OCEANEERING INTERNATIONAL INC
Form 10-K
February 28, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2006

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from __________ to __________

Commission file number 1-10945

OCEANEERING INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-2628227**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11911 FM 529	
Houston, Texas	**77041**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(713) 329-4500**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $0.25 par value	New York Stock Exchange
Rights to Purchase Series B Junior Participating Preferred Stock (currently traded with Common Stock)	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes þ, No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o, No þ

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

Large accelerated filer þ Accelerated filer o Non-accelerated filer o

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

Aggregate market value of the voting stock held by nonaffiliates of the registrant computed by reference to the closing price of $45.85 of the Common Stock on the New York Stock Exchange as of June 30, 2006, the last business day of the registrant s most recently completed second quarter: $2,444,664,000

Number of shares of Common Stock outstanding at February 16, 2007: 55,443,938

Documents Incorporated by Reference:

Portions of the proxy statement relating to the registrant s 2007 annual meeting of shareholders, to be filed on or before April 30, 2007 pursuant to Regulation 14A of the Securities Exchange Act of 1934, are incorporated by reference to the extent set forth in Part III, Items 10-14 of this report.

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Exhibit Index

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PART I

ITEM 1. BUSINESS.

GENERAL DEVELOPMENT OF BUSINESS

Oceaneering International, Inc. is a global oilfield provider of engineered services and products primarily to the offshore oil and gas industry, with a focus on deepwater applications. Through the use of its applied technology expertise, Oceaneering also serves the defense and aerospace industries. Oceaneering was organized as a Delaware corporation in 1969 out of the combination of three diving service companies founded in the early 1960s. Since our establishment, we have concentrated on the development and marketing of underwater services and products requiring the use of advanced deepwater technology. We are one of the world s largest underwater services contractors. The services and products we provide to the oil and gas industry include remotely operated vehicles, mobile offshore production systems, built-to-order specialty hardware, engineering and project management, subsea intervention services, nondestructive testing and inspection, and manned diving. We have locations in the U.S. and 17 other countries. Our international operations, principally in the North Sea, West Africa, Brazil, Australia and Asia, accounted for approximately 47% of our revenue, or $600 million, for the year ended December 31, 2006.

Our business segments are contained within two businesses services and products provided to the oil and gas industry (Oil and Gas) and all other services and products (Advanced Technologies). Our five business segments within the Oil and Gas business are Remotely Operated Vehicles (ROVs), Subsea Products, Subsea Projects, Inspection and Mobile Offshore Production Systems. We report our Advanced Technologies business as one segment. 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.

Oil and Gas. The focus of our Oil and Gas business has been toward increasing our asset base for providing services and products for deepwater offshore operations and subsea completions.

ROVs. Prior to 1995, we purchased most of our ROVs, which are submersible vehicles operated from the surface and widely used in the offshore oil and gas industry. However, in response to increased demand for more powerful systems operating in deeper water, we expanded our capabilities and established an in-house facility to design and build ROVs to meet the continued expansion of our ROV fleet. This facility was established and became fully operational in January 1998. We have built over 150 ROV systems, and we are producing all our new ROVs in-house. For a few years leading into 2005, except for units we have purchased from other ROV operators, we had kept the number of our work-class ROVs at a constant level and built new systems for replacement and upgrade of our existing fleet. In the first quarter of 2004, we completed the acquisition of 34 additional work-class ROVs and related business operations from Stolt Offshore S.A. In September 2004, we acquired 10 work-class ROVs and related equipment and business operations in North and South America from Fugro N.V. In 2005 and 2006, in response to increased demand in the deepwater market, we added 33 ROVs, 30 that we built and three that we purchased from another company, and retired 15 older ROVs.

Subsea Products. Through our Oceaneering Intervention Engineering division, we construct a variety of built-to-order specialty subsea hardware. In 2003, we purchased Rotator AS, a designer and manufacturer of subsea control valves, topside control valves, subsea chemical injection valves and specialty control panels. In 2005, we acquired Grayloc Products, L.L.C. and subsidiary (together, Grayloc), an oil and gas industry supplier of high performance clamp connectors used in production manifold, flowline and valve installations.

Our Multiflex division provides subsea hydraulic and electrohydraulic umbilicals. Offshore operators use umbilicals to, among other things, control subsea wellhead hydrocarbon flow rates. We entered this market in March 1994 through our purchase of the operating subsidiaries of Multiflex International Inc. During 1998, we constructed an umbilical plant in Brazil and relocated, modernized and increased the capabilities, including the production of steel tube umbilicals, of our umbilical manufacturing facility in Scotland. Both facilities began operations in the first half of 1999. During 2004, we moved our U.S. facility to a new location, which has added capacity and the capability of producing steel tube umbilicals, and added steel tube capability to our plant in Brazil. We started production of our first steel tube umbilicals from our U.S. facility in 2006, and we delivered approximately 95 miles of steel tube umbilicals during 2006.

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Subsea Projects. Our Subsea Projects segment consists of our subsea installation, inspection, maintenance and repair services utilizing our Gulf of Mexico vessels, including our Ocean Intervention class vessels, the *Ocean Intervention* and the *Ocean Intervention II*, which went into service in 1998 and 2000, respectively, and our specialized diving group. The Ocean Intervention class vessels are equipped with thrusters that allow them to be dynamically positioned, which means they can maintain a constant position at a location without the use of anchors. They are used in pipeline or flowline tie-ins, pipeline crossings and subsea hardware interventions and installations. Both vessels can carry and install coiled tubing or umbilicals required to bring subsea well completions into production (tie-back to production facilities). In 2006 we transferred our vessel *The Performer* from our Advanced Technologies segment to our Subsea Projects segment. As of February 2007, we were upgrading its dynamic positioning system and crane capacity for deepwater inspection, maintenance and repair projects in the Gulf of Mexico. We occasionally charter vessels from others to augment our fleet. In 2006, we chartered a larger dynamically positioned vessel for three years, and we expect the three-year term of the charter to start in April 2007.

Inspection. Our Inspection segment consists of nondestructive testing and inspection services. We supply inspection services to customers required to obtain third-party inspections to satisfy contractual structural specifications, internal safety standards or regulatory requirements. In January 2003, we acquired OIS International Inspection plc. This acquisition approximately tripled the size of our Inspection services.

Mobile Offshore Production Systems. We own three operating mobile offshore production systems:

- the floating production, storage and offloading system *Ocean Producer*, which has been operating offshore West Africa since December 1991;

- the production barge *San Jacinto*, which we acquired in December 1997 and which is currently under contract offshore Indonesia; and

- the mobile offshore production system *Ocean Legend*, which has been operating offshore Western Australia since May 2001.

In December 2003, we purchased a 50% equity interest in Medusa Spar LLC, which owns 75% of 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. The spar is currently located on the Medusa field in the Gulf of Mexico. Medusa Spar LLC has a contract covering production from the Medusa field and other nearby areas. The majority working interest owner of the Medusa field has committed to deliver minimum volumes, which we expect will generate sufficient revenue to repay Medusa Spar LLC s outstanding debt. 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.

Advanced Technologies. In August 1992 and May 1993, we purchased two businesses that formed the basis of our Advanced Technologies segment. The first business designed, developed and operated robotic systems and ROVs specializing in non-oilfield markets and provided the basis for our expansion into commercial and governmental subsea cable field support, maintenance and repair, civil works projects and commercial theme park animation. The second business designed, developed and fabricated spacecraft hardware and high-temperature insulation products. In 2003, we acquired Nauticos Corporation, a provider of marine services support to governmental and commercial customers.

General. We intend to continue our strategy of acquiring, as opportunities arise, additional assets or businesses, to improve our market position or expand into related service and product lines, either directly through merger, consolidation or purchase, or indirectly through joint ventures.

FINANCIAL INFORMATION ABOUT SEGMENTS

For financial information about our business segments, please see the table in Note 6 of the Notes to Consolidated Financial Statements in this report, which presents revenue, income from operations, depreciation and amortization expense, equity earnings (losses) of unconsolidated affiliates and capital expenditures for the years ended December 31, 2006, 2005 and 2004, and identifiable assets and goodwill by business segment as of December 31, 2006 and 2005.

DESCRIPTION OF BUSINESS

Oil and Gas

Our Oil and Gas business consists of ROVs, Subsea Products, Subsea Projects, Inspection and Mobile Offshore Production Systems.

ROVs. ROVs are submersible vehicles operated from the surface. 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. ROVs may be outfitted with manipulators, sonar, video cameras, specialized tooling packages and other equipment or features to facilitate the performance of specific underwater tasks. At December 31, 2006, we owned 186 work-class ROVs. We are the industry leader in providing ROV services on deepwater wells, which are the most technically demanding. We believe we operate the largest and most technically advanced fleet of ROVs in the world.

ROV revenue:

	Amount *(in thousands)*	Percent of Total Revenue
Year ended December 31, 2006	$ 410,256	32%
Year ended December 31, 2005	315,178	32%
Year ended December 31, 2004	223,914	29%

Subsea Products. We construct a variety of built-to-order specialty subsea hardware to ISO 9001 quality requirements. These products include:

- hydraulic, electrohydraulic and chemical injection umbilicals utilizing thermoplastic hoses and steel tubes;
- ROV tooling and work packages;
- subsea and topside control valves;
- subsea chemical injection valves;
- production control equipment;
- clamp connectors; and
- pipeline repair systems.

We market these products under the trade names Oceaneering Multiflex, Oceaneering Intervention Engineering, Oceaneering Grayloc and Oceaneering Rotator.

Offshore well operators use subsea umbilicals and production control equipment to control subsea wellhead hydrocarbon flow, monitor downhole and wellhead conditions and perform chemical injection. ROV tooling and work packages provide the operational link between an ROV and permanently installed equipment located on the sea floor. Valves are used to control and meter hydrocarbon production flow rates and to inject chemicals into production streams at the wellhead to enhance well flow characteristics.

Subsea Products revenue:

	Amount *(in thousands)*	Percent of Total Revenue
Year ended December 31, 2006	$ 364,510	29%

Year ended December 31, 2005	239,039	24%
Year ended December 31, 2004	160,410	21%

Subsea Projects. We perform subsea intervention and hardware installation services from our multiservice vessels. These services include: subsea well tie-backs; pipeline/flowline tie-ins and repairs; pipeline crossings; umbilical and other subsea equipment installations; subsea intervention and inspection, repair and maintenance activities.

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We supply commercial diving services to the oil and gas industry in the Gulf of Mexico using the traditional techniques of air, mixed gas and saturation diving, all of which use surface-supplied breathing gas. We do not use traditional diving techniques in water depths greater than 1,000 feet. We also use atmospheric diving systems, which enclose the operator in a surface pressure diving suit, in water depths up to 2,300 feet.

Subsea Projects revenue:

	Amount *(in thousands)*	Percent of Total Revenue
Year ended December 31, 2006	$ 155,046	12%
Year ended December 31, 2005	121,628	12%
Year ended December 31, 2004	70,254	9%

Inspection. Through our Oceaneering Inspection division, we offer a wide range of inspection services to customers who are required to obtain third-party inspections to satisfy contractual structural specifications, internal safety standards or regulatory requirements. We provide these services principally to customers in the oil and gas, petrochemical and power generation industries. In the U.K., we provide Independent Inspection Authority services for the oil and gas industry, which includes first-pass integrity evaluation and assessment and nondestructive testing services. We use a variety of technologies to perform pipeline inspections, both onshore and offshore.

Inspection revenue:

	Amount *(in thousands)*	Percent of Total Revenue
Year ended December 31, 2006	$ 169,014	13%
Year ended December 31, 2005	154,857	15%
Year ended December 31, 2004	145,691	19%

Mobile Offshore Production Systems. We presently own three operating mobile offshore production systems, the *Ocean Legend*, the *Ocean Producer* and the *San Jacinto.*

We also undertake engineering and project management of projects related to mobile offshore production systems. We have managed the conversion of a jackup to a production unit and in-field life extension and modifications to a floating production storage and offloading system. We also perform engineering studies for customers evaluating field development projects.

We own a 50% equity interest in Medusa Spar LLC, which owns 75% of 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. The spar is currently located on the Medusa field in the Gulf of Mexico. Medusa Spar LLC has a contract covering production from the Medusa field and other nearby areas. We report our interest in this joint venture s results in equity earnings (losses) of unconsolidated affiliates.

Mobile Offshore Production Systems revenue:

	Amount *(in thousands)*	Percent of Total Revenue
Year ended December 31, 2006	$ 52,931	4%
Year ended December 31, 2005	50,091	5%
Year ended December 31, 2004	49,387	6%

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Advanced Technologies

Our Advanced Technologies segment provides underwater intervention, engineering services and related manufacturing to meet a variety of industrial requirements, including ship and submarine husbandry, search and recovery, maintenance and repair, civil works projects, commercial theme park equipment and engineering services and products for the space industry. We do this in part by extending the use of existing assets and technology developed in oilfield operations to new applications.

We work for customers having specialized requirements in underwater or other hazardous environments outside the oil and gas industry. We provide support for the U.S. Navy, including underwater operations, data analysis, development of ocean-related computer software, and design and development of new underwater tools and systems. We also install and maintain mechanical systems for the Navy s surface ships, submarines, piers, offshore structures and moorings. We provide products and services to NASA and aerospace prime contractors and we manage the underwater activities for astronaut training at NASA s Neutral Buoyancy Laboratory. Our NASA-related activities substantially depend on continued government funding for space programs.

Advanced Technologies revenue:

	Amount (in thousands)	Percent of Total Revenue
Year ended December 31, 2006	$ 128,441	10%
Year ended December 31, 2005	117,750	12%
Year ended December 31, 2004	130,525	17%

We have a 50% interest in a joint venture we formed with a subsidiary of Smit Internationale, N.V. The joint venture was originally formed to maintain and operate commercial cable lay and maintenance equipment. Due to the condition of the telecommunications market, the single vessel used in the venture was marketed for oilfield and other uses commencing in 2004. In 2005, we purchased the cable lay and maintenance equipment from the venture and, in 2006, we purchased the vessel from the venture. Our purchase of the vessel effectively ended the operations of the venture. We subsequently sold the vessel for a small gain. The venture will be liquidated after collection of outstanding amounts receivable and payment of remaining amounts owed to creditors. We report our interest in this joint venture s results in equity earnings (losses) of unconsolidated affiliates.

MARKETING

Oil and Gas. Oil and gas exploration and development expenditures fluctuate from year to year. In particular, budgetary approval for more expensive drilling and production in deepwater, an area in which we have a high degree of focus, may be postponed or suspended during periods when exploration and production companies reduce their offshore capital spending.

We market our ROVs, Subsea Products, Subsea Projects and Inspection services and products to domestic, international and foreign national oil and gas companies engaged in offshore exploration, development and production. We also provide services and products as a subcontractor to other oilfield service companies operating as prime contractors. Customers for these services typically award contracts on a competitive-bid basis. These contracts are typically less than one year in duration, although we enter into multi-year contracts from time to time.

We market our Mobile Offshore Production Systems primarily to international and foreign national oil and gas companies. We offer systems for production and development of fields and prospects in areas lacking pipelines and processing infrastructure. Our systems can also be used for extended well testing and early production of marginal fields. Contracts are typically awarded on a competitive-bid basis, generally for periods of one or more years.

In connection with the services we perform in our Oil and Gas business, we generally seek contracts that compensate us on a dayrate basis. Under dayrate contracts, the contractor provides the ROV or vessel and the required personnel to operate the unit and compensation is based on a rate per day for each day the unit is used. The typical dayrate depends on market conditions, the nature of the operations to be performed, the duration of the work, the equipment and services to be provided, the geographical areas involved and other variables. Dayrate contracts may also contain an alternate,

lower dayrate that applies when a unit is moving to a new site or when operations are interrupted or restricted by equipment breakdowns, adverse weather or water conditions or other conditions beyond the contractor s control. Some dayrate contracts provide for revision of the specified dayrates in the event of material changes in the cost of specified items. Sales contracts for our products are generally for a fixed price.

Advanced Technologies. We market our marine services and related engineering services to government agencies, major defense contractors, NASA and NASA prime contractors, and telecommunications, construction and other industrial customers outside the energy sector. We also market to insurance companies, salvage associations and other customers who have requirements for specialized operations in deep water.

Major Customers. Our top five customers in the years ended December 31, 2006, 2005 and 2004 accounted for 23%, 22% and 23%, respectively, of our consolidated revenue. For the years ended December 31, 2006, 2005 and 2004, four of our top five customers were oil and gas exploration and production companies served by our Oil and Gas business segments. The other top-five customer was the U.S. Navy, which was served by our Advanced Technologies segment. No single customer accounted for more than 10% of our consolidated revenue in any of those three years. While we do not depend on any one customer, the loss of one of our significant customers could, at least on a short-term basis, have an adverse effect on our results of operations.

RAW MATERIALS

Most of the raw materials we use in our manufacturing operations, such as steel in various forms, electronic components and plastics, are available from many sources, and we do not depend on any single supplier or source for any of our raw materials. However, some components we use to manufacture subsea umbilicals are available from limited sources. While we have not experienced any difficulties in obtaining these materials in the past, there is currently a shortage of the specialty steel tubes we need to manufacture certain of our steel tube umbilicals. That shortage is a result of a general worldwide increase in demand for steel. Additionally, the availability of certain grades of aramid fibers, materials we use in the manufacture of our thermoplastic umbilicals, is limited due to demand for military use. At this point, we do not know how significant or prolonged the current shortages will be. Currently the lead times between the placement of an order and delivery of these materials have been extended. Any significant, prolonged shortage of these materials could result in increased costs for these materials and delays in our subsea umbilicals manufacturing operations.

COMPETITION

Our businesses are highly competitive.

Oil and Gas

We are one of several companies that provide underwater services and specialty subsea hardware on a worldwide basis. We compete for contracts with companies that have worldwide operations, as well as numerous others operating locally in various areas. We believe that our ability to provide a wide range of underwater services and products, including technological applications in deeper water (greater than 1,000 feet), on a worldwide basis should enable us to compete effectively in the oilfield exploration and development market. In some cases involving projects that require less sophisticated equipment, small companies have been able to bid for contracts at prices uneconomical to us.

ROVs. We believe we are the world s largest owner/operator of work-class ROVs employed in oil and gas related operations. We own 186 work-class ROVs, and estimate that this represents 36% of the work-class ROVs utilized in the oil and gas service industry. We compete with several major companies on a worldwide basis and with numerous others operating locally in various areas. We have fewer competitors in deeper water depths, as more sophisticated equipment and technology is needed in deeper water.

Competition for ROV services historically has been based on equipment availability, location of or ability to deploy the equipment, quality of service and price. The relative importance of these factors can vary from year to year based on market conditions. The ability to develop improved equipment and techniques and to attract and retain skilled personnel is also an important competitive factor in our markets.

Subsea Products. Although there are many competitors offering either specialized products or operating in limited geographic areas, we believe we are one of a small number of companies that compete on a worldwide basis for the provision of thermoplastic and steel tube subsea control umbilical cables.

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Subsea Projects. We perform subsea intervention and hardware installation services from our multiservice vessels in the Gulf of Mexico. We are one of many companies that offer these services. In general, our competitors can move their vessels to the Gulf of Mexico from other locations with relative ease. We also have many competitors in the supply of our commercial diving services to the oil and gas industry in the Gulf of Mexico.

Inspection. The worldwide inspection market consists of a wide range of inspection and certification requirements in many industries. We compete in only selected portions of this market. We believe that our broad geographic sales and operational coverage, long history of operations, technical reputation, application of various pipeline inspection technologies and accreditation to international quality standards enable us to compete effectively in our selected inspection services market segments.

Mobile Offshore Production Systems. Although we are one of many companies that offer leased mobile offshore production systems, we believe we are positioned to compete in this market when price is not the determining factor through our ability to identify and offer optimum solutions, supply equipment and utilize our expertise in associated subsea technology and offshore construction and operations gained through our extensive operational experience worldwide.

Frequently, oil and gas companies use prequalification procedures that reduce the number of prospective bidders for their projects. In some countries, political considerations tend to favor local contractors.

Advanced Technologies

Engineering services is a very broad market with a large number of competitors. We compete in specialized areas in which we can combine our extensive program management experience, mechanical engineering expertise and the capability to continue the development of conceptual project designs into the manufacture of prototype equipment for customers.

We also use the administrative and operational support structures of our Oil and Gas business to provide additional local support for services provided to this segment s customers.

SEASONALITY AND BACKLOG

A material amount of our consolidated revenue is generated from contracts for marine services in the Gulf of Mexico and the North Sea, which are usually more active from April through November compared to the rest of the year. Although most of our ROVs are engaged in providing drill support services, we have increased our ROV activity in offshore construction and production field maintenance. This change will increase the level of seasonality in our ROV operations, with the low point expected to be in the first quarter of the year. Our Inspection segment s operations remain more active from April through November as compared to the rest of the year. Revenues in our Mobile Offshore Production Systems, Subsea Products and Advanced Technologies segments are generally not seasonal.

The amounts of backlog orders we believed to be firm as of December 31, 2006 and 2005 were as follows (in millions):

	As of December 31, 2006		As of December 31, 2005	
	Total	1 + yr*	Total	1 + yr*
Oil and Gas				
ROVs	$ 616	$ 354	$ 405	$ 206
Subsea Products	359	68	196	34
Subsea Projects	47		35	
Inspection	161	64	97	33
Mobile Offshore Production Systems	41	13	51	26
Total Oil and Gas	1,224	499	784	299
Advanced Technologies	48		53	4
Total	$ 1,272	$ 499	$ 837	$ 303

* Represents amounts that were not expected to be performed within one year.

No material portion of our business is subject to renegotiation of profits or termination of contracts by the U.S. government.

PATENTS AND LICENSES

We currently hold a number of U.S. and foreign patents and have numerous pending patent applications. We have acquired patents and licenses and granted licenses to others when we have considered it advantageous for us to do so. Although in the aggregate our patents and licenses are important to us, we do not regard any single patent or license or group of related patents or licenses as critical or essential to our business as a whole. In general, we depend on our technological capabilities and the application of know-how rather than patents and licenses in the conduct of our operations.

REGULATION

Our operations are affected from time to time and in varying degrees by foreign and domestic political developments and foreign, federal and local laws and regulations, including those relating to:

- construction and equipping of offshore production and other marine facilities;
- marine vessel safety;
- protecting the environment;
- workplace health and safety;
- taxation of foreign earnings and earnings of expatriate personnel; and
- currency conversions and repatriation.

In addition, our Oil and Gas business depends on the demand for our products and services from the oil and gas industry and, therefore, is affected by changing taxes, price controls and other laws and regulations relating to the oil and gas industry generally. The adoption of laws and regulations curtailing offshore exploration and development drilling for oil and gas for economic and other policy reasons would adversely affect our operations by limiting demand for our services. We cannot determine the extent to which new legislation, new regulations or changes in existing laws or regulations may affect our future operations.

Our operations and properties are subject to a wide variety of increasingly complex and stringent foreign, federal, state and local environmental laws and regulations, including those governing discharges into the air and water, the handling and disposal of solid and hazardous wastes, the remediation of soil and groundwater contaminated by hazardous substances and the health and safety of employees. Sanctions for noncompliance may include revocation of permits, corrective action orders, administrative or civil penalties and criminal prosecution. Some environmental laws provide for strict, joint and several liability for remediation of spills and other releases of hazardous substances, as well as damage to natural resources. In addition, companies may be subject to claims alleging personal injury or property damage as a result of alleged exposure to hazardous substances. These laws and regulations may also expose us to liability for the conduct of or conditions caused by others, or for our acts that were in compliance with all applicable laws at the time such acts were performed.

Environmental laws and regulations that apply to our operations include the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, the Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act (each, as amended) and similar laws that provide for responses to, and liability for, releases of hazardous substances into the environment. These laws and regulations also include similar foreign, state or local counterparts to these federal laws, which regulate air emissions, water discharges, hazardous substances and waste, and require public disclosure related to the use of various hazardous substances. Our operations are also governed by laws and regulations relating to workplace safety and worker health, primarily, in the U.S., the Occupational Safety and Health Act and regulations promulgated thereunder.

Compliance with federal, state and local provisions regulating the discharge of materials into the environment or relating to the protection of the environment has not had a material impact on our capital expenditures, earnings or competitive position. We cannot predict all of the environmental requirements or circumstances that will exist in the future but anticipate that environmental control and protection standards will become increasingly stringent and costly. Based on our experience to date, we do not currently anticipate any material adverse effect on our business or consolidated financial position as a result of future compliance with existing environmental laws and regulations. However, future events, such as changes in existing laws and regulations or their interpretation, more vigorous enforcement policies of regulatory agencies, or stricter or different interpretations of existing laws and regulations, may require additional

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expenditures by us, which may be material. Accordingly, there can be no assurance that we will not incur significant environmental compliance costs in the future.

While not a legal requirement, within our Oil and Gas business we maintain various quality management systems. Our quality management systems in the United Kingdom and Norway are registered as being in conformance with ISO 9001:2000 and cover all our Oil and Gas products and services. The quality management systems of our Remotely Operated Vehicle operations in Brazil and Canada are registered to be in compliance with ISO 9001:2000. The quality management systems of our Subsea Products segment are also registered to be in conformance with ISO 9001:2000. The quality management systems of both the Oceaneering Space Systems and Oceaneering Technologies units of our Advanced Technologies segment are also ISO 9001:2000 registered. ISO 9001 is an internationally recognized system for quality management established by the International Standards Organization, and the 2000 edition emphasizes customer satisfaction and continual improvement.

EMPLOYEES

As of December 31, 2006, we had approximately 6,500 employees. Our workforce varies seasonally and peaks during the summer months. Approximately 5% of our employees are represented by unions. We consider our relations with our employees to be satisfactory.

FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS

For financial information about our geographic areas of operation, please see the table in Note 6 of the Notes to Consolidated Financial Statements in this report, which presents revenue and long-lived assets attributable to each of our geographic areas for the years ended December 31, 2006, 2005 and 2004. For a discussion of risks attendant to our foreign operations, see the discussion in Item 1A, Risk Factors under the heading Our international operations involve additional risks not associated with domestic operations.

AVAILABLE INFORMATION

Our Web site address is *www.oceaneering.com*. We make available through this Web site under Investor Relations SEC Financial Reports, free of charge, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, amendments to those reports and Section 16 filings by our directors and executive officers as soon as reasonably practicable after we, or our executive officers or directors, as the case may be, electronically file those materials with, or furnish those materials to, the SEC.

We have adopted, and posted on our Web site: our corporate governance guidelines; a code of ethics for our Chief Executive Officer and Senior Financial Officers; and charters for the Audit, Nominating and Corporate Governance and Compensation Committees of our Board of Directors.

EXECUTIVE OFFICERS OF THE REGISTRANT.

Executive Officers. The following information relates to our executive officers as of February 23, 2007:

NAME	AGE	POSITION	OFFICER SINCE	EMPLOYEE SINCE
T. Jay Collins	60	President and Chief Executive Officer and Director	1993	1993
M. Kevin McEvoy	56	Executive Vice President	1990	1979
Marvin J. Migura	56	Senior Vice President and Chief Financial Officer	1995	1995
George R. Haubenreich, Jr.	59	Senior Vice President, General Counsel and Secretary	1988	1988
Philip D. Gardner	56	Senior Vice President Subsea Products	2006	2004

W. Cardon Gerner	52	Vice President and Chief Accounting Officer	2006	2006

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Each executive officer serves at the discretion of our Chief Executive Officer and our Board of Directors and is subject to reelection or reappointment each year after the annual meeting of our shareholders. We do not know of any arrangement or understanding between any of the above persons and any other person or persons pursuant to which he was selected or appointed as an officer.

Business Experience. The following summarizes the business experience of our executive officers. Except where we otherwise indicate, each of these persons has held his current position with Oceaneering for at least the past five years.

T. Jay Collins, President and Chief Executive Officer, joined Oceaneering in 1993 as Senior Vice President and Chief Financial Officer. In 1995, he was appointed Executive Vice President Oilfield Marine Services. He was appointed our President and Chief Operating Officer in 1998 and our Chief Executive Officer in 2006. He was elected a director of Oceaneering in March 2003.

M. Kevin McEvoy, Executive Vice President, joined Oceaneering in 1984 when we acquired Solus Ocean Systems, Inc. Since 1984, he has held various senior management positions in each of our operating groups and geographic areas. He was appointed a Vice President in 1990, a Senior Vice President in 1998 and Executive Vice President in 2006.

Marvin J. Migura, Senior Vice President and Chief Financial Officer, joined Oceaneering in 1995. From 1975 to 1994, he held various financial positions with Zapata Corporation, then a diversified energy services company, most recently as Senior Vice President and Chief Financial Officer from 1987 to 1994.

George R. Haubenreich, Jr., Senior Vice President, General Counsel and Secretary, joined Oceaneering in 1988.

Philip D. Gardner, Senior Vice President Subsea Products, joined Oceaneering in 2004. He served as President of Applied Hydraulic Systems Incorporated (AHI), an oilfield manufacturer and service company, from 1998 to 2002, when it was acquired by Oil States International, Inc. He continued to serve as President of AHI to 2004. He held various senior management positions with Weatherford International Ltd. from 1992 to 1998.

W. Cardon Gerner, Vice President and Chief Accounting Officer, joined Oceaneering in September 2006. From 1999 to 2006, he held various financial positions with Service Corporation International (SCI), a global provider of death-care services, serving as Vice President Accounting from 2002 to 2006. He also served as Senior Vice President and Chief Financial Officer of Equity Corporation International 1995 to 1999. He is a Certified Public Accountant.

ITEM 1A. RISK FACTORS.

Investors in our company should consider the following matters, in addition to the other information we have provided in this report and the documents we incorporate by reference.

We derive most of our revenue from companies in the offshore oil and gas industry, a historically cyclical industry with levels of activity that are significantly affected by the levels and volatility of oil and gas prices.

We derive most of our revenue from customers in the offshore oil and gas exploration, development and production industry. The offshore oil and gas industry is a historically cyclical industry characterized by significant changes in the levels of exploration and development activities. Oil and gas prices, and market expectations of potential changes in those prices, significantly affect the levels of those activities. Worldwide political, economic and military events have contributed to oil and gas price volatility and are likely to continue to do so in the future. Any prolonged reduction in the overall level of offshore oil and gas exploration and development activities, whether resulting from changes in oil and gas prices or otherwise, could materially and adversely affect our financial condition and results of operations in our segments within our Oil and Gas business. Some factors that have affected and are likely to continue affecting oil and gas prices and the level of demand for our services and products include the following:

- worldwide demand for oil and gas;
- general economic and business conditions and industry trends;
- the ability of the Organization of Petroleum Exporting Countries, or OPEC, to set and maintain production levels and pricing;
- the level of production by non-OPEC countries;

- domestic and foreign tax policy;
- laws and governmental regulations that restrict exploration and development of oil and gas in various offshore jurisdictions;
- rapid technological changes;
- the political environment of oil-producing regions;
- the price and availability of alternative fuels; and
- overall economic conditions.

Our international operations involve additional risks not associated with domestic operations.

A significant portion of our revenue is attributable to operations in foreign countries. These activities accounted for approximately 47% of our consolidated revenue in the year ended December 31, 2006. Risks associated with our operations in foreign areas include risks of:

- war and civil disturbances or other risks that may limit or disrupt markets;
- expropriation, confiscation or nationalization of assets;
- renegotiation or nullification of existing contracts;
- foreign exchange restrictions;
- foreign currency fluctuations;
- foreign taxation;
- the inability to repatriate earnings or capital;
- changing political conditions;
- changing foreign and domestic monetary policies;
- social, political, military and economic situations in foreign areas where we do business and the possibilities of war, other armed conflict or terrorist attacks; and
- regional economic downturns.

Additionally, in some jurisdictions we are subject to foreign governmental regulations favoring or requiring the awarding of contracts to local contractors or requiring foreign contractors to employ citizens of, or purchase supplies from, a particular jurisdiction. These regulations may adversely affect our ability to compete.

Our exposure to the risks we described above varies from country to country. In recent periods, political instability and civil unrest in Indonesia and West Africa have been our greatest concerns. There is a risk that a continuation or worsening of these conditions could materially and adversely impact our future business, operations, financial condition and results of operations. Of our total consolidated revenue for the year ended December 31, 2006, we generated approximately 12% from our operations in West Africa.

Our offshore oilfield operations involve a variety of operating hazards and risks that could cause losses.

Our operations are subject to the hazards inherent in the offshore oilfield business. These include blowouts, explosions, fires, collisions, capsizings and severe weather conditions. These hazards could result in personal injury and loss of life, severe damage to or destruction of property and equipment, pollution or environmental damage and suspension of operations. We may incur substantial liabilities or losses as a result of these hazards. While we maintain insurance protection against some of these risks, and seek to obtain indemnity agreements from our customers requiring the customers to hold us harmless from some of these risks, our insurance and contractual indemnity protection may not be sufficient or effective to protect us under all circumstances or against all risks. The occurrence of a significant event not fully insured or indemnified against or the failure of a customer to meet its indemnification obligations to us could materially and adversely affect our results of operations and financial condition.

Laws and governmental regulations may add to our costs or adversely affect our operations.

Our business is affected by changes in public policy and by federal, state, local and foreign laws and regulations relating to the offshore oil and gas industry. Offshore oil and gas exploration and production operations are affected by tax, environmental, safety and other laws, by changes in those laws and changes in related administrative regulations. It is also possible that these laws and regulations may in the future add significantly to our operating costs or those of our customers or otherwise directly or indirectly affect our operations.

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Environmental laws and regulations can increase our costs, and our failure to comply with those laws and regulations can expose us to significant liabilities.

Risks of substantial costs and liabilities related to environmental compliance issues are inherent in our operations. Our operations are subject to extensive federal, state, local and foreign laws and regulations relating to the generation, storage, handling, emission, transportation and discharge of materials into the environment. Permits are required for the operation of various facilities, and those permits are subject to revocation, modification and renewal. Governmental authorities have the power to enforce compliance with their regulations, and violations are subject to fines, injunctions or both. In some cases, those governmental requirements can impose liability for the entire cost of cleanup on any responsible party without regard to negligence or fault and impose liability on us for the conduct of or conditions others have caused, or for our acts that complied with all applicable requirements when we performed them. It is possible that other developments, such as stricter environmental laws and regulations, and claims for damages to property or persons resulting from our operations, would result in substantial costs and liabilities. Our insurance policies and the contractual indemnity protection we seek to obtain from our customers may not be sufficient or effective to protect us under all circumstances or against all risks involving compliance with environmental laws and regulations.

We may issue preferred stock whose terms could adversely affect the voting power or value of our common stock.

Our certificate of incorporation authorizes us to issue, without the approval of our shareholders, one or more classes or series of preferred stock having such preferences, powers and relative, participating, optional and other rights, including preferences over our common stock respecting dividends and distributions, as our board of directors may determine. The terms of one or more classes or series of preferred stock could adversely impact the voting power or value of our common stock. For example, we might grant holders of preferred stock the right to elect some number of our directors in all events or on the happening of specified events or the right to veto specified transactions. Similarly, the repurchase or redemption rights or liquidation preferences we might assign to holders of preferred stock could affect the residual value of the common stock.

Provisions in our corporate documents and Delaware law could delay or prevent a change in control of our company, even if that change would be beneficial to our shareholders.

The existence of some provisions in our corporate documents and Delaware law could delay or prevent a change in control of our company, even if that change would be beneficial to our shareholders. Our certificate of incorporation and bylaws contain provisions that may make acquiring control of our company difficult, including:

- provisions relating to the classification, nomination and removal of our directors;
- provisions regulating the ability of our shareholders to bring matters for action at annual meetings of our shareholders;
- provisions requiring the approval of the holders of at least 80% of our voting stock for a broad range of business combination transactions with related persons; and
- the authorization given to our board of directors to issue and set the terms of preferred stock.

In addition, we have adopted a shareholder rights plan that would cause extreme dilution to any person or group who attempts to acquire a significant interest in Oceaneering without advance approval of our board of directors, while the Delaware General Corporation Law would impose some restrictions on mergers and other business combinations between us and any holder of 15% or more of our outstanding common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We maintain office, shop and yard facilities in various parts of the world to support our operations. We consider these facilities, which we describe below, to be suitable for their intended use. In these locations, we typically lease or own office facilities for our administrative and engineering staff, shops equipped for fabrication, testing, repair and

maintenance activities and warehouses and yard areas for storage and mobilization of equipment to work sites. All sites
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are available to support any of our business segments as the need arises. The groupings that follow associate our significant offices with the primary business segment they serve.

Oil and Gas. In general, our ROV, Subsea Projects and Inspection segments share facilities. Our location in Morgan City, Louisiana is the largest of these facilities and consists of ROV manufacturing and training facilities, vessel docking facilities, open and covered storage space and offices. The Morgan City facilities primarily support operations in the U.S. As a result of increased demand for our services in the Gulf of Mexico over the last three years, we are building a new, larger facility in Morgan City that will consolidate several separate facilities in the area. We have regional support offices for our North Sea, West Africa and Southeast Asia operations in Aberdeen, Dubai and Singapore. We also have operational bases in various other locations, the most significant of which are in Norway, Australia, Angola and Nigeria.

We use workshop and office space in Houston, Texas in both our Mobile Offshore Production Systems and Subsea Products business segments. Our manufacturing facilities for our Subsea Products segment are located in or near: Panama City, Florida; Houston, Texas; Edinburgh, Scotland; Nodeland, Norway; and Rio de Janeiro, Brazil. Each of these manufacturing facilities is suitable for its intended purpose and, after completion of expansion projects in process, will have sufficient capacity to respond to increases in demand for our subsea products that may be reasonably anticipated in the foreseeable future. The Panama City, Florida facility was completed in 2004, and has since added the additional capability to produce steel tube umbilicals. We also added steel tube capability to our plant in Brazil during 2004. Operations of the mobile offshore production unit *Ocean Producer* are supported through our office in Houston. Operations of the *San Jacinto* and the *Ocean Legend* are supported from our office in Perth, Australia.

Our principal manufacturing facilities are located on properties we own or hold under a long-term lease, expiring in 2014. The other facilities we use in our Oil and Gas business segments are on properties we lease.

Advanced Technologies. Our primary facilities for our Advanced Technologies segment are leased offices and workshops in Hanover, Maryland. We have regional support offices in Chesapeake, VA; Pearl Harbor, HI; and San Diego, CA, which support our services for the U.S. Navy. We also have a regional support office in Orlando, FL, which supports our commercial theme park animation activities, and facilities in Houston, Texas, which primarily support our space industry activities.

ITEM 3. LEGAL PROCEEDINGS.

In the ordinary course of business, we are subject to actions for damages alleging personal injury under the general maritime laws of the U.S., including the Jones Act, for alleged negligence. We report actions for personal injury to our insurance carriers and believe that the settlement or disposition of those suits will not have a material adverse effect on our financial position, cash flow or results of operations.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted to a vote of our security holders, through the solicitation of proxies or otherwise, during the last three months of the year ended December 31, 2006.

CAUTIONARY STATEMENT CONCERNING FORWARD-LOOKING STATEMENTS.

We are including the following discussion to inform our existing and potential security holders generally of some of the risks and uncertainties that can affect our company and to take advantage of the safe harbor protection for forward-looking statements that applicable federal securities law affords.

From time to time, our management or persons acting on our behalf make forward-looking statements to inform existing and potential security holders about our company. These statements may include projections and estimates concerning the timing and success of specific projects and our future backlog, revenue, income and capital spending. Forward-looking statements are generally accompanied by words such as estimate, project, predict, believe, expec anticipate, plan, forecast, budget, goal or other words that convey the uncertainty of future events or outcomes. I addition, sometimes we will specifically describe a statement as being a forward-looking statement and refer to this cautionary statement.

In addition, various statements this report contains, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements. Those forward-looking statements

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appear in Item 1 Business, Item 2 Properties and Item 3 Legal Proceedings in Part I of this report and in Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations, Item 7A Quantitative and Qualitative Disclosures About Market Risk and in the Notes to Consolidated Financial Statements incorporated into Item 8 of Part II of this report and elsewhere in this report. These forward-looking statements speak only as of the date of this report, we disclaim any obligation to update these statements, and we caution you not to rely unduly on them. We have based these forward-looking statements on our current expectations and assumptions about future events. While our management considers these expectations and assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. These risks, contingencies and uncertainties relate to, among other matters, the following:

- worldwide demand for oil and gas;
- general economic and business conditions and industry trends;
- the highly competitive nature of our businesses;
- decisions about offshore developments to be made by oil and gas companies;
- the increased use of subsea completions and our ability to capture associated market share;
- the continued strength of the industry segments in which we are involved;
- the levels of oil and gas production to be processed by the Medusa field production spar platform;
- our future financial performance, including availability, terms and deployment of capital;
- the continued availability of qualified personnel;
- operating risks normally incident to offshore exploration, development and production operations;
- hurricanes and other adverse weather conditions;
- changes in, or our ability to comply with, government regulations, including those relating to the environment;
- rapid technological changes; and
- social, political, military and economic situations in foreign countries where we do business and the possibilities of war, other armed conflicts or terrorist attacks.

We believe the items we have outlined above are important factors that could cause our actual results to differ materially from those expressed in a forward-looking statement made in this report or elsewhere by us or on our behalf. We have discussed most of these factors in more detail elsewhere in this report. These factors are not necessarily all the important factors that could affect us. Unpredictable or unknown factors we have not discussed in this report could also have material adverse effects on actual results of matters that are the subject of our forward-looking statements. We do not intend to update our description of important factors each time a potential important factor arises. We advise our security holders that they should (1) be aware that important factors we do not refer to above could affect the accuracy of our forward-looking statements and (2) use caution and common sense when considering our forward-looking statements.

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Part II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

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 2006 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.

In June 2006, we effected a two-for-one stock in the form of a stock dividend. All historical share and per share data in this annual report on Form 10-K reflect this stock split.

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):

	Year Ended 2006		Year Ended 2005	
For the quarter ended:	High	Low	High	Low
March 31	$ 30.06	$ 25.05	$ 20.74	$ 17.51
June 30	45.85	27.55	20.49	15.75
September 30	47.23	27.80	27.08	19.55
December 31	46.91	28.73	27.64	21.86

On February 16, 2007, there were 376 holders of record of our common stock. On that date, the closing sales price, as quoted on the New York Stock Exchange, was $41.52. 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.

We did not repurchase any shares of our common stock in the fourth quarter of 2006.

EQUITY COMPENSATION PLAN INFORMATION

The following presents equity compensation plan information as of December 31, 2006:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)
Equity compensation plans approved by security holders	293,500	$ 15.54	2,236,050
Equity compensation plans not approved by security holders	369,750	$ 13.87	
Total	663,250	$ 14.61	2,236,050

At December 31, 2006, there were: (1) no shares of Oceaneering common stock under equity compensation plans not approved by security holders available for grant; and (2) 2,236,050 shares of Oceaneering common stock under equity compensation plans approved by security holders available for grant, in the form of stock options, stock appreciation rights or stock awards, subject to no more than a remaining 968,150 shares being used for awards other than stock options or stock appreciation rights to employees and nonemployee directors of Oceaneering. In light of the new expense recognition requirements adopted by the Financial Accounting Standards Board effective as of January 1, 2006, 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. For a description of the material features of each of these plans, see Note 8 of Notes to Consolidated Financial Statements.

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ITEM 6. SELECTED 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:

	Year Ended December 31,				
(in thousands, except per share amounts)	2006	2005	2004	2003	2002
Revenue	$ 1,280,198	$ 998,543	$ 780,181	$ 639,249	$ 547,467
Cost of services and products	984,077	819,263	648,378	528,465	433,302
Gross margin	296,121	179,280	131,803	110,784	114,165
Selling, general and administrative expense	101,785	85,211	67,939	56,787	46,462
Income from operations	$ 194,336	$ 94,069	$ 63,864	$ 53,997	$ 67,703
Net income	$ 124,494	$ 62,680	$ 40,300	$ 29,301	$ 40,133
Diluted earnings per share	2.26	1.17	0.78	0.60	0.81
Depreciation and amortization	80,456	79,613	65,619	56,963	52,341
Capital expenditures	193,842	142,269	153,184	100,370	34,552

Other Financial Data:

	As of December 31,				
(in thousands, except ratios)	2006	2005	2004	2003	2002
Working capital ratio	1.87	1.77	1.62	1.69	2.01
Working capital	$ 243,939	$171,566	$106,204	$ 91,793	$117,039
Total assets	1,242,022	989,568	819,664	662,856	590,348
Long-term debt	194,000	174,000	142,172	122,324	117,600
Shareholders equity	696,764	536,118	454,437	359,375	313,865

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION.

All statements in this annual report on Form 10-K, 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

The table that follows sets out our revenue and profitability for the years ended December 31, 2006, 2005 and 2004.

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004

Revenue	$1,280,198	$998,543	$780,181
Gross Margin	296,121	179,280	131,803
Gross Margin %	23%	18%	17%
Operating Income	194,336	94,069	63,864
Operating Income %	15%	9%	8%
Net Income	124,494	62,680	40,300

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We generate 90% of our revenue from our services and products provided to the oil and gas industry. In 2006, we increased revenue by 28%, led by our Subsea Products (up 52%), ROV (up 30%) and Subsea Projects (up 27%) segments. Our Subsea Products segment revenue increased from sales of Multiflex umbilicals and Oceaneering Intervention Engineering specialty subsea products, particularly ROV tooling, and clamps from our Grayloc Products division, which we acquired at the end of June 2005. Our ROV segment increase was primarily a result of an improvement in average pricing and growth in days on hire for our work-class fleet. Our Subsea Projects segment continued to benefit from increased demand, which resulted in improved rates and high utilization for our seven vessels and diving assets.

The $124 million consolidated net income we earned in 2006 was the highest in our history. The $62 million increase in 2006 results was attributable to higher profit contributions from all of our oilfield businesses, with each setting annual profit records. The Subsea Products and ROV improvements reflect our strategic focus on deepwater and subsea completion activity. Our Subsea Projects increase was due to demand increases for hurricane damage projects and deepwater infrastructure installation and inspection, repair, and maintenance (IRM) work in the Gulf of Mexico. Our Inspection growth was attributable to securing work with higher profit margins and controlling expenses. Including equity income from our investment in Medusa Spar LLC, our Mobile Offshore Production Systems segment earned a record pre-tax income contribution.

In 2006, we invested in the following major capital projects:

- additions of work-class ROVs, including 17 placed into service during the year;
- purchase of equipment to increase capacity at our Subsea Products manufacturing facilities;
- purchase of an oil tanker for possible future conversion to a mobile offshore production and storage system in the event we obtain a suitable contract;
- beginning of construction of a saturation diving system for our Subsea Projects segment to meet growing demand; and
- commencement of upgrades of the dynamic positioning system and crane capacity of our vessel, *The Performer*.

For 2007, we expect earnings growth of about 20%, led by increases in operating income in our Subsea Products and ROV segments.

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 and other subsea specialty products that we provide.

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*	3,745

* industry projection

According to publicly available information published by Quest Offshore Resources, Inc., the projected global market for subsea tree orders in 2007 will be over 550 trees, up from 467 trees in 2006. Industry-wide umbilical orders in

2007 are forecast to increase to around 1,540 miles, up over 65% from approximately 920 miles in 2006. With the 2006 start up of our steel tube manufacturing line in our Panama City, FL umbilical plant and expansion of our thermoplastic manufacturing capacity at our Scotland plant, we are well positioned to secure a share of this work.

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,

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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.

	2006	2005	2004
Average number of floating rigs in use	191	175	154
ROV days-on-hire (in thousands)	56	52	40
ROV utilization	85%	83%	70%

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 revenue 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 2006, 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 when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, price is fixed or determinable 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   carrying values to forecasts of undiscounted cash flows associated with the assets 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. 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 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. Effective January 1, 2007, as required by FASB Staff Position No. AUG AIR-1, *Accounting for Planned Major Maintenance Activities*, we will no longer accrue drydock expense in advance, but we will charge drydocking expenses to the income statement as incurred. While we are currently evaluating the impact of this Staff Position upon our financial statements, we do not believe there will be a material effect on our financial statements upon its adoption.

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 2006 and 2005, we recorded reductions of income tax expense of $1.3 million and $1.8 million, respectively, 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, 2006, we had working capital of $244 million, including cash of $26 million. Additionally, we had $136 million available under our revolving credit facility, which was scheduled to expire in

January 2008. In January 2007, we amended the revolving credit facility to $300 million and to expire in January 2012, thereby increasing our available credit by $50 million and extending the duration of the facility by four years. At December 31, 2006, our debt-to-total capitalization ratio was 22%.

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 $151 million, $94 million and $100 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Our capital expenditures, including business acquisitions, for the years ended December 31, 2006, 2005 and 2004 were $194 million, $142 million and $153 million, respectively. Our capital expenditures during 2006 included $113 million in our ROV segment, principally for additions and upgrades to our ROV fleet to expand the fleet and replace older units we retired and for facilities infrastructure to support our growing ROV fleet size. We plan to continue adding ROVs at levels we determine appropriate to meet market opportunities as they arise. In 2006, we commenced improvements in our Subsea Products facilities, including the addition of equipment to increase manufacturing capacity at our umbilical plant in the U.K. and our subsea valve facility in Norway and purchased an oil tanker for possible future conversion to a mobile offshore production and storage system in the event we obtain a suitable contract. We also began upgrades to a dynamically-positioned vessel and began construction of a saturation diving system to meet demand in our Subsea Projects segment. 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.

In September 2002, our Board of Directors approved a plan to repurchase up to 6,000,000 shares of our common stock, subject to a $75 million aggregate purchase price limitation. Under this plan, we repurchased 1,795,600 shares of common stock through the year ended December 31, 2006, at a total cost of $20.1 million. Through December 31, 2006, 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, 2006 was $33 million, and it requires scheduled quarterly payments through 2009. 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 $5.4 million, $2.3 million and $1.7 million of cash distributions from Medusa Spar LLC and recognized $11.2 million, $10.1 million and $8.2 million of equity in the earnings of Medusa Spar LLC in 2006, 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, 2006, our investment in Medusa Spar LLC was $63 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 2006, our $151 million of cash provided from operating activities was net of $46 million of increases in accounts receivable and $84 million of increases in inventory and other current assets. The increases in accounts receivable was due to an increase in revenue in the fourth quarter of 2006 as compared to the fourth quarter of 2005. The increases in inventory and other current assets principally related to raw materials and ROV parts. The raw materials increase related to preparations for building items reflected in our Subsea Products backlog, which increased more than 80% over the level at December 31, 2005. The increase in ROV parts inventory related to equipment waiting for assembly into ROVs to be placed in service in 2007 and an increase in parts to be used for servicing our growing ROV fleet. 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 increase in accounts receivable was 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 related to equipment waiting for assembly into ROVs to be placed in service in 2006 and an increase in parts to be used for servicing our growing ROV fleet. The raw materials increase related to preparations for building items reflected in our Subsea Products backlog, which increased nearly 150% over the level at December 31, 2004.

In 2006, we used $187 million in investing activities, including $113 million to modernize and add additional units to our ROV fleet and $38 million to add capacity to our Subsea Products facilities. 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 2006 and 2005, we received $8 million and $23 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.

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, 2006 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

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, 2006, 2005 and 2004.

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	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Remotely Operated Vehicles			
Revenue	$ 410,256	$315,178	$223,914
Gross Margin	129,929	84,419	59,501
Gross Margin %	32%	27%	27%
Operating Income	111,022	68,962	48,397
Operating Income %	27%	22%	22%
Utilization %	85%	83%	70%
Subsea Products			
Revenue	364,510	239,039	160,410
Gross Margin	81,380	37,113	26,971
Gross Margin %	22%	16%	17%
Operating Income	53,645	13,941	10,891
Operating Income %	15%	6%	7%
Subsea Projects			
Revenue	155,046	121,628	70,254
Gross Margin	65,119	31,122	10,297
Gross Margin %	42%	26%	15%
Operating Income	59,585	26,219	5,472
Operating Income %	38%	22%	8%
Inspection			
Revenue	169,014	154,857	145,691
Gross Margin	28,501	21,704	16,351
Gross Margin %	17%	14%	11%
Operating Income	14,946	7,946	4,564
Operating Income %	9%	5%	3%
Mobile Offshore Production Systems			
Revenue	52,931	50,091	49,387
Gross Margin	17,136	18,330	18,347
Gross Margin %	32%	37%	37%
Operating Income	16,001	16,796	16,565
Operating Income %	30%	34%	34%
Total Oil and Gas			
Revenue	$1,151,757	$880,793	$649,656
Gross Margin	322,065	192,688	131,467
Gross Margin %	28%	22%	20%
Operating Income	255,199	133,864	85,889
Operating Income %	22%	15%	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, which focuses on building new ROVs. These new vehicles are designed for use around the world in water depths to 10,000 feet. We have added over 150 of these ROVs to our fleet since that time. We added 17 ROVs in 2006 while retiring six older units. We plan to continue adding ROVs at levels we determine appropriate to meet market opportunities as they arise. For 2006, our ROV revenue increased 30% over 2005 from an improvement in average pricing and growth in days on hire for our work-class fleet. Operating income increased by over 60%. Margin percentages increased, as 2005 included $6.1 million of additional depreciation associated with the retirement of four older ROVs and obsolete ROV components.

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

We anticipate ROV operating income to increase $20 million to $30 million in 2007 from a higher average fleet size and pricing.

Our Subsea Products revenue in 2006 was 52% higher than in 2005, while gross margin and operating income percentages significantly improved. We achieved higher sales of umbilicals and of our specialty hardware, and segment operating income nearly quadrupled. During the year, we resolved the mechanical problems we previously experienced at our Panama City, FL umbilical facility and we processed a higher workload at all three of our umbilical manufacturing plants. The increase in sales of specialty hardware came particularly from ROV tooling and clamps. The increase in clamp sales was primarily attributable to the full year of operations from our Grayloc division, which we acquired at the end of June 2005.

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.

We anticipate our Subsea Products segment operating income will grow $30 million to $45 million in 2007, driven by a continuation of a high level of subsea completion activity, which we expect will result in an improvement in our umbilical sales and a general increase in our specialty hardware sales. Our Subsea Products backlog increased to $359 million at December 31, 2006 from $196 million at December 31, 2005.

In 2006, our Subsea Projects segment had better results than 2005 due to work related to hurricane damage from Hurricanes Katrina and Rita and an escalation in demand for installation projects and our inspection, maintenance and repair services on the deepwater infrastructure in the Gulf of Mexico. Annual operating income more than doubled as we continued to benefit from rate increases and high utilization for our seven vessels and our diving assets.

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, as a result of high demand, we benefited from improved pricing. In addition, we spot-chartered three vessels and a barge from which we provided services.

We anticipate our 2007 operating income for Subsea Projects to be about the same as 2006, based on our expectations of continued favorable demand for deepwater installation and inspection, repair and maintenance activities and hurricane damage-related projects.

For 2006, our Inspection revenue increased and margins improved over 2005. This was attributable to our successes in providing more value-added services, securing new contracts, and controlling our operating expenses. Our operating income grew by over 85%.

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 subsequent to our purchase of OIS International Inspection plc in 2003.

We expect that our Inspection segment operating income will decline in 2007, due to a revenue reduction resulting from the completion of a major pipeline project in 2006 and reduced emphasis on providing lower margin manpower services.

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. The decreases in margins were the result of the anticipated decline in the dayrate of the *Ocean Legend*, as per the customer renewal option terms in the existing contract.

We anticipate our Mobile Offshore Production Systems operating income in 2007 will decline from 2006 by approximately 25% 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.

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Advanced Technologies. The table that follows sets out revenue and profitability for this segment for the years ended December 31, 2006, 2005 and 2004.

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Revenue	$128,441	$117,750	$130,525
Gross Margin	19,862	20,772	25,016
Gross Margin %	15%	18%	19%
Operating Income	11,585	12,539	17,515
Operating Income %	9%	11%	13%

Our Advanced Technologies margins for 2006 decreased from those of 2005, primarily due to the transfer of *The Performer* to our Subsea Projects segment in April 2006. Our 2006 revenue was higher than 2005 from demand for general engineering services.

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.

We anticipate our Advanced Technologies 2007 operating income will be slightly higher than 2006 from higher U.S. Navy demand for general engineering services and submarine repair, maintenance and engineering projects.

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. A portion of 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, 2006, 2005 and 2004.

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Gross margin expenses	$(45,806)	$(34,180)	$(24,680)
% of revenue	4%	3%	3%
Operating expenses	(72,448)	(52,334)	(39,540)
% of revenue	6%	5%	5%

Our unallocated gross margin and operating expenses increased in 2006 over 2005, primarily due to compensation related to incentive plans as a result of record results and our higher stock price. Our unallocated operating expenses in 2006 and 2005 included $5.8 million and $2.7 million, respectively, related to post-retirement benefits for our current chairman and former chief executive officer.

In November 2001, we entered into an agreement with our Chairman (the Chairman) who was also then our Chief Executive Officer. That agreement was amended in 2006. Pursuant to the amended agreement, the Chairman relinquished his position as Chief Executive Officer in May 2006 and began his post-employment service period on December 31, 2006. The agreement provides for 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 for so long as our Board of Directors desires that he shall continue to serve in that capacity. The agreement provides the Chairman with post-employment benefits for ten years following his services to us. The amendment includes a lump-sum cash buyout, to be paid in 2007, of the Chairman s entitlement to perquisites and administrative assistance during that ten-year period (expected to run from 2011 to 2021). As a result, we recorded $2.8 million of associated expense in the fourth quarter of 2006. The agreement also provides for medical coverage on an after-tax basis to the Chairman, his spouse and children during his service with us and thereafter for their lives. We are recognizing the net present value of the post-employment benefits over the expected service period. If the service

period is terminated for
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any reason (other than the Chairman s refusal to continue serving), we will recognize all the previously unaccrued benefits in the period in which that termination occurs.

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 2006 and 2005 principally due to the additional expenses associated with the increased activity levels, 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.

	Year Ended December 31,		
(dollars in thousands)	2006	2005	2004
Interest income	$ 730	$ 505	$ 999
Interest expense, net of amounts capitalized	(12,920)	(10,102)	(8,388)
Equity earnings (losses) of unconsolidated affiliates:			
Medusa Spar LLC	11,213	10,082	8,171
Cable lay and maintenance	838	290	(3,132)
Canadian ROV joint venture		38	1,071
Other income (expense), net	(3,302)	(432)	(1,662)
Provision for income taxes			