

# A Breakthrough Year



**OCEANEERING**

*Annual Report 2005*



## *Corporate Profile*

Oceaneering is an advanced applied technology company that provides engineered products and services to Customers who operate in marine, space, and other harsh environments.

Oceaneering's services and products are marketed worldwide to oil and gas companies, government agencies, and firms in the aerospace, and marine engineering and construction industries. Business offerings include remotely operated vehicles, mobile offshore production systems, built-to-order specialty hardware, engineering and project management, subsea intervention and installation services, non-destructive testing and inspections, and manned diving.

## *Mission Statement*

Oceaneering's mission is to increase the net wealth of its Shareholders by providing safe, cost-effective, and quality-based technical solutions satisfying Customer needs in harsh environments worldwide.

## *About the Cover*

In February 2005 Oceaneering's stock market capitalization broke through the \$1 billion mark for the first time and it ended the year at over \$1.3 billion. This milestone is a measurement of accomplishing our mission to increase the net wealth of our Shareholders.

## *Background*

Founded in 1964, Oceaneering has grown from an air and mixed gas diving business in the Gulf of Mexico to a diversified, advanced applied technology organization operating worldwide.

We have achieved this growth by executing a plan of internal development augmented by strategic acquisitions.

During the year ended December 31, 2005, we earned net income of \$62.7 million on revenue of \$999 million while employing approximately 5,500 people working out of 56 locations in 20 countries. We serve our offshore oil and gas Customers through the trade names of Oceaneering International, Oceaneering Intervention Engineering (OIE), Oceaneering Multiflex, Oceaneering Grayloc, Oceaneering Rotator, and Oceaneering Inspection Services. Our Advanced Technologies Group, which includes Oceaneering Technologies and Oceaneering Space Systems, serves our Customers outside the oil patch.

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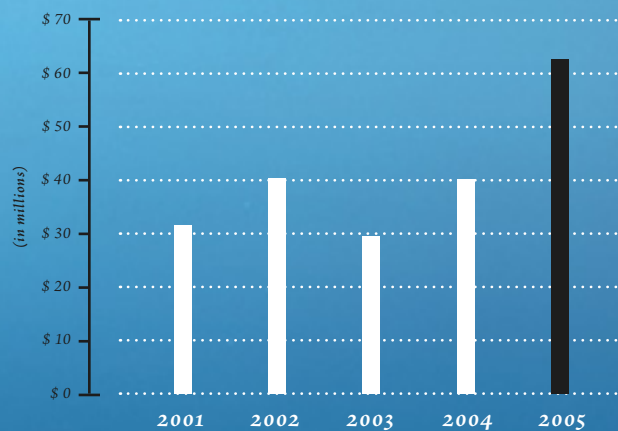
## Financial Highlights

(\$ in thousands, except per share amounts)

	2005	2004	% Increase
Revenue	\$ 998,543	\$ 780,181	28%
Gross Margin	179,280	131,803	36%
Operating Income	94,069	63,864	47%
Net Income	62,680	40,300	56%
Diluted Earnings Per Share	2.34	1.57	49%

Oceaneering reported record earnings for the fourth time in the last five years, up 56% over 2004. We achieved record Remotely Operated Vehicles, Subsea Projects, and Inspection operating income. Including equity income from the Medusa Spar, we also earned record Mobile Offshore Production Systems pre-tax income contribution.

### Net Income







## Letter to Shareholders

*2005 was a “BREAKTHROUGH YEAR”. In February, our market capitalization went above the \$1 billion mark. For everyone interested in Oceaneering, this was certainly exhilarating news. Our journey began at zero in a carport in the mid ‘60’s; went to almost \$200 million in the boom days of the early ‘80’s; then back to nearly zero in the bust of the mid ‘80’s; and closed 2005 above \$1.3 billion. And, the really good news is — this journey is “continuing on” as 2006 and the years beyond are expected to be better yet ...*

The year-over-year improvement in net income was broad based, with five of our six business activities contributing to the increase — four with record setting pre-tax income contributions. During 2005 our operating leverage to an improving market was clearly evident. ROV days on hire increased to over 51,500 — up more than 25%, and our fleet utilization rate increased to 83% from 70% in 2004. ROV’s operating income increased by more than 40%. Subsea Projects’ operating income increased nearly five-fold compared to 2004 and was more than double the previous record year in 2002. Rounding out our top four record producers were both the Inspection and Mobile Offshore Production Systems businesses.

What causes excellent results? Good markets for sure (and these are definitely good times for hydrocarbon commodity, price-driven markets), a simple road map (strategy) so Customers, employees and shareholders can easily understand where we are going — and the most important ingredient is talented and dedicated people. Our strategy is straightforward and simple. We provide technical solutions in selected niche markets where our mechanical engineering expertise gives our Customers value-added products and services. We sell solutions, *not* “activities or things”. Our solutions benefit all three phases of the offshore life cycle (exploration, development and production), are concentrated on the deepwater

geographies of the world, and use the best-in-class subsea technologies. We are conservatively financed, aggressive and singularly focused in our pursuit of operational excellence and believe continuous quality improvement is the way to achieve our objectives. We hire, train and value a special sort of person who operates safely, provides innovative ideas for our Customers, works well in teams, and enjoys what he or she does.

Many things come up during the course of a year — and 2005 was no exception. The biggest events for us were two category 5 hurricanes in the Gulf of Mexico. While the repair work from these storms aided our financial results in 2005 (and will continue to do so in 2006 and beyond), perhaps the most important attribute of these natural disasters was the way it brought out the best in our people.

*“... deeds of heroism are but offered to those who, for many long years, have been heroes in obscurity and silence.” Maurice Maeterlinck 1898*

Let me give you two examples (out of many) where our people helped to meet the needs of others. One of our contractors came ashore from an Oceaneering vessel that had gone to port well away from the storm area. She heard her hometown of Biloxi was in shambles and her five children missing. Can you even begin to imagine, for a brief instant, what real panic must feel like? Through the determined efforts of the captain of our vessel and her Oceaneering teammates, she was not only safely reunited with her family, she returned home with food, clothing, and supplies for all.

When it became apparent that many people were trapped in the flooded areas of New Orleans, eight of our people hitched up their

boats (nearly everyone in South Louisiana has access to a boat of some sort...) and headed to the Big Easy. They rescued over 800 people from rooftops and surrounding areas and left only when the authorities stopped their efforts for safety and security reasons.

These are "True Heroes" and we are very proud they are also Oceaneering employees. Our heroes are those who did all they could (and a little more) to help calm and alleviate the fears of the moment. I could go on and on about the heroism displayed by many, the compassion provided by our employees for their teammates, and the sheer tenacity of all who achieved so much in the face of disaster.

*"Knowing is not enough; we must apply.  
Willing is not enough, we must do."* Goethe

Each year I get a few comments about my stories of employees in our annual reports. I'm sure many companies have their heroes and I'm not trying to "out-hero anyone"; I'm merely attempting to describe the character of our people and let the readers of our annual report understand the way we so naturally form teams to produce outstanding results. In turn, these results produce outstanding shareholder returns.

Our teams are all inclusive — while the leading role goes to our Customers, our employees and vendors are the supporting cast that makes the whole show work. To be successful at Oceaneering takes talent, persistence, ability to work in teams — and one additional part — the simple willingness to "go and help someone find their kids". I am pleased to confirm and reiterate what I have said before; it really is about our people making a difference.

We now have over 5,500 employees at Oceaneering. Each one is unique and endowed with special qualities. It is the job of all our leaders to bring out these innate

character traits and build effective teams to solve a wide variety of interesting problems. We have a great strategy, technical prowess in niche markets, and we have a world of opportunity to provide needed solutions to help meet the energy needs of a growing population. Most importantly, we have great people who care every day about satisfying our Customers' expectations for safe, innovative, and reliable solutions.

I want to thank all our constituents — our Customers for giving us the opportunities to satisfy their needs, our vendors for their assistance in helping us exceed our Customers' expectations, and especially our employees for all their heroic efforts, with and without the drama and tragedy of hurricanes. Thanks.



John R. Huff  
CHAIRMAN AND  
CHIEF EXECUTIVE OFFICER







# Oceaneering at a Glance

## *2005 Review*

Earnings of nearly \$63 million were the highest in Oceaneering's history, 56% better than last year's record result. Best-ever ROV, Subsea Projects, and Inspection operating income was achieved. We also earned record Mobile Offshore Production Systems pre-tax income contribution, including equity income from the Medusa Spar.

During the year we continued to position the organization for future growth and increased profitability. This included investing \$56 million to modernize and increase our work class ROV fleet from 168 to 175 vehicles and \$42 million to acquire Grayloc Products, a manufacturer of high performance clamp connectors. We also increased our Subsea Products backlog to \$196 million, approximately 150%.

## *2006 and 2007 Outlook*

We expect to achieve new earnings records in both 2006 and 2007.

Earnings per share (EPS) in 2006 are forecast to increase to \$2.90–\$3.10 based on achieving an improvement in profit contribution from our Subsea Products, ROV, Subsea Projects, and Inspection oilfield business activities.

For 2007 we believe the trend for our Customers to invest their enormous cash flows in offshore and subsea projects will continue. The current inventory of deepwater fields that have yet to be developed, the extent to which floating rigs are already under firm contracts, and the market outlook for subsea trees and umbilicals are indications of healthy demand for our products and services.

## REMOTELY OPERATED VEHICLES



**2005** Record financial results were achieved due to an increase in our fleet utilization to 83%, from 70% in 2004, expansion of our average fleet size and higher average pricing per day-on-hire. Operating income improved over 40%.

**2006** The profit contribution from this segment is expected to improve considerably due to increases in our average fleet size, fleet utilization, and price per day-on-hire.

## MOBILE OFFSHORE PRODUCTION SYSTEMS



**2005** Record pre-tax income contribution was achieved as we earned over \$10 million of equity income from our ownership position in the Medusa Spar, up more than 20% from 2004.

**2006** Pre-tax income is expected to decline as the result of a lower dayrate going into effect in mid-May for use of the *Ocean Legend*. Equity income from our ownership position in the Medusa Spar is expected to increase slightly.

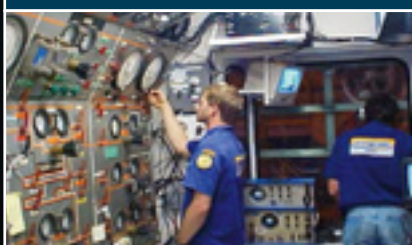
## SUBSEA PRODUCTS



**2005** Operating income increased by more than 25% due to better profit contributions from OIE specialty product sales, particularly ROV tooling, Installation Workover and Control Systems, valves, and clamps. The clamp contribution was due to the Grayloc acquisition at the end of June.

**2006** Financial performance is anticipated to grow significantly due to higher sales of Multiflex umbilicals and each of OIE's product lines, including a full year contribution from Grayloc.

## SUBSEA PROJECTS



**2005** Record results were achieved on the strength of inspections and repairs to pipeline and platform damage caused by Hurricanes Ivan, Katrina, and Rita. Operating income was up nearly fivefold compared to 2004 and was more than double the previous record set in 2002.

**2006** Financial performance is expected to be higher as the result of a general escalation in deepwater infrastructure inspection, repair, and maintenance activities and continuation of hurricane pipeline and platform repair work. Our ability to undertake this work will be augmented by the addition of a second saturation diving system and the transfer of *The Performer*, a company-owned vessel, from our Advanced Technologies business.

## INSPECTION



**2005** Record financial results were accomplished as the result of our success in selling more value-added services, particularly those related to integrity management and specialized inspection techniques. Operating income grew by nearly 75%.

**2006** Profitability is expected to improve based on securing work with higher project margins, the continued rationalization of less profitable operations, and facility consolidation savings.

## ADVANCED TECHNOLOGIES



**2005** Financial results declined largely due to a decrease in demand by the U.S. Navy for waterfront facility work and general engineering services, and a reduction in deep ocean search and recovery projects. The decline in gross margin was also partially attributable to expenses incurred in relocating our Maryland office.

**2006** We anticipate the overall financial contribution of these operations to be lower as we are transferring *The Performer* to our Subsea Projects business to undertake expected hurricane inspection work in the Gulf of Mexico. Results from the remainder of these business activities are anticipated to show some improvement, specifically for U.S. Navy work pertaining to general engineering services.



## Oceaneering Operations



### *Remotely Operated Vehicles*

#### FINANCIAL SUMMARY

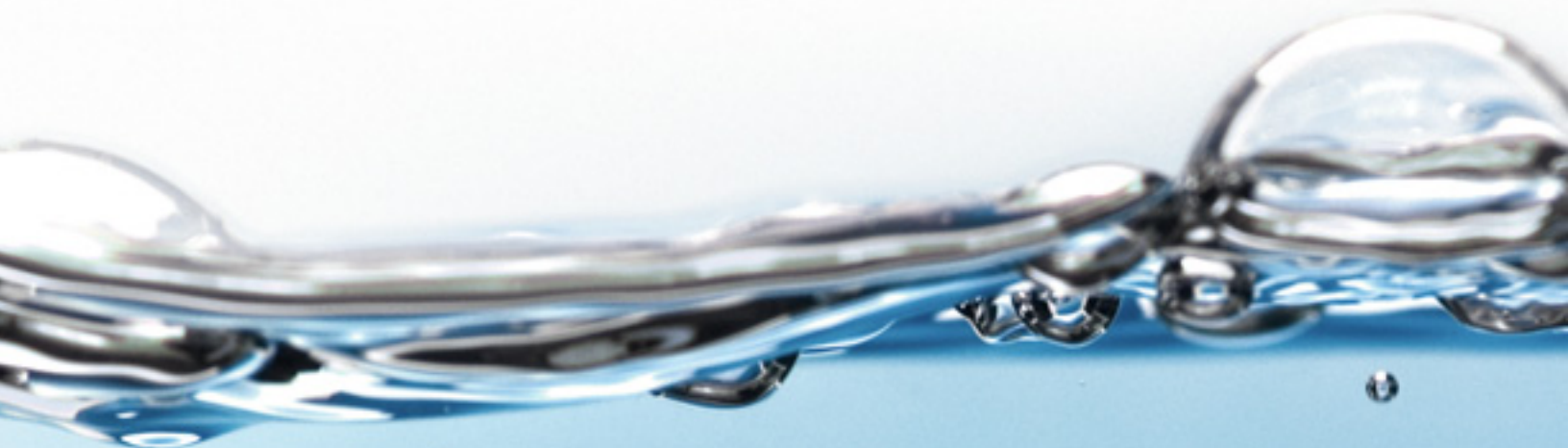
We achieved all-time high revenue, gross margin, and operating income. This was due to a 28% growth in our work class fleet days on hire and a 10% increase in average pricing. The rise in days on hire was the result of an improvement in fleet utilization to 83%, from 70% in 2004, and a 9% expansion of our average fleet size.

Operating income increased over 40% and operating income per day-on-hire improved by more than 10%.

#### DURING THE YEAR WE:

Retained our position as the industry leader with a 38% market share and continued to be the primary provider of ROV drill support services in the U.S. Gulf of Mexico, Norway, West Africa, and Mexico. At year end we had 175 vehicles in our fleet, up from 168 at the beginning of the year.

Millennium 20 Pigging Operation







Millennium Plus 25 Installed on Construction Support Vessel

Announced the addition of 24 vehicles to our fleet at an estimated capital cost of \$47 million. Twelve were in service at year end and the remaining systems are anticipated to be working by mid-2006. We have contract commitments for eleven of these vehicles, a reflection of the growing market demand for ROV services and our status as the premier supplier. About half of them are initially going to work in drill support. The others will be used for construction and production maintenance on the growing number of deepwater field developments.



Continued to pioneer vehicle innovations with the introduction of our Hydra® Magnum and Millennium Vector Thrust systems to improve maneuverability in high currents and to install steel tube flying leads. They are rated at 170-hp and 220-hp, respectively. The Vector Thrust vehicles have multitasking capability and are designed to easily interface with the complex sensors and tooling packages required for well completions, subsea hardware installations, and other underwater construction projects.



*Ocean Legend - Western Australia*

Developed a proprietary ROV electronic telemetry control system that has advanced diagnostics for improved maintenance and troubleshooting. We now install this on all of our new vehicles.

Successfully demonstrated a computer software simulation package we developed featuring collision dynamics and a 3-D view of the subsea work to be performed. This has enabled our Customers to plan and rehearse subsea construction projects prior to going offshore, improving safety and reliability while reducing project costs.

## *Mobile Offshore Production Systems*

### **FINANCIAL SUMMARY**

We achieved record pre-tax income from our MOPS business activities, including equity income from the Medusa Spar. Segment operating income improved slightly as each of our three wholly-owned systems worked the entire year under profitable contracts.

### **DURING THE YEAR WE:**

Earned over \$10 million of equity income from our ownership position in the Medusa Spar, up more than 20% from 2004. Our investment in this spar uniquely positioned us to market Oceaneering services

*Ocean Producer - Angola*





Multiflex Manufacturing Plant, Panama City, FL —  
Umbilical Loadout to *Ocean Intervention II*

and products for other projects surrounding it.

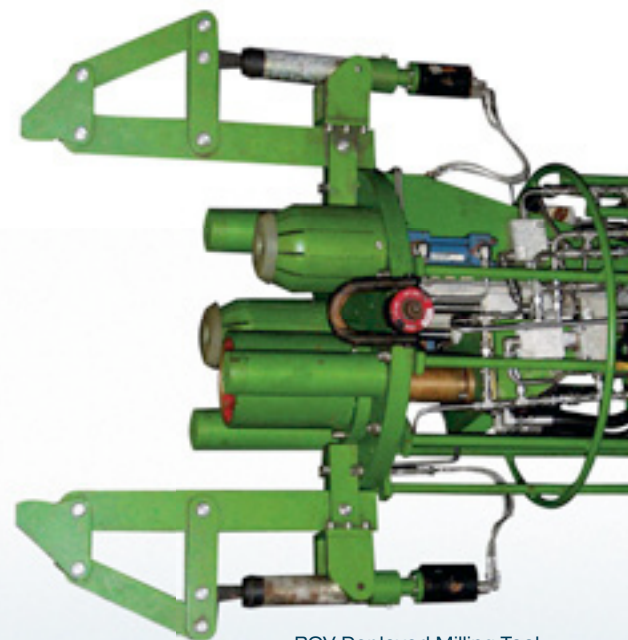
In 2005 we participated in the first two projects — the subsea tiebacks of Medusa North and Ulysses, where we supplied engineering and project management, subsea hardware, and both the umbilical and flowline installation services.

Continued to charter the *Ocean Producer*, *Ocean Legend*, and *PB San Jacinto* and they performed beyond all contractual operating requirements with excellent safety performance.

## Subsea Products

### FINANCIAL SUMMARY

We achieved record revenue and improved operating income by nearly 25%. This was accomplished on higher sales of OIE specialty products, particularly ROV tooling, Installation Workover Control Systems (IWOCs), valves, and clamps. At year end contracted backlog was an all-time high \$96 million, nearly 50% higher than at the beginning of the year.



ROV Deployed Milling Tool





Grayloc Subsea Clamp

Rotator Directional Control Valve Manifold

**DURING THE YEAR WE:**

Acquired Grayloc Products, L.L.C. (Grayloc) for \$42 million. Grayloc is the leading oil and gas industry supplier of high performance clamp connectors used in production manifold, flow line, and valve installations. This acquisition was immediately accretive to our earnings and offers us an opportunity to develop synergies with our existing pipeline flange and repair system connectors.


Announced approximately \$30 million of capital investment projects to increase our subsea control valve production capacity, enhance manufacturing of umbilicals at our Scotland plant, and to add four IWOCS to our rental fleet in the Gulf of Mexico. The valve and umbilical plant expansions are targeted for completion during the fourth quarter of 2006.

Were awarded a five-year, global supply contract by FMC Kongsberg Subsea AS (FMC) to provide directional control valves to be installed on FMC subsea production trees. This contract extends a 20-year relationship between Oceaneering Rotator and FMC and gives us an important base level of business to participate in the secular market growth for specialty subsea hardware currently underway.





Umbilical Termination Assembly



Continued to develop new specialty subsea products. These included ROV tools and repair hardware used in hurricane damage remediation, steel tube flying lead assemblies, gas lift connectors, IWOCS capable of operating in 10,000 feet of water and handling 20,000 psi reservoir pressure, and a swivel ring flange pipeline repair system.

Made significant progress installing umbilical steel tube cabling equipment in our U.S. plant. This equipment is expected to be operational during the first quarter of 2006. By the end of 2005 we had secured over \$20 million of steel tube umbilical contracts to be produced at this plant.

Secured eight key contracts from Petrobras with a combined value of approximately \$48 million to supply over 140 miles of production control umbilicals for deepwater fields offshore Brazil and in the Gulf of Mexico. These will be used to tieback subsea wells to floating and fixed production platforms or to supply power to subsea pumps. The pump umbilical will enable the recovery of heavy crude from a marginal field development. Deliveries began in 2005 and are expected to be complete by the third quarter of 2007.



Gas Lift Connector



## Subsea Projects

### FINANCIAL SUMMARY

Record financial results were achieved on the strength of demand increases for hurricane damage remediation projects and deepwater infrastructure inspection, maintenance, and repair (IMR) work in the Gulf of Mexico.

Operating income increased nearly fivefold compared to 2004 and was almost double the previous record set in 2002. Subsea Projects contracted backlog at year end was \$35 million, an all-time high and up 65% year-over-year.

### DURING THE YEAR WE:

Achieved higher utilization for our six vessels and diving assets and chartered three vessels and a barge. We also increased prices for our services due to an industry shortage of equipment and qualified personnel resulting from an escalation of hurricane inspection and repair work.

Secured a one-year contract for use of the MSV *Ocean Intervention* to conduct IMR of deepwater subsea facilities. The contract commenced in November and contains Customer options for two one-year extensions, with dayrate escalation provisions. Examples of the work to be done include changing out pods and chokes, installing flowline jumpers and umbilical flying leads, and supporting diving operations on floating production platforms.



*Ocean Intervention II* Flexible Flowline and Umbilical Installation

M7 Saturation Diving System







Radiographic Pipeline Inspection

Began construction of a second saturation (SAT) diving system to meet growing demand to repair pipeline and platform damage caused by Hurricanes Ivan, Katrina, and Rita. This repair work is expected to last for several years. This SAT system will be installed on a vessel of opportunity and is expected to be available in June 2006.

Decided to transfer the *The Performer* to oilfield service work. This vessel is expected to commence service for hurricane inspections in March 2006. We also entered into contract discussions to provide a SAT system and two Hydra® Millennium ROVs for an initial period of two years to support platform scrapping and plug and abandonment operations.

## Inspection

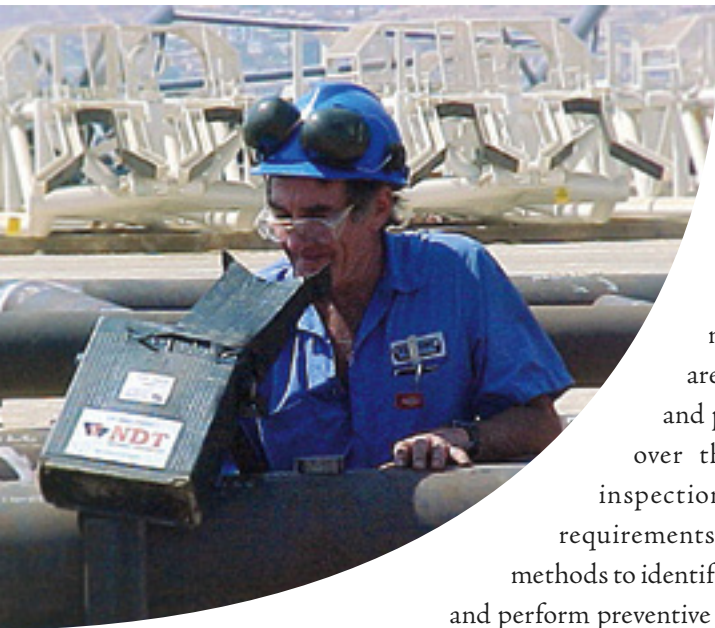
### FINANCIAL SUMMARY

Inspection achieved best-ever revenue, gross margin, and operating income results due to increasing demand for our services. All of our worldwide locations contributed to this performance.

Operating income improved nearly 75% as the result of demand growth and increased value-added service sales. The value-added services included phased-array ultrasonic pipeline weld inspections, integrity and asset management of offshore production platforms, and specialized inspections, such as computerized radiography and guided wave ultrasonics. We also benefited from cost savings from facility consolidations.



Ultrasonic Inspection of Subsea Riser Protection Frames

**DURING THE YEAR WE:**

Maintained our position as a leading market provider of pipeline weld inspections by investing in both automated ultrasonic and advanced x-ray pipeline crawlers to meet growing market demand.

Invested in a variety of high technology devices to grow our ability to perform computerized radiography, corrosion mapping, and long-range ultrasonic inspections. The devices are being used to inspect offshore production facilities and petrochemical and power generation plants over their life cycle. These specialized inspection services address evolving requirements for more cost-effective methods to identify integrity issues, plan and perform preventive maintenance, and ensure reliability and safety.

## Advanced Technologies

### FINANCIAL SUMMARY

ADTECH financial performance declined primarily due to a decrease in demand by the U.S. Navy (USN) for waterfront facility installation, maintenance, and repair work and general engineering services. Results were also unfavorably impacted by a reduction in deep ocean search and recovery activity and expenses incurred in relocating our Maryland office.



Space Shuttle Tile Repair





*Curse of DarKastle ... The Ride*

**DURING THE YEAR WE:**

Won a follow-on USN Office of Naval Research contract to support an initiative to supply forces ashore from ships acting as an offshore sea base. The contract encompasses design, build, test, and at-sea demonstrations to provide a prototype system for cargo transfer between large ships in high sea states.

Secured several contracts for early technology development that improved our position to be an equipment supplier to NASA for the new space exploration program. Other space-related accomplishments included development and delivery of a "Return to Flight" tool set for repairing the Space Shuttles while in orbit, and delivery of a system to NASA's Kennedy Space Center for inspecting the leading edge of a Shuttle's wings after each mission.

Delivered 15 ride vehicles and a show control system to Busch Gardens Williamsburg for their new and thrilling entertainment ride — *Curse of DarKastle*. This ride was honored with the Entertainment Industries' THEA Award for Outstanding Achievement for an Attraction in 2005.

Completed the overhaul of a USN submarine Dry Deck Shelter (DDS) at our new maintenance facility in Chesapeake, VA. DDS's are installed on U.S. Navy submarines to support missions by Special Operations Forces. This marked the first time a DDS overhaul was completed at a facility other than a shipyard. We are currently working on a second DDS overhaul, which will be completed in 2006.



Submarine Dry Deck Shelter



## Corporate Headquarters

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Fax: (65) 6261-3230

## Operational Bases

### INTERNATIONAL

Cabinda, Angola  
Lobito, Angola  
Luanda, Angola  
Baku, Azerbaijan  
Perth, Western Australia  
Macaé, Brazil  
Niteroi - RJ, Brazil  
St. John's, Newfoundland, Canada  
Halifax, Nova Scotia, Canada  
Cairo, Egypt  
Gloucester, England  
Immingham, England  
London, England  
Stockton, England  
Thurrock, England  
Whitley Bridge, England  
Malabo, Equatorial Guinea  
Mumbai, India  
Kuala Lumpur, Malaysia  
Miri, Sarawak, Malaysia  
Mexico D.F., Mexico  
Cd. del Carmen, Mexico  
Eket, Nigeria  
Ikeja, Lagos, Nigeria  
Port Harcourt, Nigeria  
Warri, Nigeria  
Nodeland, Norway  
Stavanger, Norway  
Johannesburg, Republic of South Africa  
Aberdeen, Scotland  
Rosyth, Scotland  
Jurong, Singapore  
Zug, Switzerland  
Abu Dhabi, U.A.E.  
Dubai, U.A.E.  
Swansea, Wales

### UNITED STATES

Bayou Vista, Louisiana  
Chesapeake, Virginia  
Clear Lake, Texas  
Corpus Christi, Texas  
Friendswood, Texas  
Groton, Connecticut  
Hanover, Maryland  
Houma, Louisiana  
Houston, Texas  
Huntsville, Alabama  
Lafayette, Louisiana  
Middletown, Rhode Island  
Morgan City, Louisiana  
New Orleans, Louisiana  
Orlando, Florida  
Panama City, Florida  
Pearl Harbor, Hawaii  
Portsmouth, New Hampshire  
San Diego, California  
Silverdale, Washington



## 2005 Financial Section







## OCEANEERING COMMON STOCK

Oceaneering's common stock is listed on the New York Stock Exchange under the symbol OII. We submitted to the New York Stock Exchange during 2005 a certification of our Chief Executive Officer regarding compliance with the Exchange's corporate governance listing standards. We also included as exhibits to this annual report on Form 10-K, as filed with the SEC, the certifications of our Chief Executive Officer and Chief Financial Officer required under Section 302 of the Sarbanes-Oxley Act of 2002.

The following table sets out, for the periods indicated, the high and low sales prices for our common stock as reported on the New York Stock Exchange (consolidated transaction reporting system):

For the quarter ended:	2005		2004	
	High	Low	High	Low
March 31	\$ 41.47	\$ 35.01	\$ 36.34	\$ 27.69
June 30	40.98	31.50	34.32	27.95
September 30	54.16	39.10	37.69	29.40
December 31	55.27	43.71	39.06	34.26

On March 3, 2006, there were 386 holders of record of our common stock. On that date, the closing sales price, as quoted on the New York Stock Exchange, was \$56.38. We have not made any common stock dividend payments since 1977, and we currently have no plans to pay cash dividends. Our credit agreements contain restrictions on the payment of dividends. See Note 4 of Notes to Consolidated Financial Statements included in this report.

## SELECTED HISTORICAL FINANCIAL DATA

The following table sets forth certain selected historical consolidated financial data and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operation and our Consolidated Financial Statements and Notes included in this report. The following information may not be indicative of our future operating results.

### Results of Operations:

(in thousands, except per share amounts)	Year Ended December 31,				
	2005	2004	2003	2002	2001
Revenue	\$ 998,543	\$ 780,181	\$ 639,249	\$ 547,467	\$ 524,660
Cost of services and products	819,263	648,378	528,465	433,302	424,329
Gross margin	179,280	131,803	110,784	114,165	100,331
Selling, general and administrative expense	85,211	67,939	56,787	46,462	43,733
Income from operations	\$ 94,069	\$ 63,864	\$ 53,997	\$ 67,703	\$ 56,598
Net income	\$ 62,680	\$ 40,300	\$ 29,301	\$ 40,133	\$ 31,322
Diluted earnings per share	2.34	1.57	1.20	1.63	1.33
Depreciation and amortization	79,613	65,619	56,963	52,341	47,906
Capital expenditures	142,269	153,184	100,370	34,552	57,661

### Other Financial Data:

(in thousands, except ratios)	As of December 31,				
	2005	2004	2003	2002	2001
Working capital ratio	1.77	1.62	1.69	2.01	1.70
Working capital	\$ 171,566	\$ 106,204	\$ 91,793	\$ 117,039	\$ 84,655
Total assets	989,568	819,664	662,856	590,348	580,331
Long-term debt	174,000	142,172	122,324	117,600	170,000
Shareholders' equity	536,118	454,437	359,375	313,865	250,216

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

All statements in this Annual Report, other than statements of historical facts, including, without limitation, statements regarding our business strategy, plans for future operations and industry conditions, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to various risks, uncertainties and assumptions, including those we refer to under the heading "Cautionary Statement Concerning Forward-Looking Statements" in Part I of this report. Although we believe that the expectations reflected in such forward-looking statements are reasonable, because of the inherent limitations in the forecasting process, as well as the relatively volatile nature of the industries in which we operate, we can give no assurance that those expectations will prove to have been correct. Accordingly, evaluation of our future prospects must be made with caution when relying on forward-looking information.

### *Executive Overview*

We generate over 85% of our revenue from our services and products provided to the oil and gas industry. In 2005, we increased revenue by 28%, led by our ROV (up 41%), Subsea Products (up 49%) and Subsea Projects (up 73%) segments. The ROV segment increase was primarily a result of increased utilization and rates, and a larger average work-class fleet size. Our Subsea Products segment revenue increased from sales of specialty products, including clamps from our Grayloc Products division, which we acquired at the end of June 2005. Our Subsea Projects vessel utilization increased to 84% from 66% in 2004, and we also spot-chartered three vessels and a barge from which we provided services. The increased Subsea Projects demand was a result of services needed after Hurricanes Ivan, Katrina and Rita. The \$62.7 million net income we earned in 2005 was the highest in our history. The \$22.4 million increase in 2005 results was attributable to higher profit contributions from all of our oilfield operating segments and equity income from Medusa Spar LLC.

In 2005, we completed the following acquisitions and major capital investments:

- acquisition of Grayloc Products, L.L.C. and subsidiary (together, "Grayloc"); and
- addition of 16 work class ROVs, including three acquired from MTQ Corporation Limited, while retiring nine older ROVs.

For 2006, we expect improved results from all of our oilfield segments, with the exception of Mobile Offshore Production Systems, as, under the terms of the customer's renewal option, the dayrate for the *Ocean Legend* will decrease in May 2006.

We use our ROVs in the offshore oil and gas industry to perform a variety of underwater tasks, including drill support, installation and construction support, pipeline inspection and surveys and subsea production facility operation and maintenance. The largest percentage of our ROVs are usually used to provide drill support services. Therefore, utilization of floating drilling rigs is a leading market indicator for this business. The following table shows average floating rig use and our ROV utilization.

	2005	2004	2003
Average number of floating rigs in use	175	154	151
ROV utilization	83%	70%	70%

We believe that growth in our Subsea Products segment will be driven by a rise in the use of subsea completions. Historically, there has been a strong correlation between the number of annual subsea tree orders and the follow on of orders for umbilicals.



The following table shows industry data and projections for worldwide subsea completion installations by decade.

Period	Number of Subsea Completions
1960s	68
1970s	87
1980s	426
1990s	1,092
2000s*	3,790

\* industry projection

Publicly available industry baseline estimates project the global market for subsea tree orders in 2006 to be over 490 trees, up from 430 trees in 2005. Industry-wide umbilical orders in 2006 are expected to increase to around 2,400 kilometers, up from approximately 2,200 kilometers in 2005.

According to Quest Offshore Resources, Inc., the 2006 worldwide market for steel tube umbilicals is expected to grow by 350 kilometers, or 30%, led by growth in West Africa. Demand in the Gulf of Mexico ("GOM") is forecast to continue at the record pace of approximately 500 kilometers set in 2005. The 2006 GOM outlook is for a larger number of orders, as about one-third of the GOM market in 2005 was associated with one project. With the expected March 2006 start up of a steel tube manufacturing line in our Panama City, FL umbilical plant, we should be well positioned to secure a significant part of this work.

#### *Critical Accounting Policies and Estimates*

We have based the following discussion and analysis of our financial condition and results of operations on our consolidated financial statements, which we have prepared in conformity with accounting principles generally accepted in the U.S.. These principles require us to make various estimates, judgments and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the periods we present. We base our estimates on historical experience, available information and other assumptions we believe to be reasonable under the circumstances. On an ongoing basis, we evaluate our estimates; however, our actual results may differ from these estimates under different assumptions or conditions. The following discussion summarizes the accounting policies we believe (1) require our management's most difficult, subjective or complex judgments and (2) are the most critical to our reporting of results of operations and financial position.

**Revenue Recognition.** We recognize our revenue according to the type of contract involved. On a daily basis, we recognize our billings under contracts that provide for specific time, material and equipment charges, which we bill periodically, ranging from weekly to monthly.

We account for significant fixed-price contracts, which we enter into mainly in our Subsea Products and Advanced Technologies segments, and occasionally in our Subsea Projects segment, using the percentage-of-completion method. In 2005, we accounted for 15% of our revenue using the percentage-of-completion method. In determining whether a contract should be accounted for using the percentage-of-completion method, we consider whether:

- the customer provides specifications for the construction of facilities or production of goods or for the provision of related services;
- we can reasonably estimate our progress towards completion and our costs;
- the contract includes provisions as to the enforceable rights regarding the goods or services to be provided, consideration to be received and the manner and terms of payment;
- the customer can be expected to satisfy its obligations under the contract; and
- we can be expected to perform our contractual obligations.

Under the percentage-of-completion method, we recognize estimated contract revenue based on costs incurred to date as a percentage of total estimated costs. Changes in the expected cost of materials and labor, productivity, scheduling and other factors affect the total estimated costs. Additionally, external factors, including weather or other factors outside of

our control, may also affect the progress and estimated cost of a project's completion and, therefore, the timing of income and revenue recognition. We routinely review estimates related to our contracts and reflect revisions to profitability in earnings immediately. If a current estimate of total contract cost indicates an ultimate loss on a contract, we recognize the projected loss in full when we determine it. In prior years, we have recorded adjustments to earnings as a result of revisions to contract estimates. Although we are continually striving to improve our ability to estimate our contract costs and profitability, adjustments to overall contract costs could be significant in future periods. We recognize the remainder of our revenue as we deliver the goods and services and collection is reasonably assured.

**Long-lived Assets.** We evaluate our property and equipment for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be appropriate. We base these evaluations on a comparison of the assets' fair values, which are generally based on forecasts of undiscounted cash flows associated with the assets, or fair market value of the assets, to the carrying amounts of the assets. If the carrying value of the asset is greater than the undiscounted cash flows, an impairment is recorded as the amount, if any, by which the carrying amounts exceed the fair values. Our expectations regarding future sales and undiscounted cash flows are highly subjective, cover extended periods of time and depend on a number of factors outside our control, such as changes in general economic conditions, laws and regulations. Accordingly, these expectations could differ significantly from year to year.

In 2005, we recorded \$6.1 million of impairments as additional depreciation in our ROV segment. These provisions related to the retirement of four vehicles and obsolete ROV components. In 2004, our 50%-owned cable lay and maintenance joint venture recorded an impairment of \$7.2 million related to some of its equipment. We also recorded an additional impairment of \$0.4 million of our investment. After taking into account a deferred gain of \$2.1 million we had generated upon formation of the venture, the two impairments reduced our equity earnings of unconsolidated affiliates by \$1.9 million in 2004.

We expense the costs of repair and maintenance as we incur them, except for drydocking costs associated with our larger vessels. We estimate and accrue these drydocking costs over a period of time in advance of future drydockings. These amounts are included in accrued liabilities on our balance sheets. We recognize differences between the estimates and actual costs incurred in the income statement.

**Loss Contingencies.** We self-insure for workers' compensation, maritime employer's liability and comprehensive general liability claims to levels we consider financially prudent and carry insurance for exposures beyond the self-insurance levels, which can be by occurrence or in the aggregate. We determine the level of accruals by reviewing our historical experience and current year claim activity. We do not record accruals on a present-value basis. We review each claim with insurance adjusters and establish specific reserves for known liabilities. We establish an additional reserve for incidents incurred but not reported to us for each year using our estimates and based on prior experience. We believe we have established adequate accruals for uninsured expected liabilities arising from those obligations. However, it is possible that future earnings could be affected by changes in our estimates relating to these matters.

We are involved in various claims and actions against us, most of which are covered by insurance. We believe that our ultimate liability, if any, that may result from these claims and actions will not materially affect our financial position, cash flows or results of operations.

**Income Taxes.** Our tax provisions are based on our expected taxable income, statutory rates and tax-planning opportunities available to us in the various jurisdictions in which we operate. Determination of taxable income in any jurisdiction requires the interpretation of the related tax laws. We are at risk that a taxing authority's final determination of our tax liabilities may differ from our interpretation. Our effective tax rate may fluctuate from year to year as our operations are conducted in different taxing jurisdictions, the amount of pre-tax income fluctuates and our estimates regarding the realizability of items such as foreign tax credits may change. In 2005, we recorded a \$1.8 million reduction of income tax expense resulting from the resolution of tax contingencies related to certain foreign tax liabilities we recorded in prior years. Currently payable income tax expense represents either nonresident withholding taxes or the liabilities expected to be reflected on our income tax returns for the current year, while the net deferred tax expense or benefit represents the change in the balance of deferred tax assets or liabilities as reported on our balance sheet.

We establish valuation allowances to reduce deferred tax assets when it is more likely than not that some portion or all of the deferred tax assets will not be realized in the future. While we have considered estimated future taxable income and ongoing prudent and feasible tax-planning strategies in assessing the need for the valuation allowances, changes in these estimates and assumptions, as well as changes in tax laws, could require us to adjust the valuation allowances for our



deferred tax assets. These adjustments to the valuation allowance would impact our income tax provision in the period in which such adjustments are identified and recorded.

For a summary of our major accounting policies and a discussion of recently adopted accounting standards, please read Note 1 to our Consolidated Financial Statements.

### *Liquidity and Capital Resources*

We consider our liquidity and capital resources adequate to support our operations and internally generated growth initiatives. At December 31, 2005, we had working capital of \$172 million, including cash of \$26 million. Additionally, we had \$176 million available under our revolving credit facility, which is scheduled to expire in January 2008. At December 31, 2005, our debt-to-total capitalization ratio was 25%.

We expect our operating cash flow to meet our ongoing annual cash requirements, including debt service, for the foreseeable future. Our net cash provided by operating activities was \$94 million, \$100 million and \$95 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Our capital expenditures, including business acquisitions, for the years ended December 31, 2005, 2004 and 2003 were \$142 million, \$153 million and \$100 million, respectively. Our capital expenditures during 2005 included the acquisition of Grayloc for \$42 million and additions to our ROV fleet to replace older units we retired and to increase the number of units. Our capital expenditures during 2004 included the acquisitions of 34 work-class ROVs from Stolt Offshore S.A. and 10 work-class ROVs from Fugro N.V. These two acquisitions totaled \$69 million. Our other capital expenditures in 2004 included \$38 million to upgrade our umbilical plants in the U.S. and Brazil, other additions to our ROV fleet to replace older units we retired and a new diving vessel. Our capital expenditures during 2003 included the acquisitions of OIS International Inspection plc, Nauticos Corporation, Reflange, Inc. and Rotator AS. These acquisitions totaled \$58 million. Our other capital expenditures in 2003 included additions to our fleet of ROVs to replace older units we retired, the start of costs to upgrade our umbilical plants in the U.S. and Brazil, and vessel upgrades.

In September 2002, our Board of Directors approved a plan to repurchase up to 3,000,000 shares of our common stock, subject to a \$75 million aggregate purchase price limitation. Under this plan, we repurchased 897,800 shares of common stock through the year ended December 31, 2005, at a total cost of \$20.1 million. Through December 31, 2005, we had reissued all of these shares as contributions to our 401(k) plan or for exercised stock options under our incentive plans. For a description of our incentive plans, please read Note 8 to our Consolidated Financial Statements.

We have not guaranteed any debt not reflected on our consolidated balance sheet. In December 2003, we acquired a 50% interest in Medusa Spar LLC. At formation, Medusa Spar LLC borrowed \$84 million, or approximately 50% of its total capitalization, from a group of banks. The balance of the bank loan at December 31, 2005 was \$47 million. The bank loan is secured by minimum throughput guarantees by the other investors in Medusa Spar LLC. We expect the minimum throughput guarantees will generate sufficient revenue for Medusa Spar LLC to repay the bank loan. We are under no obligation to provide Medusa Spar LLC or the banks with additional funds to repay the loan. The majority of the cash flow generated by Medusa Spar LLC will be used to repay the bank loan until the loan is retired. After that, the cash flow from Medusa Spar LLC will be available for distribution to the equity holders. We received \$2.3 million and \$1.7 million of cash distributions from Medusa Spar LLC and recognized \$10.1 million and \$8.2 million of equity in the earnings of Medusa Spar LLC in 2005 and 2004, respectively. Medusa Spar LLC is a variable interest entity under Financial Accounting Standards Board Interpretation No. 46(R) ("FIN No. 46(R)"). As we are not the primary beneficiary of Medusa Spar LLC, we are accounting for our investment in Medusa Spar LLC using the equity method of accounting. At December 31, 2005, our investment in Medusa Spar LLC was \$57 million.

Our principal source of cash from operating activities is our net income, adjusted for the non-cash expenses of depreciation and amortization and stock compensation under our restricted stock plan. In 2005 and 2004, we received \$23 million and \$32 million, respectively, in cash flow from financing activities as proceeds from the sale of our common stock, primarily pursuant to the exercise of employee stock options. In 2005, our \$94 million of cash provided from operating activities was net of \$57 million of increases in accounts receivable and \$37 million of increases in inventory and other current assets. The increases in accounts receivable is due to an increase in revenue for the fourth quarter of 2005 as compared to the fourth quarter of 2004. The increases in inventory and other current assets principally related to ROV spare parts and raw materials. The increase in ROV parts inventory partially related to equipment waiting for

assembly into ROVs to be placed in service in 2006. The raw materials related to preparations for building items reflected in our Subsea Products backlog, which increased nearly 150% over the level at December 31, 2004. In 2004, our accounts receivable increased by \$55 million. When we purchased the ROVs and related business operations from Stolt Offshore S.A. and Fugro N.V. in 2004, we did not acquire any related accounts receivable. Therefore, as we accumulated revenue from our operations of the ROVs, our associated accounts receivable increased.

In 2005, we used \$139 million in investing activities, including \$46 million related to business acquisitions, primarily Grayloc, and \$56 million to modernize and add additional units and equipment to our ROV business. In 2004, we used \$153 million in our investing activities, attributable to the business acquisitions and capital expenditures mentioned above. We used \$143 million in 2003 in investing activities, in large part attributable to business acquisitions and our investment in Medusa Spar LLC.

Because of our significant foreign operations, we are exposed to currency fluctuations and exchange risks. We generally minimize these risks primarily through matching, to the extent possible, revenue and expense in the various currencies in which we operate. Cumulative translation adjustments as of December 31, 2005 relate primarily to our permanent investments in and loans to our foreign subsidiaries. See Item 7A – "Quantitative and Qualitative Disclosures About Market Risk." Inflation has not had a material effect on our revenue or income from operations in the past three years, and no such effect is expected in the near future.

### *Results of Operations*

The table that follows sets out our revenue and profitability for the years ended December 31, 2005, 2004 and 2003.

<i>(dollars in thousands)</i>	Year Ended December 31,		
	2005	2004	2003
Revenue	\$ 998,543	\$ 780,181	\$ 639,249
Gross Margin	179,280	131,803	110,784
Gross Margin %	18%	17%	17%
Operating Income	94,069	63,864	53,997
Operating Income %	9%	8%	8%
Net Income	62,680	40,300	29,301

Information on our business segments is shown in Note 6 of the Notes to Consolidated Financial Statements included in this report.

**Oil and Gas.** The table that follows sets out revenue and profitability for the business segments within our Oil and Gas business for the years ended December 31, 2005, 2004 and 2003.



(dollars in thousands)	Year Ended December 31,		
	2005	2004	2003
<b>Remotely Operated Vehicles</b>			
Revenue	\$ 315,178	\$ 223,914	\$ 160,359
Gross Margin	84,419	59,501	42,037
Gross Margin %	27%	27%	26%
Operating Income	68,962	48,397	34,925
Operating Income %	22%	22%	22%
Utilization %	83%	70%	70%
<b>Subsea Products</b>			
Revenue	239,039	160,410	107,540
Gross Margin	37,113	26,971	18,416
Gross Margin %	16%	17%	17%
Operating Income	13,941	10,891	4,466
Operating Income %	6%	7%	4%
<b>Subsea Projects</b>			
Revenue	121,628	70,254	68,796
Gross Margin	31,122	10,297	10,946
Gross Margin %	26%	15%	16%
Operating Income	26,219	5,472	6,626
Operating Income %	22%	8%	10%
<b>Mobile Offshore Production Systems</b>			
Revenue	50,091	49,387	46,836
Gross Margin	18,330	18,347	18,213
Gross Margin %	37%	37%	39%
Operating Income	16,796	16,565	15,712
Operating Income %	34%	34%	34%
<b>Inspection</b>			
Revenue	154,857	145,691	136,599
Gross Margin	21,704	16,351	16,557
Gross Margin %	14%	11%	12%
Operating Income	7,946	4,564	5,246
Operating Income %	5%	3%	4%
<b>Total Oil and Gas</b>			
Revenue	\$ 880,793	\$ 649,656	\$ 520,130
Gross Margin	192,688	131,467	106,169
Gross Margin %	22%	20%	20%
Operating Income	133,864	85,889	66,975
Operating Income %	15%	13%	13%

In response to (1) continued increasing demand to support deepwater drilling and (2) identified future construction and production maintenance work, we announced an ROV fleet expansion program in 1995 to build new ROVs. These new

vehicles are designed for use around the world in water depths to 10,000 feet and in severe weather conditions. We have added over 100 of these ROVs to our fleet since that time. We added 16 ROVs in 2005 while retiring nine older units. We plan to add at least 12 more ROVs in 2006.

For 2005, our ROV revenue increased 41% over 2004 from higher utilization percentage, a higher number of units available and higher dayrates. Margin percentages remained flat, as we incurred \$6.1 million of writeoffs associated with the retirement of four older ROVs and obsolete ROV components.

For 2004, our ROV revenue was 40% higher than in 2003. Gross margin increased 42%. These increases resulted primarily from the acquisition of 44 work-class ROVs during 2004 – 34 in February and 10 in September.

We anticipate ROV utilization and margins to increase in 2006 as we are increasing our ROV fleet size to service demand for the support of construction and production maintenance on the growing number of deepwater field developments and additional ROVs providing drill support on floating drilling rigs.

Our Subsea Products revenue in 2005 was 49% higher than in 2004, while gross margin and operating income percentages were relatively flat. We achieved higher sales of our specialty hardware, particularly from sales of ROV tooling, installation workover and control systems, valves and clamps. The clamps are associated with our acquisition of Grayloc at the end of June 2005.

Our Subsea Products revenue in 2004 was 49% higher than in 2003, while gross margin and operating income increased 46% and 144%, respectively. We achieved greater profit contributions from our specialty products, particularly from sales of valves and ROV-related tooling and product rentals.

For 2003, our Subsea Products revenue, margins and gross margin percentages were down due to lower activity at our umbilical plants in the U.K. and Brazil. In 2003, our Subsea Products gross margin was favorably impacted by \$2.8 million due to the successful completion and resolution of issues related to several projects, including a related insurance claim, on a more favorable basis than we had previously anticipated. In 2003, margins were unfavorably impacted by our accrual of \$600,000 of personnel severance costs associated with the move of our U.S. umbilical plant to Panama City, Florida.

We anticipate improved results from our Subsea Products segment in 2006, driven by a continuation of a high level of subsea completion activity, which we expect will result in an improvement in our umbilical sales, a general increase in our specialty hardware sales, including a full year of clamp sales from Grayloc. Our Subsea Products backlog increased to \$196 million at December 31, 2005 from \$79 million at December 31, 2004.

Our Mobile Offshore Production Systems results were fairly consistent for the three periods presented as our three major units continued to work under the same contracts.

We anticipate our Mobile Offshore Production Systems operations in 2006 to decline from 2005 as a result of a lower dayrate going into effect in mid-May for the use of the *Ocean Legend*, as per the customer renewal option terms in the existing contract.

In 2005, our Subsea Projects segment had better results than 2004 due to: a continuation of inspection and repair work necessitated by Hurricane Ivan and additional inspection and repair work necessitated by Hurricanes Katrina and Rita. During the year, our vessel utilization increased to 84% over the 66% we attained in 2004. In addition, we spot-chartered three vessels and a barge from which we provided services.

Our Subsea Projects results were slightly lower in 2004 as compared to 2003 on slightly higher revenue. In the fourth quarter of 2004, we had increased demand for our manned diving and vessel-based project inspection and repair services due to Hurricane Ivan and subsea infrastructure needs. Margins in 2003 were favorably impacted by reduction in cost estimates of \$1.9 million due to the favorable completion of an installation project and the settlement of a personal injury claim.

In 2006, we expect our Subsea Projects segment to have improved results over 2005 due to a continuation of inspection and repair work necessitated by the hurricanes into 2007 and a general escalation in deepwater infrastructure inspection,



repair and maintenance activities. In 2006, we will add a saturation diving system and transfer our vessel, *The Performer*, from our Advanced Technologies segment.

For 2005, our Inspection revenue and margins increased over 2004. We were able to sell more value-added services and raise our margin percentages in 2005, after we incurred expenses in 2004 to close and relocate offices as part of our effort to increase operating efficiencies after our purchase of OIS International Inspection plc in 2003.

For 2004, our Inspection revenue increased and gross margin was comparable to that achieved in 2003. However, operating income declined as we incurred the previously mentioned expenses to close and relocate offices.

We expect that our margin percentages in our Inspection segment will improve in 2006, as we continue to secure work with higher profit margins, rationalize less-profitable operations and realize consolidation savings.

**Advanced Technologies.** The table that follows sets out revenue and profitability for this segment for the years ended December 31, 2005, 2004 and 2003.

(dollars in thousands)	Year Ended December 31,		
	2005	2004	2003
Revenue	\$ 117,750	\$ 130,525	\$ 119,119
Gross Margin	20,772	25,016	22,115
Gross Margin %	18%	19%	19%
Operating Income	12,539	17,515	15,067
Operating Income %	11%	13%	13%

Our Advanced Technologies revenue, gross margin and operating margin for 2005 decreased from 2004, due to lower demand from the Navy for waterfront facility work and general engineering services and a reduction of deepwater search and recovery projects. We also incurred expenses in relocating our Maryland office.

Our Advanced Technologies revenue, gross margin and operating margin for 2004 increased over 2003, largely due to an increase in space-related work for NASA's return to flight of the space shuttle program. This segment's 2003 results were adversely affected by a \$500,000 charge as a result of settling a lawsuit against us for a higher amount than we had anticipated and previously accrued.

We anticipate our Advanced Technologies 2006 results will be slightly lower than 2005 due to the transfer of *The Performer* to our Subsea Projects segment.

**Unallocated Expenses.** Our unallocated expenses, *i.e.*, those not associated with a specific business segment, within gross margin consist of expenses related to our incentive and deferred compensation plans, including restricted stock and bonuses, as well as other general expenses. Our restricted stock expense varies with the market price of our common stock. Our unallocated expenses within operating income consist of those within gross margin plus general and administrative expenses related to corporate functions. The table that follows sets out our unallocated expenses for the years ended December 31, 2005, 2004 and 2003.

(dollars in thousands)	Year Ended December 31,		
	2005	2004	2003
Gross margin expenses	\$ (34,180)	\$ (24,680)	\$ (17,500)
% of revenue	3%	3%	3%
Operating expenses	(52,334)	(39,540)	(28,045)
% of revenue	5%	5%	4%

Our gross margin and operating expenses increased in 2005 over 2004, primarily due to larger bonus payments to employees as a result of our record financial results. Our selling, general and administrative expenses increased in 2005

and 2004 principally due to the additional expenses related to companies and operations we acquired, increased costs related to Sarbanes-Oxley Act compliance and documentation, and expenses related to training and implementation of a new enterprise software system that we began activating in 2005. Our unallocated expenses in 2004 included \$1.8 million related to a terminated acquisition effort.

**Other.** The table that follows sets forth our significant financial statement items below the operating income line.

<i>(dollars in thousands)</i>	Year Ended December 31,		
	2005	2004	2003
Interest income	\$ 505	\$ 999	\$ 573
Interest expense, net of amounts capitalized	(10,102)	(8,388)	(7,811)
Equity earnings (losses) of unconsolidated affiliates:			
Medusa Spar LLC	10,082	8,171	(65)
Cable lay and maintenance	290	(3,132)	(754)
Canadian ROV joint venture	38	1,071	859
Other income (expense), net	(432)	(1,662)	(1,720)
Provision for income taxes	31,770	20,623	15,778

Interest expense increased in 2005 and 2004 as we used debt to partially finance capital expenditures and acquisitions. Interest rates were also slightly higher. Interest expense is net of capitalized interest of \$0.1 million and \$0.4 million for the years ended December 31, 2005 and 2004, respectively. In 2004, we started earning equity income from our 50% investment in Medusa Spar LLC, which we acquired in December 2003. Medusa Spar LLC owns 75% of a production spar in the Gulf of Mexico and earns its revenue from tariffs charged on production processed through the facility. During 2004 and 2005, additional wells were connected to the facility, thereby raising 2005 throughput over the 2004 level. In 2006, we expect an increase in equity in earnings of unconsolidated affiliates from our investment in Medusa Spar LLC as the production throughput was interrupted in 2005 for approximately three months due to Hurricanes Katrina and Rita. Due to the condition of the telecommunications market, our cable lay and maintenance venture is currently inactive and the single vessel used in the venture has been marketed for oilfield and other uses since 2004. In 2004, we recognized \$1.9 million of pre-tax impairments related to the venture. In March 2005, we purchased the cable lay and maintenance equipment from the venture. We have entered into a contract to purchase the vessel from the venture. Our completion of the purchase of the vessel will effectively wind-up the venture. Other income (expense), net, primarily consists of foreign currency gains and losses.

Our effective tax rate, including foreign, state and local taxes, was 34%, 34% and 35% for the years ended December 31, 2005, 2004 and 2003, respectively. We lowered our effective tax rate to 34% in 2005, as we resolved tax contingencies related to certain foreign tax liabilities we recorded in prior years. For 2006, we anticipate an effective tax rate of approximately 36%.

#### *Off-Balance Sheet Arrangements*

We do not have any off-balance sheet arrangements, as defined by SEC rules.

#### *Contractual Obligations*

At December 31, 2005, we had payments due under contractual obligations as follows:

<i>(dollars in thousands)</i>	Payments due by period				
	Total	2006	2007-2008	2009-2010	After 2010
Long-term Debt	\$ 174,000	\$ 20,000	\$ 114,000	\$ 40,000	\$ -
Operating Leases	54,638	8,341	13,111	10,635	22,551
Purchase Obligations	30,247	30,247	-	-	-
Other Long-term Obligations reflected on our balance sheet under GAAP	48,621	980	2,045	2,072	43,524
<b>TOTAL</b>	<b>\$ 307,506</b>	<b>\$ 59,568</b>	<b>\$ 129,156</b>	<b>\$ 52,707</b>	<b>\$ 66,075</b>



At December 31, 2005, we have orders totaling \$30 million, including approximately \$24 million for specialized steel tubes to be used in our manufacturing of steel tube umbilicals. Due to the current shortage of these specialized materials caused by a general worldwide increase in demand for steel, the lead times between placing the order and delivery have become extended. We have contracts to build umbilicals that will use over 80% of the orders. We also have other identified opportunities that could utilize these materials. However, should we decide not to accept delivery of the steel tubes, we would incur cancellation charges of at least 10% of the amount canceled.

## QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are currently exposed to certain market risks arising from transactions we have entered into in the normal course of business. These risks relate to interest rate changes and fluctuations in foreign exchange rates. We do not believe these risks are material. We have not entered into any market risk sensitive instruments for trading purposes. We manage our exposure to interest rate changes through the use of a combination of fixed and floating rate debt. See Note 4 of Notes to Consolidated Financial Statements included in this report for a description of our long-term debt agreements, interest rates and maturities. We believe that significant interest rate changes will not have a material near-term impact on our future earnings or cash flows. Because we operate in various oil and gas exploration and production regions in the world, we conduct a portion of our business in currencies other than the U.S. dollar. The functional currency for several of our international operations is the applicable local currency. We manage our exposure to changes in foreign exchange rates principally through arranging compensation in U.S. dollars or freely convertible currency and, to the extent possible, by limiting compensation received in other currencies to amounts necessary to meet obligations denominated in those currencies. We use the exchange rates in effect as of the balance sheet date to translate assets and liabilities as to which the functional currency is the local currency, resulting in translation adjustments that we reflect as accumulated other comprehensive income or loss in the shareholders' equity section of our Consolidated Balance Sheets. We recorded adjustments of (\$13.4 million), \$12.4 million and \$11.7 million to our equity accounts for the years ended December 31, 2005, 2004 and 2003, respectively. Positive adjustments reflect the net impact of the strengthening of various foreign currencies against the U.S. dollar for locations where the functional currency is not the U.S. dollar. Conversely, negative adjustments reflect the effect of a strengthening dollar.

We recorded foreign currency income (losses) of \$0.2 million, (\$1.2 million) and (\$1.2 million) in our income statements in 2005, 2004 and 2003, respectively, related to our foreign operations. In 2004, the majority of our foreign currency losses related to our U.K. operations and, in 2003, the majority of our foreign currency losses related to our Brazil operations. Some of our U.K. subsidiary's revenue is from U.S. dollar-denominated contracts. If the U.S. dollar weakens against the British pound sterling, we will incur currency losses for the period the related accounts receivable are outstanding. Our Subsea Products business in Brazil conducts much of its operations in U.S. dollars, which is its functional currency.

## CONTROLS AND PROCEDURES

### Disclosure Controls and Procedures

In accordance with Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), we carried out an evaluation, under the supervision and with the participation of management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2005 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in our internal control over financial reporting that occurred during the year ended December 31, 2005 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as that term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is a process designed to provide reasonable, but not absolute, assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with accounting principles generally accepted in the United States of America. We developed our internal control over financial reporting through a process in which our management applied its judgment in assessing the costs and benefits of various controls and procedures, which, by their nature, can provide only reasonable assurance regarding the control objectives. You should note that the design of any system of controls is based in part on various assumptions about the likelihood of future events, and we cannot assure you that any system of controls will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Under the supervision and with the participation of our management, including our principal executive, financial and accounting officers, we have conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included a review of the documentation surrounding our financial reporting controls, an evaluation of the design effectiveness of these controls, testing of the operating effectiveness of these controls and an evaluation of our overall control environment. Our procedures and evaluation did not include the internal controls of Grayloc Products L.L.C. and subsidiary, which constituted \$21 million and \$14 million of our total and net assets, respectively, as of December 31, 2005 and \$20 million and \$3 million of our revenue and net income, respectively, for the year then ended. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2005.

Ernst & Young LLP, an independent registered public accounting firm, has audited our management's assessment of the effectiveness of our internal control over financial reporting, as stated in their report which follows.

### **Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting**

#### **The Board of Directors and Stockholders of Oceaneering International, Inc.**

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Oceaneering International, Inc. and subsidiaries ("Oceaneering") maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Oceaneering's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the



company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Report on Internal Control over Financial Reporting, management's assessment and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Grayloc Products L.L.C. and subsidiary, which is included in the financial statements of Oceaneering and constituted \$21 million and \$14 million of total and net assets, respectively, as of December 31, 2005 and \$20 million and \$3 million of revenue and net income, respectively, for the year then ended. Our audit of internal control over financial reporting of Oceaneering also did not include an evaluation of the internal control over financial reporting of Grayloc Products L.L.C. and subsidiary.

In our opinion, management's assessment that Oceaneering International, Inc. maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Oceaneering International, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2005 consolidated financial statements of Oceaneering International, Inc. and subsidiaries and our report dated March 10, 2006 expressed an unqualified opinion thereon.



Houston, Texas  
March 10, 2006

## INDEX TO FINANCIAL STATEMENTS AND SCHEDULES

### *Index to Financial Statements*

#### Report of Independent Registered Public Accounting Firm

#### Consolidated Balance Sheets

#### Consolidated Statements of Income

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#### Consolidated Statements of Shareholders' Equity and Comprehensive Income

#### Notes to Consolidated Financial Statements

#### Selected Quarterly Financial Data (unaudited)

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All schedules for which provision is made in the applicable regulations of the Securities and Exchange Commission have been omitted because they are not required under the relevant instructions or because the required information is included in the financial statements included herein or in the related footnotes thereto.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders and Board of Directors of Oceaneering International, Inc.:

We have audited the accompanying consolidated balance sheets of Oceaneering International, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, cash flows and shareholders' equity and comprehensive income for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of Oceaneering's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oceaneering International, Inc. and subsidiaries as of December 31, 2005 and 2004 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Oceaneering International, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in "Internal Control — Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 10, 2006 expressed an unqualified opinion thereon.

*Ernst + Young LLP*

Houston, Texas  
March 10, 2006



## CONSOLIDATED BALANCE SHEETS

<i>(in thousands, except share data)</i>	December 31,	
	2005	2004
<b>ASSETS</b>		
<b>Current Assets:</b>		
Cash and cash equivalents	\$ 26,308	\$ 16,781
Accounts receivable, net of allowances for doubtful accounts	244,044	190,921
Revenue in excess of amounts billed	25,453	15,201
Inventory and other	98,428	53,973
Total current assets	<u>394,233</u>	<u>276,876</u>
<b>Property and Equipment, at cost:</b>		
Marine services equipment	493,054	460,852
Mobile offshore production equipment	146,751	148,683
Manufacturing facilities	125,003	111,897
Other	77,450	64,237
	<u>842,258</u>	<u>785,669</u>
Less accumulated depreciation	433,057	384,615
Net property and equipment	<u>409,201</u>	<u>401,054</u>
<b>Other Assets:</b>		
Goodwill	84,608	62,977
Investments in unconsolidated affiliates	61,598	55,615
Other	39,928	23,142
<b>Total Assets</b>	<u><u>\$ 989,568</u></u>	<u><u>\$ 819,664</u></u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities:</b>		
Accounts payable	\$ 64,306	\$ 47,397
Accrued liabilities	142,168	112,477
Income taxes payable	16,193	10,798
Total current liabilities	<u>222,667</u>	<u>170,672</u>
<b>Long-term Debt</b>	<u>174,000</u>	<u>142,172</u>
<b>Other Long-term Liabilities</b>	<u>56,783</u>	<u>52,383</u>
<b>Commitments and Contingencies</b>		
<b>Shareholders' Equity:</b>		
Common Stock, par value \$0.25 per share; 90,000,000 shares authorized; 26,779,444 and 25,820,236 shares issued	6,695	6,455
Additional paid-in capital	179,132	146,403
Retained earnings	348,031	285,351
Accumulated other comprehensive income	2,260	16,228
Total shareholders' equity	<u>536,118</u>	<u>454,437</u>
<b>Total Liabilities and Shareholders' Equity</b>	<u><u>\$ 989,568</u></u>	<u><u>\$ 819,664</u></u>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF INCOME

<i>(in thousands, except per share data)</i>	Year Ended December 31,		
	2005	2004	2003
<b>Revenue</b>	<b>\$ 998,543</b>	<b>\$ 780,181</b>	<b>\$ 639,249</b>
<b>Cost of Services and Products</b>	<b>819,263</b>	<b>648,378</b>	<b>528,465</b>
<b>Gross margin</b>	<b>179,280</b>	<b>131,803</b>	<b>110,784</b>
<b>Selling, General and Administrative Expense</b>	<b>85,211</b>	<b>67,939</b>	<b>56,787</b>
<b>Income from operations</b>	<b>94,069</b>	<b>63,864</b>	<b>53,997</b>
<b>Interest Income</b>	<b>505</b>	<b>999</b>	<b>573</b>
<b>Interest Expense, net of amounts capitalized</b>	<b>(10,102)</b>	<b>(8,388)</b>	<b>(7,811)</b>
<b>Equity earnings of unconsolidated affiliates</b>	<b>10,410</b>	<b>6,110</b>	<b>40</b>
<b>Other Income (Expense), Net</b>	<b>(376)</b>	<b>(1,596)</b>	<b>(1,669)</b>
<b>Minority Interests</b>	<b>(56)</b>	<b>(66)</b>	<b>(51)</b>
<b>Income before income taxes</b>	<b>94,450</b>	<b>60,923</b>	<b>45,079</b>
<b>Provision for Income Taxes</b>	<b>31,770</b>	<b>20,623</b>	<b>15,778</b>
<b>Net Income</b>	<b>\$ 62,680</b>	<b>\$ 40,300</b>	<b>\$ 29,301</b>
<b>Basic Earnings per Share</b>	<b>\$ 2.40</b>	<b>\$ 1.61</b>	<b>\$ 1.23</b>
<b>Diluted Earnings per Share</b>	<b>\$ 2.34</b>	<b>\$ 1.57</b>	<b>\$ 1.20</b>
<b>Weighted average number of common shares</b>	<b>26,150</b>	<b>24,993</b>	<b>23,903</b>
<b>Incremental shares from stock options</b>	<b>674</b>	<b>692</b>	<b>550</b>
<b>Weighted average number of common shares and equivalents</b>	<b>26,824</b>	<b>25,685</b>	<b>24,453</b>

*The accompanying Notes are an integral part of these Consolidated Financial Statements.*



**CONSOLIDATED STATEMENTS OF CASH FLOWS**

<i>(in thousands)</i>	Year Ended December 31,		
	2005	2004	2003
<b>Cash Flows from Operating Activities:</b>			
Net income	<u>\$ 62,680</u>	<u>\$ 40,300</u>	<u>\$ 29,301</u>
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	79,613	65,619	56,963
Noncash compensation and other	562	12,931	10,372
Undistributed earnings of unconsolidated affiliates	(8,406)	(3,150)	-
Increase (decrease) in cash from:			
Accounts receivable and revenue in excess of amounts billed, net	(56,921)	(54,916)	5,856
Inventory and other current assets	(37,477)	(1,606)	(2,799)
Other assets	(702)	(4,846)	(5,487)
Accounts payable	12,574	15,267	2,323
Accrued liabilities	26,000	27,071	(2,787)
Income taxes payable	11,572	338	1,658
Other long-term liabilities	<u>4,400</u>	<u>2,724</u>	<u>(603)</u>
Total adjustments to net income	<u>31,215</u>	<u>59,432</u>	<u>65,496</u>
<b>Net Cash Provided by Operating Activities</b>	<u>93,895</u>	<u>99,732</u>	<u>94,797</u>
<b>Cash Flows from Investing Activities:</b>			
Business acquisitions	(46,242)	(69,192)	(57,828)
Purchases of property and equipment and other	(96,027)	(83,992)	(42,542)
Dispositions of property and equipment	3,011	515	668
Decrease (increase) in other investments	<u>-</u>	<u>73</u>	<u>(43,227)</u>
<b>Net Cash Used in Investing Activities</b>	<u>(139,258)</u>	<u>(152,596)</u>	<u>(142,929)</u>
<b>Cash Flows from Financing Activities:</b>			
Net proceeds from revolving credit and other long-term debt, net of expenses	31,828	19,280	21,935
Payments of term loan	-	-	(17,600)
Proceeds from issuance of common stock	23,062	31,969	9,329
Purchases of treasury stock	<u>-</u>	<u>-</u>	<u>(13,337)</u>
<b>Net Cash Provided by Financing Activities</b>	<u>54,890</u>	<u>51,249</u>	<u>327</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u>9,527</u>	<u>(1,615)</u>	<u>(47,805)</u>
<b>Cash and Cash Equivalents – Beginning of Period</b>	<u>16,781</u>	<u>18,396</u>	<u>66,201</u>
<b>Cash and Cash Equivalents – End of Period</b>	<u>\$ 26,308</u>	<u>\$ 16,781</u>	<u>\$ 18,396</u>

*The accompanying Notes are an integral part of these Consolidated Financial Statements.*

# CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

(in thousands)							Accumulated Other			Total
	Common Stock		Additional Paid-in Capital	Unearned Comp- ensation	Treasury Stock	Retained Earnings	Comprehensive Income (Loss)			
	Shares	Amounts					Fair Value of Interest Rate Hedge	Currency Translation Adjustments	Pension Liability	
<b>Balance, December 31, 2002</b>	<b>24,813</b>	<b>\$ 6,203</b>	<b>\$ 111,150</b>	<b>\$ (2,324)</b>	<b>\$ (7,309)</b>	<b>\$ 215,750</b>	<b>\$ (308)</b>	<b>\$ (5,574)</b>	<b>\$ (3,723)</b>	<b>\$ 313,865</b>
Comprehensive Income:										
Net Income	-	-	-	-	-	29,301	-	-	-	29,301
Change in fair value of interest rate hedge	-	-	-	-	-	-	308	-	-	308
Minimum pension liability adjustment	-	-	-	-	-	-	-	-	1,542	1,542
Translation adjustments	-	-	-	-	-	-	-	11,735	-	11,735
Total Comprehensive Income	-	-	-	-	-	29,301	308	11,735	1,542	42,886
Restricted stock expense	-	-	4,163	1,285	-	-	-	-	-	5,448
Stock options exercised	-	-	(2,058)	-	6,756	-	-	-	-	4,698
Tax benefits from stock plans	-	-	1,184	-	-	-	-	-	-	1,184
Treasury stock purchases	-	-	-	-	(13,337)	-	-	-	-	(13,337)
Treasury stock issued to company benefit plan, at average cost	-	-	304	-	4,327	-	-	-	-	4,631
<b>Balance, December 31, 2003</b>	<b>24,813</b>	<b>6,203</b>	<b>114,743</b>	<b>(1,039)</b>	<b>(9,563)</b>	<b>245,051</b>	<b>-</b>	<b>6,161</b>	<b>(2,181)</b>	<b>359,375</b>
Comprehensive Income:										
Net Income	-	-	-	-	-	40,300	-	-	-	40,300
Change in fair value of interest rate hedge	-	-	-	-	-	-	-	-	-	-
Minimum pension liability adjustment	-	-	-	-	-	-	-	-	(151)	(151)
Translation adjustments	-	-	-	-	-	-	-	12,399	-	12,399
Total Comprehensive Income	-	-	-	-	-	40,300	-	12,399	(151)	52,548
Restricted stock expense	39	10	4,926	592	-	-	-	-	-	5,528
Restricted stock forfeitures	-	-	280	-	(280)	-	-	-	-	-
Stock options exercised	852	213	17,852	-	9,143	-	-	-	-	27,208
Tax benefits from stock plans	-	-	5,017	-	-	-	-	-	-	5,017
Common stock issued to company benefit plan	116	29	-	-	-	-	-	-	-	29
Treasury stock issued to company benefit plan, at average cost	-	-	4,032	-	700	-	-	-	-	4,732
<b>Balance, December 31, 2004</b>	<b>25,820</b>	<b>6,455</b>	<b>146,850</b>	<b>(447)</b>	<b>-</b>	<b>285,351</b>	<b>-</b>	<b>18,560</b>	<b>(2,332)</b>	<b>454,437</b>
Comprehensive Income:										
Net Income	-	-	-	-	-	62,680	-	-	-	62,680
Change in fair value of interest rate hedge	-	-	-	-	-	-	518	-	-	518
Minimum pension liability adjustment	-	-	-	-	-	-	-	-	(1,108)	(1,108)
Translation adjustments	-	-	-	-	-	-	-	(13,378)	-	(13,378)
Total Comprehensive Income	-	-	-	-	-	62,680	518	(13,378)	(1,108)	48,712
Restricted stock expense	78	19	3,584	228	-	-	-	-	-	3,831
Restricted stock forfeitures	-	-	78	-	(78)	-	-	-	-	-
Stock options exercised	846	212	21,327	-	50	-	-	-	-	21,589
Tax benefits from stock plans	-	-	6,177	-	-	-	-	-	-	6,177
Common stock issued to company benefit plan	35	9	1,335	-	-	-	-	-	-	1,344
Treasury stock issued to company benefit plan, at average cost	-	-	-	-	28	-	-	-	-	28
<b>Balance, December 31, 2005</b>	<b>26,779</b>	<b>\$ 6,695</b>	<b>\$ 179,351</b>	<b>\$ (219)</b>	<b>\$ -</b>	<b>\$ 348,031</b>	<b>\$ 518</b>	<b>\$ 5,182</b>	<b>\$ (3,440)</b>	<b>\$ 536,118</b>

The accompanying Notes are an integral part of these Consolidated Financial Statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. SUMMARY OF MAJOR ACCOUNTING POLICIES

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of Oceaneering International, Inc. and our 50% or more owned and controlled subsidiaries. We also consolidate entities that are determined to be variable interest entities as defined in Financial Accounting Standards Board ("FASB") Interpretation No. 46(R) ("FIN No. 46(R)") if we determine that we are the primary beneficiary; otherwise, we account for these entities using the equity method of accounting. We use the equity method to account for our investments in unconsolidated affiliated companies of which we own an equity interest of between 20% and 50% and as to which we have significant influence, but not control, over operations. All significant intercompany accounts and transactions have been eliminated.

#### *Cash and Cash Equivalents*

Cash and cash equivalents include demand deposits and highly liquid investments with original maturities of three months or less from the date of the investment.

#### *Accounts Receivable – Allowances for Doubtful Accounts*

The following table sets forth the activity of our allowances for doubtful accounts receivable:

(in thousands)	Balance at beginning of Period	Additions		Deductions	Balance at end of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
For the year ended December 31, 2003	\$ 2,763	\$ -	\$ -	\$ -	\$ 2,763
For the year ended December 31, 2004	\$ 2,763	\$ -	\$ -	\$ -	\$ 2,763
For the year ended December 31, 2005	\$ 2,763	\$ -	\$ 112	\$ 2,763	\$ 112

We determine the need for allowances for doubtful accounts using the specific identification method. We do not generally require collateral from our customers.

#### *Inventory and Other Current Assets*

Inventory and other current assets consisted of the following:

(in thousands)	December 31,	
	2005	2004
Inventory of spare parts for remotely operated vehicles	\$ 38,981	\$ 14,595
Other inventory, primarily raw materials	39,924	19,208
Deferred taxes	9,091	11,996
Other	10,432	8,174
Total	<u>\$ 98,428</u>	<u>\$ 53,973</u>

Inventory is valued at lower of cost or market. We determine cost using the weighted-average method.



### Property and Equipment

We provide for depreciation of property and equipment primarily on the straight-line method over estimated useful lives of three to 20 years for marine services equipment, up to 12 years for mobile offshore production equipment and three to 25 years for buildings, improvements and other equipment.

We charge the costs of repair and maintenance of property and equipment to operations as incurred, while we capitalize the costs of improvements. We estimate and accrue in advance for anticipated drydocking expenses of our larger vessels. These amounts are included in accrued liabilities on our balance sheets. We recognize differences between the estimates and the actual costs in the income statement.

The following table sets forth the activity of our accruals for drydocking for the periods presented:

(in thousands)	Balance at beginning of Period	Additions		Deductions	Balance at end of Period
		Charged to Costs and Expenses	Charged to Other Accounts		
For the year ended December 31, 2003	\$ 2,095	\$ 1,291	\$ 109	\$ 1,964	\$ 1,531
For the year ended December 31, 2004	\$ 1,531	\$ 495	\$ 41	\$ 860	\$ 1,207
For the year ended December 31, 2005	\$ 1,207	\$ 1,022	\$ (48)	\$ 900	\$ 1,281

We capitalize interest on assets where the construction period is anticipated to be more than three months. In 2005 and 2004, we capitalized \$0.1 million and \$0.4 million of interest, respectively. We do not allocate general administrative costs to capital projects. Upon the disposition of property and equipment, the related cost and accumulated depreciation accounts are relieved and any resulting gain or loss is included as an adjustment to cost of services and products.

Our management periodically, and upon the occurrence of a triggering event, reviews the realizability of long-lived assets, excluding goodwill and indefinite-lived intangibles, to be held and used by us to determine whether any events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. For long-lived assets to be held and used, we base our evaluation on impairment indicators such as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements and other external market conditions or factors that may be present. If such impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, we determine whether an impairment has occurred through the use of an undiscounted cash flows analysis of the asset at the lowest level for which identifiable cash flows exist, or quoted market prices. If an impairment has occurred, we recognize a loss for the difference between the carrying amount and the fair value of the asset. For assets held for sale or disposal, the fair value of the asset is measured using quoted market prices. Assets are classified as held for sale when we have a plan for disposal of certain assets and those assets meet the held for sale criteria. In 2005, we recorded \$6.1 million of impairments as additional depreciation in our ROV segment, based on net realizable value. These provisions related to the retirement of four vehicles and obsolete ROV components. In 2004, our 50%-owned cable lay and maintenance joint venture recorded an impairment of \$7.2 million related to some of its equipment. We also recorded an additional impairment of \$0.4 million of our investment. After taking into account a deferred gain of \$2.1 million we had generated upon formation of the venture, the two impairments reduced our equity earnings of unconsolidated affiliates by \$1.9 million in 2004. We made no other impairment adjustments on long-lived assets during the periods presented.

### Business Acquisitions

In January 2003, we acquired OIS International Inspection plc, an international provider of inspection and nondestructive testing services, for approximately \$29 million. In April 2003, we acquired Nauticos Corporation, a provider of marine products and services support to governmental and commercial customers, and Reflange, Inc., a manufacturer of patented metal seal piping connectors and a supplier of on-site machining services, for approximately \$8 million and \$5 million, respectively. In September 2003, we acquired Rotator AS, a designer and manufacturer of subsea control valves, topside control valves, subsea chemical injection valves and specialty control panels, for approximately \$15 million. These

acquisitions were accounted for using the purchase method of accounting, with the purchase price being allocated to the net assets acquired based on their fair market values at the date of acquisition. Goodwill, all non-deductible, associated with these four acquisitions was \$24 million. In February 2004, we acquired 34 work-class ROVs and related business operations from Stolt Offshore S.A. for approximately \$52 million and in September 2004 we acquired 10 work-class ROVs and related business operations from Fugro N.V. for approximately \$17 million. We accounted for these acquisitions using the purchase method of accounting, with the purchase price being allocated to the net assets acquired based on their fair market values at the date of acquisition. In June 2005, we acquired Grayloc Products L.L.C. and subsidiary (together "Grayloc"), an oil and gas industry supplier of clamp connectors for approximately \$42 million. We accounted for this acquisitions using the purchase method of accounting, with the purchase price being allocated to the net assets acquired based on their fair market values at the date of acquisition. We have made preliminary purchase price allocations based on estimates using information currently available to us, and the allocations are subject to change when we obtain final asset and liability valuations. Our current estimate of goodwill, all non-deductible, associated with the Grayloc acquisition is \$22 million and estimated other intangible assets are \$13 million. These acquisitions were not material. As a result, we have not included pro forma information. The results of operations of OIS International Inspection plc, Nauticos Corporation, Reflange, Inc., Rotator AS and Grayloc, and the assets and business operations acquired from Stolt Offshore S.A. and Fugro N.V. are included in our consolidated statements of income from the respective dates of acquisition.

### *Goodwill and Intangible Assets*

Effective January 1, 2002, we adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, *Goodwill and Other Intangible Assets*. This standard changed the accounting for goodwill and certain other intangible assets from an amortization method to an impairment-only approach. The standard also requires a reassessment of the useful lives of identifiable intangible assets other than goodwill and at least an annual test for impairment of goodwill and intangible assets with indefinite lives.

In accordance with the requirements of SFAS No. 142, we tested the goodwill attributable to each of our reporting units for impairment as of December 31, 2005, 2004 and 2003 and concluded that there was no impairment. Our reporting units are the product and service lines one level below our operating segments, except for Inspection and Subsea Projects, which are each a single reporting unit. We estimated fair value using discounted cash flow methodologies and market comparable information.

Within our balance sheet caption Other Assets: Other at December 31, 2005, we have \$15.4 million of intangible assets, primarily acquired in connection with business combinations. These intangible assets include trade names, intellectual property and customer relationships, and are being amortized over a weighted average remaining life of approximately 13 years.

### *Revenue Recognition*

We recognize our revenue according to the type of contract involved. On a daily basis, we recognize our billings under contracts that provide for specific time, material and equipment charges, which we bill periodically, ranging from weekly to monthly.

We account for significant fixed-price contracts, which we enter into mainly in our Subsea Products and Advanced Technologies segments, and occasionally in our Subsea Projects segment, using the percentage-of-completion method. In 2005, we accounted for 15% of our revenue using the percentage-of-completion method. In determining whether a contract should be accounted for using the percentage-of-completion method, we consider whether:

- the customer provides specifications for the construction of facilities or production of goods or for the provision of related services;
- we can reasonably estimate our progress towards completion and our costs;
- the contract includes provisions as to the enforceable rights regarding the goods or services to be provided, consideration to be received and the manner and terms of payment;
- the customer can be expected to satisfy its obligations under the contract; and
- we can be expected to perform our contractual obligations.

Under the percentage-of-completion method, we recognize estimated contract revenue based on costs incurred to date as a percentage of total estimated costs. Changes in the expected cost of materials and labor, productivity, scheduling and other factors affect the total estimated costs. Additionally, external factors, including weather or other factors outside of our control, may also affect the progress and estimated cost of a project's completion and, therefore, the timing of income and revenue recognition. We routinely review estimates related to our contracts and reflect revisions to profitability in earnings immediately. If a current estimate of total contract cost indicates an ultimate loss on a contract, we recognize the projected loss in full when we determine it. In prior years, we have recorded adjustments to earnings as a result of revisions to contract estimates. Although we are continually striving to improve our ability to estimate our contract costs and profitability, adjustments to overall contract costs could be significant in future periods. We recognize the remainder of our revenue as we deliver the goods and services and collection is reasonably assured.

Revenue in Excess of Amounts Billed relates to recoverable costs and accrued profits on contracts in progress. Billings in Excess of Revenue Recognized on uncompleted contracts are classified in accrued liabilities.

Revenue in Excess of Amounts Billed is summarized as follows:

(in thousands)	December 31,	
	2005	2004
Revenues recognized on uncompleted contracts	\$ 84,664	\$ 68,819
Less: Billings of customers	(59,211)	(53,618)
Revenue in excess of amounts billed	<u>\$ 25,453</u>	<u>\$ 15,201</u>

Billings in Excess of Revenue Recognized on uncompleted fixed-price contracts accounted for using the percentage-of-completion method are summarized as follows:

(in thousands)	December 31,	
	2005	2004
Amounts billed to customers	\$ 26,301	\$ 29,555
Less: Revenues recognized	(22,286)	(21,898)
Billings in excess of revenue recognized	<u>\$ 4,015</u>	<u>\$ 7,657</u>

### *Stock-Based Compensation*

As permitted under SFAS No. 123, *Accounting for Stock-Based Compensation*, through December 31, 2005, we used the intrinsic value method of accounting established by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, to account for our stock-based compensation programs. Accordingly, we did not recognize any compensation expense when the exercise price of an employee stock option was equal to the Common Share market price on the grant date. The following illustrates the pro forma effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS No. 123:



<i>(in thousands, except per share amounts)</i>	Year Ended December 31,		
	2005	2004	2003
Net income:			
As reported	\$ 62,680	\$ 40,300	\$ 29,301
Employee stock-based compensation expense included in net income, net of income tax benefit	5,727	6,827	5,315
Pro forma compensation expense determined under fair value methods for all awards, net of income tax benefit	(8,779)	(11,515)	(11,197)
Pro forma	<u>\$ 59,628</u>	<u>\$ 35,612</u>	<u>\$ 23,419</u>
Pro forma earnings per common share:			
Basic	\$ 2.28	\$ 1.42	\$ 0.98
Diluted	\$ 2.22	\$ 1.39	\$ 0.96
Reported earnings per common share:			
Basic	\$ 2.40	\$ 1.61	\$ 1.23
Diluted	\$ 2.34	\$ 1.57	\$ 1.20

For purposes of these pro forma disclosures, the fair value of each option grant was estimated on the date of grant using a Black-Scholes option pricing model. The following assumptions for the years ended December 31, 2005, 2004 and 2003, respectively, were computed on a weighted average basis: expected volatility of 32.7%, 36.2% and 45.0%; risk-free interest rate of 3.65%, 3.18% and 2.26%; expected average life of 3.0 years; and no expected dividends. The weighted average fair values of the options granted in the years ended December 2005, 2004 and 2003 were \$9.02, \$10.25 and \$7.57, respectively. The estimated fair value of the options is amortized to pro forma expense over the vesting periods of the options.

### *Income Taxes*

We provide income taxes at appropriate tax rates in accordance with our interpretation of the respective tax laws and regulations after review and consultation with our internal tax department, tax advisors and, in some cases, legal counsel in various jurisdictions. We provide for deferred income taxes for differences between carrying amounts of assets and liabilities for financial and tax reporting purposes. Our policy is to provide for deferred U.S. income taxes on foreign income only to the extent such income is not to be invested indefinitely in the related foreign entity. We provide a valuation allowance against deferred tax assets when it is more likely than not that the asset will not be realized.

### *Foreign Currency Translation*

The functional currency for several of our foreign subsidiaries is the applicable local currency. Results of operations for foreign subsidiaries with functional currencies other than the U.S. dollar are translated into U.S. dollars using average exchange rates during the period. Assets and liabilities of these foreign subsidiaries are translated into U.S. dollars using the exchange rates in effect at the balance sheet date, and the resulting translation adjustments are accumulated as a component of shareholders' equity. All foreign currency transaction gains and losses are recognized currently in the Consolidated Statements of Income.

Our subsidiary in Brazil uses the U.S. dollar as its functional currency. Because of local requirements, its original books of record are kept in Brazilian currency. These financial statements are translated as follows: nonmonetary assets, share par value and paid-in capital are translated at historical exchange rates, preserving the original U.S. dollar basis; revenue and expenses are translated at the average rates of exchange during the period, except for depreciation and amortization and material transfers from inventory, which are translated at historical exchange rates; and all other financial statement accounts are translated at the rate of exchange at the end of each period. Remeasurement adjustments to state the

monetary accounts of local currency as current U.S. dollars are credited or charged directly to income. We recorded \$0.2 million, (\$1.2 million) and (\$1.2 million) of foreign currency gains (losses) in 2005, 2004 and 2003, respectively. Such amounts are included as a component of Other Income (Expense), Net.

### *Earnings Per Share*

Basic and diluted earnings per share are computed by dividing net income by the weighted average number of common shares and the weighted average number of common shares plus common share equivalents, respectively. The weighted average number of common shares and equivalents for each of 2005, 2004 and 2003 excludes averages of 66,000, 13,000 and 899,000 stock options, respectively, which were antidilutive.

### *Financial Instruments*

We recognize all derivative instruments as either assets or liabilities in the balance sheet and measure those instruments at fair value. Subsequent changes in fair value are reflected in current earnings or other comprehensive income, depending on whether a derivative instrument is designated as part of a hedge relationship and, if it is, the type of hedge relationship.

### *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires that our management make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

### *New Accounting Standards*

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*. SFAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We believe there will be no material effect on our financial statements upon adoption of this statement.

In December 2004, the Financial Accounting Standards Board issued SFAS No. 123 (revised 2004), *Share-Based Payments* ("SFAS 123R"). SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized over their vesting periods in the income statement based on their estimated fair values. SFAS 123R was to be effective for all public entities in the first interim or annual reporting period beginning after June 15, 2005. In April 2005, however, the Securities and Exchange Commission adopted a rule that defers the required effective date of SFAS 123R for registrants such as us until the beginning of the first fiscal year that starts after June 15, 2005. This statement applies to all awards granted after the required effective date and to awards modified, repurchased or canceled after that date, as well as the unvested portion of awards granted prior to the effective date of SFAS 123R. Although we have not completed our analysis of the impact of SFAS 123R, we believe the pro forma expenses for the periods presented above under the caption "Stock-Based Compensation" provide reasonable approximations of the stock-based compensation expense that would have been recorded in our consolidated statements of income under SFAS 123R. We currently estimate that existing option grants will cause us to recognize approximately an additional \$0.01 per diluted share of equity- and option-based compensation expense for 2006, assuming we elect the modified prospective transition alternative. However, our estimates may increase or decrease materially once we complete our analysis of the impact of SFAS 123R.

In light of the new accounting principles established by SFAS 123R, the Compensation Committee of our Board of Directors has expressed its intention to refrain from using stock options as a component of employee compensation for our executive officers and other employees for the foreseeable future, and the Board has expressed its intention to refrain from using stock options as a component of nonemployee director compensation for the foreseeable future.

## 2. INVESTMENTS IN UNCONSOLIDATED AFFILIATES

Our investments in unconsolidated affiliates consists of the following:

(in thousands)	December 31,		
	2005	2004	2003
Medusa Spar LLC	\$ 57,440	\$ 49,987	\$ 43,640
Smit-Oceaneering Cable Systems LLC	2,811	3,192	6,367
Other	1,347	2,436	2,176
	<u>\$ 61,598</u>	<u>\$ 55,615</u>	<u>\$ 52,183</u>

In December 2003, we purchased a 50% equity interest in Medusa Spar LLC for \$43.7 million. Medusa Spar LLC owns a 75% interest in a production spar platform. Medusa Spar LLC's revenue is derived from processing oil and gas production for a fee based on the volumes processed (throughput). The majority working interest owner of the Medusa field, the spar's initial location, has committed to deliver a minimum throughput, which we expect will generate sufficient revenue to repay Medusa Spar LLC's bank debt. The Medusa Spar LLC financed its acquisition of its 75% interest in the production spar platform using approximately 50% debt and 50% equity from its equity holders. Our maximum exposure to loss from our investment in Medusa Spar LLC is our \$57 million investment. Medusa Spar LLC is a variable interest entity. As we are not the primary beneficiary under FIN 46(R), we are accounting for our investment in Medusa Spar LLC under the equity method of accounting. Summarized 100% financial information relative to Medusa Spar LLC and a reconciliation of the underlying equity in net assets to our carrying value follows this discussion.

Due to the condition of the telecommunications market, our cable lay and maintenance venture is currently inactive and the single vessel used in the venture has been marketed for oilfield and other uses since 2004. In 2004, we recognized \$1.5 million of pre-tax impairments related to the venture after taking into account a deferred gain of \$2.1 million we had generated upon formation of the venture. We also recorded an additional impairment of \$0.4 million of our investment. The two impairments reduced our equity earnings of unconsolidated affiliates by \$1.9 million. In March 2005, we purchased the cable lay and maintenance equipment from the venture. We have entered into a contract to purchase the vessel from the venture. Our completion of the purchase of the vessel will effectively wind-up the venture. Total equity income (loss) from our investment in Smit-Oceaneering Cable Systems LLC was \$0.3 million, (\$3.1 million) and (\$0.8 million) for the years ended December 31, 2005, 2004 and 2003, respectively.



<i>(in thousands)</i>	December 31,		
	2005	2004	2003
<b>Medusa Spar LLC</b>			
<b>Condensed Balance Sheets</b>			
<b>ASSETS</b>			
Current Assets	\$ 12,669	\$ 3,435	\$ 205
Property and Equipment, net	147,938	157,416	166,893
Other Non-Current Assets	1,575	1,751	2,098
Total Assets	<u>\$ 162,182</u>	<u>\$ 162,602</u>	<u>\$ 169,196</u>
<b>LIABILITIES AND MEMBERS' EQUITY</b>			
Current Maturities of Long-Term Debt	\$ 13,744	\$ 17,125	\$ 19,502
Other Current Liabilities	21	44	1,274
Total Current Liabilities	13,765	17,169	20,776
Long-Term Debt, net of current maturities	33,237	46,981	64,106
Other Comprehensive Income (Loss)	1,594	883	(100)
Members' Equity	113,586	97,569	84,414
Total Liabilities and Members' Equity	<u>\$ 162,182</u>	<u>\$ 162,602</u>	<u>\$ 169,196</u>
<b>Condensed Statements of Operations</b>			
Revenue	\$ 32,500	\$ 29,312	\$ 348
Depreciation	(9,478)	(9,478)	(357)
General and Administrative	(83)	(113)	(2)
Interest	(2,286)	(3,169)	(115)
Net Income (Loss)	<u>\$ 20,653</u>	<u>\$ 16,552</u>	<u>\$ (126)</u>
<b>Reconciliation of the Carrying Value of the Investment to Underlying Equity in Net Assets:</b>			
Underlying Equity in Net Assets - 50%	\$ 56,793	\$ 48,785	\$ 42,207
Basis Differences	647	1,202	1,433
Carrying Value of Investment in Medusa Spar LLC in the Consolidated Financial Statements	<u>\$ 57,440</u>	<u>\$ 49,987</u>	<u>\$ 43,640</u>

We are amortizing the basis differences on the straight-line method over six to 15 years.

Our 50% share of the undistributed earnings of Medusa Spar LLC was \$14.5 million at December 31, 2005.

### 3. INCOME TAXES

We file a consolidated U.S. federal income tax return for Oceaneering International, Inc. and our domestic subsidiaries, including acquired companies from their respective dates of acquisition. We conduct our international operations in a number of locations that have varying laws and regulations with regard to income and other taxes, some of which are subject to interpretation. Our management believes that adequate provisions have been made for all taxes that will ultimately be payable, although final determination of tax liabilities may differ from our estimates. On a geographic basis, which excludes foreign earnings of our U.S. companies and excludes allocations of overhead and interest expense to our foreign subsidiaries, income (loss) before income taxes attributable to the U.S. was \$4.8 million, (\$3.2 million) and (\$1.9 million) for the years ended December 31, 2005, 2004 and 2003, respectively. The following table sets forth our provisions for income taxes.

(in thousands)	Year Ended December 31,		
	2005	2004	2003
U.S. federal and state	\$ 11,930	\$ 1,622	\$ 2,550
Foreign	19,840	19,001	13,228
Total provision	<u>\$ 31,770</u>	<u>\$ 20,623</u>	<u>\$ 15,778</u>
Current	\$ 32,071	\$ 16,379	\$ 16,261
Deferred	(301)	4,244	(483)
Total provision	<u>\$ 31,770</u>	<u>\$ 20,623</u>	<u>\$ 15,778</u>
Cash taxes paid	<u>\$ 19,372</u>	<u>\$ 17,995</u>	<u>\$ 16,890</u>

As of December 31, 2005 and 2004, our worldwide deferred tax assets, liabilities and net deferred tax liabilities were as follows:

(in thousands)	December 31,	
	2005	2004
<b>Deferred tax assets:</b>		
Deferred compensation	\$ 15,818	\$ 12,168
Foreign tax credit carryforwards	12,811	10,140
Accrued expenses	6,864	5,177
Deferred income	1,152	4,459
Net operating loss carryforwards	-	4,016
Other	7,665	9,591
Gross deferred tax assets	44,310	45,551
Valuation allowance	-	-
Total deferred tax assets	<u>\$ 44,310</u>	<u>\$ 45,551</u>
<b>Deferred tax liabilities:</b>		
Property and equipment	\$ 35,896	\$ 37,290
Unremitted equity earnings	11,673	8,258
Other	2,471	2,450
Total deferred tax liabilities	<u>\$ 50,040</u>	<u>\$ 47,998</u>
Net deferred income tax liability	<u>\$ 5,730</u>	<u>\$ 2,447</u>

Our net deferred tax liability is reflected on our balance sheet as follows:

(in thousands)	December 31,	
	2005	2004
Deferred tax liabilities	\$ 14,905	\$ 14,532
Current deferred assets	(9,091)	(11,996)
Long-term assets	(84)	(89)
Net deferred income tax liability	<u>\$ 5,730</u>	<u>\$ 2,447</u>

We have \$17 million of earnings of our Swiss subsidiary, Oceaneering International AG, that we consider indefinitely reinvested outside the U.S. and that we do not expect to repatriate. None of our foreign tax credits are scheduled to expire before December 31, 2014.

Prior to 2004, we had established a valuation allowance for deferred tax assets after taking into account factors that are likely to affect our ability to utilize the tax assets. We conduct business through several foreign subsidiaries and, although we expect our consolidated operations to be profitable, there is no assurance that profits will be earned in entities or jurisdictions that have NOLs available. Income taxes, computed by applying the federal statutory income tax rate of 35% to income before income taxes and minority interests, are reconciled to the actual provisions for income taxes as follows:

(in thousands)	Year Ended December 31,		
	2005	2004	2003
Computed U.S. statutory expense	\$ 33,077	\$ 21,346	\$ 15,795
Change in valuation allowances	-	(1,307)	(557)
State and local taxes and other, net	(1,307)	584	540
Total provision for income taxes	<u>\$ 31,770</u>	<u>\$ 20,623</u>	<u>\$ 15,778</u>

Included in the line for state and local taxes and other, net, for 2005 is a \$1.8 million credit from resolution of tax contingencies related to certain foreign tax liabilities we recorded in prior years.

#### 4. DEBT

Long-term Debt consisted of the following:

(in thousands)	December 31,	
	2005	2004
6.72% Senior Notes	\$ 100,000	\$ 100,000
Revolving credit facility	74,000	41,000
Other	-	1,172
Long-term Debt	<u>\$ 174,000</u>	<u>\$ 142,172</u>

We have \$100 million aggregate principal amount of 6.72% Senior Notes outstanding and scheduled to be paid in five equal annual installments beginning September 2006.

We have a \$250 million revolving credit facility (the "Credit Agreement") that expires in January 2008. We pay a facility fee ranging from .20% to .30% per annum, depending on our debt-to-capitalization ratio, on the banks' commitments. Under the Credit Agreement, we have the option to borrow at the London Interbank Offered Rate ("LIBOR") plus a margin ranging from .55% to 1.075%, depending on our debt-to-capitalization ratio, or at the agent bank's prime rate. At December 31, 2005, we had \$74 million of borrowings outstanding under the Credit Agreement and \$176 million available for borrowing. The weighted average interest rates on our outstanding borrowings were 6.1% and 5.4% at December 31, 2005 and 2004, respectively.

Scheduled maturities of Long-term Debt outstanding as of December 31, 2005 were as follows:

(in thousands)	6.72% Notes	Revolving Credit	Total
2006	\$ 20,000	\$ -	\$ 20,000
2007	20,000	-	20,000
2008	20,000	74,000	94,000
2009	20,000	-	20,000
Thereafter	20,000	-	20,000
Total	<u>\$ 100,000</u>	<u>\$ 74,000</u>	<u>\$ 174,000</u>



Maturities in 2006 are not classified as current as of December 31, 2005, since we are able to extend the maturity by reborrowing under the revolving credit facility with a maturity date after one year.

The 6.72% Senior Notes contain restrictive covenants as to minimum net worth, debt-to-capitalization ratio, fixed charge coverage, interest coverage and restricted payments. Restricted payments, which include dividends and treasury stock purchases, are limited from April 1, 1998, on a net basis, to the sum of \$25 million plus 50% of our consolidated net income after April 1, 1998, plus cash proceeds from any sales of our common stock. The \$250 million revolving credit agreement contains restrictive covenants as to minimum net worth, debt-to-capitalization ratio, interest coverage and restricted payments. Under the revolving credit agreement, restricted payments, which include dividends and treasury stock purchases, are limited to \$100 million plus the sum of, since October 1, 2003, 50% of our consolidated net income plus any cash proceeds from any sales of our common stock.

We made cash interest payments of \$10.2 million, \$8.3 million and \$8.0 million in the years ended December 31, 2005, 2004 and 2003, respectively. We capitalized interest charges of \$0.1 and \$0.4 million in the years ended December 31, 2005 and 2004, respectively, as part of construction-in-progress.

## 5. COMMITMENTS AND CONTINGENCIES

### *Lease Commitments*

At December 31, 2005, we occupied several facilities under noncancellable operating leases expiring at various dates through 2091. Future minimum rentals under these leases are as follows:

*(in thousands)*

2006	\$ 8,341
2007	7,017
2008	6,094
2009	5,651
2010	4,984
Thereafter	22,551
Total Lease Commitments	<u>\$ 54,638</u>

Rental expense, which includes hire of vessels, specialized equipment and real estate rental, was approximately \$38 million, \$26 million and \$18 million for the years ended December 31, 2005, 2004 and 2003, respectively.

### *Insurance*

We self-insure for workers' compensation, maritime employer's liability and comprehensive general liability claims to levels we consider financially prudent and carry insurance for exposures beyond the self-insurance levels, which can be by occurrence or in the aggregate. We determine the level of accruals by reviewing our historical experience and current year claim activity. We do not record accruals on a present-value basis. We review each claim with insurance adjusters and establish specific reserves for all known liabilities. We establish an additional reserve for incidents incurred but not reported to us for each year using management estimates and based on prior experience. We believe that we have established adequate accruals for uninsured expected liabilities arising from those obligations.

### *Litigation*

Various actions and claims are pending against us, most of which are covered by insurance. Although we cannot predict the ultimate outcome of these matters, we believe the ultimate liability, if any, that may result from these actions and claims will not materially affect our financial position or results of operations.

*Letters of Credit*

We had \$16 million and \$24 million in letters of credit outstanding as of December 31, 2005 and 2004, respectively, as guarantees in force for self-insurance requirements and various performance and bid bonds, which are usually for the duration of the applicable contract.

*Financial Instruments and Risk Concentration*

In the normal course of business, we manage risks associated with foreign exchange rates and interest rates through a variety of strategies, including the use of hedging transactions. As a matter of policy, we do not use derivative instruments unless there is an underlying exposure. We do not use derivative instruments for trading or speculative purposes. At December 31, 2005, we did not have any derivative financial instruments in place.

Other financial instruments that potentially subject us to concentrations of credit risk are principally cash and cash equivalents and accounts receivable. The carrying values of cash and cash equivalents and bank borrowings approximate their fair values due to the short maturity of those instruments or the short-term duration of the associated interest rate periods. Accounts receivable are generated from a broad group of customers, primarily from within the energy industry, which is our major source of revenue. Due to their short-term nature, carrying values of our accounts receivable and accounts payable approximate fair market value.

We estimated the fair value of our \$100 million of 6.72% Senior Notes to be \$102 million as of December 31, 2005. We arrived at this estimate by computing the present value of the future principal and interest payments using a yield-to-maturity interest rate for securities of similar quality and term.

**6. OPERATIONS BY BUSINESS SEGMENT AND GEOGRAPHIC AREA***Business Segment Information*

We supply a comprehensive range of integrated technical services and products to a variety of industries and we are one of the world's largest underwater services contractors. Our Oil and Gas business consists of Remotely Operated Vehicles ("ROVs"), Subsea Products, Subsea Projects, Mobile Offshore Production Systems and Inspection. Our ROV segment provides submersible vehicles operated from the surface to support offshore oil and gas exploration, production and construction activities. Our Subsea Products segment supplies umbilicals, production control equipment, pipeline repair systems and ROV tooling and work packages. Our Subsea Projects segment provides multiservice vessels, oilfield diving and support vessel operations, which are used primarily in inspection, repair and maintenance activities. Our Mobile Offshore Production Systems segment provides offshore production facilities through three mobile offshore production systems that we own and a 50%-owned entity, which owns 75% of another system. Our Inspection segment provides customers with a wide range of third-party inspection services to satisfy contractual structural specifications, internal safety standards and regulatory requirements. Our Advanced Technologies business provides project management, engineering services and equipment for applications in non-oilfield markets. Unallocated Expenses are those not associated with a specific business segment. These consist of expenses related to our incentive and deferred compensation plans, including restricted stock and bonuses, as well as other general expenses, including corporate administrative expenses.

The table that follows presents Revenue, Income from Operations, Depreciation and Amortization Expense and Equity Earnings (Losses) of Unconsolidated Affiliates by business segment:

(in thousands)	Year Ended December 31,		
	2005	2004	2003
<b>Revenue</b>			
Oil and Gas			
Remotely Operated Vehicles	\$ 315,178	\$ 223,914	\$ 160,359
Subsea Products	239,039	160,410	107,540
Subsea Projects	121,628	70,254	68,796
Mobile Offshore Production Systems	50,091	49,387	46,836
Inspection	154,857	145,691	136,599
Total Oil and Gas	880,793	649,656	520,130
Advanced Technologies	117,750	130,525	119,119
Total	<u>\$ 998,543</u>	<u>\$ 780,181</u>	<u>\$ 639,249</u>
<b>Income from Operations</b>			
Oil and Gas			
Remotely Operated Vehicles	\$ 68,962	\$ 48,397	\$ 34,925
Subsea Products	13,941	10,891	4,466
Subsea Projects	26,219	5,472	6,626
Mobile Offshore Production Systems	16,796	16,565	15,712
Inspection	7,946	4,564	5,246
Total Oil and Gas	133,864	85,889	66,975
Advanced Technologies	12,539	17,515	15,067
Unallocated Expenses	(52,334)	(39,540)	(28,045)
Total	<u>\$ 94,069</u>	<u>\$ 63,864</u>	<u>\$ 53,997</u>
<b>Depreciation and Amortization Expense</b>			
Oil and Gas			
Remotely Operated Vehicles	\$ 39,837	\$ 32,605	\$ 27,175
Subsea Products	11,992	8,184	7,210
Subsea Projects	6,938	6,107	5,274
Mobile Offshore Production Systems	11,612	11,054	10,415
Inspection	5,100	4,608	4,103
Total Oil and Gas	75,479	62,558	54,177
Advanced Technologies	2,305	2,100	2,004
Unallocated Expenses	1,829	961	782
Total	<u>\$ 79,613</u>	<u>\$ 65,619</u>	<u>\$ 56,963</u>
<b>Equity Earnings (Losses) of Unconsolidated Affiliates</b>			
Oil and Gas			
Remotely Operated Vehicles	\$ 38	\$ 1,071	\$ 859
Mobile Offshore Production Systems	10,082	8,171	(65)
Total Oil and Gas	10,120	9,242	794
Advanced Technologies	290	(3,132)	(754)
Total	<u>\$ 10,410</u>	<u>\$ 6,110</u>	<u>\$ 40</u>



The following tables present Assets, Goodwill and Capital Expenditures by business segment as of and for the periods indicated:

(in thousands)	December 31,	
	2005	2004
<b>Assets</b>		
Oil and Gas		
Remotely Operated Vehicles	\$ 314,989	\$ 254,020
Subsea Products	271,046	184,473
Subsea Projects	88,284	81,582
Mobile Offshore Production Systems	133,698	132,534
Inspection	54,510	62,459
Total Oil and Gas	862,527	715,068
Advanced Technologies	46,234	50,636
Corporate and Other	80,807	53,960
Total	<u>\$ 989,568</u>	<u>\$ 819,664</u>

### Goodwill

Oil and Gas		
Remotely Operated Vehicles	\$ 25,181	\$ 23,421
Subsea Products	37,218	17,950
Inspection	11,755	11,152
Total Oil and Gas	74,154	52,523
Advanced Technologies	10,454	10,454
Total	<u>\$ 84,608</u>	<u>\$ 62,977</u>

(in thousands)	Year Ended December 31,		
	2005	2004	2003
<b>Capital Expenditures</b>			
Oil and Gas			
Remotely Operated Vehicles	\$ 56,102	\$ 86,250	\$ 22,320
Subsea Products	64,680	44,311	26,629
Subsea Projects	4,671	4,063	5,828
Mobile Offshore Production Systems	3,071	2,242	1,043
Inspection	5,675	4,595	30,710
Total Oil and Gas	134,199	141,461	86,530
Advanced Technologies	3,067	1,170	12,047
Corporate and Other	5,003	10,553	1,793
Total	<u>\$ 142,269</u>	<u>\$ 153,184</u>	<u>\$ 100,370</u>

Income from operations for each business segment is determined before interest income or expense, other income (expense), minority interests and provision for income taxes. An allocation of these items is not considered practical. All assets specifically identified with a particular business segment have been segregated. Cash and cash equivalents, certain inventory and other current assets, certain investments and other assets have not been allocated to particular business segments and are included in Corporate and Other.

No individual customer accounted for more than 10% of our consolidated revenue in any of the years ended December 31, 2005, 2004 or 2003.

### Geographic Operating Areas

The following table summarizes certain financial data by geographic area:

(in thousands)	Year Ended December 31,		
	2005	2004	2003
<b>Revenue</b>			
United States	\$ 410,291	\$ 339,682	\$ 305,444
United Kingdom	162,138	115,210	105,991
West Africa	130,799	96,617	77,643
Norway	129,250	76,090	36,019
Australia	30,266	43,018	29,543
Brazil	37,804	25,651	16,901
Canada	16,092	4,828	3,900
Indonesia	12,352	13,429	14,537
Other Asia	54,107	51,801	28,882
Other	15,444	13,855	20,389
Total	<u>\$ 998,543</u>	<u>\$ 780,181</u>	<u>\$ 639,249</u>
<b>Long-Lived Assets</b>			
United States	\$ 336,381	\$ 286,452	\$ 225,955
Europe	75,441	85,478	80,014
West Africa	55,069	49,279	21,730
Asia	12,141	16,079	13,711
Australia	55,171	62,631	69,752
Brazil	21,641	25,673	14,877
Other	17,795	-	-
Total	<u>\$ 573,639</u>	<u>\$ 525,592</u>	<u>\$ 426,039</u>

Revenue is based on location where services are performed and facility location for products.

## 7. ACCRUED LIABILITIES AND OTHER LONG-TERM LIABILITIES

Accrued liabilities and other long-term liabilities consisted of the following:

(in thousands)	December 31,	
	2005	2004
<b>Accrued Liabilities:</b>		
Payroll and related costs	\$ 69,387	\$ 47,170
Accrued job costs	33,341	28,788
Self-insurance reserves for claims expected to be paid within one year	6,672	6,351
Billings in excess of revenue recognized	14,869	16,122
Other	17,899	14,046
Total Accrued Liabilities	<u>\$ 142,168</u>	<u>\$ 112,477</u>
<b>Other Long-Term Liabilities:</b>		
Deferred income taxes	\$ 14,905	\$ 14,532
Self-insurance reserves not expected to be paid within one year	5,498	5,669
Accrued defined benefit plan obligations	9,942	6,094
Supplemental Executive Retirement Plan	19,199	14,931
Minority interests and other	7,239	11,157
Total Other Long-Term Liabilities	<u>\$ 56,783</u>	<u>\$ 52,383</u>

## 8. EMPLOYEE BENEFIT PLANS AND SHAREHOLDER RIGHTS PLAN

### *Retirement Investment Plans*

We have several employee retirement investment plans that, taken together, cover most of our full-time employees. The Oceaneering Retirement Investment Plan is a 401(k) plan in which U.S. employees may participate by deferring a portion of their gross monthly salary and directing us to contribute the deferred amount to the plan. We match a portion of the employees' deferred compensation. Our contributions to the 401(k) plan were \$5.8 million, \$5.3 million and \$4.7 million for the plan years ended December 31, 2005, 2004 and 2003, respectively.

We also make matching contributions to other foreign employee savings plans similar in nature to a 401(k). In 2005 and 2004, these contributions, principally related to plans associated with U.K. and Norwegian subsidiaries were \$2.7 million and \$1.9 million, respectively.

The Oceaneering International, Inc. Supplemental Executive Retirement Plan covers selected key management employees and executives, as approved by the Compensation Committee of our Board of Directors (the "Compensation Committee"). Under this plan, we accrue an amount determined as a percentage of the participant's gross monthly salary and the amounts accrued are treated as if they are invested in one or more investment vehicles pursuant to this plan. Expenses related to this plan during the years ended December 31, 2005, 2004 and 2003 were \$2.0 million, \$2.3 million and \$2.3 million, respectively.

### *Incentive and Stock Option Plans*

Under the 2005 Incentive Plan ("Incentive Plan"), a total of 1,200,000 shares of our common stock was made available for awards to employees and nonemployee members of our Board of Directors.

The Incentive Plan is administered by the Compensation Committee; however, the full Board of Directors makes determinations regarding awards to nonemployee directors under the Incentive Plan. The Compensation Committee or Board, as applicable, determines the type or types of award(s) to be made to each participant and sets forth in the related award agreement the terms, conditions and limitations applicable to each award. Stock options, stock appreciation rights and stock and cash awards may be made under the Incentive Plan. Options outstanding under the Incentive Plan and prior plans vest over a six-month, a three-year or a four-year period and are exercisable over a period of five, seven or ten years after the date of grant or five years after the date of vesting. Under the Incentive Plan, a stock option must have a term not exceeding seven years from the date of grant and must have an exercise price of not less than the fair market value of a share of our common stock on the date of grant. The Compensation Committee may not: (1) grant, in exchange for a stock option, a new stock option having a lower exercise price; or (2) reduce the exercise price of a stock option. In light of the new accounting principles established by SFAS 123R, which we adopted effective as of January 1, 2006, the Compensation Committee has expressed its intention to refrain from using stock options as a component of employee compensation for our executive officers and other employees for the foreseeable future, and the Board has expressed its intention to refrain from using stock options as a component of nonemployee director compensation for the foreseeable future.

Through 2005, we recognized no compensation cost for stock options as we issued no options at an option price below the fair market value of the stock at the date of the grant. See Note 1 – "Summary of Major Accounting Policies – Stock-Based Compensation" for fair market values and pro forma financial effects had compensation cost for these stock options been determined based on fair value.



Information regarding option plans is as follows:

	Shares under Option	Weighted Average Exercise Price
Balance at December 31, 2002	1,977,975	\$ 21.23
Granted	843,600	23.10
Exercised	(296,500)	15.37
Forfeited	(34,700)	23.15
Balance at December 31, 2003	2,490,375	22.53
Granted	323,550	36.36
Exercised	(1,260,925)	21.58
Forfeited	(43,950)	23.11
Balance at December 31, 2004	1,509,050	26.28
Granted	42,000	33.80
Exercised	(847,475)	25.48
Forfeited	(46,850)	26.10
Balance at December 31, 2005	656,725	\$ 27.82

The following table provides information about the options outstanding at December 31, 2005.

Range of Exercise Prices	Outstanding			Exercisable	
	Number of Shares at December 31, 2005	Weighted Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Number of Shares at December 31, 2005	Weighted Average Exercise Price
\$7.50 – 23.82	293,075	2.40	\$ 22.72	121,675	\$ 22.49
\$23.83 – 29.81	144,750	1.90	\$ 26.29	139,100	\$ 26.19
\$29.82 – 37.27	218,900	4.30	\$ 35.66	218,900	\$ 35.66

#### *Restricted Stock Plan Information*

During the year ended December 31, 2004, the Compensation Committee granted restricted units of our common stock to certain of our key executives and employees. No restricted common stock units or restricted common stock were granted in 2005 or 2003. These grants are subject to earning requirements on the basis of a percentage change between the price of our common stock versus the average of the common stock price of a peer group of companies over a two-year period. Up to one-half of the grants made in 2004 may be earned each year depending on our cumulative common stock performance, with any amount earned subject to vesting in five equal installments over a five-year period, conditional upon continued employment. At the time of vesting of a restricted common stock unit, the participant will be issued a share of our common stock for each common stock unit vested. At the time of each vesting, a participant receives a tax-assistance payment. As of December 31, 2005, all of the grants made in 2004 had been earned. As of December 31, 2005, 508,350 shares or units of restricted stock were outstanding and unvested under this and former, similar grants, all of which were earned, subject to vesting requirements. The numbers and weighted average grant date fair values of restricted stock units granted in 2004 were 22,000 and \$30.49. Compensation expense under the restricted stock plans was \$8.8 million, \$10.5 million and \$8.2 million for the years ended December 31, 2005, 2004 and 2003, respectively. Each grantee of shares of restricted common stock mentioned in this paragraph is deemed to be the record owner of those shares during the restriction period, with the right to vote and receive any dividends on those shares. The restricted stock units granted in 2004 carry no voting or dividend rights.

#### *Shareholder Rights Plan*

We adopted a Stockholder Rights Plan on November 20, 1992, which was amended and restated as of November 16, 2001. Each Right initially entitles the holder to purchase from us a fractional share consisting of one one-hundredth of a share of Series B Junior Participating Preferred Stock, at a purchase price of \$60 per fractional share, subject to adjustment. The Rights generally will not become exercisable until ten days after a public announcement that a person or

group has acquired 15% or more of our common stock (thereby becoming an "Acquiring Person") or the commencement of a tender or exchange offer that would result in a person or group becoming an Acquiring Person (the earlier of such dates being called the "Distribution Date"). Rights were issued and will continue to be issued with all shares of our common stock that are issued until the Distribution Date. Until the Distribution Date, the Rights will be evidenced by the certificates representing our common stock and will be transferable only with our common stock. Generally, if any person or group becomes an Acquiring Person, each Right, other than Rights beneficially owned by the Acquiring Person (which will thereupon become void), will thereafter entitle its holder to purchase, at the Rights' then current exercise price, shares of our common stock having a market value of two times the exercise price of the Right. At any time until ten days after a public announcement that the Rights have been triggered, we will generally be entitled to redeem the Rights for \$.01 and to amend the Rights in any manner other than certain specified exceptions. Certain subsequent amendments are also permitted. The Rights expire on November 20, 2011.

#### *Post-Employment Benefit*

In November 2001, we entered into an agreement with our Chairman and Chief Executive Officer (the "Chairman"). The agreement provides for a specific employment period with us through August 15, 2006, followed by a specific service period ending no later than August 15, 2011, during which the Chairman, acting as an independent contractor, has agreed to serve as nonexecutive Chairman of our Board of Directors if requested to serve in that capacity by our Board of Directors. The agreement provides the Chairman with a post-employment benefit of ten years following his services to us. The agreement also provides for medical coverage on an after-tax basis to the Chairman, his spouse and children during his employment with us, and, under certain circumstances, thereafter for their lives. We are recognizing the net present value of the post-employment benefits over the expected service period. Our accrued liability under this post-employment benefit was \$4.6 million and \$2.0 million at December 31, 2005 and 2004, respectively. If the service period is reduced or terminated under circumstances entitling the Chairman to these post-employment benefits, we will recognize the previously unaccrued benefits.

**SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)***(in thousands, except per share data)*

<b>Quarter Ended</b>	<b>Year Ended December 31, 2005</b>				
	<b>March 31</b>	<b>June 30</b>	<b>Sept. 30</b>	<b>Dec. 31</b>	<b>Total</b>
Revenue	\$ 210,737	\$ 235,970	\$ 263,111	\$ 288,725	\$ 998,543
Gross profit	33,203	40,567	49,334	56,176	179,280
Income from operations	14,493	20,660	28,335	30,581	94,069
Net income	10,592	14,673	17,714	19,701	62,680
Diluted earnings per share	\$ 0.40	\$ 0.55	\$ 0.66	\$ 0.72	\$ 2.34
Weighted average number of common shares and equivalents	26,510	26,582	26,921	27,282	26,824

<b>Quarter Ended</b>	<b>Year Ended December 31, 2004</b>				
	<b>March 31</b>	<b>June 30</b>	<b>Sept. 30</b>	<b>Dec. 31</b>	<b>Total</b>
Revenue	\$ 166,628	\$ 194,653	\$ 192,862	\$ 226,038	\$ 780,181
Gross profit	25,634	32,869	34,205	39,095	131,803
Income from operations	8,957	16,831	18,719	19,357	63,864
Net income	4,830	10,912	12,846	11,712	40,300
Diluted earnings per share	\$ 0.19	\$ 0.43	\$ 0.50	\$ 0.45	\$ 1.57
Weighted average number of common shares and equivalents	25,378	25,589	25,871	25,903	25,685



# Directors and Key Management

## Directors

**T. JAY COLLINS**  
President and Chief Operating  
Officer of Oceaneering  
International, Inc.

**JEROLD J. DESROCHE**  
Partner and a Director of  
National Power Company

**DAVID S. HOOKER**  
Chairman of Ocean Hover Limited  
and a Director of Aminex Plc

**JOHN R. HUFF**  
Chairman and Chief Executive  
Officer of Oceaneering  
International, Inc.

**D. MICHAEL HUGHES**  
Owner of The Broken Arrow  
Ranch and Affiliated Businesses

**HARRIS J. PAPPAS**  
President of Pappas Restaurants,  
Inc. and a Director of Luby's, Inc.

## Corporate Management

**JOHN R. HUFF**  
Chairman and Chief  
Executive Officer

**T. JAY COLLINS**  
President and Chief  
Operating Officer

**MARVIN J. MIGURA**  
Senior Vice President and  
Chief Financial Officer

**GEORGE R.  
HAUBENREICH, JR.**  
Senior Vice President, General  
Counsel, and Secretary

**STEPHEN E. BRADSHAW**  
Vice President Business  
Development

**GREGG K. FARRIS**  
Vice President Information  
Technology

**JOHN L. ZACHARY**  
Controller and Chief  
Accounting Officer

**ROBERT P. MINGOIA**  
Treasurer

**ROBERT P. MOSCHETTA**  
Vice President Health  
Safety Environment

**JANET G. CHARLES**  
Director of Human Resources

## Offshore Oil and Gas Services and Products

**M. KEVIN McEVOY**  
Senior Vice President –  
Western Region

**JERRY A. GAUTHIER**  
Vice President & General  
Manager, Americas

**NORR D. GORMAN**  
Vice President & General  
Manager, Oilfield  
Projects & Diving

**ROBERT "PAT" MANNINA**  
Vice President, ROV  
Western Region

**CHARLES A. ROYCE**  
Vice President, Sales  
& Marketing

**SCOTT A. WAGNER**  
Vice President & General  
Manager, Brazil

**WAYNE M. BETTS**  
Manager, ROV Brazil

**DELL D. DODSON**  
Manager, Worldwide  
ROV SCM

**LANNY L. FALGOUT**  
Commercial Manager

**STEVEN HALL**  
Manager, Diving

**JEFF HARRIS**  
Manager, ROV Commercial

**MIKE ELLIS**  
Manager, Installation Projects

**RANDALL G. KILLE**  
Manager, IMR Projects

**WARREN KLINGLER**  
Manager, Dive/Marine

**DUANE LANDRY**  
Region Controller

**TIM LAWRENCE**  
Manager, ROV Canada

**J. DAVID MACNAMARA**  
Manager, Worldwide  
ROV Materials

**ERNESTO MARCOS**  
Country Manager, Mexico

**PATRICK MATTHEWS**  
Manager, Survey

**DARRIN MCGUIRE**  
Manager, Marine

**DARRYL RUNDQUIST, SR.**  
Manager, ROV Operations

**MIKE TODD**  
Manager, Subsea  
Projects Operations

**WAYNE A. REED**  
Manager, HSE

**THOMAS VERHAGEN**  
Region Business Manager

**CLYDE HEWLETT**  
Vice President & General  
Manager – MOPS

**FRED E. SHUMAKER**  
Vice President, Commercial

**MIKE CHERRY**  
Operations Manager, Angola

**ANDY HENDERSON**  
Manager, Subsea Tiebacks

**MAX KATTNER**  
Engineering Manager

**ED LILES**  
Project Manager

**BEN NEWTON**  
Managing Director, Australia

**RICK SPOTTSWOOD**  
Construction Manager

**RICHARD J. THOMPSON**  
Manager of Operations, MOPS

**ALEXANDER WESTWOOD**  
Senior Vice President –  
Eastern Region

**ERIC JOHNSTON**  
Vice President, Inspection

**KEVIN KERINS**  
Vice President, ROV  
Eastern Region

**ANDREW ATKINSON**  
Director & General  
Manager, Asia

**COLIN FORBES**  
Regional Legal Counsel

**MALCOLM GRAY**  
Pipelines Manager, Inspection

**FIONA INKSTER**  
Regional Human  
Resources Manager

**CHANDRU LALWANI**  
Region Controller

**BERNT AAGE LIE**  
General Manager, Commercial  
& Administration, Norway

**ANDREW MACKIE**  
Manager, Tax

**MARTIN McDONALD**  
ROV Manager, Africa  
& Middle East

**JOHN McMENEMY**  
Commercial Manager,  
Inspection

**JAMES McNAB**  
Global Technology  
Manager, Inspection

**ALEX MUSTARD**  
Regional Manager, Inspection,  
Aberdeen & North Sea

**C. ANDRE OLIVIER**  
Manager, Inspection Americas

**ALISTAIR PARLEY**  
ROV Manager, Technical  
Support, Eastern Region

**JONATHAN E. PLAYFORD**  
Commercial Manager, ROV

**NEIL RIDDLE**  
Regional Manager, Inspection,  
Asia, Africa, & Middle East

**HAROLD ROBERTS**  
Manager Business  
Development, West Africa

**ERIK H. SAESTAD**  
ROV General  
Manager, Norway

**NIGEL SMITH**  
ACET Software  
Development Manager

**JOHN WATKINSON**  
Regional Manager, Inspection,  
England & Wales

**NEIL WELLAM**  
ROV Manager, Operations  
Support, Europe

**F. RICHARD FRISBIE**  
Senior Vice President –  
Deepwater Technologies

**DREW TRENT**  
Vice President, Deepwater  
Technical Solutions

**CHARLES ERIC BROWN**  
General Manager, OIE U.K.

**CHARLES B. HANSEN**  
General Manager, OIE Norway

**PHILIP D. GARDNER**  
Senior Vice President –  
Subsea Products

**JOHN ADAMS**  
Vice President,  
Manufacturing – Grayloc

**MARK GALAGAZA**  
Vice President – OIE

**BRUCE T. GARTHWAITE**  
Vice President, Exploration &  
Production Support Group

**FERGUS HINES**  
Vice President,  
Engineering – Multiflex

**STEVE KLAK**  
Vice President, Engineering &  
Quality Assurance – Grayloc

**BOB MAHL**  
Vice President,  
Finance – Grayloc

**GERALD MARSH**  
President – Grayloc

**JOHN MARSH**  
Vice President,  
Manufacturing – Multiflex

**MIKE ROBBINS**  
Vice President, Sales &  
Marketing – Grayloc

**JEFFREY M. WHITE**  
Vice President, Sales &  
Marketing – Multiflex

**CHARLIE BACKHOUSE**  
General Manager –  
Multiflex U.K.

**HASSAN BOKHARI**  
Manager, Manufacturing  
Operations – OIE

**FERNANDO FONTES**  
Manager, Operations –  
Multiflex Brazil

**LINDA WAINWRIGHT**  
General Manager –  
Multiflex U.S.

**ROBERT C. BURNETT**  
Sr. Contracts Manager –  
Subsea Products

**CHAD BLANCHARD**  
Manager, IWOCs  
Service/Rental

**JOHN CHARALAMBIDES**  
Manager, Pipeline Repair  
Systems – Grayloc

**MICHAEL T.  
CUNNINGHAM**  
Manager, Sales &  
Marketing – OIE

**ALAN CURTIS**  
Controller – Subsea Products

**ANTHONY FRANKLIN**  
Business Development  
Manager – Subsea Products

**PAUL FRIKSTAD**  
Managing Director – Rotator

**MICHAEL HESSEL, JR.**  
Business Development  
Manager – Subsea Products

**DANIEL A. KROHN**  
Subsea Field Development  
Manager – OIE

**PETER A. MOLES**  
Chief Engineer, Special  
Projects – OIE

**LYNDA MORSE**  
Director, Materials  
Management – Subsea Products

**TOM POLLOCK**  
Managing Director, U.K.  
Operations – Grayloc

**KATIE SWICK**  
Manager, Marketing –  
Subsea Products

**RUSSELL W. TALBOT**  
Director, Quality Assurance –  
Subsea Products

## Advanced Technologies

**JOHN R. KREIDER**  
Senior Vice President

**MARK M. GITTLEMAN**  
Vice President & General  
Manager, Oceaneering  
Space Systems

**DUNCAN MCLEAN**  
Vice President & General  
Manager, OTECH

**TOM STOWELL**  
Vice President & General  
Manager, Marine Services

**DONALD W. WELCH**  
Vice President, Strategic  
Business Development

**ROBERT BROWN**  
Division Controller

**KENT COPELAND**  
Manager, Robotics &  
Automation Programs

**CHUCK DOTY**  
Director, Submarine  
Programs, Marine Services

**JOHN HAMMOND**  
Manager, San Diego

**R. DAN JOLLY**  
Manager, Development Projects

**LARRY KARL**  
Manager, Marine Systems

**ROY KLUSENDORF**  
Manager, Business  
Development, Space Systems

**DAVE MAUCK**  
Manager, Entertainment  
Systems

**CRAIG MCLAUGHLIN**  
Manager, OTECH Nauticos

**MARTY MERZWA**  
Director, Business  
Development, Marine Services

**NOREEN O'NEILL**  
Director, Contracts

**AMJAD QURESHI**  
HSE Manager

**JEFFREY SCHMIDT**  
Sub-Safe Program Director  
/ Marketing Director,  
Marine Services

**FRANK SAGER**  
Manager, Operations  
& Services / NBL

**PERRY SMITH**  
Manager, Waterfront Facilities  
& Diving, Marine Services

**DAVE WALLACE**  
Manager, Thermal & Military  
Systems, Space Systems

**DAVE WEAVER**  
Manager, Marine Projects

**MICHAEL WITHEY**  
Manager, Human Space  
Flight Programs

## **Corporate Office**

Oceaneering International, Inc.  
11911 FM 529  
Houston, Texas 77041-3011  
P.O. Box 40494  
Houston, Texas 77240-0494  
Telephone: (713) 329-4500  
Fax: (713) 329-4951  
www.oceaneering.com

## **Stock Symbol: OII**

Stock traded on NYSE  
CUSIP Number: 675232102  
Please direct communications concerning stock transfer requirements or lost certificates to our transfer agent.

## **Transfer Agent and Registrar**

Computershare Trust Company, N.A.  
P.O. Box 43078  
Providence, RI 02940-3078  
Overnight Deliveries:  
250 Royall Street  
Canton, MA 02021-1011  
OII Account Information – www.computershare.com  
Telephone: (781) 575-2879  
Fax: (781) 575-3605  
Hearing Impaired/TDD: (800) 952-9245

## **Annual Shareholders' Meeting**

Date: May 12, 2006  
Time: 8:30 a.m. CDT  
Location: Oceaneering International, Inc.  
Corporate Office Atrium  
11911 FM 529  
Houston, Texas 77041

## **Independent Public Accountants**

Ernst & Young LLP  
5 Houston Center  
1401 McKinney, Ste. 1200  
Houston, Texas 77010-4035

## **Counsel**

Baker Botts L.L.P.  
One Shell Plaza  
910 Louisiana Street  
Houston, Texas 77002-4995

## **Form 10-K**

The entire Form 10-K, as filed with the Securities and Exchange Commission, may be accessed through the Oceaneering website [www.oceaneering.com](http://www.oceaneering.com) by selecting "Investor Relations," then "SEC Financial Reports," then selecting the desired report, or may be obtained by writing to:

George R. Haubenreich, Jr.  
Secretary  
Oceaneering International, Inc.  
P.O. Box 40494  
Houston, Texas 77240-0494

## **Photo Credits**

### **COVER**

ROV – Courtesy of Shell International E&P Inc. Houston  
SAT Diving Bell – Roger Smith  
Rope Access Inspection – Courtesy of Tahanie Thibodeaux  
Medusa Spar

### **AT A GLANCE**

ROV System – Gonzo Eychner  
IWOCS Control Panel – Van VanDeCapelle  
M7 SAT Diving Bell Control Van – Larry Miller  
Refinery Inspection – Emiliano Lardone  
U.S. Navy Submarine – Courtesy of U.S. Navy

### **OPERATIONS**

PAGE 6 Millennium 20 – John Murphy  
PAGE 7 ROV Layout and Launch –  
Millennium 25 Installation Crew  
PAGE 8 *Ocean Legend* – Roger Avery  
PAGE 9 Panama City, FL Facility – Courtesy of Al Short  
PAGE 10 Rotator DCV Manifold – Bjørn Ole Nyborg  
PAGE 11 Umbilical Termination Assembly –  
Frank Connors  
Gas Lift Connector – Mike Cunningham  
PAGE 12 *Ocean Intervention II* Flowline – Casey Connoley  
M7 SAT Diving System – Roger Smith  
PAGE 14 Space Shuttle – Courtesy of NASA  
PAGE 15 *DarKastle* – Courtesy of  
Busch Gardens Williamsburg  
Submarine – Courtesy of U.S. Navy  
PAGE 16 Squid – Angel D. Perez and  
*Ocean Service* ROV Crew

## **Forward-Looking Statements**

All statements in this report that express a belief, expectation, or intention, as well as those that are not historical fact, are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current information and expectations that involve a number of risks, uncertainties, and assumptions. Among the factors that could cause the actual results to differ materially from those indicated in the forward-looking statements are: industry conditions; prices of crude oil and natural gas; Oceaneering's ability to obtain and the timing of new projects; operating risks; changes in government regulations; technological changes; and changes in competitive factors. Should one or more of these risks or uncertainties materialize, or should the assumptions underlying the forward-looking statements prove incorrect, actual outcomes could vary materially from those indicated. These and other risks are fully described in Oceaneering's annual report on Form 10-K for the year ended December 31, 2005 and other periodic filings with the Securities and Exchange Commission.



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