and publish a 9,000+ word article hours after a company PR without advance knowledge.

## HMS Victory Project Obstacles Summary

(click to enlarge)



The [full announcement from the UK](#) can be found here

Most notably, the announcement is clear that MHF and OMEX have an arrangement to move forward that conforms with the

The UK Government announcement states that the Maritime Heritage Foundation has adopted:

1. The [Annex to the UNESCO Convention 2001](#)
2. The [Museums Association's Code of Ethics](#)
3. The government's [heritage policy](#) (including the UNESCO Annex and Key Management Principles)

More on how these restrictions impact the project economics and viability below.

## Hurdle 1: UK Marine Management Organization

The UK MMO has yet to approve the project. They [must grant a license](#) to move forward after an Environmental Impact Assessment is filed publicly with the project plan. Our understanding is this process takes on average 3 months although complex applications may take longer, during which there is a period where interested parties and the public can offer scrutiny and comment which the MMO must take into consideration.

The [Public Register is available online](#) and as of this writing neither OMEX nor MHF appear to have filed a plan. This would not normally be a concern for a project like this. However, as of November 2013, according to a FOIA request, the MMO [was investigating OMEX for potential charges](#) for violating licensing requirements. We have submitted an update request to determine if this investigation is ongoing.

## Hurdle 2: A cash bond or equivalent must be posted prior to commencing the work so it can be completed

According to the UNESCO CPUCH Annex section 18, there must be a bond posted for the full cost of the salvage before work can even start. If we estimate a full recovery would cost \$20-30mm and just this first "at risk surface items" piece of the project would cost \$3mm, how would OMEX be able to fund this? We estimate OMEX's maximum possible cash balance will be approximately \$3mm as of the end of this month unless they have been able to borrow more on the as yet undisclosed "Marketing agreement loan".

*Cash estimate end of June 30 (10Q): \$5.7mm - 4 mos \* \$2-3mm cash burn/mo + \$5mm loan (closed in Aug) = between \$2.7mm and -\$1.3mm as of Oct 31.*

The weather is rough at the HMS Victory site until late March in 4-5 months and the cash burn between now and then would overwhelm even the most optimistic liquidity scenarios posited without a substantially dilutive equity raise.

## Hurdle 3: Former CEO's GALT Resources still has a large override on proceeds

"Galt will also receive 50% of Odyssey's net proceeds, if any, on the HMSVictory project until Galt receives two times its initial investment and thereafter will receive 7.5125% of Odyssey's net proceeds from the HMSVictory project." "Galt will receive 7.5125% of net proceeds from the HMSVictory project after they recoup their investment of \$3,756,250 plus three times the investment" ([OMEX 2013 10-K](#))

Essentially it looks like GALT gets 50% of any net proceeds to OMEX until they recoup \$15mm and then a 7.5125% royalty on anything in excess of that.

Hurdle 4: Will the Actual Descendants of Lord Admiral Balchen demand a judicial review and hold up the process?

The representatives have made the following statement via email to the media which was forwarded to us. They also have a [website](#).

(start quote)

As the only direct descendants of Admiral Balchen of HMS Victory we feel the same sense of duty towards his crew he would have felt. We are disappointed, but not surprised given Lord Lingfield's connections to the top of the Conservative Party, that the Government has chosen to allow a company, Odyssey Marine Exploration, which was condemned in a US Court for acting "contrary to Law" on a similar historic warship, to salvage the grave of our ancestor and his 1100 crew.

As part of the consultation which must come before any work we will insist that the work is supervised by independent archaeologists from English Heritage to ensure the work is done appropriately and with due respect to the site as a memorial and grave.

In the meantime there are still many questions to be asked about today's decision such as, is it appropriate that the same consultant, Dr Sean Kingsley of Wreckwatch International, acts for both Odyssey Marine Exploration and the Maritime Heritage Foundation?

This was disclosed in the UK Parliament in February 2014 [our italics]

24 Feb 2014 : Column 146W - Hansard

HMS Victory

**Mr Kevan Jones:** To ask the Secretary of State for Culture, Media and Sport what meetings *a. she*, *b. Ministers* in her Department and *c. officials* in her Department have had with Odyssey Marine Exploration regarding the excavation of HMS Victory 1744; and what was discussed at each such meeting. [187720]

**Mr Vaizey:** *At a recent roundtable meeting, I met a representative of Wreck Watch International, who is also a consultant to Odyssey Marine Exploration. This was in his capacity as archaeological contractor to the Maritime Heritage Foundation. The future management of the wreck was discussed.*

<http://www.publications.parliament.uk/pa/cm201314/cmhansrd/cm140224/text/140224w0005.htm>  
<http://wreckwatch.wordpress.com/about/>

...and just what did former Culture Secretary Jeremy Hunt agree at his unminuted meeting with Lord Lingfield in the Summer of 2010 when Mr Hunt admits HMS Victory was discussed."

From the descendants of Admiral Balchen

(end quote)

**BIG Hurdle 1:** The agreement with MHF must have changed, the old one did not conform - OMEX SEC filings are consistent with this.

The following is the actual language regarding the HMS Victory contract that OMEX has used in their press releases and SEC filings. The original 2012 press release and corresponding 10-K indicated a "% of treasure" potential payment which is what is being repeated now as a basis for calculating 'lottery ticket' upside. However, this type of contract does not conform with the UNESCO Annex - which UNTIL NOW OMEX/MHF had not formally agreed to conform to. Note the language changes in the SEC filing 10-K filed March 2014 that appears to indicate that there is NO LONGER a "% of treasure" contract, as has been speculated.

Feb 2, 2012 [Odyssey Marine Exploration Executes Agreement with Maritime Heritage Foundation](#)

The relevant language to which some have speculated that, if there is a large amount of treasure found then OMEX could get a large percentage of this:

The agreement calls for Odyssey's project costs to be reimbursed and for Odyssey to be paid a percentage of the recovered artifacts' fair value. The preferred option is for Odyssey to be compensated in cash. However, if the Foundation determines, based on the principles

adopted for its own collection management and curation policy, that it is in its best interest to de-accession certain artifacts, the Foundation may choose to compensate Odyssey with artifacts in lieu of cash.

§ Odyssey will receive the equivalent of 80% of the fair value of artifacts which were primarily used in trade or commerce or were private property and bear no direct connection to the construction, navigation, defense or crew of the ship, such as coins or other cargo.

§ Odyssey will receive the equivalent of 50% of the fair value of all other objects typically associated with the construction, crewing and sailing of ships including, but not limited to, the ship's hull, fittings, fasteners, construction elements, clothing, organic remains, foodstuffs, cooking utensils, pottery, weapons, ammunition, ground tackle and navigational equipment.

§ For any private property including coins or other cargo administered through the Receiver of Wreck, the Foundation has agreed that Odyssey shall receive 80% of the value.

**March 2013:** Section on Page 5 of [OMEX 2012 SEC 10-K Filing](#)

The Foundation has contracted with Odyssey to provide a full range of archaeological, recovery, conservation and other services.

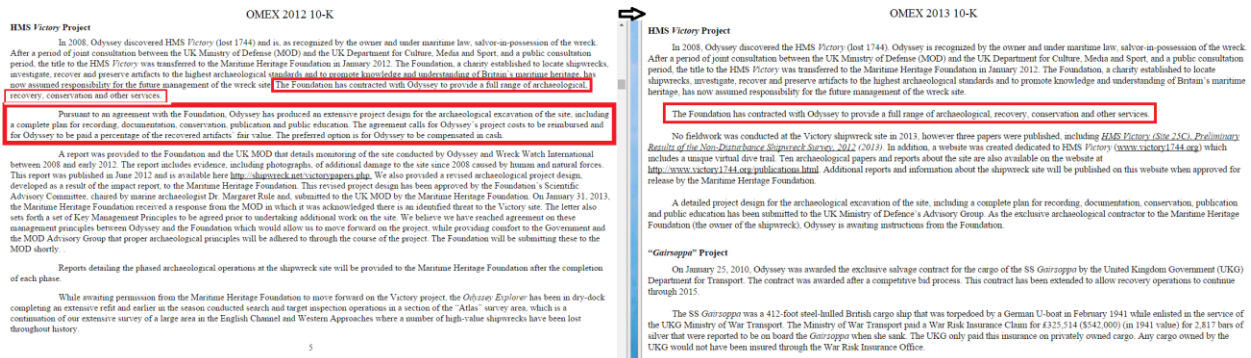
*Pursuant to an agreement with the Foundation, Odyssey has produced an extensive project design for the archaeological excavation of the site, including a complete plan for recording, documentation, conservation, publication and public education. The agreement calls for Odyssey's project costs to be reimbursed and for Odyssey to be paid a percentage of the recovered artifacts' fair value. The preferred option is for Odyssey to be compensated in cash.*

\*This language was brought to our attention by numerous archaeologists who highlighted the UNESCO CPUCH Annex, to which the UK is a signatory to.

The Annex clearly states that:

- 1) the site is to be considered as one indivisible unit, there is no recognized legal language such as "trade goods" for artifacts to be judged non-archaeological in nature
- 2) recovered artifacts cannot be sold commercially

**March 2014:** The italicized paragraph above was **deleted** in the **OMEX 2013 SEC 10-K** filing (section now on page 6).



**October 24, 2014:** OMEX HMS Victory Press release does not mention any agreement with the MHF regarding percentage of artifacts' fair value and reiterates "All recovered artifacts will be declared to the Receiver of Wreck in accordance with UK legislation"

Specifically the Annex language that is relevant for this project:

**Rule 2.** The commercial exploitation of underwater cultural heritage for trade or speculation or its irretrievable dispersal is fundamentally incompatible with the protection and proper management of underwater cultural heritage. *Underwater cultural heritage shall not be traded, sold, bought or bartered as commercial goods.*

**Rule 18.** The project design shall demonstrate an ability, such as by securing a bond, to fund the project through to completion.

**Rule 33.** The project archives, including any underwater cultural heritage removed and a copy of all supporting documentation shall, as far as possible, be kept together and intact as a collection in a manner that is available for professional and public access as well as for the curation of the archives.

The Museums Association Code of Ethics is extremely strict on the sale of material:

In 2007 the Museums Association amended its code of ethics to accept financially motivated disposal in exceptional circumstances, when it can be demonstrated that all of the following factors have been satisfied:

- it will significantly improve the long-term public benefit derived from the remaining collection

- it is not to generate short-term revenue (for example to meet a budget deficit)
- it is as a last resort after other sources of funding have been thoroughly explored
- extensive prior consultation with sector bodies has been undertaken
- the item under consideration lies outside the museum's established core collection as defined in the collections policy.

In addition, the code requires museums to ring fence any money raised as a result of disposal through sale solely and directly for the benefit of the museum's collection.

Money raised must be restricted to the long-term sustainability, use and development of the collection.

We assess proposed financially motivated disposals on a case-by-case basis against the criteria in the Code of Ethics.

<http://www.museumsassociation.org/collections/sale-of-collections>

HURDLE: It is "highly unlikely" that gold even exists at the site according to scientific research

We will not rehash all of the circuitous and circumstantial arguments made by certain holders of how there *could* be a large amount of gold at the site of the Victory. In fact OMEX has never claimed in any SEC document that there is likely to be gold treasure down there. Our Summary Interpretation of the Facts:

- A [thorough study conducted by Wessex Archaeology](#) on numerous sources concluded that is "highly unlikely" that there is gold specie or bullion.
- Most of the argument for gold being aboard is highly circumstantial: it was a ship, ships sometimes carry gold, there was world trade at the time.
- The only specific piece of evidence highlighted is a quote from a Dutch newspaper (The ship was traveling from Portugal to the UK?) that references UK Pounds rather than Dutch currency which seems odd.



· OMEX failed to provide the actual source of this quote to the Wessex study or to anyone else to our knowledge so its quality cannot be ascertained. Neither would OMEX release or discuss any other "research" regarding a bullion cargo which they claimed to possess with the Wessex Archaeology Authors. However OMEX did admit they had found no evidence that the Victory called at Lisbon on its return voyage. [Wessex Archaeology Desk Top Study p32 5.5.42]

- It is also the case that the precise way HMS Victory broke up and sank is currently unknown. Even if bullion or valuables were present on board the ship, they still may not be present on the current wreck site.

In order to believe there is substantial gold down there, you would have to believe that:

1) A 74 year old Admiral Balchen would have taken aboard undocumented gold to earn a personal transport fee

2) That a huge amount of gold could simply disappear and not leave any documented trace with insurance records or shipping records

This is reminiscent of the numerous "Secret Gold" stories that have been hyped in the past including the most recent "[Secret Army Gold](#)" nonsense in the SSCA project that has of course not turned up.

*No "secret gold" stories ever work out, these things have records and don't disappear.  
"Fool me once shame on you, fool me twice, shame on me."*

Best case IF there is treasure and other hurdles are overcome: A lengthy court battle like the "Black Swan"?

We expect that some motivated parties would have investors believe that:

- despite all the clear language both in the Museum Code and the UNESCO Annex;

- and despite the fact that OMEX's 10K appears to indicate that the contract regarding "% of treasure" has been changed from 2012->2013

-That somehow OMEX will still be able to collect some large % of the gold treasure value (assuming it's there - which there is no scientific evidence of...) because perhaps only

"cultural items" will be considered part of the pact and OMEX will be able to get the 'side items' of gold to sell.

To be perfectly clear: This is without legal precedent and contrary to the current rules. Rules can always change but not quickly and there is no way this could happen without challenge. Will it turn out as bad as the "Black Swan" case with Spain? This is unknown of course but given the involvement of numerous interested parties in the UK it will not be simple despite assertions. Further - OMEX's own SEC filings (above) are consistent with the fact that there is no longer even an agreement relating to "% of treasure" but rather just a fee-for-service / day-rate model.

OMEX claimed they are going to shift towards new projects where the legal ownership is clear up front: and this is an example of that IF there is no "% of treasure" compensation but rather only a day rate / fee-for-service model which is all we believe OMEX is even attempting to do now. Even in what seemed to be simple cases like the SSCA, it is STILL under appeal as of this writing and OMEX has received \$0 from the Reciever and as far as we can tell has no timetable to receive any until the appeals are resolved.

Likely project economics most likely to produce more losses, highlight unviability of business model with current corporate overhead and debt load

Estimating the potential project economics based on facts gets us to the chart below. OMEX received \$250k for salvaging 2 cannon (\$125k each) when they first found the ship. If there are a maximum 98 more cannon to save and there is no bulk discount for the receiver of wreck then there could be as much as \$12.25mm revenue - 50% of which goes to GALT and then the rest (and more) go to expenses and corporate overhead.

(click to enlarge)

<b>HMS Victory Project Economics Estimate</b>		
	(\$mm)	\$/sh @ 90mm shares
Cannon value: 98 @ \$125k each?	\$ 12.25	\$ 0.14
GALT Resources 50% royalty	\$ (6.13)	\$ (0.07)
Salvage Costs (3 mos @ \$1.3mm/mo)	\$ (4.00)	\$ (0.04)
Gross Project Profit	\$ 2.13	\$ 0.02
Corporate overhead @ \$1mm/mo	\$ (3.00)	\$ (0.03)
Net Project Profit	\$ (0.88)	\$ (0.01)

We believe that OMEX is trying to use this project as a "prestige project" in order to generate more fee-for-service business from other National governments. This is fine and if done in compliance with all the relevant UNESCO conventions can be a win-win for all involved. However, there is NO "lottery ticket" upside - these treasures belong to the public and there are numerous contractors able to salvage them for a fee-for-service model that OMEX appears to be transitioning to. However, such a business model does not justify the extravagant corporate overhead of \$1mm/month+ that OMEX burns.

We respect the changes that new CEO Mark Gordon is doing and appreciate the significant toning down of hype in the press releases. There is still a long way to go towards shareholder transparency but unfortunately these new facts highlight that the enterprise is worth less than the current debt load. Paying a \$100mm valuation for a small, relatively low margin salvage business is not economic for shareholders.

Editor's Note: This article covers one or more stocks trading at less than \$1 per share and/or with less than a \$100 million market cap. Please be aware of the risks associated with these stocks.

**Additional disclosure:** Ryan Morris, President, Meson Capital, has pledged to donate his personal profits from OMEX short sales to charity. Full disclaimer at [omextruth.com](http://omextruth.com)