OCEANEERING INTERNATIONAL INC
Form 10-K
February 28, 2007

Table of Contents

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.

Oceaneering International, Inc.
Form 10-K
Table of Contents

Exhibit Index

Table of Contents

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.

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.

Table of Contents

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.

Table of Contents

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%

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.

8

Table of Contents

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

10

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

Table of Contents

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.

Table of Contents

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
14

Table of Contents

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

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.

Table of Contents

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.

Table of Contents

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

18

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, 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.

Table of Contents

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.

Table of Contents

(dollars in thousands)	Year Ended December 31, 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.

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.

Table of Contents

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
26

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	66,401	31,770	20,623

Interest expense increased in 2006 and 2005, primarily because we used debt to partially finance capital expenditures and acquisitions. Interest rates were also slightly higher. Interest expense is net of capitalized interest of $0.1 million, $0.1 million and $0.4 million for the years ended December 31, 2006, 2005 and 2004, respectively.

In 2004, we started earning equity income from our 50% investment in Medusa Spar LLC, which we acquired in December 2003. Medusa Spar LLC owns 75% of a production spar in the Gulf of Mexico and earns its revenue from tariffs charged on production processed through the facility. During 2004 and 2005, additional wells were connected to the facility, thereby raising 2006 and 2005 throughput over the 2004 level. In 2007, we expect a decrease of approximately $10 million in equity in earnings of unconsolidated affiliates from our investment in Medusa Spar LLC due to lower production throughput at the spar.

Due to the condition of the telecommunications market, the single vessel used in the cable lay and maintenance 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.

Other income (expense), net, primarily consists of foreign currency gains and losses.

Our effective tax rate, including foreign, state and local taxes, was 35%, 34% and 34% for the years ended December 31, 2006, 2005 and 2004, respectively. In each of 2006 and 2005, we lowered our effective tax rate, as we resolved tax contingencies of $1.3 million and $1.8 million, respectively, related to certain foreign tax liabilities we recorded in prior years. In 2004, our rate was less than the U.S. statutory rate of 35% because we reversed valuation allowances related to net operating loss carryforwards, as we were able to utilize those carryforwards. For 2007, we anticipate an effective tax rate of approximately 36%.

Off Balance Sheet Arrangements

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

Contractual Obligations
At December 31, 2006, we had payments due under contractual obligations as follows:

(dollars in thousands)	Payments due by period				
	Total	2007	2008-2009	2010-2011	After 2011
Long-term Debt	$ 194,000	$ 20,000	$ 40,000	$ 20,000	$ 114,000
Operating Leases	123,259	26,607	39,865	13,761	43,026
Purchase Obligations	51,614	51,614			
Other Long-term Obligations reflected on our balance sheet under GAAP	46,792	517	1,129	2,156	42,990
TOTAL	$ 415,665	$ 98,738	$ 80,994	$ 35,917	$ 200,016

The above schedule takes into account the terms of the January 2007 amendment of our revolving credit facility, which extended its maturity to January 2012.

At December 31, 2006, we had outstanding purchase orders totaling $52 million, including approximately $47 million for specialized steel tubes to be used in our manufacturing of steel tube umbilicals. Due to the current shortage of these specialized materials caused by a general worldwide increase in demand for steel, the lead times between placing the order and delivery have become extended. We have contracts to build umbilicals that will use over 90% of the orders. We also have other identified opportunities that could utilize these materials. However, should we decide not to accept delivery of the steel tubes, we would incur cancellation charges of at least 10% of the amount canceled.

Effects of Inflation and Changing Prices

Our financial statements are prepared in accordance with generally accepted accounting principles in the United States, using historical U.S. dollar accounting, or historical cost. Statements based on historical cost, however, do not adequately reflect the cumulative effect of increasing costs and changes in the purchasing power of the dollar, especially during times of significant and continued inflation.

In order to minimize the negative impact of inflation on our operations, we attempt to cover the increased cost of anticipated changes in labor, material and service costs, either through an estimate of those changes, which we reflect in the original price, or through price escalation clauses in our contracts.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We are currently exposed to certain market risks arising from transactions we have entered into in the normal course of business. These risks relate to interest rate changes and fluctuations in foreign exchange rates. We do not believe these risks are material. We have not entered into any market risk sensitive instruments for speculative or trading purposes. We manage our exposure to interest rate changes through the use of a combination of fixed and floating-rate debt. See Note 4 of Notes to Consolidated Financial Statements included in this report for a description of our long-term debt agreements, interest rates and maturities. We believe that significant interest rate changes will not have a material near-term impact on our future earnings or cash flows. Because we operate in various oil and gas exploration and production regions in the world, we conduct a portion of our business in currencies other than the U.S. dollar. The functional currency for several of our international operations is the applicable local currency. We manage our exposure to changes in foreign exchange rates principally through arranging compensation in U.S. dollars or freely convertible currency and, to the extent possible, by limiting compensation received in other currencies to amounts necessary to meet obligations denominated in those currencies. We use the exchange rates in effect as of the balance sheet date to translate assets and liabilities as to which the functional currency is the local currency, resulting in translation adjustments that we reflect as accumulated other comprehensive income or loss in the shareholders equity section of our Consolidated Balance Sheets. We recorded adjustments of $17.3 million, ($14.3 million) and $12.4 million to our equity accounts for the years ended December 31, 2006, 2005 and 2004, respectively. Positive adjustments reflect the net impact of the strengthening of various foreign currencies against the U.S. dollar for locations where the functional currency is not the U.S. dollar. Conversely, negative adjustments reflect the effect of a strengthening dollar.

Table of Contents

We recorded foreign currency transaction gains (losses) of ($2.5 million), $0.2 million and ($1.2 million) in our Consolidated Income Statements in 2006, 2005 and 2004, respectively, related to our foreign operations. In 2006 and 2004, the majority of our foreign currency losses related to our U.K. operations. Some of our U.K. subsidiary s revenue is from U.S. dollar-denominated contracts. If the U.S. dollar weakens against the British pound sterling, we will incur currency losses for the period the related accounts receivable are outstanding.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

In this report, our consolidated financial statements and supplementary data appear following the signature page to this report and are incorporated in this item by reference.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

ITEM 9A. CONTROLS AND PROCEDURES.

Disclosure Controls and Procedures

In accordance with Rules 13a-15 and 15d-15 under the Securities Exchange Act of 1934, as amended (the Exchange Act), we carried out an evaluation, under the supervision and with the participation of management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based on that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of December 31, 2006 to provide reasonable assurance that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. There has been no change in our internal control over financial reporting that occurred during the year ended December 31, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Management s Report on Internal Control Over Financial Reporting

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

Under the supervision and with the participation of our management, including our principal executive, financial and accounting officers, we have conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. This evaluation included a review of the documentation surrounding our financial reporting controls, an evaluation of the design effectiveness of these controls, testing of the operating effectiveness of these controls and an evaluation of our overall control environment. Based on that evaluation, our management has concluded that our internal control over financial reporting was effective as of December 31, 2006. Ernst & Young LLP, an independent registered public accounting firm, has audited our management s assessment of the effectiveness of our internal control over financial reporting, as stated in their report which follows.

Table of Contents

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

The Board of Directors and Shareholders of
Oceaneering International, Inc.

We have audited management s assessment, included in the accompanying Management s Report on Internal Control Over Financial Reporting, that Oceaneering International, Inc. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Oceaneering International, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the company s internal control over financial reporting based on our audit.

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

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

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

In our opinion, management s assessment that Oceaneering International, Inc. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Oceaneering International, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Oceaneering International, Inc. and subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, cash flows and shareholders equity and comprehensive income for each of the three years in the period ended December 31, 2006 and our report dated February 27, 2007 expressed an unqualified opinion thereon.

Houston, Texas /s/ ERNST & YOUNG LLP
February 27, 2007

Table of Contents

ITEM 9B. OTHER INFORMATION.

We have no other information to report for the fourth quarter of this year covered by this annual report on Form 10-K that would have been required to be, and was not, reported on a Form 8-K.

Part III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

The information with respect to the directors and nominees for election to our Board of Directors is incorporated by reference from the section Election of Directors in our definitive proxy statement to be filed on or before April 30, 2007, relating to our 2007 Annual Meeting of Shareholders.

Information concerning our Audit Committee and the audit committee financial expert is incorporated by reference from the section entitled Additional Information relating to our Board of Directors in the proxy statement referred to in this Item 10. Information concerning our Code of Ethics is incorporated by reference from the section entitled Code of Ethics for the Chief Executive Officer and Senior Financial Officers in the proxy statement referred to in this Item 10.

The information with respect to our executive officers is provided under the heading Executive Officers of the Registrant following Item 4 of Part I of this report. There are no family relationships between any of our directors or executive officers.

The information with respect to the reporting by our directors and executive officers and persons who own more than 10% of our Common Stock under Section 16 of the Securities Exchange Act of 1934 is incorporated by reference from the section entitled Section 16(b) Beneficial Ownership Reporting Compliance in the proxy statement referred to in this Item 10.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by Item 11 is incorporated by reference from the sections Compensation Discussion and Analysis, Compensation of Directors, Compensation of Executive Officers, Compensation Committee Interlocks and Insider Participation and Compensation Committee Report in the proxy statement referred to in Item 10 above.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

The information required by Item 12 is incorporated by reference from (1) the Equity Compensation Plan Information table appearing in Item 5 Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities in Part II of this report and (2) the section Election of Directors Security Ownership of Management and Certain Beneficial Owners in the proxy statement referred to in Item 10 above.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by Item 13 is incorporated by reference from the section Certain Relationships and Related Transactions in the proxy statement referred to in Item 10 above.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by Item 14 is incorporated by reference from the section Ratification of Appointment of Auditors Fees Incurred by Oceaneering for Ernst & Young LLP in the proxy statement referred to in Item 10 above.

Table of Contents

Part IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.

(a) Documents filed as part of this report.

1. Financial Statements.
   (i) Report of Independent Registered Public Accounting Firm

   (ii) Consolidated Balance Sheets

   (iii) Consolidated Statements of Income

   (iv) Consolidated Statements of Cash Flows

   (v) Consolidated Statements of Shareholders Equity and Comprehensive Income

   (vi) Notes to Consolidated Financial Statements
2. Financial Statement Schedules

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

3. Exhibits:

			Registration or File Number	Form of Report	Report Date	Exhibit Number
*	3.01	Restated Certificate of Incorporation	1-10945	10-K	Dec. 2000	3.01
*	3.02	Amended and Restated By-Laws	1-10945	10-K	Dec. 2002	3.02
*	4.01	Specimen of Common Stock Certificate	1-10945	10-K	March 1993	4(a)
*	4.02	Amended and Restated Shareholder Rights Agreement dated as of November 16, 2001	1-10945	8-K	Nov. 2001	4.1
*	4.03	Note Purchase Agreement dated as of September 8, 1998 relating to $100,000,000 6.72% Senior Notes due September 8, 2010	1-10945	10-Q	Sept. 1998	4.01
*	4.04	Amended and Restated Credit Agreement ($250,000,000 Revolving Credit Facility with Accordion to $300,000,000) dated as of January 2, 2004	1-10945	10-K	Dec. 2003	4.05
*	4.05	First Amendment to Amended and Restated Credit Agreement dated January 22, 2007	1-10945	8-K	Jan. 2007	4.2

We and certain of our consolidated subsidiaries are parties to debt instruments under which the total amount of securities authorized does not exceed 10% of our total consolidated assets. Pursuant to paragraph 4(iii)(A) of

Item 601(b) of Regulation S-K, we agree to furnish a copy of those instruments to the Securities and Exchange Commission on request.

*	10.01	Defined Contribution Master Plan and Trust Agreement and Adoption Agreement for the Oceaneering International, Inc. Retirement Investment Plan	1-10945	10-K	Dec. 2001	10.01
*	10.02+	Service Agreement dated as of November 16, 2001 between Oceaneering and John R. Huff	1-10945	10-K	Dec. 2001	10.02
*	10.03+	Modification dated as of May 12, 2006 of Service Agreement between Oceaneering and John R. Huff	1-10945	8-K	May 2006	10.01

32

Table of Contents

			Registration or File Number	Form of Report	Report Date	Exhibit Number
*	10.04+	Second Modification dated as of August 25, 2006 of Service Agreement between Oceaneering and John R. Huff	1-10945	8-K	Aug. 2006	10.01
*	10.05+	Amended and Restated Service Agreement dated as of December 21, 2006 between Oceaneering and John R. Huff	1-10945	8-K	Dec. 2006	10.01
*	10.06+	Trust Agreement dated as of May 12, 2006 between Oceaneering and United Trust Company, National Association	1-10945	8-K	May 2006	10.02
*	10.07+	2002 Non-Executive Incentive Plan	1-10945	10-Q	Sept. 2002	10.03
*	10.08+	Amended and Restated Supplemental Executive Retirement Plan	1-10945	10-Q	Sept. 2002	10.02
*	10.09+	1999 Restricted Stock Award Incentive Agreements dated August 19, 1999	1-10945	10-Q	Sept. 1999	10.1
*	10.10+	Change of Control Agreements dated as of November 16, 2001 between Oceaneering and John R. Huff, T. Jay Collins, Marvin J. Migura, M. Kevin McEvoy and George R. Haubenreich, Jr., respectively	1-10945	10-K	Dec. 2001	10.06
*	10.11+	1999 Bonus Restricted Stock Award Agreements	1-10945	10-K/A	March 2000	10.20
*	10.12+	1999 Incentive Plan	1-10945	10-K	March 2000	10.08
*	10.13+	Oceaneering International, Inc. 2006 Cash Bonus Award Program	1-10945	10-Q	March 2006	10.01
*	10.14+	1990 Long-Term Incentive Plan	33-36872	S-8	Sept. 1990	4(f)
*	10.15+	1990 Nonemployee Directors Stock Option Plan	33-36872	S-8	Sept. 1990	4(g)
*	10.16+	Form of Indemnification Agreement dated November 16, 2001 between Oceaneering and each of its Directors, Marvin J. Migura, M. Kevin McEvoy and George R. Haubenreich, Jr.	1-10945	10-K	Dec. 2001	10.12
*	10.17+	Non-qualified Stock Option Award Agreements under the 2002 Incentive Plan with John R.	1-10945	10-Q	Sept. 2002	10.05

		Huff, T. Jay Collins, Marvin J. Migura, M. Kevin McEvoy, George R. Haubenreich, Jr. and John L. Zachary				
*	10.18+	1996 Incentive Plan of Oceaneering International, Inc.	1-10945	10-Q	Sept. 1996	10.02
*	10.19+	1996 Restricted Stock Award Incentive Agreements dated August 23, 1996	1-10945	10-Q	Sept. 1996	10.03
*	10.20+	1997 Bonus Restricted Stock Award Agreements dated April 22, 1997	1-10945	10-K	March 1997	10.20
*	10.21+	Amendment No. 1 to 1990 Nonemployee Director Stock Option Plan	1-10945	10-K	March 1999	10.19
*	10.22+	1998 Bonus Restricted Stock Award Agreements	1-10945	10-K	March 1999	10.20
*	10.23+	2002 Incentive Plan	1-10945	10-Q	June 2002	10.01
*	10.24+	Amended and Restated 2002 Restricted Stock Unit Award Agreements with John R. Huff, T. Jay Collins, Marvin J. Migura, M. Kevin McEvoy, George R. Haubenreich, Jr. and John L. Zachary	1-10945	10-Q	Sept. 2002	10.04
*	10.25+	2005 Incentive Plan	333 124947	S-8	May 2005	4.5
*	10.26+	Form of 2006 Employee Restricted Stock Unit Agreement for John R. Huff, T. Jay Collins, Marvin J. Migura, M. Kevin McEvoy, George R. Haubenreich, Jr., and John L. Zachary	1-10945	8-K	Feb. 2006	10.1
*	10.27+	Form of 2006 Performance Unit Agreement for John R. Huff, T. Jay Collins, Marvin J. Migura, M. Kevin McEvoy, George R. Haubenreich, Jr., and John L. Zachary	1-10945	8-K	Feb. 2006	10.2
*	10.28+	2006 Performance Award: Goals and Measures, relating to the form of 2006 Performance Unit Agreement	1-10945	8-K	Feb. 2006	10.3
*	10.29+	Form of 2006 Nonemployee Director Restricted Stock Agreement	1-10945	8-K	Feb. 2006	10.4

Table of Contents

			Registration or File Number	Form of Report	Report Date	Exhibit Number
*	10.30+	Form of 2007 Employee Restricted Stock Unit Agreement for T. Jay Collins, M. Kevin McEvoy, Marvin J. Migura, George R. Haubenreich, Jr., Philip D. Gardner and W. Cardon Gerner	1-10945	8-K	Feb. 2007	10.1
*	10.31+	Form of 2007 Nonemployee Director Restricted Stock Agreement for Jerold J. DesRoche, David S. Hooker, D. Michael Hughes and Harris J. Pappas	1-10945	8-K	Feb. 2007	10.6
*	10.32+	Form of 2007 Chairman Restricted Stock Unit Agreement for John R. Huff	1-10945	8-K	Feb. 2007	10.3
*	10.33+	Form of 2007 Performance Unit Agreement for T. Jay Collins, M. Kevin McEvoy, Marvin J. Migura, George R. Haubenreich, Jr., Philip D. Gardner and W. Cardon Gerner	1-10945	8-K	Feb. 2007	10.2
*	10.34+	Form of 2007 Chairman Performance Unit Agreement for John R. Huff	1-10945	8-K	Feb. 2007	10.4
*	10.35+	2007 Performance Award: Goals and Measures, relating to the Form of 2007 Performance Unit Agreement and Form of Chairman Performance Unit Agreement	1-10945	8-K	Feb. 2007	10.5
	12.02	Statement showing Computation of Ratio of Earnings to Fixed Charges				
	21.01	Subsidiaries of Oceaneering				
	23.01	Consent of Independent Registered Public Accounting Firm				
	31.01	Rule 13a 14(a)/15d 14(a) certification of Chief Executive Officer				
	31.02	Rule 13a 14(a)/15d 14(a) certification of Chief Financial Officer				
	32.01	Section 1350 certification of Chief Executive Officer				
	32.02	Section 1350 certification of Chief Financial Officer				

*

Indicates exhibit previously filed with the Securities and Exchange Commission as indicated and incorporated herein by reference.

\+ Indicates management contract or compensatory plan or arrangement.

34

Table of Contents

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

OCEANEERING INTERNATIONAL, INC.

Date: February 28, 2007

By: **/s/ T. JAY COLLINS**

T. Jay Collins
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/s/ T. JAY COLLINS	Chief Executive Officer and Director (Principal Executive Officer)	February 28, 2007
T. Jay Collins		
/s/ MARVIN J. MIGURA	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 28, 2007
Marvin J. Migura		
/s/ W. CARDON GERNER	Vice President and Chief Accounting Officer (Principal Accounting Officer)	February 28, 2007
W. Cardon Gerner		
/s/ JOHN R. HUFF	Chairman of the Board	February 28, 2007
John R. Huff		
/s/ JEROLD J. DESROCHE	Director	February 28, 2007
Jerold J. DesRoche		
/s/ DAVID S. HOOKER	Director	February 28, 2007
David S. Hooker		
/s/ D. MICHAEL HUGHES	Director	February 28, 2007

D. Michael Hughes

/s/ HARRIS J. PAPPAS	Director	February 28, 2007

Harris J. Pappas

Table of Contents

INDEX TO FINANCIAL STATEMENTS AND SCHEDULES

Index to Financial Statements

Index to Schedules

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of Oceaneering International, Inc. and subsidiaries (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, cash flows and shareholders equity and comprehensive income for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Oceaneering International, Inc. and subsidiaries at December 31, 2006 and 2005 and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* and, effective December 31, 2006, the Company adopted Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R).*

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 27, 2007 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG LLP

Houston, Texas
February 27, 2007

Table of Contents

CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)	December 31, **2006**	2005
ASSETS		
Current Assets:		
Cash and cash equivalents	**$ 26,228**	$ 26,308
Accounts receivable, net of allowances for doubtful accounts	**315,255**	269,497
Inventory and other current assets	**182,162**	98,428
Total current assets	**523,645**	394,233
Property and Equipment, at cost:		
Marine services equipment	**635,490**	493,054
Mobile offshore production equipment	**152,854**	146,751
Manufacturing facilities	**151,826**	125,003
Other	**99,872**	77,450
	1,040,042	842,258
Less accumulated depreciation	**516,335**	433,057
Net property and equipment	**523,707**	409,201
Other Assets:		
Goodwill	**86,931**	84,608
Investments in unconsolidated affiliates	**64,496**	61,598
Other	**43,243**	39,928
Total Assets	**$ 1,242,022**	$ 989,568
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	**$ 70,777**	$ 64,306
Accrued liabilities	**180,073**	142,168
Income taxes payable	**28,856**	16,193
Total current liabilities	**279,706**	222,667
Long-term Debt	**194,000**	174,000
Other Long-term Liabilities	**71,552**	56,783

Commitments and Contingencies		
Shareholders Equity:		
Common Stock, par value $0.25 per share; 90,000,000 shares authorized; 54,440,488 and 53,558,888 shares issued	**13,610**	13,390
Additional paid-in capital	**191,910**	172,437
Retained earnings	**472,525**	348,031
Accumulated other comprehensive income	**18,719**	2,260
Total shareholders equity	**696,764**	536,118
Total Liabilities and Shareholders Equity	**$ 1,242,022**	$ 989,568

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

37

Table of Contents

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)	Year Ended December 31, **2006**	2005	2004
Revenue	**$ 1,280,198**	$ 998,543	$ 780,181
Cost of Services and Products	**984,077**	819,263	648,378
Gross margin	**296,121**	179,280	131,803
Selling, General and Administrative Expense	**101,785**	85,211	67,939
Income from operations	**194,336**	94,069	63,864
Interest Income	**730**	505	999
Interest Expense, net of amounts capitalized	**(12,920)**	(10,102)	(8,388)
Equity earnings of unconsolidated affiliates	**12,051**	10,410	6,110
Other Income (Expense), Net	**(3,164)**	(376)	(1,596)
Minority Interests	**(138)**	(56)	(66)
Income before income taxes	**190,895**	94,450	60,923
Provision for Income Taxes	**66,401**	31,770	20,623
Net Income	**$ 124,494**	$ 62,680	$ 40,300
Basic Earnings per Share	**$ 2.31**	$ 1.20	$ 0.81
Diluted Earnings per Share	**$ 2.26**	$ 1.17	$ 0.78
Weighted average number of common shares	**53,990**	52,300	49,986
Incremental shares from stock equivalents	**1,001**	1,347	1,384
Weighted average number of common shares and equivalents	**54,991**	53,647	51,370

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

38

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
(in thousands)	**2006**	2005	2004
Cash Flows from Operating Activities:			
Net income	**$ 124,494**	$ 62,680	$ 40,300
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**80,456**	79,613	65,619
Noncash compensation and other	**11,292**	562	12,931
Undistributed earnings of unconsolidated affiliates	**(2,898)**	(8,406)	(3,150)
Increase (decrease) in cash from:			
Accounts receivable,net	**(45,758)**	(56,921)	(54,916)
Inventory and other current assets	**(83,734)**	(37,477)	(1,606)
Other assets	**(4,415)**	(702)	(4,846)
Accounts payable	**6,471**	12,574	15,267
Accrued liabilities	**37,904**	26,000	27,071
Income taxes payable	**12,663**	11,572	338
Other long-term liabilities	**14,769**	4,400	2,724
Total adjustments to net income	**26,750**	31,215	59,432
Net Cash Provided by Operating Activities	**151,244**	93,895	99,732
Cash Flows from Investing Activities:			
Business acquisitions	**(1,491)**	(46,242)	(69,192)
Purchases of property and equipment and other	**(192,351)**	(96,027)	(83,992)
Dispositions of property and equipment	**6,826**	3,011	515
Decrease (increase) in other investments			73
Net Cash Used in Investing Activities	**(187,016)**	(139,258)	(152,596)
Cash Flows from Financing Activities:			
Net proceeds from revolving credit, net of expenses	**40,000**	31,828	19,280
Payments of 6.72% Senior Notes	**(20,000)**		
Proceeds from issuance of common stock	**8,320**	23,062	31,969
Excess tax benefits from stock-based compensation	**7,372**		
Net Cash Provided by Financing Activities	**35,692**	54,890	51,249

Net Increase (Decrease) in Cash and Cash Equivalents	**(80)**	9,527	(1,615)
Cash and Cash Equivalents Beginning of Period	**26,308**	16,781	18,396
Cash and Cash Equivalents End of Period	**$ 26,228**	$ 26,308	$ 16,781

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

39

Table of Contents

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME

	Common Stock		Additional	Unearned			Accumulated Other Comprehensive Income (Loss)			
	Issued		Paid-in	Comp-	Treasury	Retained	Fair Value of Interest Rate	Currency Translation	Pension	
(in thousands)	Shares	Amounts	Capital	ensation	Stock	Earnings	Hedge	Adjustments	Liability	Total
Balance, December 31, 2003	**49,627**	**$ 12,406**	**$ 108,540**	**$ (1,039)**	**$ (9,563)**	**$ 245,051**	**$**	**$ 6,161**	**$ (2,181)**	**$ 359,375**
Comprehensive Income:										
Net Income						40,300				40,300
Minimum pension liability adjustment, net of tax									(151)	(151)
Translation adjustments								12,399		12,399
Total Comprehensive Income						40,300		12,399	(151)	52,548
Restricted stock expense	78	20	4,916	592						5,528
Restricted stock forfeitures			280		(280)					
Stock options exercised	1,703	426	17,639		9,143					27,208
Tax benefits from stock plans			5,017							5,017
Common stock issued to company benefit plan	232	58								58
Treasury stock issued to company benefit plan, at average cost			4,003		700					4,703
Balance, December 31,	**51,640**	**12,910**	**140,395**	**(447)**		**285,351**		**18,560**	**(2,332)**	**454,437**

2004										
Comprehensive Income:										
Net Income						62,680				62,680
Change in fair value of interest rate hedge, net of tax							518			518
Minimum pension liability adjustment, net of tax									(217)	(217)
Translation adjustments								(14,269)		(14,269)
Total Comprehensive Income						62,680	518	(14,269)	(217)	48,712
Restricted stock expense	156	39	3,564	228						3,831
Restricted stock forfeitures			78		(78)					
Stock options exercised	1,692	423	21,116		50					21,589
Tax benefits from stock plans			6,177							6,177
Common stock issued to company benefit plan	70	18	1,326							1,344
Treasury stock issued to company benefit plan, at average cost					28					28
Balance, December 31, 2005	**53,558**	**13,390**	**172,656**	**(219)**		**348 ,031**	**518**	**4,291**	**(2,549)**	**536,118**
Comprehensive Income:										
Net Income						124,494				124,494
Change in fair value of interest rate hedge, net of tax							(165)			(165)
Minimum pension liability adjustment, net of tax									843	843

Translation adjustments								17,282		17,282
Total Comprehensive Income						124,494	(165)	17,282	843	142,454
Adjustment to initially apply SFAS No. 158, net of tax									(1,501)	(1,501)
Restricted stock expense	228	57	2,604	1,060						3,721
Restricted stock forfeitures			73		(73)					
Restricted stock grant	32	8	856	(917)						(53)
Stock options exercised	622	155	8,092		73					8,320
Stock options expense			333							333
Tax benefits from stock plans			7,372							7,372
Balance, December 31, 2006	**54,440**	**$ 13,610**	**$ 191,986**	**$ (76)**	**$**	**$ 472,525**	**$ 353**	**$ 21,573**	**$ (3,207)**	**$ 696,764**

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

40

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF MAJOR ACCOUNTING POLICIES

Principles of Consolidation

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

On May 12, 2006, our Board of Directors declared a two-for-one stock split to be effected in the form of a stock dividend of our common stock to our shareholders of record at the close of business on May 25, 2006. The stock dividend was distributed on June 19, 2006. All historical share and per share data in these financial statements reflect this stock split. Our total number of authorized shares of common stock and the par value of our common stock were unchanged by this stock split. We have restated shareholders equity to give retroactive recognition of the stock split for all periods presented by reclassifying an amount equal to the par value of the additional shares issued through the stock dividend from additional paid-in capital to common stock.

C*ash and Cash Equivalents*

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

Accounts Receivable Allowances for Doubtful Accounts

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

		Additions			
(in thousands)	Balance at beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at end of Period
For the year ended December 31, 2004	$ 2,763	$	$	$	$ 2,763
For the year ended December 31, 2005	$ 2,763	$	$ 112	$ 2,763	$ 112
For the year ended December 31, 2006	$ 112	$	$ 2	$	$ 114

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

Table of Contents

Inventory and Other Current Assets

Inventory and other current assets consisted of the following:

	December 31,	
(in thousands)	2006	2005
Inventory of parts for remotely operated vehicles	$ 61,763	$ 38,981
Other inventory, primarily raw materials	78,130	39,924
Deferred income taxes	18,618	9,091
Other	23,651	10,432
Total	$ 182,162	$ 98,428

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

Property and Equipment

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

We charge the costs of repair and maintenance of property and equipment to operations as incurred, while we capitalize the costs of improvements. We estimate and accrue in advance for anticipated drydocking expenses of our larger vessels. These amounts are included in accrued liabilities on our balance sheets. We recognize differences between the estimates and the actual costs in the income statement. See the section *New Accounting Standards* in this Note 1 for a discussion of the change in this methodology, which will be effective for us starting January 1, 2007.

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

		Additions			
(in thousands)	Balance at beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts	Deductions	Balance at end of Period
For the year ended December 31, 2004	$ 1,531	$ 495	$ 41	$ 860	$ 1,207
For the year ended December 31, 2005	$ 1,207	$ 1,022	$ (48)	$ 900	$ 1,281
For the year ended December 31, 2006	$ 1,281	$ 833	$ 27	$ 1,971	$ 170

We capitalize interest on assets where the construction period is anticipated to be more than three months. In 2006, 2005 and 2004, we capitalized $0.1 million, $0.1 million and $0.4 million of interest, respectively. We do not allocate general administrative costs to capital projects. Upon the disposition of property and equipment, the related cost and accumulated depreciation accounts are relieved and any resulting gain or loss is included as an adjustment to cost of services and products.

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

Business Acquisitions

In February 2004, we acquired 34 work-class ROVs and related business operations from Stolt Offshore S.A. for approximately $52 million and in September 2004 we acquired 10 work-class ROVs and related business operations from Fugro N.V. for approximately $17 million. We accounted for these acquisitions using the purchase method of accounting, with the purchase price being allocated to the net assets acquired based on their fair market values at the date of acquisition. In June 2005, we acquired Grayloc Products L.L.C. and subsidiary (together Grayloc), an oil and gas industry supplier of clamp connectors for approximately $42 million. We accounted for this acquisition using the purchase method of accounting, with the purchase price being allocated to the net assets acquired based on their fair market values at the date of acquisition. Our goodwill, all non-deductible, associated with the Grayloc acquisition was $22 million and other intangible assets were $14 million. The results of operations of Grayloc are included in our consolidated statements of income from the date of acquisition.

Goodwill and Intangible Assets

In accordance with the requirements of Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, we tested the goodwill attributable to each of our reporting units for impairment as of December 31, 2006, 2005 and 2004 and concluded that there was no impairment. Our reporting units are the product and service lines one level below our operating segments, except for Inspection, which is a single reporting unit. We estimated fair value using discounted cash flow methodologies and market comparable information.

Within our balance sheet caption Other Assets: Other at December 31, 2006 and 2005, we have $14.9 million and $15.4 million, respectively, of intangible assets, primarily acquired in connection with business combinations. These intangible assets include trade names, intellectual property and customer relationships, and are being amortized over a weighted average remaining life of approximately 12 years.

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. 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.

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

Revenue in Excess of Amounts Billed on uncompleted fixed-price contracts accounted for using the percentage-of-completion method is summarized as follows:

	December 31,	
(in thousands)	2006	2005
Revenue recognized on uncompleted contracts	$ 175,155	$ 84,664
Less: Billings of customers	(167,309)	(59,211)
Revenue in excess of amounts billed	$ 7,846	$ 25,453

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

	December 31,	
(in thousands)	2006	2005
Amounts billed to customers	$ 14,073	$ 26,301
Less: Revenue recognized	(8,734)	(22,286)
Billings in excess of revenue recognized	$ 5,339	$ 4,015

Stock-Based Compensation

As permitted under SFAS No. 123, *Accounting for Stock-Based Compensation*, through December 31, 2005, we used the intrinsic value method of accounting established by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, to account for our stock-based compensation programs. Accordingly, we did not recognize any compensation expense when the exercise price of an employee stock option was equal to the Common Share market price on the grant date and all other provisions are fixed. The following illustrates the pro forma effect on net income and earnings per share for 2005 and 2004 if we had applied the fair value recognition provisions of SFAS No. 123:

(in thousands, except per share amounts)	Year Ended December 31, 2005	2004
Net income:		
As reported	$ 62,680	$ 40,300
Employee stock-based compensation expense included in net income, net of income tax benefit	5,727	6,827
Pro forma compensation expense determined under fair value methods for all awards, net of income tax benefit	(8,779)	(11,515)
Pro forma	$ 59,628	$ 35,612
Pro forma earnings per common share:		
Basic	$ 1.14	$ 0.71
Diluted	$ 1.11	$ 0.69
Reported earnings per common share:		
Basic	$ 1.20	$ 0.81
Diluted	$ 1.17	$ 0.78

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

Subsequent to December 31, 2005, we have accounted for share-based compensation in accordance with SFAS No. 123 (revised 2004), *Share-Based Payments* (SFAS 123R). SFAS 123R requires all share-based payments to directors, officers and employees, including grants of stock options, to be recognized over their vesting periods in the income statement based on their estimated fair values. SFAS 123R applies to all awards granted after December 31, 2005 and to awards modified, repurchased or canceled after that date, as well as the unvested portion of awards granted prior to December 31, 2005. We believe the pro forma expenses for the periods presented above provide reasonable approximations of the share-based compensation expense that would have been recorded in our Consolidated Statements of Income in those periods under SFAS 123R. Existing option grants caused us to recognize an additional amount of less than $0.01 per diluted share of share-based compensation expense for 2006, under the modified prospective transition alternative that we elected.

In light of the new accounting expense recognition requirements established by SFAS 123R, the Compensation Committee of our Board of Directors has expressed its intention to refrain from using stock options as a component of 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. No stock options were granted in 2006. For more information on our employee benefit plans, see Note 8.

Income Taxes

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

Table of Contents

Foreign Currency Translation

The functional currency for several of our foreign subsidiaries is the applicable local currency. Results of operations for foreign subsidiaries with functional currencies other than the U.S. dollar are translated into U.S. dollars using average exchange rates during the period. Assets and liabilities of these foreign subsidiaries are translated into U.S. dollars using the exchange rates in effect at the balance sheet date, and the resulting translation adjustments are accumulated as a component of shareholders equity. All foreign currency transaction gains and losses are recognized currently in the Consolidated Statements of Income. We recorded ($2.5 million), $0.2 million and ($1.2 million) of foreign currency gains (losses) in 2006, 2005 and 2004, respectively, and such amounts are included as a component of Other Income (Expense), Net.

Earnings Per Share

Basic and diluted earnings per share are computed by dividing net income by the weighted average number of common shares and the weighted average number of common shares plus common share equivalents, respectively. The weighted average number of common shares and equivalents for 2005 and 2004 excluded 132,000 and 26,000 stock options, respectively, which were antidilutive.

Financial Instruments

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

Use of Estimates

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

New Accounting Standards

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. This interpretation clarifies the criteria for recognizing income tax benefits under SFAS No. 109, *Accounting for Income Taxes*, and requires additional financial statement disclosures about uncertain tax positions. The interpretation is effective for us beginning January 1, 2007. We are evaluating the impact of this interpretation on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*. SFAS No. 158 requires us to recognize the funded status of the pension and postretirement plans in our balance sheet, along with a corresponding noncash, after-tax adjustment to shareholders equity. Funded status is determined as the difference between the fair value of plan assets and the projected benefit obligation. Changes in the funded status will be recognized in other comprehensive income (loss). We adopted SFAS No. 158 at the end of 2006, as required.

In September 2006, the FASB issued FASB Staff Position No. AUG AIR-1, *Accounting for Planned Major Maintenance Activities*. The Staff Position will prohibit companies from recognizing planned major maintenance costs by accruing a liability over several reporting periods before the maintenance is performed the accrue-in-advance method. We currently use the accrue-in-advance method for anticipated drydocking of our vessels. This Staff Position is effective for us beginning January 1, 2007, and we will prospectively charge drydocking expenses to the income statement as incurred. While we are currently evaluating the impact of this Staff Position, we do not believe there will be a material effect on our financial statements upon its adoption.

Table of Contents

2. INVESTMENTS IN UNCONSOLIDATED AFFILIATES

Our investments in unconsolidated affiliates consists of the following:

	December 31,		
(in thousands)	2006	2005	2004
Medusa Spar LLC	$ 63,149	$ 57,440	$ 49,987
Smit-Oceaneering Cable Systems LLC		2,811	3,192
Other	1,347	1,347	2,436
	$ 64,496	$ 61,598	$ 55,615

In December 2003, we purchased a 50% equity interest in Medusa Spar LLC for $43.7 million. Medusa Spar LLC owns a 75% interest in a production spar platform. Medusa Spar LLC s revenue is derived from processing oil and gas production for a fee based on the volumes processed (throughput). The majority working interest owner of the Medusa field, the spar s initial location, has committed to deliver a minimum throughput, which we expect will generate sufficient revenue to repay Medusa Spar LLC s bank debt. The Medusa Spar LLC financed its acquisition of its 75% interest in the production spar platform using approximately 50% debt and 50% equity from its equity holders. Our maximum exposure to loss from our investment in Medusa Spar LLC is our $63 million investment. Medusa Spar LLC is a variable interest entity. As we are not the primary beneficiary under FIN 46(R), we are accounting for our investment in Medusa Spar LLC under the equity method of accounting. Summarized 100% financial information relative to Medusa Spar LLC and a reconciliation of the underlying equity in net assets to our carrying value follows this discussion.

Our cable lay and maintenance venture is in the process of winding up. The venture s single vessel has been used for oilfield and other uses since 2004. In 2004, we recognized $1.5 million of pre-tax impairments related to the venture after taking into account a deferred gain of $2.1 million we had generated upon formation of the venture. We also recorded an additional impairment of $0.4 million of our investment. The two impairments reduced our equity earnings of unconsolidated affiliates by $1.9 million. In 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. Total equity income (loss) from our investment in Smit-Oceaneering Cable Systems LLC was $0.8 million, $0.3 million and ($3.1 million) for the years ended December 31, 2006, 2005 and 2004, respectively.

Table of Contents

(in thousands)	2006	December 31, 2005	2004
Medusa Spar LLC			
Condensed Balance Sheets			
ASSETS			
Current Assets	$ 20,419	$ 12,669	$ 3,435
Property and Equipment, net	138,461	147,938	157,416
Other Non-Current Assets	979	1,575	1,751
Total Assets	$ 159,859	$ 162,182	$ 162,602
LIABILITIES AND MEMBERS EQUITY			
Current Maturities of Long-Term Debt	$ 11,499	$ 13,744	$ 17,125
Other Current Liabilities	24	21	44
Total Current Liabilities	11,523	13,765	17,169
Long-Term Debt, net of current maturities	21,738	33,237	46,981
Other Comprehensive Income	1,097	1,594	883
Members Equity	125,501	113,586	97,569
Total Liabilities and Members Equity	$ 159,859	$ 162,182	$ 162,602
Condensed Statements of Operations			
Revenue	$ 34,216	$ 32,500	$ 29,312
Depreciation	(9,477)	(9,478)	(9,478)
General and Administrative	(109)	(83)	(113)
Interest	(1,935)	(2,286)	(3,169)
Net Income	$ 22,695	$ 20,653	$ 16,552
Reconciliation of the Carrying Value of the Investment to Underlying Equity in Net Assets:			
Underlying Equity in Net Assets - 50%	$ 62,751	$ 56,793	$ 48,785
Basis Differences	398	647	1,202
Carrying Value of Investment in Medusa Spar LLC in the Consolidated Financial Statements	$ 63,149	$ 57,440	$ 49,987

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

Our 50% share of the cumulative undistributed earnings of Medusa Spar LLC was $20.9 million and $15.0 million at December 31, 2006 and 2005, respectively.

Table of Contents

3. INCOME TAXES

We file a consolidated U.S. federal income tax return for Oceaneering International, Inc. and our domestic subsidiaries, including acquired companies from their respective dates of acquisition. We conduct our international operations in a number of locations that have varying laws and regulations with regard to income and other taxes, some of which are subject to interpretation. Our management believes that adequate provisions have been made for all taxes that will ultimately be payable, although final determination of tax liabilities may differ from our estimates. Income (loss) before income taxes attributable to the U.S. was $108.1 million, $42.7 million and $14.7 million for the years ended December 31, 2006, 2005 and 2004, respectively. The following table sets forth our provisions for income taxes.

	Year Ended December 31,		
(in thousands)	2006	2005	2004
U.S. federal and state	$ 37,384	$ 11,930	$ 1,622
Foreign	29,017	19,840	19,001
Total provision	$ 66,401	$ 31,770	$ 20,623
Current	$ 70,661	$ 32,071	$ 16,379
Deferred	(4,260)	(301)	4,244
Total provision	$ 66,401	$ 31,770	$ 20,623
Cash taxes paid	$ 49,876	$ 19,372	$ 17,995

As of December 31, 2006 and 2005, our worldwide deferred tax assets, liabilities and net deferred tax liabilities were as follows:

	December 31,	
(in thousands)	2006	2005
Deferred tax assets:		
Deferred compensation	$ 19,988	$ 15,818
Foreign tax credit carryforwards	6,815	12,811
Accrued expenses	9,648	6,864
Deferred income	3,412	1,152
Net operating loss carryforwards	1,483	
Other	10,902	7,665
Gross deferred tax assets	52,248	44,310
Valuation allowance		
Total deferred tax assets	$ 52,248	$ 44,310
Deferred tax liabilities:		
Property and equipment	$ 34,211	$ 35,896

Basis difference in equity investments	13,794	11,673
Unremitted foreign earnings	4,151	
Other	2,874	2,471
Total deferred tax liabilities	$ 55,030	$ 50,040
Net deferred income tax liability	$ 2,782	$ 5,730

49

Table of Contents

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

(in thousands)	December 31, 2006	2005
Deferred tax liabilities	$ 21,400	$ 14,905
Current deferred assets	(18,618)	(9,091)
Long-term assets		(84)
Net deferred income tax liability	$ 2,782	$ 5,730

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

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

(in thousands)	Year Ended December 31, 2006	2005	2004
Computed U.S. statutory expense	$ 66,862	$ 33,077	$ 21,346
Change in valuation allowances			(1,307)
State and local taxes and other, net	(461)	(1,307)	584
Total provision for income taxes	$ 66,401	$ 31,770	$ 20,623

Included in the line for state and local taxes and other, net, for 2006 and 2005 are credits of $1.3 million and $1.8 million, respectively, from resolution of tax contingencies related to certain foreign tax liabilities we recorded in prior years.

4. DEBT

Long-term Debt consisted of the following:

(in thousands)	December 31, 2006	2005
6.72% Senior Notes	$ 80,000	$ 100,000
Revolving credit facility	114,000	74,000
Long-term Debt	$ 194,000	$ 174,000

We have $80 million aggregate principal amount of 6.72% Senior Notes outstanding and scheduled to be paid in four remaining equal annual installments each September through 2010.

As of December 31, 2006, we had a $250 million revolving credit facility (the Credit Agreement) that was scheduled to expire in January 2008. We had to pay a facility fee ranging from 0.20% to 0.30% per annum, depending on our debt-to-capitalization ratio, on the banks commitments. Under the Credit Agreement, we had the option to borrow at the London Interbank Offered Rate (LIBOR) plus a margin ranging from 0.55% to 1.075%, depending on our debt-to-capitalization ratio, or at the agent bank s prime rate. At December 31, 2006, we had $114 million of borrowings outstanding under the Credit Agreement and $136 million available for borrowing. The weighted average interest rates on all our outstanding borrowings were 6.2% and 6.1% at December 31, 2006 and 2005, respectively.

Table of Contents

In January 2007, we amended the Credit Agreement as follows:

- the amount of the facility was increased from $250 million to $300 million;
- the maturity of the facility was changed from January 2008 to January 2012;
- we deleted the facility fee, which applied to the entire $250 million facility, and the utilization fee, which applied to borrowings if we used more than one-third of the facility;
- we added a commitment fee ranging from 0.125% to 0.175% on the unused portion of the facility, depending on our debt-to-capitalization ratio; and
- we changed the range of margins on LIBOR borrowings, so that it now ranges from 0.50% to 1.25%, depending on our debt-to-capitalization ratio.

Otherwise, the principal terms of the agreement are the same as described above. While there is an easing on restrictions related to the payment of dividends in the amended agreement, the restrictions on the 6.72% Senior Notes remain in place.

The 6.72% Senior Notes contain restrictive covenants as to minimum net worth, debt-to-capitalization ratio, fixed charge coverage, interest coverage and restricted payments. Restricted payments, which include dividends and treasury stock purchases, are limited from April 1, 1998, on a net basis, to the sum of $25 million plus 50% of our consolidated net income after April 1, 1998, plus cash proceeds from any sales of our common stock. As amended in January 2007, the $300 million revolving credit agreement contains restrictive covenants as to debt-to-capitalization ratio and interest coverage.

Taking into account the terms of the January 2007 amendment of our revolving credit facility, scheduled maturities of Long-term Debt outstanding as of December 31, 2006 were as follows:

(in thousands)	6.72% Notes	Revolving Credit	Total
2007	$ 20,000	$	$ 20,000
2008	20,000		20,000
2009	20,000		20,000
2010	20,000		20,000
Thereafter		114,000	114,000
Total	$ 80,000	$ 114,000	$ 194,000

Maturities in 2007 are not classified as current as of December 31, 2006, since we are able and intend to extend the maturity by reborrowing under the revolving credit facility with a maturity date after one year.

We made cash interest payments of $13.2 million, $10.2 million and $8.3 million in the years ended December 31, 2006, 2005 and 2004, respectively.

5. COMMITMENTS AND CONTINGENCIES

Lease Commitments

At December 31, 2006, we occupied several facilities under noncancellable operating leases expiring at various dates through 2025. Future minimum rentals under these leases are as follows:

(in thousands)	
2007	$ 26,607
2008	20,388

2009	19,477
2010	7,330
2011	6,431
Thereafter	43,026
Total Lease Commitments	$ 123,259

Rental expense, which includes hire of vessels, specialized equipment and real estate rental, was approximately $34 million, $38 million and $26 million for the years ended December 31, 2006, 2005 and 2004, respectively.

Insurance

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

Litigation

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

Letters of Credit

We had $17 million and $16 million in letters of credit outstanding as of December 31, 2006 and 2005, respectively, as guarantees in force for self-insurance requirements and various performance and bid bonds, which are usually for the duration of the applicable contract.

Financial Instruments and Risk Concentration

In the normal course of business, we manage risks associated with foreign exchange rates and interest rates through a variety of strategies, including the use of hedging transactions. As a matter of policy, we do not use derivative instruments unless there is an underlying exposure. We do not use derivative instruments for trading or speculative purposes. At December 31, 2006, we did not have any derivative financial instruments in place.

At December 31, 2006, our unconsolidated affiliate, Medusa Spar LLC, had an interest rate swap in place related to its outstanding debt. The notional amount of the interest rate swap is equal to the outstanding principal amount of the loan throughout the term of the debt agreement. Our share of the fair value of the interest rate swap is deferred in accumulated other comprehensive income and is subsequently reclassified into equity earnings from unconsolidated affiliates in the periods in which the hedged interest payments on the variable rate debt affect earnings.

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

We estimated the fair value of our $80 million of 6.72% Senior Notes to be $81 million as of December 31, 2006. We arrived at this estimate by computing the present value of the future principal and interest payments using a yield-to-maturity interest rate for securities of similar quality and term.

6. OPERATIONS BY BUSINESS SEGMENT AND GEOGRAPHIC AREA

Business Segment Information

We supply a comprehensive range of integrated technical services and products to a variety of industries and we are one of the world s largest underwater services contractors. Our Oil and Gas business consists of Remotely Operated Vehicles (ROVs), Subsea Products, Subsea Projects, Mobile Offshore Production Systems and Inspection. Our ROV segment provides submersible vehicles operated from the surface to support offshore oil and gas exploration, production and construction activities. Our Subsea Products segment supplies a variety of built-to-order specialty subsea hardware. Our Subsea Projects segment provides multiservice vessels, oilfield diving and support vessel operations, which are used primarily in inspection, repair and maintenance activities.

Table of Contents

Our Mobile Offshore Production Systems segment provides offshore production facilities through three mobile offshore production systems that we own and a 50%-owned entity, which owns 75% of another system. Our Inspection segment provides customers with a wide range of third-party inspection services to satisfy contractual structural specifications, internal safety standards and regulatory requirements. Our Advanced Technologies business provides project management, engineering services and equipment for applications in non-oilfield markets.
Unallocated Expenses are those not associated with a specific business segment. These consist of expenses related to our incentive and deferred compensation plans, including restricted stock and bonuses, as well as other general expenses, including corporate administrative expenses.
The table that follows presents Revenue, Income from Operations, Depreciation and Amortization Expense and Equity Earnings (Losses) of Unconsolidated Affiliates by business segment:

Table of Contents

	Year Ended December 31,		
(in thousands)	2006	2005	2004
Revenue			
Oil and Gas			
Remotely Operated Vehicles	$ 410,256	$ 315,178	$ 223,914
Subsea Products	364,510	239,039	160,410
Subsea Projects	155,046	121,628	70,254
Inspection	169,014	154,857	145,691
Mobile Offshore Production Systems	52,931	50,091	49,387
Total Oil and Gas	1,151,757	880,793	649,656
Advanced Technologies	128,441	117,750	130,525
Total	$ 1,280,198	$ 998,543	$ 780,181
Income from Operations			
Oil and Gas			
Remotely Operated Vehicles	$ 111,022	$ 68,962	$ 48,397
Subsea Products	53,645	13,941	10,891
Subsea Projects	59,585	26,219	5,472
Inspection	14,946	7,946	4,564
Mobile Offshore Production Systems	16,001	16,796	16,565
Total Oil and Gas	255,199	133,864	85,889
Advanced Technologies	11,585	12,539	17,515
Unallocated Expenses	(72,448)	(52,334)	(39,540)
Total	$ 194,336	$ 94,069	$ 63,864
Depreciation and Amortization Expense	&nb		