

Odyssey Gives Up Control For Distressed Loan, Significantly Dilutes Potential Upside

Must Read | Mar. 16, 2015 8:03 AM ET | About: [Odyssey Marine Exploration, Inc. \(OMEX\)](#)

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

Summary

- Friday afternoon, OMEX announced a dilutive distressed loan to Minera del Norte (MINOSA), a Mexican iron and coal company that will give them control of the Company.
- MINOSA received a call option to purchase all of OMEX's Oceanica stake for \$40mm which it could exercise tomorrow if it wanted.
- The loan is distributed monthly to fund OMEX's cash burn BUT MINOSA can determine to not proceed to at its SOLE DISCRETION if it does not like Oceanica.
- Is OMEX abandoning the shipwreck business entirely with this deal as well as HMS Victory's recent failure? Will OMEX be the next Chatham Rock Phosphate?
- Though this deal prevents imminent bankruptcy, it carries a heavy cost and severely limits any upside for current shareholders even in the best case scenarios for Oceanica.

On Friday afternoon, a classic time to release bad news when investors are off for the weekend, Odyssey Marine Exploration (NASDAQ:[OMEX](#)) posted a press release and 8-K with documents for a complex deal that gives up control of the company while severely diluting potential upside to existing shareholders. Though the deal still requires shareholder approval - given that many shareholders were looking for a homerun for the risk they take with OMEX stock, they may be upset with how little they are receiving for handing over the majority of their upside to a new investor with no history with the company. Management seems to have taken the easy way out rather than truly "going for it" to create value for their current shareholders. Will shareholders demand appraisal rights to get their full value they believe in?

It is a complex deal and we hope to help investors understand the true implications of this deal as we believe the press release issued Friday was highly misleading. We include direct quotes from the legal documents filed by OMEX to the SEC.

The [purchase agreement](#) begins:

WHEREAS, the Company has informed the Investor that without the Loans and the Contemplated Transactions, it would be subject to financial distress;

Deal Process Steps

- 1) March 11 - June 30: The \$14.75mm loan and loan closings (March 11: \$2mm; March 15: \$6mm; Apr 30: \$3mm; May 31: \$2mm; June 30: \$1.75mm) - This fully encumbers OMEX's Oceanica 54mm shares.
- 2) Before 150 days: The "Preliminary Transactions," which include giving MINOSA majority of the board and a 6-1 reverse share split.
- 3) The "Initial Closing" occurring on the **later of** 150 days from March 11 or 3 days after the conditions are met. This provides OMEX with 35mm shares of convertible (at \$1/sh) preferred 8% interest equity delivered (the first \$14.75mm to repay the loan)
- 4) The "Subsequent Closings" occurring March 1, 2016; Sept, 2016; March 2017; March 2018 which provide more convertible (at \$1/sh) preferred 8% interest equity.
- 5) At any point in the future at MINOSA's option, if OMEX stock trades above \$1.26, they can purchase an additional 86.7mm convertible preferred shares at \$0.50/sh creating enormous dilution per share.

The most important thing to understand about this process is in the [purchase agreement](#) section 6.2(I) - This gives MINOSA the UNILATERAL ability to not proceed while apparently still maintaining its full lien on the 54mm Oceanica shares. On the other hand, OMEX does not appear to have any ability to force MINOSA to provide any additional capital if the need arises. **Section 6.2. Investor Conditions.** The obligation of Investor to consummate the Initial Closing is subject to the satisfaction (or waiver by Investor in its sole discretion) of the following conditions:

Don Diego Consent. The Investor shall, in its Sole Discretion, be satisfied with the viability of the Don Diego Project (including, but not limited to, the status of the application for and the terms of all necessary Permits related to the Don Diego Project).



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MINOSA designed themselves an escape hatch for each step of the way in section 6.2 of the purchase agreement

Step 1: March 11 - June 30: The \$14.75mm loan at 8%

As reported in OMEX's [press release](#) - the deal is to provide \$14.75mm in 8% loans to Odyssey between March 11 (\$2mm already closed) and June 30 in order to fund OMEX's ongoing cash burn and presumably refinance the roughly \$8mm of debt due in May 2015 due to Fifth Third tied to proceeds from the SS Central America that still has not been monetized.

Given OMEX's historical cash burn and upcoming debt payments due, this loan appears to be enough to fund the company through approximately July IF a) they lower their cash burn to only \$1.5mm/month and b) repay the \$8mm Fifth Third loan in May. However, unless they lower cash burn further (i.e. terminating employees?) or somehow extend the Fifth Third May loan, it seems like additional capital will be required before the September "Initial Closing" which provides the dilutive preferred equity that converts effectively at \$1/share.

The \$14.75mm loan fully encumbers all of OMEX's 54mm Oceanica shares

According to the [Pledge Agreement](#) for this loan - if OMEX fails on its obligations - it loses its entire Oceanica stake.

PLEDGE AGREEMENT, dated as of March 11, 2015 (this "Agreement"), between **MINERA DEL NORTE, S.A. DE C.V.**, a Mexican *societe anonime* (hereinafter referred to as "**PLEDGEE**"), **ODYSSEY MARINE ENTERPRISES LTD.**, a corporation existing under the laws of the Commonwealth of The Bahamas, (hereinafter referred to as "**ODYSSEY**" or "**PLEDGOR**"), and **OCEANICA RESOURCES, S. DE R.L.**, a *sociedad de responsabilidad limitada* existing under the laws of the Republic of Panama (hereinafter referred to as "**OCEANICA**").

...

SECTION 12. Termination. This agreement can be terminated at any time by **PLEDGEE** constituting sufficient cause for **PLEDGEE** to demand full and immediate payment, regardless of the duration of the agreement, for any of the following:

- (A) Any delays in the payment of any of the Obligations.
- (B) If **PLEDGEE** deems **PLEDGOR's** financial condition has deteriorated up to a point where **PLEDGOR** is not capable of paying its Obligations to **PLEDGEE** or any other creditor.
- (C) The installment of any bankruptcy proceedings, insolvency, attachments or creditor's meetings against the **PLEDGOR**.
- (E) If **PLEDGOR** does not abide by any and all obligations under this contract.

Section 12 is the most interesting in that it appears that MINOSA can again unilaterally deem that OMEX's financial condition has deteriorated and can accelerate the pledge which effectively gives them full ownership of OMEX's Oceanica 54mm shares. Interestingly, in section 14 Remedies Upon Default - there does not appear to be any ability to cure a default. So OMEX again is in an extremely weak negotiating position here.



This deal puts OMEX in an extremely weak negotiating position going forward

MINOSA Can take ALL of OMEX's Oceanica Stake for \$40mm tomorrow if it wants

As part of the initial loan transaction for \$14.75mm, MINOSA receives a [call option](#) to purchase ALL 54 million of OMEX's Oceanica shares for \$40 million. At any time in the next year as long as before the "initial closing" (in 150+ days) they can exercise this. If OMEX's stake in Oceanica were worth more than \$40mm, why would it give away an option to completely exit Oceanica for this valuation?

The Right. Subject to Section 6.1 hereof, during the period commencing on the date hereof and ending on the date that is one year from the date hereof (the "*Expiration Date*"), Purchaser shall have the right to purchase from Holder, and Holder shall be obligated to sell to Purchaser, the Subject Shares in exchange for the Option Consideration (the "*Right*"); provided, however, if the Initial Closing (as defined in the Purchase Agreement) has occurred, then Purchaser may not exercise the Right unless and until any of the conditions to a Subsequent Closing (as defined in the Purchase Agreement) are not satisfied (whether or not the date of determination is a Subsequent Closing Date). In consideration of the granting of the Right, on the date hereof, Purchaser shall pay to Holder \$1.00.

Step 2: By September or so - "Preliminary Transactions" - Is OMEX exiting the treasure hunting business?

From the purchase agreement:

Section 1.4. Preliminary Transactions. Prior to the consummation of the Initial Closing, the Company shall undertake the following transactions (the "*Preliminary Transactions*"):

file, or cause to be filed, the Articles Amendment with the Secretary of State of the State of Nevada providing for, among other things: a 1-for-6 reverse stock split of the Common Stock, upon which every six shares of issued and outstanding Common Stock shall be automatically combined into one issued and outstanding share of Common Stock, without any change in the par value per share; and (ii) classifying the Company's Board of Directors (the "*Board of Directors*") into three different classes, with the entire Board of Directors being elected at the Stockholder Meeting, and thereafter, with one Class subject to election in each year, with Class I being subject to election in 2016; and

include in the Proxy Statement designees of Investor, reasonably acceptable to the Board of Directors (the "*Investor Designees*"), for election as the Class III Directors and as a majority of the Class II Directors (**and in the aggregate constituting a majority of the Board of Directors**).

OMEX is giving up full control of the board for this deal. What does that mean for the future of the treasure hunting business and the Odyssey Explorer? Why would a Mexican iron and coal miner (MINOSA) want to pursue historical shipwrecks that have never been profitable investments? How much will OMEX have to lower costs under this new leadership resulting in employee headcount reductions?

Understanding the dilution "Initial Closing" and "Subsequent Closings"

Management has repeatedly talked about how they will not raise equity or dilute existing shareholders and have numerous "non-dilutive" transactions they can perform. This transaction is as dilutive as we could have ever conceived, contemplating (if approved by shareholders) issuing 188 Million new shares for an average price of \$0.77 in addition to the current 90 million (up from 86 million just 3 mos ago). This dilutes existing shareholders to a mere 31% of the company! More alarmingly, these preferred shares that will constitute 69% of the capital structure appear to be perpetual with an 8% compounding liquidation preference which creates a continuously growing strain on the publicly listed common shares.

While the majority of shareholders still have to approve the deal, this appears to handcuff the Company from future actions and even in the (unlikely) event that Oceanica materializes into a valuable project, that value will not materially accrue to common shareholders.

Upside is severely capped with this deal even if short and long term hurdles are overcome

Even if Oceanica overcomes the numerous impossible hurdles to become a viable commercial project and in, say 3 years is valued at \$500 million, the upside is limited.

Hypothetical extreme example: Oceanica worth \$500 million in 3 years:

$\$500 \text{ million} * 54\% \text{ OMEX stake in project} = \270mm

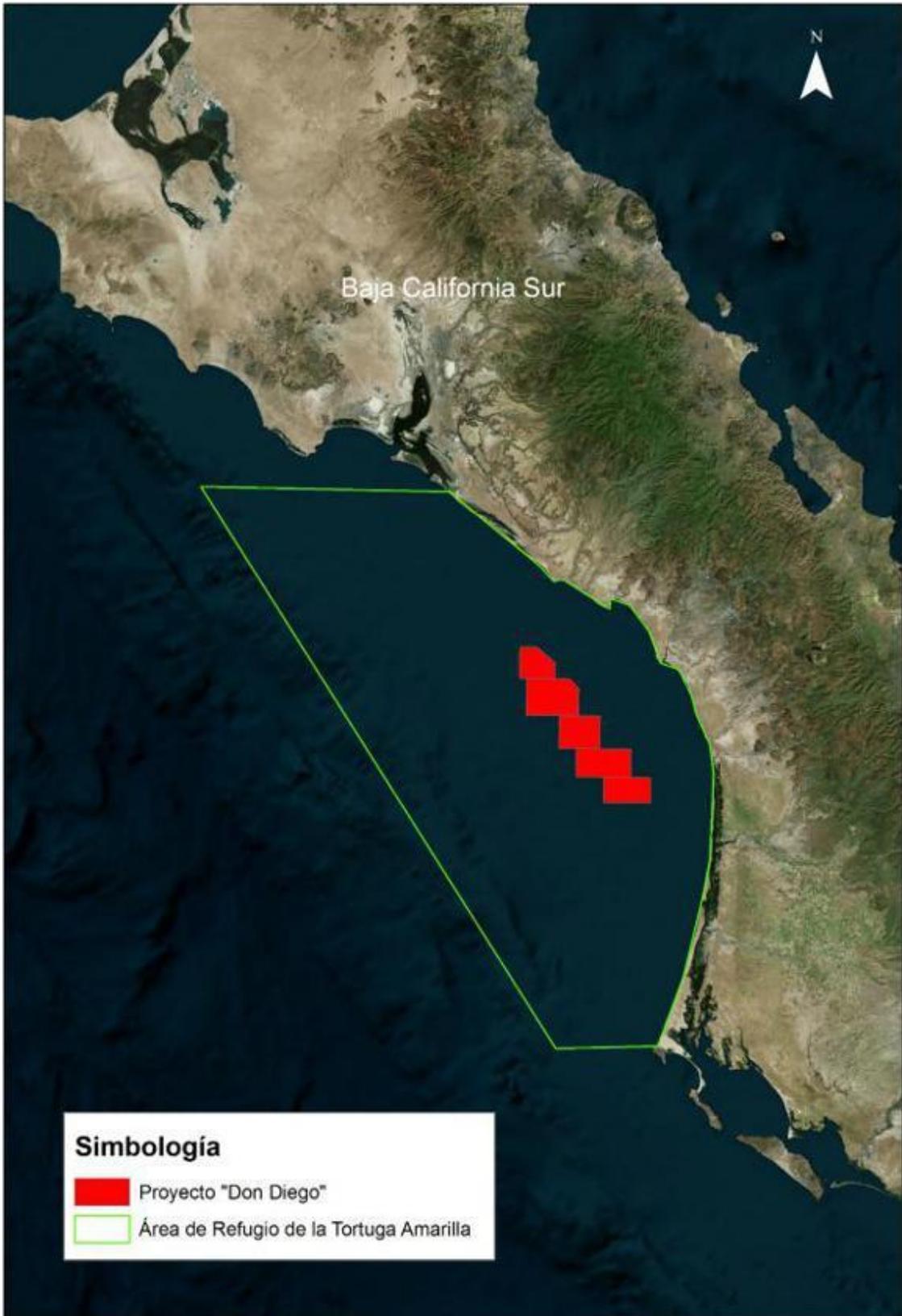
$90\text{mm} + 188\text{mm new shares} = 278\text{mm shares}$

$= \$0.97/\text{share value}$

Note, we maintain that Oceanica is clearly worth \$0 and has yet to even clear a SINGLE hurdle towards becoming an economic project - the first issue being environmental approval.

Oceanica Environmental Approval Faces New Challenges

In fact, just in recent weeks there has been an additional unexpected hurdle introduced to the Oceanica project in Mexico. On March 4, [it was reported](#) that the project is located in an area that SEMARNAT has earmarked as an environmentally protected zone for endangered marine life, notably turtles. Shortly after this on March 13, it [was reported](#) that a local politician has taken up the cause to assist the fishing coops to protect themselves from the threats posed by the project.



Management grants MAKO 4,000,000 shares for no apparent consideration

The single most shocking thing about this deal that has already been finalized is the disclosure that there has been an unexpected 4,000,000 shares of dilution. From the [8-K](#):

Termination of Mako Option Agreements

Mako Resources, LLC and OME are parties to two Unit Option Agreements (the "Mako Option Agreements"), **which were extended in December 2014**, pursuant to which Mako currently has the right to purchase an aggregate of six million of the shares of Oceanica from OME. On March 11, 2015, Mako, OME, and the Company entered into a termination agreement (the "Termination Agreement") pursuant to which the Mako Option Agreements were terminated immediately prior to the execution and delivery of the Purchase Agreement by the parties thereto. In consideration of the termination, the Company agreed to issue and deliver 4,000,000 shares of Common Stock to Mako.

Facts:

- 1) Mako's options originally expired Dec 2013 where only \$2.5mm were exercised bringing in a small amount of cash.
- 2) OMEX extended, for no consideration, those options while increasing the strike price to Dec 2014.
- 3) Without disclosing anything to shareholders until now, the options expired Dec 31, 2014 without having been exercised.
- 4) OMEX - again for NO consideration - extended the options to Mako, presumably so OMEX could continue to claim it as a "potential non-dilutive source of liquidity."
- 5) In order to consummate the deal with MINOSA, OMEX had to purchase the option for 4,000,000 shares that it has just granted for FREE to Mako months before!

Why did Mako just receive such a sweetheart deal at the expense of more dilution for current shareholders?

Is this OMEX's Exit from the Shipwreck business?

The HMS Victory is back in limbo or worse for OMEX after the decision March 5th (still not announced to shareholders by OMEX) that the [MOD has reversed OMEX's permission](#) to begin work on the site. Will this apparent extra scrutiny result in OMEX paying the UK government its \$4.9mm [shortfall](#) from the Gairsoppa project? Why would a Mexican iron and coal mining company want to invest its capital in treasure hunting ventures? Surely with them controlling the board of OMEX after this deal, they would eliminate this part of the business?

From a stock market perspective, OMEX is the only "pure play" treasure hunting / shipwreck company on the market for those investors looking for such "exposure." However - its transition into a focused junior mining company is considerably less unique and not exactly a hot space lately. The only other pure-play undersea mining company [Chatham Rock](#) just declined 90% after failing to receive environmental approval. The junior mining space more broadly has suffered awful returns - JUNR a broad junior mining ETF has declined roughly 70% in the last 2 years.

(click to enlarge)



Is OMEX going to just become yet another junior mining stock?

Questions for conference call at 10am EST March 16, 2015

- 1) What happens now with the HMS Victory that the MOD reversed its decision in November?
- 2) Is OMEX exiting the treasure hunting business?
- 3) The Odyssey Explorer does not appear to have moved for months on AIS - has the crew been furloughed in order to save money?

- 4) Will Mark Gordon remain CEO under the new board controlled by MINOSA?
- 5) When is the next deadline with SEMARNAT for Oceanica?
- 6) Why has OMEX taken so many precautions in preparation for shareholder lawsuits arising from this deal?
- 7) Why was there no quote from MINOSA in the press release Friday for this deal where they will be taking control of OMEX?
- 8) Is the \$10mm "Marketing Loan" from Monaco Financial LLC now in default because of the HMS Victory rescinding of permission?
- 9) Are Monaco Financial's marketing rights granted to it as part of the \$10mm loan impaired by the Feb 3rd court ruling that overturned Ira Kane and reinstated CGMG's marketing rights to the SS Central America?
- 10) What happened to the "non-dilutive" financing options that the CFO mentioned on the last conference call?

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