LIQUID AUDIO INC
Form 10-Q
November 14, 2001

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

[X] Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended SEPTEMBER 30, 2001

or

[_] 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 000-25977

LIQUID AUDIO, INC.

(Exact name of registrant as specified in its charter)

Delaware	77-0421089
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
800 Chesapeake Drive, Redwood City, CA	94063
(Address of principal executive offices)	(Zip Code)

(650) 549-2000

(Registrant's telephone number, including area code)

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) had been subject to such filing requirements for the past 90 days. X Yes _____ No

As of October 31, 2001, there were 22,704,615 shares of registrant's Common Stock outstanding.

LIQUID AUDIO, INC.

INDEX

PART I. FINANCIAL INFORMATION ....

ITEM 1. FINANCIAL STATEMENTS ....

Condensed Consolidated Balance Sheets as of September 30, 2001 and December 31, 2000
Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2001 and 2000
Condensed Consolidated Statements of Cash Flows for the nine months ended September 30
Notes to Condensed Consolidated Financial Statements
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS ....
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK ....

PART II. OTHER INFORMATION ....

ITEM 1. LEGAL PROCEEDINGS ....
ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS ....
ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS ....
ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K ....

SIGNATURES ....

INDEX TO EXHIBITS FOR FORM 10-Q ....

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LIQUID AUDIO, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30 2001
Assets	(unaudited)
Current assets:	
Cash and cash equivalents	$ 97,009
Short-term investments	--
Accounts receivable from third parties, net	433
Accounts receivable from related parties, net	--
Other current assets	1,480
Total current assets	98,922
Restricted cash	826
Investment in strategic partner	--
Property and equipment, net	4,819
Other assets	164
Total assets	$ 104,731
Liabilities and stockholders' equity	
Current liabilities:	
Accounts payable	$ 1,559
Accrued expenses and other current liabilities	4,229
Deferred revenue from third parties	168
Deferred revenue from related parties	568

Capital lease obligations, current portion	52
Equipment loan, current portion	290
Total current liabilities	6,866
Capital lease obligations, non-current portion	--
Equipment loan, non-current portion	--
Note payable to related party	376
Total liabilities	7,242
Stockholders' equity:	
Common stock	23
Additional paid-in capital	202,831
Unearned compensation	(67)
Accumulated deficit	(105,271)
Accumulated other comprehensive income (loss)	(27)
Total stockholders' equity	97,489
Total liabilities and stockholders' equity	$ 104,731

See accompanying notes to condensed consolidated financial statements.

1

LIQUID AUDIO, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts; unaudited)

	Three Months Ended September 30,		
	2001	2000	2
Net revenues:			
License	$ 171	$ 174	$
Services	214	727	
Business development (related party)	890	2,454	
Total net revenues	1,275	3,355	
Cost of net revenues:			
License	68	64	
Services	212	720	
Business development (related party)	--	7	
Non-cash cost of revenue	69	2	
Total cost of net revenues	349	793	
Gross profit	926	2,562	

Operating expenses:			
Sales and marketing	2,360	4,694	
Non-cash sales and marketing	13	58	
Research and development	3,733	6,088	
Non-cash research and development	10	27	
General and administrative	1,630	2,055	
Non-cash general and administrative	1	16	
Strategic marketing--equity instruments	(45)	550	
Restructuring	--	--	
Total operating expenses	7,702	13,488	
Loss from operations	(6,776)	(10,926)	(
Other income (expense), net	870	2,209	
Loss in equity investment	(154)	(175)	
Net loss	$ (6,060)	$ (8,892)	$(
Net loss per share:			
Basic and diluted	$ (0.27)	$ (0.40)	$
Weighted average shares	22,640	22,304	

See accompanying notes to condensed consolidated financial statements.

2

LIQUID AUDIO, INC.
CONDENSED CONSOLIDATED OF CASH FLOWS
(in thousands; unaudited)

	Nine Mo Septe
	2001
Cash flows from operating activities:	
Net loss	$(31,361)
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	3,054
Amortization of unearned compensation	(76)
Allowance for doubtful accounts and sales returns reserve	1,458
Loss in equity investment	1,254
Strategic marketing-equity instruments	607
Non-cash cost of revenue	254
Loss on disposal of and write-down of property and equipment	1,748
Common stock issued for legal settlement	--
Other	(17)
Changes in assets and liabilities:	
Accounts receivable from third parties	344
Accounts receivable from related parties	(257)

Other assets	(698)
Accounts payable	(1,755)
Accrued expenses and other current liabilities	707
Deferred revenue from third parties	(272)
Deferred revenue from related parties	(419)
Net cash used in operating activities	(25,429)
Cash flows from investing activities:	
Acquisition of property and equipment	(792)
Proceeds from sale of fixed assets	33
Sales (purchases) of short-term investments, net	27,384
Equity investment	(165)
Net cash provided by (used in) investing activities	26,460
Cash flows from financing activities:	
Proceeds from issuance of common stock, net of repurchases	170
Payments made under capital leases	(96)
Payments made under equipment loan	(442)
Net cash provided by (used in) financing activities	(368)
Effect of exchange rates on cash and cash equivalents	(52)
Net increase (decrease) in cash and cash equivalents	611
Cash and cash equivalents at beginning of period	96,398
Cash and cash equivalents at end of period	$ 97,009
Supplemental disclosures:	
Cash paid for interest	$ 58
Non-cash investing and financing activities:	
Issuance of warrants in connection with strategic marketing agreements	$ 126
Issuance of common stock in connection with strategic marketing agreements	735
Issuance of common stock upon exercise of warrant	--
Issuance of common stock for intellectual property	--

See accompanying notes to condensed consolidated financial statements

LIQUID AUDIO, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

NOTE 1 - THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The Company

Liquid Audio, Inc. (the "Company") was incorporated in California in January 1996 and reincorporated in Delaware in April 1999. In July 2000, the Company established a wholly-owned subsidiary in the United Kingdom, Liquid Audio Europe PLC, which reregistered in August 2001 as Liquid Audio Europe

Limited, to develop sales in Europe. The Company was formed with the goal of becoming the premier provider of software applications and services that enable the secure delivery and sale of digital music over the Internet. The Company's end-to-end solutions enable the secure distribution, promotion and sale of high quality music files while providing consumers with the ability to access, preview and purchase that music via the Internet.

Basis of presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company and reflect all adjustments, which are in the opinion of management, necessary for a fair presentation of the interim periods presented. The results of operations for the three months ended September 30, 2001 are not necessarily indicative of the results to be expected for any subsequent quarter or for the year ending December 31, 2001. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the Securities and Exchange Commission's rules and regulations. A condensed consolidated statement of comprehensive loss has not been presented because the components of comprehensive loss are not material.

These unaudited condensed consolidated interim financial statements and notes included herein should be read in conjunction with the Company's audited consolidated financial statements and notes as included in the Company's Annual Report on Form 10-K for the year ended December 31, 2000 as filed with the Securities and Exchange Commission (the "SEC") on March 30, 2001.

Reclassifications

Certain reclassifications have been made to the prior periods' consolidated financial statements to conform to the current period presentation. The statement of operations reflects reclassifications to allocate the non-cash compensation expense related to the issuance of stock options from a single line presentation within operating expenses to the respective amounts in cost of net revenues, sales and marketing, research and development and general and administrative expense. The reclassifications had no effect on net loss, stockholders' equity or cash flows.

Revenue recognition

Software license revenues are recognized when persuasive evidence of an arrangement exists, delivery has occurred, no significant Company obligations with regard to implementation or integration exist, the fee is fixed or determinable and collection is probable as prescribed in Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition." For arrangements with multiple elements, the total fee from the arrangement is allocated among each element based upon vendor specific objective evidence ("VSOE") of fair value. VSOE of fair value for the service elements is based upon the standard hourly rate the Company charges for services when such services are sold separately. VSOE of fair value for annual maintenance is established based upon the optional stated renewal rate. When VSOE of fair value exist for all undelivered elements, the Company accounts for the delivered elements, primarily the license portion, based upon the "residual method" as prescribed by SOP No. 98-9, "Modification of SOP 97-2 with Respect to Certain Transactions." The Company recognizes revenue allocated to maintenance ratably over the contract period, which is generally twelve months.

LIQUID AUDIO, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Business development revenue primarily consists of license and maintenance fees derived from contractual agreements with the Company's strategic partners. These U.S. dollar-denominated, non-refundable fees are based upon agreements whereby the strategic partners are contractually obligated to pay to the Company a fixed fee for the right to license and use the Company's proprietary technology in various countries. The total fee from business development agreements are allocated among the various elements of the contracts based on VSOE of fair value. The fees are recognized by the Company as earned, the specific timing of which depends on the terms and conditions of the particular contractual arrangements, including payment terms. When VSOE of fair value does not exist for the undelivered elements, the total fee from the business development arrangement is recognized ratably over the period of the contract.

The Company also generates license and service revenues from digital music kiosk sales and hosting services. Revenue derived from hosting services include subscription fees from artists for encoding and storing music files, e-commerce services and transaction reporting. Music delivery services revenue include transaction fees from sales of digital recorded music through the Company's website affiliates and fees from music retailers and websites related to the sample digital music clips delivery service. Revenue from kiosk sales consist of software licenses and services revenue from equipment and kiosk-related services. The Company bears full credit risk with respect to substantially all sales.

Restricted cash

At September 30, 2001, the Company had a cash balance of $826,000 in the form of certificates of deposit, which were restricted from withdrawal. The amount serves as collateral to a letter of credit issued by the Company's bank to the Company's lessor as security deposit on a long-term lease.

Principles of consolidation

The financial statements include the accounts of the Company and its subsidiary. Significant intercompany transactions and balances have been eliminated. Investments in entities in which the Company can exercise significant influence, but are less than majority owned and not otherwise controlled by the Company, are accounted for under the equity method.

Recent accounting pronouncements

On October 3, 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". SFAS No. 144 supercedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 applies to all long-lived assets (including discontinued operations) and consequently amends Accounting Principles Board Opinion No. 30. SFAS No. 144 develops one accounting model for long-lived assets that are to be disposed of by sale. SFAS No. 144 requires that long-lived assets that are to be disposed of by sale be measured at the lower of book value or fair value less cost to sell. Additionally, SFAS No. 144 expands the scope of discontinued operations to include all components of an entity with operations that (1) can be distinguished from the rest of the entity and (2) will be eliminated from the ongoing operations of the entity in a disposal transaction. SFAS No. 144 is effective for the Company for all financial statements issued in fiscal 2002. The Company does not believe that the adoption of SFAS No. 144 will have a material impact on its financial position or results

of operations.

LIQUID AUDIO, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 2 - BALANCE SHEET COMPONENTS (IN THOUSANDS):

	September 30, 2001
Accounts receivable from third parties, net:	
Accounts receivable	$ 921
Less: allowance for doubtful accounts and sales returns reserve...	(488)
	$ 433

The allowance for doubtful accounts and sales returns reserve increased (decreased) by $(52,000) and $271,000 for the nine months ended September 30, 2001 and the year ended December 31, 2000, respectively. Write-offs against the allowance for doubtful accounts and sales returns reserve were $48,000 and $43,000 for the nine months ended September 30, 2001 and the year ended December 31, 2000, respectively.

	September 30, 2001
Accounts receivable from related parties, net:	
Accounts receivable	$ 1,555
Less: allowance for doubtful accounts and sales returns reserve...	(1,555)
	$ --

The allowance for doubtful accounts and sales returns reserve increased by $1,510,000 and $45,000 for the nine months ended September 30, 2001 and the year ended December 31, 2000, respectively. No write-offs against the allowance for doubtful accounts and sales returns reserve were made for the nine months ended September 30, 2001 and the year ended December 31, 2000, respectively.

	September 30, 2001	December 31, 2000
Property and equipment:		
Computer equipment and purchased software ...	$ 11,445	$ 12,190
Website and software development costs	235	399
Furniture and fixtures	554	774
Leasehold improvements	536	682
	12,770	14,045
Less:		
Accumulated depreciation and amortization	(7,951)	(5,185)
	$ 4,819	$ 8,860

Property and equipment includes $195,000 and $784,000 of equipment under capital leases at September 30, 2001 and December 31, 2000, respectively. Accumulated depreciation and amortization for equipment under capital leases was $187,000 and $734,000 at September 30, 2001 and December 31, 2000, respectively.

6

	September 30, 2001	December 31, 2000
Accrued expenses and other current liabilities:		
Compensation and benefits	$ 2,087	$ 2,321
Restructuring	452	--
Consulting and professional services	324	475
Other....................................	1,366	726
	$ 4,229	$ 3,522

NOTE 3 - RELATED PARTIES:

Investment in Cyber Music Entertainment

The Company owns 8.48% of the outstanding shares of Cyber Music Entertainment ("CME"), formerly Liquid Audio Japan ("LAJ"), and accounts for its investment under the equity method of accounting. The Company's proportionate share of loss for the nine months ended September 30, 2001 is $1,254,000 (unaudited).

In June 2001, the Company and LAJ mutually agreed to terminate the licensing and reseller agreements (the "Agreements") between the two companies. As a result, Liquid Audio Japan renamed its company to Cyber Music Entertainment and no longer distributes the Company's technology nor utilizes the Company's digital distribution platform to offer services to the Japanese music market. According to the mutual termination agreement, effective September 30, 2001, CME ceased using Liquid Audio trademarks, including the company name, and returned all of the Company's products, technology and licenses. The Company does not

believe that it has any outstanding obligations in connection with the Agreements. As a result, the Company recognized the remaining deferred revenue balance of $890,000 from CME in the three months ended September 20, 2001. The Company intends to establish a new office and to build new relationships with label, retail and consumer electronic companies.

Investment in Liquid Audio Korea

In December 1998, the Company signed an agreement with a strategic partner to establish a Korean corporation, Liquid Audio Korea Co. Ltd. ("LAK"), to develop a local business to enable the digital delivery of music to customers in Korea. In September 2001, the Company notified LAK of its default under the licensing and reseller agreements between the two companies due to LAK's failure to make contractual payments as scheduled. LAK did not cure the default during the cure period. Accordingly, the Company exercised its rights under the agreements to terminate the licensing and reseller agreements. Outstanding accounts receivable from LAK have been fully reserved for, and no revenue from LAK was recorded in the three months ended September 30, 2001.

Liquid Audio Greater China

In June 2000, the Company signed an agreement with a strategic partner to establish a British Virgin Islands corporation, Liquid Audio Greater China ("LAGC"). In September 2001, the Company notified LAGC of its default under the licensing and reseller agreements between the two companies due to LAGC's failure to make contractual payments as scheduled. LAGC did not cure the defaults during the cure period. Accordingly, the Company exercised its rights under the agreements to terminate the licensing and reseller agreements. Outstanding accounts receivable from LAGC have been fully reserved for, and no revenue from LAGC was recorded in the three months ended September 30, 2001.

7

Liquid Audio South East Asia

In September 2000, the Company signed an agreement with a strategic partner to establish a Singaporean corporation, Liquid Audio South East Asia ("LASE"). In September 2001, the Company notified the strategic partner of LASE of its default under the licensing and reseller agreements between the two companies due to the strategic partner's failure to make contractual payments as scheduled. The strategic partner did not cure the defaults during the cure period. Accordingly, the Company exercised its rights under the agreements to terminate the licensing and reseller agreements. Outstanding accounts receivable from the strategic partner have been fully reserved for, and no revenue from the strategic partner or LASE was recorded in the three months ended September 30, 2001.

Total business development revenue

Total business development revenues are summarized as follows (in thousands):

	Three Months Ended September 30,		Nin S
	2001	2000	2001

Cyber Music Entertainment and strategic partner	$ 890	$ 847	$ 1,
Liquid Audio South East Asia and strategic partner	--	1,260	
Liquid Audio Greater China and strategic partner	--	347	
Liquid Audio Korea and strategic partner	--	--	
	$ 890	$ 2,454	$ 2,

At September 30, 2001, the deferred revenue from related parties balance of $568,000 relates to a payment of $568,000 received in September 2001 from a shareholder of Liquid Audio Greater China. The Company is in the process of reestablishing its operations in Greater China. The remaining deferred revenue balance of $568,000 will not be recognized as revenue until the Company has finalized its operating structure in Greater China.

NOTE 4 - NET LOSS PER SHARE:

Basic and diluted net loss per share is computed by dividing the net loss available to common stockholders for the period by the weighted average number of common shares outstanding during the period. The calculation of diluted net loss per share excludes potential common shares if the effect is anti-dilutive. Potential common shares consist of unvested restricted common stock, incremental common shares issuable upon the exercise of stock options and common shares issuable upon the exercise of common stock warrants.

The following table sets forth the computation of basic and diluted net loss per share for the periods indicated (in thousands, except per share amounts):

	Three Months Ended September 30,		
	2001	2000	
Numerator:			
Net loss	$ (6,060)	$ (8,892)	$
Denominator:			
Weighted average shares	22,645	22,355	
Weighted average unvested common shares subject to repurchase	(5)	(51)	
Denominator for basic and diluted calculation	22,640	22,304	
Net loss per share:			
Basic and diluted	$ (0.27)	$ (0.40)	$

The following table sets forth potential shares of common stock that are not included in the diluted net loss per share calculation above because to do so would be anti-dilutive for the periods indicated (in thousands):

	Three Months Ended September 30,		Nine M Sept
	2001	2000	2001
Common stock options	3,080	2,505	2,955
Common stock warrants	875	558	875
Unvested common stock subject to repurchase	5	51	8

NOTE 5 - STRATEGIC MARKETING -- EQUITY AGREEMENTS:

In June 1999, the Company signed an Advertising Agreement with Amazon.com, Inc. ("Amazon.com") to collaborate on event-based advertising using the Company's digital delivery services. In connection with this agreement, the Company issued a fully vested warrant to purchase approximately 254,000 shares of common stock to Amazon.com. The warrant was valued at $2,022,000 and was recognized as strategic marketing-equity instruments expense ratably over the one-year term of the agreement, which ended in June 2000. As a result, $844,000 was recognized as strategic marketing-equity instruments expense in the nine months ended September 30, 2000.

In August 1999, the Company signed a Digital Audio Co-Marketing and Distribution Agreement with Yahoo! to promote the distribution of digital music on its web site. In connection with this agreement, the Company granted Yahoo! three warrants totaling 250,000 shares of common stock. The first warrant for 83,334 shares vested immediately. The first warrant was valued at $903,000 and was recognized ratably over the one-year term of the agreement as strategic marketing-equity instruments expense. The second warrant for 83,333 shares vested in August

2000. The second warrant was initially valued at $426,000 and was recognized ratably over the one-year period ending at the vesting date as strategic marketing-equity instruments expense. The second warrant was revalued at each balance sheet date through the vesting date. As a result, the original charge of $426,000 was reduced to $312,000 based on current fair market value. The third warrant for 83,333 shares vested in August 2001. The third warrant was initially valued at $105,000 and was recognized ratably over the one-year period ending at the vesting date. The third warrant was revalued at each balance sheet date through the vesting date. As a result, the original charge of $105,000 was reduced to $54,000 based on current fair market value. In the nine months ended September 30, 2001, $0, $0 and $16,000 were recognized as strategic marketing-equity instruments expense for the first, second and third warrants, respectively. In the nine months ended September 30, 2000, $577,000, $(114,000) and $23,000 were recognized as strategic marketing-equity instruments expense for the first, second and third warrants, respectively.

In July 2000, the Company signed an agreement with Virgin Holdings, Inc. ("Virgin"), an affiliate of EMI Recorded Music, to promote the distribution of digital music over the Internet using the Company's technology. Pursuant to this agreement, the Company issued 150,000 shares of common stock to Virgin. These shares were valued at $1,181,000 and was recognized as strategic marketing-equity instruments expense ratably over the one-year term of the agreement. As a result, $591,000 and $295,000 were recognized as strategic marketing-equity instruments expense in the nine months ended September 30, 2001

and 2000, respectively.

In December 2000, the Company signed an agreement with BMG Entertainment ("BMG") to obtain the right to distribute BMG sound recordings and related artwork through kiosks. In connection with this agreement, the Company issued 50,000 shares of common stock to BMG. These shares were valued at $195,000 and are being recognized as non-cash cost of net revenues ratably over the one-year term of the agreement. As a result, $144,000 was recognized as non-cash cost of net revenues in the nine months ended September 30, 2001. Additionally, the Company granted a warrant for a total of 233,300 shares of common stock. Of the total, 77,768 shares vest in December 2001, and the cost will be remeasured each quarter until a commitment for performance has been reached or the warrant vests, based on current fair market value. At September 30, 2001, the 77,768 shares under this warrant was valued at $148,000, of which $110,000 was recognized as non-cash cost of net revenues in the nine months ended September 30, 2001. The unamortized portion will be remeasured at each balance sheet date through the vesting date and amortized over the remaining vesting period. If BMG renews the agreement after December 2001, the remaining shares will vest at 6,481 shares per month commencing January 2002 for one year and 6,480 shares per month commencing January 2003 for one year. Such shares will be valued at the fair market value of the Company's common stock upon BMG renewing the agreement at each renewal date.

NOTE 6 - RESTRUCTURING:

In May 2001, the Company adopted a corporate restructuring program to reduce expenses to preserve the Company's cash position while the digital music market develops. The restructuring included a worldwide workforce reduction, a consolidation of three Redwood City, California offices into one facility and other expense management initiatives. A restructuring charge of $3,672,000 was recorded in operating expense in the three months ended June 30, 2001.

The restructuring charge included involuntary employee separation costs of $1,116,000 for 79 employees worldwide, 20 in sales and marketing, 32 in research and development, 13 in general and administrative and 6 in operations functions in the U.S., and 2 in sales and marketing, 3 in research and development and 3 in operations functions outside the U.S.

Lease costs of $824,000 were accrued in the three months ended June 30, 2001 pertaining to the estimated future obligations for non-cancelable lease payments for excess facilities that were vacated due to reductions in workforce.

Asset impairment costs of $1,732,000 were recorded, primarily for property and equipment, furniture and fixtures, computer software and leasehold improvements for assets no longer in use from de-emphasized business lines, reductions in workforce and excess facilities.

A summary of the restructuring cost is outlined as follows (in thousands):

	Severance and Benefits	Facilities	Asset Impairment
Severance and benefits	$ 1,116	$ --	$
Accrued lease costs	--	824	
Property and equipment impairment	--	--	1,7

Total	1,116	824	1,7
Cash paid	(1,116)	--	
Non-cash	--	--	(1,7
Restructuring reserve balance at June 30, 2001	--	824	
Cash paid	--	(372)	
Restructuring reserve balance at September 30, 2001	$ --	$ 452	$

Remaining cash expenditures related to net lease expense due to the consolidation of facilities will be paid over the lease terms through the second quarter of 2002.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis contains forward-looking statements within the meaning of Federal securities laws. You can identify these statements because they use forward-looking terminology such as "may," "will," "expect," "anticipate," "estimate," "continue," "believe," "intend" or other similar words. These words, however, are not the exclusive means by which you can identify these statements. You can also identify forward-looking statements because they discuss future expectations, contain projections of results of operations or of financial conditions, characterize future events or circumstances or state other forward-looking information. We have based all forward-looking statements included in Management's Discussion and Analysis on information currently available to us, and we assume no obligation to update any such forward-looking statements. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, actual results could differ materially from those projected in the forward-looking statements. Potential risks and uncertainty include, among others, those set forth under the caption "Additional Factors Affecting Future Results" included in this "Management's Discussion and Analysis of Financial Condition and Results of Operations."

While we believe that the discussion and analysis in this report is adequate for a fair presentation of the information, we recommend that you read this discussion and analysis with "Management's Discussion and Analysis" included in our Annual Report on Form 10-K for the year ended December 31, 2000 filed with the SEC.

Overview

We are a leading provider of software products and services that enable artists, record companies and retailers to create, syndicate and sell music digitally over the Internet. Our products and services are based on an open technical architecture that is designed to support a variety of digital music formats. From our inception in January 1996 through early 1997, we devoted substantially all of our efforts to product development, raising capital and recruiting personnel. We first generated revenues in the first quarter of 1997 through the licensing of our Liquifier Pro, Liquid Server and Liquid Player software products. In November 1997, we introduced a subscription-based hosting

service for digital recorded music using our technology. In July 1998, to enhance consumer access to the music we were hosting, we launched the Liquid Music Network ("LMN"), a syndicated network that currently links over 1,000 affiliated music-related and music retailer websites.

In early 1999, we began to place greater emphasis on developing and marketing our digital music delivery services. Since that time, we have invested significant resources to increase our distribution reach by expanding the LMN, building our syndicated music catalog available for sale, actively participating in standards initiatives and establishing our international presence. We also have established international initiatives within the Pacific Rim and a subsidiary in Europe to lay the groundwork for offering digital music download services to consumers in these markets. As a provider of digital music delivery services, we expect our revenue sources to expand beyond software license sales to include sales of digital recorded music and digital music subscriptions. Revenues from digital music sales and transaction fees from our music delivery services represented less than 7%, 6% and 1% of total net revenues in the nine months ended September 30, 2001 and the twelve months ended December 31, 2000 and 1999, respectively. Our Liquid Music Network began offering syndicated music through music retailer websites in the third quarter of 1999.

To date, we have derived our revenues primarily from the licensing of software products and service fees associated with business development contracts. Business development revenues primarily consist of license and maintenance fees from agreements under which we give our strategic related partners (the "Partners") the right to license and use our digital recorded music delivery technology. These U.S. dollar-denominated, non-refundable fees are allocated among the various elements of the contract based on vendor specific objective evidence ("VSOE") of fair value. When VSOE of fair value exist for the undelivered elements, primarily maintenance, we account for the license portion based on the "residual method" as prescribed by SOP No. 98-9, "Modification of SOP 97-2 with Respect to Certain Transactions." When VSOE of fair value does not exist for the undelivered elements, we recognize the total fee from a business development contract ratably over the term of the contract. The total fee from business development arrangements is recognized when payment becomes due if extended payment terms exist. Revenue recognition is deferred if the Partners stop making their contractual payments. We also license our software

products to record companies, artists and websites. Software license revenues are recognized when persuasive evidence of an arrangement exists, the fee is fixed and determinable, collection is probable and delivery has occurred. Services revenues from maintenance fees related to our licensed software products and hosting fees from record companies and artists are recognized over the service period, typically one year. We intend to increase our services revenues by significantly expanding our music delivery services. Revenue derived from hosting services include subscription fees from artists for encoding and storing music files, e-commerce services and transaction reporting. Music delivery services revenue include transaction fees from sales of digital recorded music through our LMN website affiliates and fees from music retailers and websites related to the sample digital music clips delivery service. Revenue from kiosk sales consists of software licenses and services revenue from equipment and kiosk-related services. We bear full credit risk with respect to substantially all sales.

Business development revenues as a percentage of total net revenues were 58%, 63% and 48% in the nine months ended September 30, 2001 and the twelve months ended December 31, 2000 and 1999, respectively. Liquid Audio Korea

("LAK"), Liquid Audio Greater China ("LAGC"), Liquid Audio South East Asia ("LASE") through our strategic partner and Liquid Audio Japan ("LAJ") did not make their contractual payments as scheduled in the third quarter of 2000, late 2000, late 2000 and the second quarter of 2001, respectively. We were unsuccessful in receiving any additional payments from these customers.

In June 2001, we and LAJ mutually agreed to terminate the licensing and reseller agreements (the "Agreements") between the two companies. As a result, Liquid Audio Japan renamed its company to Cyber Music Entertainment ("CME") and no longer distributes our technology nor utilizes our digital distribution platform to offer services to the Japanese music market. Effective September 30, 2001, CME ceased using Liquid Audio trademarks, including the company name, and returned all of our products, technology and licenses. We do not believe we have any outstanding obligations in connection with the Agreements. As a result, we recognized the remaining deferred revenue balance of $890,000 from CME in the three months ended September 20, 2001. We intend to establish a new office and to build new relationships with label, retail and consumer electronic companies.

In September 2001, we notified LAK, LAGC and LASE through our strategic partner of their defaults under the licensing and reseller agreements between us and the aforementioned companies due to their failures to make contractual payments as scheduled. LAK, LAGC and our strategic partner of LASE did not cure the defaults during the cure periods. Accordingly, we exercised our rights to terminate the licensing and reseller agreements. Outstanding accounts receivable from LAK, LAGC and our strategic partner of LASE have been fully reserved for, and no revenue from LAK, LAGC or LASE were recorded in the three months ended September 30, 2001.

In the first nine months of 2001, approximately 58% of total net revenues came from sales to two customers, Cyber Music Entertainment and Liquid Audio Greater China. In 2000, approximately 53% of total net revenues came from sales to two customers, Cyber Music Entertainment and Liquid Audio South East Asia through our strategic partner. In 1999, approximately 73% of total net revenues came from sales to three customers, Adaptec, Inc., Super Stage, Inc. and Liquid Audio Korea. International revenues represented approximately 62%, 69% and 49% of total net revenues in the nine months ended September 30, 2001 and the twelve months ended December 31, 2000 and 1999, respectively.

In May 2001, we adopted a corporate restructuring program to reduce expenses to preserve our cash position while the digital music market develops. The restructuring included a worldwide workforce reduction, a consolidation of three Redwood City, California offices into one facility and other expense management initiatives. We are de-emphasizing our efforts in less productive, non-core business areas that do not directly support secure digital download opportunities, including digital music kiosks, music hosting for independent artists and labels, music clips service and encoding services. We plan to focus on software licensing and digital music delivery services that complement our secure digital download business. We plan to support the emerging market for digital music subscriptions, enabling major portals, online retailers and secure audio device manufacturers to offer subscription-based digital music download services. This strategy leverages and enhances both our core digital download services and our player software licensing business. We recorded a restructuring charge of $3.7 million in the second quarter of 2001.

We have a limited operating history upon which investors may evaluate our business and prospects. Since inception we have incurred significant losses, and as of September 30, 2001 we had an accumulated deficit of approximately $105.3 million. We expect to incur additional losses and continued negative cash flow

from operations through at least 2002. Our revenues may not increase or even continue at their current levels and we may not achieve or maintain profitability or generate cash from operations in future periods. The digital music market may never develop to the extent that we are able to generate positive cash flows. Our prospects must be considered in light of the risks, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies in new and rapidly evolving markets such as the digital delivery of recorded music. We may not be successful in addressing these risks, and our failure to do so would harm our business.

Results of Operations

The following table sets forth, for the periods presented, certain data derived from our unaudited condensed statement of operations as a percentage of total net revenues. The operating results in any period are not necessarily indicative of the results that may be expected for any future period.

	Three Months Ended September 30,	
	2001	2000
Net revenues:		
License	13%	5%
Services	17	22
Business development (related party)	70	73
Total net revenues	100	100
Cost of net revenues:		
License	5	2
Services	17	22
Business development (related party)	--	--
Non-cash cost of revenue	5	--
Total cost of net revenues	27	24
Gross profit	73	76
Operating expenses:		
Sales and marketing	185	140
Non-cash sales and marketing	1	2
Research and development	293	182
Non-cash research and development	1	1
General and administrative	128	61
Non-cash general and administrative	--	--
Strategic marketing-equity instruments	(4)	16
Restructuring	--	--
Total operating expenses	604	402
Loss from operations	(531)	(326)
Other income (expense), net	68	66

Loss in equity investment	(12)	(5)
Net loss	(475)%	(265)%

Three Months Ended September 30, 2001 and 2000

Total Net Revenues

Total net revenues decreased 62% to $1.3 million for the three months ended September 30, 2001 from $3.4 million in the comparable period of 2000.

License. License revenues decreased 2% to $171,000 for the three months ended September 30, 2001 from $174,000 in the comparable period of 2000. This decrease was due to a reduction in kiosk software and other technology licenses as a result of our de-emphasis in the digital music kiosk business area.

Services. Services revenues decreased 71% to $214,000 for the three months ended September 30, 2001 from $727,000 in the comparable period of 2000. This decrease was due to decreases in encoding services, kiosk-related equipment sales, promotion and advertising services and Liquid Muze Previews service in the 2001 period.

Business Development (Related Party). Business development revenues decreased 64% to $890,000 for the three months ended September 30, 2001 from $2.5 million in the comparable period of 2000. The decrease was primarily due to the deferment of revenue from Liquid Audio Korea, Liquid Audio Greater China and Liquid Audio South East Asia through our strategic partner due to those customers stopping scheduled payments to us, partially offset by software licensing and related maintenance revenues from Cyber Music Entertainment. We do not believe we have any outstanding obligations in connection with our contracts with Cyber Music Entertainment. As a result, we recognized the remaining deferred revenue balance in the three months ended September 30, 2001.

Total Cost of Net Revenues

Our gross profit decreased to approximately 73% of total net revenues for the three months ended September 30, 2001 from approximately 76% of total net revenues in the comparable period of 2000. Total cost of net revenues decreased 56% to $349,000 in the 2001 period from $793,000 in the 2000 period.

License. Cost of license revenues primarily consists of royalties paid to third-party technology vendors and costs of documentation, duplication and packaging. Cost of license revenues increased 6% to $68,000 for the three months ended September 30, 2001 from $64,000 in the comparable period of 2000. Cost of license revenues increased due to the addition of technology licenses in 2001 and product mix differences.

Services. Cost of services revenues primarily consists of compensation for customer service, encoding and professional services personnel, kiosk-related equipment and an allocation of our occupancy costs and other overhead attributable to our services revenues. Cost of services revenues decreased 71% to $212,000 for the three months ended September 30, 2001 from $720,000 in the comparable period of 2000. The decrease in cost of services revenues was due to the reduction in the number of encoding, customer service and professional services personnel and kiosk-related equipment due to our corporate restructuring.

Business Development (Related Party). Cost of business development revenues primarily consists of kiosk-related equipment and royalties paid to third-party technology vendors. Cost of business development revenues was $0 for the three months ended September 30, 2001 and $7,000 in the comparable period of 2000.

Non-Cash Cost of Revenues. Non-cash cost of revenues consist of expenses associated with the value of common stock and warrants issued to partners as part of our content acquisition agreements and stock-based employee compensation arrangements. Common stock expense is based on the fair value of the stock at the time it was issued. Warrant expense is based on the estimated fair value of the warrants based on the Black-Scholes option pricing model and the provisions of EITF 96-18. In December 2000, we signed an agreement with BMG Entertainment ("BMG") to obtain the right to distribute BMG sound recordings and related artwork through kiosks. In connection with this agreement, we issued 50,000 shares of common stock to BMG, valued at $195,000 and are being recognized ratably over the initial one-year term of the agreement; as a result, $48,000 was recognized as non-cash cost of revenues. Also in connection with this agreement, we granted a warrant for a total of 233,300 shares of common stock. Of the total, 77,768 shares vest in December 2001, and the cost will be remeasured each quarter until a commitment for performance has been reached or the warrant vests, based on current fair market value. At September 30, 2001, the 77,768 shares under this warrant were valued at $148,000, of which $21,000 was recognized as non-cash cost of revenues for the three months ended September 30, 2001. The unamortized portion will be remeasured at each balance sheet date through the vesting date and amortized over the remaining vesting period. If BMG renews the agreement after December 2001, the remaining shares will vest at 6,481 shares per month commencing January 2002 for one year and 6,480 shares per month commencing January 2003 for one year. Such shares will be valued at the fair market value of our common stock upon BMG renewing the agreement at each renewal date. Stock compensation expense for customer service, encoding and professional services personnel was $0 and $2,000 for the three months ended September 30, 2001 and 2000, respectively. We have fully amortized stock compensation expense related to these personnel in the three months ended September 30, 2001, and accordingly no future expense related to these stock options will be incurred.

16

Operating Expenses

Sales and Marketing. Sales and marketing expenses consist primarily of compensation for our sales, marketing and business development personnel, compensation for customer service and professional services personnel attributable to sales and marketing activities, advertising, trade show and other promotional costs, design and creation expenses for marketing literature and our website and an allocation of our occupancy costs and other overhead. Sales and marketing expenses decreased 50% to $2.4 million for the three months ended September 30, 2001 from $4.7 million in the comparable period of 2000. This decrease was primarily due to decreases in the number of sales and marketing personnel due to our corporate restructuring and expense management initiatives, advertising and promotional programs.

Research and Development. Research and development expenses consist primarily of compensation for our research and development, network operations and product management personnel, payments to outside contractors and, to a lesser extent, depreciation on equipment used for research and development and an allocation of our occupancy costs and other overhead. Research and development expenses decreased 39% to $3.7 million for the three months ended September 30, 2001 from $6.1 million in the comparable period of 2000. This

decrease was primarily due to decreases in the number of personnel and outside contractors due to our corporate restructuring and expense management initiatives.

General and Administrative. General and administrative expenses consist primarily of compensation for personnel and payments to outside contractors for general corporate functions, including finance, information systems, human resources, facilities, legal and general management, fees for professional services, bad debt expense and an allocation of our occupancy costs and other overhead. General and administrative expenses decreased 21% to $1.6 million for the three months ended September 30, 2001 from $2.1 million in the comparable period of 2000. This decrease was primarily due to a reduction in legal fees related to patent infringement claims against us (see Part II, Item 1 "Legal Proceedings") and decreases in the number of personnel and outside contractors due to our corporate restructuring and expense management initiatives, partially offset by an increase in the allowance of doubtful accounts related to accounts receivable from third and related parties.

Strategic Marketing--Equity Instruments. Strategic marketing-equity instruments consist of expenses associated with the value of common stock and warrants issued to partners as part of our strategic marketing agreements. Common stock expense is based on the fair value of the stock at the time it was issued. Warrant expense is based on the estimated fair value of the warrants based on the Black-Scholes option pricing model and the provisions of EITF 96-18. Strategic marketing-equity instruments expense was $(45,000) and $550,000 in the three months ended September 30, 2001 and 2000, respectively. In June 1999, we signed an advertising agreement with Amazon.com, Inc. ("Amazon.com") to collaborate on event-based advertising using our digital delivery services. In connection with this agreement, we issued a fully vested warrant to purchase approximately 254,000 shares of common stock to Amazon.com. The warrant was valued at $2.0 million and was recognized ratably over the one-year term of the agreement; as a result, $0 was recognized as strategic marketing-equity instruments expense in the three months ended September 30, 2000. In August 1999, we signed a Digital Audio Co-Marketing and Distribution Agreement with Yahoo! to promote the distribution of digital music on its web site. In connection with this agreement, we granted Yahoo! three warrants totaling 250,000 shares of common stock. The first warrant for 83,334 shares vested immediately. The first warrant was valued at $903,000 and was recognized ratably over the one-year term of the agreement. The second warrant for 83,333 shares vested in August 2000. The second warrant was initially valued at $426,000 and was recognized ratably over the one-year period ending at the vesting date. The second warrant was revalued at each balance sheet date through the vesting date. As a result, the original charge of $426,000 was reduced to $312,000 based on current fair market value. The third warrant for 83,333 shares vested in August 2001. The third warrant was initially valued at $105,000 and was recognized ratably over the one-year period ending at the vesting date. The third warrant was revalued at each balance sheet date through the vesting date. As a result, the original charge of $105,000 was reduced to $54,000 based on current fair market value. In the three months ended September 30, 2001, $0, $0 and $(45,000) were recognized as strategic marketing-equity instruments expense for the first, second and third warrants, respectively. In the three months ended September 30, 2000, $131,000, $100,000 and $23,000 were recognized as strategic marketing-equity instruments expense for the first, second and third warrants, respectively. In July 2000, we signed an agreement with Virgin Holdings, Inc. ("Virgin"), an affiliate of EMI Recorded Music, to promote the distribution of digital music over the Internet using our technology. Pursuant to

this agreement, we issued 150,000 shares of common stock to Virgin. These shares

were valued at $1.2 million and recognized ratably over the one-year term of the agreement. As a result, $0 and $295,000 was recognized as strategic marketing-equity instruments expense in the three months ended September 30, 2001 and 2000, respectively.

Non-Cash Sales and Marketing, Research and Development and General and Administrative. Non-cash sales and marketing, research and development and general and administrative expenses relate to stock-based employee compensation arrangements. The total unearned compensation recorded by us from inception to September 30, 2001 was $3.6 million. We recognized $24,000 and $101,000 of stock compensation expense for the three months ended September 30, 2001 and 2000, respectively. We expect quarterly amortization related to those options to be approximately $22,000 for the fourth quarter of 2001 and annual amortization to be approximately $45,000 during 2002. These future compensation charges would be reduced if sales and marketing, research and development and general and administrative employees who hold the applicable options terminate employment prior to the expiration of their option vesting period.

Other Income (Expense), Net. Interest income consists of earnings on our cash, cash equivalents and short-term investments. Interest expense consists of expenses related to our financing obligations, which include borrowings under equipment loans and capital lease obligations. Other income (expense), net decreased to $870,000 for the three months ended September 30, 2001 from $2.2 million in the comparable period of 2000. This decrease was primarily due to interest received on higher average cash and cash equivalent balances in the 2000 period resulting from proceeds of the initial and follow-on public offerings of our common stock in July 1999 and December 1999, respectively.

Loss in Equity Investment. Loss in equity investment consists of our share of losses from our investment in a related party using the equity method of accounting under a 3-month lag. Loss in equity investment was $154,000 and $175,000 for the three months ended September 30, 2001 and 2000, respectively. The expenses represent our share of the loss of Cyber Music Entertainment, and for the 2001 period, up to our investment balance in Cyber Music Entertainment.

Nine Months Ended September 30, 2001 and 2000

Total Net Revenues

Total net revenues decreased 60% to $4.0 million for the nine months ended September 30, 2001 from $9.8 million in the comparable period of 2000.

License. License revenues decreased 36% to $655,000 for the nine months ended September 30, 2001 from $1.0 million in the comparable period of 2000. This decrease was due to a reduction in kiosk software and other technology licenses as a result of our de-emphasis in the digital music kiosk business area.

Services. Services revenues decreased 57% to $1.0 million for the nine months ended September 30, 2001 from $2.3 million in the comparable period of 2000. This decrease was due to decreases in encoding services, kiosk-related equipment sales, promotion and advertising services and Liquid Muze Previews service in the 2001 period.

Business Development (Related Party). Business development revenues decreased 64% to $2.3 million for the nine months ended September 30, 2001 from $6.4 million in the comparable period of 2000. The decrease was primarily due to the deferment of revenue from Liquid Audio Greater China in the first and third quarters of 2001, Cyber Music Entertainment in the second quarter of 2001 and Liquid Audio Korea and Liquid Audio South East Asia through our strategic partner in the first nine months of 2001 due to those customers stopping scheduled payments to us.

Total Cost of Net Revenues

Our gross profit decreased to approximately 52% of total net revenues for the nine months ended September 30, 2001 from approximately 76% of total net revenues in the comparable period of 2000. Total cost of net revenues

decreased 19% to $1.9 million for the nine months ended September 30, 2001 from $2.3 million in the comparable period of 2000.

License. Cost of license revenues increased 122% to $355,000 for the nine months ended September 30, 2001 from $160,000 in the comparable period of 2000. Cost of license revenues increased due to the addition of technology licenses in 2001 and product mix differences.

Services. Cost of services revenues decreased 38% to $1.3 million for the nine months ended September 30, 2001 from $2.1 million in the comparable period of 2000. The decrease in cost of services revenues was due to the reduction in the number of encoding, customer service and professional services personnel and kiosk-related equipment due to our corporate restructuring.

Business Development (Related Party). Cost of business development revenues was $0 for the nine months ended September 30, 2001 and $75,000 in the comparable period of 2000.

Non-Cash Cost of Revenues. Non-cash cost of revenues were $250,000 for the nine months ended September 30, 2001 and $1,000 in the comparable period of 2000.

Operating Expenses

Sales and Marketing. Sales and marketing expenses decreased 19% to $10.1 million for the nine months ended September 30, 2001 from $12.4 million in the comparable period of 2000. This decrease was primarily due to decreases in the number of sales and marketing personnel due to our corporate restructuring and expense management initiatives, advertising and promotional programs.

Research and Development. Research and development expenses decreased 19% to $13.7 million for the nine months ended September 30, 2001 from $16.9 million in the comparable period of 2000. This decrease was primarily due to decreases in the number of personnel and outside contractors due to our corporate restructuring and expense management initiatives.

General and Administrative. General and administrative expenses increased 47% to $7.9 million for the nine months ended September 30, 2001 from $5.4 million in the comparable period of 2000. This increase was primarily due to an increase in the allowance of doubtful accounts related to accounts receivables from related and third parties and legal fees related to patent infringement claims against us (see Part II, Item 1 "Legal Proceedings").

Strategic Marketing--Equity Instruments. Strategic marketing-equity instruments expense was $607,000 for the nine months ended September 30, 2001 and $1.6 million in the comparable period in 2000.

Non-Cash Sales and Marketing, Research and Development and General and Administrative. We recognized $(72,000) and $367,000 of non-cash sales and marketing, research and development and general and administrative expenses for the nine months ended September 30, 2001 and 2000, respectively.

Other Income (Expense), Net. Other income (expense), net decreased to $3.7 million for the nine months ended September 30, 2001 from $6.7 million in the comparable period of 2000. This decrease was primarily due to interest received on higher average cash and cash equivalent balances in the 2000 period resulting from proceeds of the initial and follow-on public offerings of our common stock in July 1999 and December 1999, respectively.

Loss in Equity Investment. Loss in equity investment was $1.3 million and $628,000 for the nine months ended September 30, 2001 and 2000, respectively.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through the initial and follow-on public offerings of common stock, private placements of our preferred stock, equipment financing, lines of credit and short-term loans.

As of September 30, 2001, we had raised $65.9 million and $93.7 million through our initial and follow-on public offerings of common stock, respectively, and $29.8 million through the sale of our preferred stock. At September 30, 2001, we had approximately $97.0 million of cash, cash equivalents and short-term investments.

Net cash used in operating activities was $25.4 million and $18.4 million for the nine months ended September 30, 2001 and 2000, respectively. Net cash used for operating activities in the 2001 period was primarily the result of net losses from operations, depreciation and amortization of $3.1 million, amortization of unearned compensation of $(76,000), strategic marketing-equity instruments charges of $607,000, non-cash cost of revenue of $254,000, an increase in the allowance for doubtful accounts and sales returns reserve of $1.5 million, loss in equity investment of $1.3 million, loss on disposal of and increase in asset impairment for property and equipment of $1.7 million, other charges of $(17,000) and a net decrease in working capital items of $2.4 million. The net decrease in working capital items include a decrease in accounts receivable of $87,000, increase in other assets of $698,000, decrease in accounts payable of $1.8 million, increase in accrued expenses and other liabilities of $707,000 and a decrease in deferred revenue of $691,000. Net cash used for operating activities in the 2000 period was primarily the result of net losses from operations, depreciation and amortization of $2.3 million, amortization of unearned compensation of $368,000, strategic marketing-equity instruments charges of $1.6 million, an increase in the allowance for doubtful accounts and sales returns reserve of $155,000, loss in equity investment of $628,000, common stock issued for legal settlement of $354,000, other charges of $(22,000) and a net decrease in working capital items of $737,000. The net decrease in working capital items include an increase in accounts receivable of $2.0 million, increase in other assets of $672,000, increase in accounts payable of $932,000, increase in accrued expenses and other liabilities of $1.1 million and a decrease in deferred revenue of $51,000.

Net cash provided by (used in) investing activities was $26.5 million and $(39.9) million for the nine months ended September 30, 2001 and 2000, respectively. Net cash provided by (used in) investing activities in each of these periods was primarily related to net sales (purchases) of short-term investments and the acquisition of property and equipment in both periods.

Net cash provided by (used in) financing activities was $(368,000) and $151,000 for the nine months ended September 30, 2001 and 2000, respectively. The net cash used in financing activities for the 2001 period is due primarily

to payments made under our equipment loan and capital leases. The net cash provided in financing activities for the 2000 period is due primarily to proceeds from the issuance of stock under the employee stock purchase plan, partially offset by payments made under our equipment loan and capital leases.

We had a bank equipment loan facility that provided for advances of up to $3.0 million through November 1999. Borrowings under the equipment loan facility are repayable in monthly installments over three years and bear interest at the bank's prime interest rate plus 0.25%. Borrowings are secured by the related equipment and other assets. Under the equipment loan facility, we had borrowed amounts totaling $1.8 million through September 30, 2001. We also have lease financing agreements that provide for the lease of computers and office equipment of up to $1.0 million. As of September 30, 2001, we had borrowed $737,000 under the lease financing agreements. Our other significant commitments consist of obligations under non-cancelable operating leases, which totaled $8.0 million, net of rental income of $206,000, as of September 30, 2001 and are payable in monthly installments through 2005 and a note payable to related party in the amount of $376,000 that was issued in the three months ended March 31, 1999. The note payable to related party is repayable in Japanese yen and bears interest at 0.5% above a Japanese bank's prime rate. The principal is due on December 31, 2003, with quarterly interest payments.

We have no material commitments for capital expenditures or strategic investments. We may use cash to acquire or license technology, products or businesses related to our current business. In addition, we anticipate that we will experience a decline in our operating expenses for the foreseeable future and that our operating expenses will be a material use of our cash resources.

We believe that existing cash and cash equivalents and financing available under lease agreements will be sufficient to meet our anticipated cash needs for working capital and capital expenditures for the foreseeable future, although we may seek to raise additional capital during that period. The sale of additional equity or convertible debt

20

securities could result in additional dilution to our stockholders. There can be no assurance that financing will be available in amounts or on terms acceptable to us, if at all.

Market Risk

At September 30, 2001, we had an investment portfolio of money market funds, commercial securities and U.S. Government bonds. We had a related party loan at September 30, 2001 of $376,000, which was denominated in Japanese yen and bore interest at 0.5% above a Japanese bank's prime rate. These instruments, like all fixed income instruments, are subject to interest rate risk. The fixed income portfolio will fall in value and the strategic related partner note payable interest would increase if there were an increase in interest rates. If market interest rates were to increase immediately and uniformly by 10% from levels as of December 31, 2000, the decline of the fair value of the fixed income portfolio and strategic related partner note payable would not be material.

As a global concern, we face exposure to adverse movements in foreign currency exchange rates. These exposures may change over time as business practices evolve and could seriously harm our financial results. Substantially all of our international sales are currently denominated in U.S. dollars. An increase in the value of the U.S. dollar relative to foreign currencies could make our products and services more expensive and therefore, reduce the demand

for our products and services. Reduced demand for our products and services could seriously harm our financial results. Currently, we do not hedge against any foreign currencies and as a result, could incur unanticipated gains or losses.

ADDITIONAL FACTORS AFFECTING FUTURE RESULTS

Our Limited Operating History in the New Market of Digital Delivery of Music over the Internet Increases the Possibility that the Value of Your Investment Will Decline

We incorporated in January 1996. We did not start generating revenues until the first quarter of 1997. In early 1999 we began to place greater emphasis on developing and marketing our digital music delivery services. Accordingly, we are still in the early stages of development and have only a limited operating history upon which you can evaluate our business. You should evaluate our chances of financial and operational success in light of the risks, uncertainties, expenses, delays and difficulties associated with starting a new business, many of which may be beyond our control.

We Have a History of Losses, We Expect Losses to Continue and We Might Not Achieve or Maintain Profitability

Our accumulated deficit as of September 30, 2001 was approximately $105.3 million. We had net losses of approximately $24.2 million and $33.7 million in 1999 and 2000, respectively, and $31.4 million in the nine months ended September 30, 2001. Given the level of our planned operating and capital expenditures, we expect to continue to incur losses and negative cash flows through at least 2002. Even if we ultimately do achieve profitability, we may not be able to sustain or increase profitability on a quarterly or annual basis. If our revenues grow more slowly than we anticipate, or if our operating expenses exceed our expectations and cannot be adjusted accordingly, our business will be harmed.

Fluctuations in Our Quarterly Revenues and Operating Results Might Lead to Reduced Prices for Our Stock

Our quarterly results of operations have varied in the past, and you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance. In some future periods, our results of operations are likely to be below the expectations of public market analysts and investors. In this event, the price of our common stock would likely decline. Factors that have caused our results to fluctuate in the past and that are likely to affect us in the future include the following:

- competition for consumers from traditional retailers as well as providers of online music services;
- the announcement and introduction of new products and services by us and our competitors;
- our ability to increase the number of websites that will use our platform for digital music delivery;
- the timing of our partners' introduction of new products and services for digital music sales; and
- variability and length of the sales cycle associated with our product

and service offerings.

In addition, other factors may also affect us, including:

- market adoption and growth of sales of digitally downloaded recorded music over the Internet;

- our ability to attract significant numbers of music recordings to be syndicated in our format;

- our ability to provide reliable and scalable service, including our ability to avoid potential system failures;

- market acceptance of new and enhanced versions of our products and services; and

- the price and mix of products and services we offer.

Some of these factors are within our control and others are outside of our control.

Several of Our Customers Have Had Limited Operating Histories, Are Unprofitable and Might Have Difficulty Meeting Their Payment Obligations to Us

Several of our significant customers have had limited operating histories and have not achieved profitability. We believe that this will be true of other customers in the future. As of September 30, 2001, 52% and 65% of our accounts receivable from third parties and accounts receivables from related parties, respectively, or $474,000 and $1.0 million, respectively, were more than 30 days past due. You should evaluate the ability of these companies to meet their payment obligations to us in light of the risks, expenses and difficulties encountered by companies with limited operating histories. If one or more of our customers were unable to pay for our services in the future, or paid more slowly than we anticipate, recognition of revenue might be delayed and our business might be harmed.

We Face and Might Face Intellectual Property Infringement Claims that Might Be Costly to Resolve

From time to time, we receive letters from corporations and other entities suggesting that we review patents to which they claim rights or claiming that we infringe on their patent rights. Such claims may result in our being involved in litigation. Although we do not believe we infringe the proprietary rights of any party, we cannot assure you that parties will not assert additional claims in the future or that any claims will not be successful. We could incur substantial costs and diversion of management resources to defend any claims relating to proprietary rights, which could harm our business. In addition, we are obligated under certain agreements to indemnify the other party for claims that we infringe on the proprietary rights of third parties. If we are required to indemnify parties under these agreements, our business could be harmed. If someone asserts a claim against us relating to proprietary technology or information, we might seek licenses to this intellectual property. We might not be able to obtain licenses on commercially reasonable terms, or at all. The failure to obtain the necessary licenses or other rights might harm our business. See "Other Information--Legal Proceedings."

If Artists and Record Labels Are Not Satisfied that They Can Securely, Digitally Deliver Their Music Over the Internet, We Might Not Have Sufficient Content to

Attract Consumers

Our success depends on our ability to aggregate a sufficient amount and variety of digital recorded music for syndication. In particular, until a significant number of artists and their record labels adopt a strategy of digitally delivering music over the Internet, the growth of our business might be limited. We currently do not create our own content; rather, we rely on record companies and artists for digital recorded music to be syndicated using our format. We believe record companies will remain reluctant to distribute their recorded music digitally unless they are satisfied that the digital delivery of their music over the Internet will not result in the unauthorized copying and distribution of that music. If record companies do not believe that recorded music can be securely delivered over the Internet, they will not allow the digital distribution of their recorded music and we might not have sufficient content to attract consumers. If we cannot offer a sufficient amount and variety of digital recorded music for syndication, our business might be harmed.

If Standards for the Secure, Digital Delivery of Recorded Music Are Not Adopted, the Piracy Concerns of Record Companies and Artists Might Not Be Satisfied, and They Might Not Use Our Platform for Digital Delivery of Their Music

Because other digital recorded music formats, such as MP3, do not contain mechanisms for tracking the source or ownership of digital recordings, users are able to download and distribute unauthorized or "pirated" copies of copyrighted recorded music over the Internet. This piracy is a significant concern to record companies and artists, and is the reason many record companies and artists are reluctant to digitally deliver their recorded music over the Internet. If a standard format is not adopted, however, unsecure copies of recorded music may continue to be available on the Internet, and record companies and artists might not permit the digital delivery of their music. Additionally, as long as pirated recordings are available, many consumers will choose free pirated recordings rather than paying for legitimate recordings. Accordingly, if a standard format for the secure digital delivery of music is not adopted, our business might be harmed.

We have designed our current products to be adaptable to different music industry and technology standards. Numerous standards in the marketplace, however, could cause confusion as to whether our products and services are compatible. If a competitor were to establish the dominant industry standard, our business would be harmed.

If We Do Not Establish Relationships with Additional International Partners, Our Revenues Might Decline

In the past, we derived a portion of our revenues from business development fees from relationships with our international partners, including Liquid Audio Korea, Liquid Audio Japan, Liquid Audio Greater China and Liquid Audio South East Asia through our strategic partner. We recently terminated our relationships with these partners. Consequently, we do not expect additional revenue will be generated from them. If we are unable to establish additional relationships with international partners, and if such additional relationships do not generate a significant amount of revenue in future periods, then our future revenues could be lower than we anticipate and our business could be harmed. Furthermore, the commercial terms for these relationships could cause our revenues to vary from period-to-period, which might result in unpredictability of our revenues.

Our Revenues Would Be Negatively Effected by the Loss of a Significant Customer

We have derived, and we believe that we will continue to derive, a substantial portion of our net revenues from a limited number of customers and projects. Our ten largest customers for 1999, 2000 and the nine months ended September 30, 2001 represented approximately 86%, 78% and 86%, respectively, of our total net revenues. The loss of any significant customer or any significant reduction of total net revenues generated by significant customers, without an increase in revenues from other sources, would harm our business. The volume of products or services we sell to specific customers is likely to vary year to year, and a major customer in one year may not use our services in a subsequent year. A customer's decision not to use our services in a subsequent year might harm our business.

We Might Need Additional Capital in the Future and Additional Financing Might Not Be Available

We currently anticipate that our available cash resources and financing available under existing lease agreements will be sufficient to meet our anticipated working capital and capital expenditure requirements for the foreseeable future. However, we may need to raise additional funds through public or private debt or equity financing in order to:

- take advantage of opportunities, including acquisitions of complementary businesses or technologies;

- develop new products or services; or

- respond to competitive pressures.

Any additional financing we may need may not be available on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, we might not be able to take advantage of unanticipated opportunities, develop new products or services, or otherwise respond to unanticipated competitive pressures, and our business could be harmed. Our forecast of the period of time through which our financial resources will be adequate to support our operations is a forward-looking statement that involves risks and uncertainties, and actual results could vary materially as a result of a number of factors, including those set forth in this "Additional Factors Affecting Future Results" section.

Our Future Success Depends on Our Key Personnel

Our future success depends to a significant extent on the continued service of our key technical, sales and senior management personnel and their ability to execute our growth strategy. The loss of the services of any of our senior level management, or other key employees, could harm our business. Our future performance will depend, in part, on the ability of our executive officers to work together effectively. Our executive officers may not be successful in carrying out their duties or running our company. Any dissent among executive officers could impair our ability to make strategic decisions quickly in a rapidly changing market.

Our future success also depends on our ability to attract, retain and motivate highly skilled employees. Competition for employees in our industry is intense. Although we provide compensation packages that include incentive stock options, cash incentives and other employee benefits, the volatility and current market price of our common stock may make it difficult for us to attract, assimilate and retain highly qualified employees in the future.

We have from time to time in the past experienced, and we expect to continue to experience in the future, difficulty in hiring and retaining highly skilled employees with appropriate qualifications.

We Depend on Proprietary Rights to Develop and Protect Our Technology

Our success and ability to compete substantially depends on our internally developed technologies and trademarks, which we protect through a combination of patent, copyright, trade secret and trademark laws. Patent applications or trademark registrations may not be approved. Even if they are approved, our patents or trademarks may be successfully challenged by others or invalidated. If our trademark registrations are not approved because third parties own these trademarks, our use of these trademarks would be restricted unless we enter into arrangements with the third-party owners, which might not be possible on commercially reasonable terms or at all.

The primary forms of intellectual property protection for our products and services internationally are patents and copyrights. Patent protection throughout the world is generally established on a country-by-country basis. To date, we have applied for four patents outside the United States. Copyrights throughout the world are protected by several international treaties, including the Berne Convention for the Protection of Literary and Artistic Works. Despite these international laws, the level of practical protection for intellectual property varies among countries. In particular, United States government officials have criticized countries such as China and Brazil for inadequate intellectual property protection. If our intellectual property is infringed in any country without a high level of intellectual property protection, our business could be harmed.

We generally enter into confidentiality or license agreements with our employees, consultants and corporate partners, and generally control access to and distribution of our technologies, documentation and other proprietary information. Despite our efforts to protect our proprietary rights from unauthorized use or disclosure, parties may attempt to disclose, obtain or use our solutions or technologies. The steps we have taken may not prevent misappropriation of our solutions or technologies, particularly in foreign countries where laws or law enforcement practices may not protect our proprietary rights as fully as in the United States.

We have licensed, and we may license in the future, certain proprietary rights to third parties. While we attempt to ensure that the quality of our brand is maintained by our business partners, they may take actions that could impair the value of our proprietary rights or our reputation. In addition, these business partners may not take the same steps we have taken to prevent misappropriation of our solutions or technologies.

Companies Might Not Develop or Consumers Might Not Adopt Devices That Will Play Digitally Downloaded Music

We believe that the market for digitally recorded music delivered over the Internet will not develop significantly until consumers are able to enjoy this music other than solely through the use of a personal computer. Several consumer electronics companies have introduced or announced plans to introduce devices that will allow digital music delivered over the Internet to be played away from the personal computer. If companies fail to introduce additional devices, consumers do not adopt these devices or our products and services are incompatible with these devices, our business would be harmed. In addition, digital music can be transferred to a compact disc, but that transfer requires a compact disc recorder ("CD-R"). Many desktop computer manufacturers offer CD-Rs in their computers. If companies do not continue to offer CD-Rs in their

computers, consumers do not adopt CD-Rs or our products and services are incompatible with CD-Rs, our business might be harmed.

If We Do Not Increase the Number of Websites that Use Our Platform, Our Business Will Not Grow

In order to grow our business, we need to increase the number of websites, including websites operated by music retailers, that use our technology and our syndicated content to digitally deliver recorded music. To increase the number of websites, we must do the following:

- offer competitive products and services that meet industry standards;

- attract more music content;

- make it easy and cost-effective for music-related websites to sell digital music;

- develop relationships with online retailers, music websites, online communities, broadband providers and Internet broadcasters; and

- develop relationships with international music websites, retailers and broadband providers.

Any failure to achieve one or more of these objectives would harm our business. We may not be successful in achieving any of these objectives.

Due to the Many Factors that Influence Market Acceptance, Consumers Might Not Accept Our Platform

Our success will depend on growth in consumer acceptance of our platform as a method for digital delivery of recorded music over the Internet. Factors that might influence market acceptance of our platform include the following, over which we have little or no control:

- the availability of sufficient bandwidth on the Internet to enable consumers to download digital recorded music rapidly and easily;

- the willingness of consumers to invest in computer technology that facilitates the downloading of digital music;

- the cost of time-based Internet access;

- the number, quality and variety of digital recordings available for purchase through our system relative to those available through other online digital delivery companies, digital music websites, music swapping or sharing websites or through traditional physical delivery of recordings;

- the availability of portable devices to which digital recorded music can be transferred;

- the fidelity and quality of the sound of the digital recorded music; and

- the level of consumer comfort with the process of downloading and paying for digital music over the Internet, including ease of use and lack of concern about transaction security.

We Might Not Be Successful in the Development and Introduction of New Products and Services

We depend in part on our ability to develop new or enhanced products and services, such as our subscription-based service offering, in a timely manner and to provide new products and services that achieve rapid and broad market acceptance. We may fail to identify new product and service opportunities successfully and develop and bring to market new products and services in a timely manner. In addition, product innovations may not achieve the market penetration or price stability necessary for profitability.

As the online medium continues to evolve, we plan to leverage our technology by introducing complementary products and services as additional sources of revenue. Accordingly, we may change our business model to take advantage of new business opportunities, including business areas in which we do not have extensive experience. For example, we will continue to devote significant resources to the development of digital music delivery services, as well as our software licensing business. If we fail to develop these or other businesses successfully, our business would be harmed.

We Might Experience Delays in the Development of New Products and Services

We must continue to innovate and develop new versions of our software to remain competitive in the market for digital delivery of recorded music solutions. Our software products and services development efforts are inherently difficult to manage and keep on schedule. Our failure to manage and keep those development projects on schedule might harm our business.

26

The Market for Digital Delivery of Music Over the Internet is Highly Competitive, and if We Cannot Compete Effectively, Our Ability to Generate Meaningful Revenues Would Suffer Dramatically

Competition among companies in the business of digital delivery of music over the Internet is intense. If we do not compete effectively or if we experience pricing pressures, reduced margins or loss of market share resulting from increased competition, our business might be harmed.

Competition is likely to increase as new companies enter the market and current competitors expand their products and services or merge with other competitors. Many of these potential competitors are likely to enjoy substantial competitive advantages, including the following:

- larger audiences;
- larger technical, production and editorial staffs;
- greater brand recognition;
- access to more recorded music content;
- a more established Internet presence;
- a larger advertiser base; and
- substantially greater financial, marketing, technical and other resources.

New Competitors Could Enter the Industry with Alternative Business Models, Which, if Successful, Could Harm Our Business

New competitors may enter our market with alternative business models. For example, companies may provide free music downloading from a website, earning revenues on an advertising or subscription basis. This model could be more attractive to consumers. If we are unable to compete with such companies or adapt our business model, products or services to a more consumer-favorable model, our business could be harmed.

If MusicNet and Pressplay License Content to Our Competitors, Our Business Could be Harmed

The major U.S. record companies have recently formed ventures for the licensing of their content to online music service providers. BMG Entertainment, EMI, Real Networks and Warner Music Group have formed a venture called "MusicNet." Also, Universal Music Group (an unit of Vivendi Universal) and Sony Music Entertainment have formed a venture called "Pressplay." If Musicnet or Pressplay launch their services, they may license significant quantities of content to other third party online music service providers.

Pressplay has reported that it has entered into distribution agreements with affiliates, including Yahoo!, Microsoft Network and MP3.com, and that it has entered into licensing agreements with six independent record labels including Madacy, Navarre, OWIE, Razor & Tie, Roadrunner and Rounder. The press has reported that MusicNet has licensed its service to America Online, Real Networks and Napster and that MusicNet has entered into a licensing agreement with Zomba Label Group which encompasses seven record labels: flagship Jive Records, Jive Electro, Silvertone, Verity, Brentwood, Reunion, and Volcano. If our competitors obtain licenses for significant amount of content from MusicNet and Pressplay and we are unable to obtain similar rights on commercially reasonable terms, these competitors may be able to develop a more compelling consumer product and our business could be harmed.

If Our Platform Does Not Provide Sufficient Rights Reporting Information, Record Companies and Artists Are Unlikely to Digitally Deliver Their Recorded Music Using Our Platform

Record companies and artists must be able to track the number of times their recorded music is downloaded so that they can make appropriate payments to music rights organizations, such as the American Society of Composers,

Authors and Publishers, Broadcast Music Incorporated and SESAC, Inc. If our products and services do not accurately or completely provide this rights reporting information, record companies and artists might not use our platform to digitally deliver their recorded music, and our business might be harmed.

Our Business Might Be Harmed if We Fail to Price Our Products and Services Appropriately

The price of Internet products and services is subject to rapid and frequent change. We may be forced, for competitive or technical reasons, to reduce or eliminate prices for certain of our products or services. If this happens, our business might be harmed.

Our Business Might Be Harmed if Challenges Against Intellectual Property Laws by New Digital Music Delivery Technologies Are Successful

New music sharing technologies allowing users to locate and download copies of digital music stored on the hard drives of other users without payment have been introduced into the market. Because some digital recorded music formats, such as MP3, do not contain mechanisms for tracking the source of ownership of digital recordings, users are able to download copies of copyrighted recorded music over the Internet without being required to compensate the owners of these copyrights. These downloads are a significant concern to record companies and artists. The Recording Industry Association of America has filed a suit seeking a permanent injunction against the use of these file-sharing technologies for exchange of copyrighted works. Several recording artists have also taken legal action against companies providing music sharing technology. If the injunction is denied, and it is determined that this file sharing technology is non-infringing, record companies and artists may limit their use of the Internet to sell and distribute their copyrighted materials. Even if the technology is determined to be infringing, it may be difficult to prevent this type of file sharing because of the non-centralized character of these technologies. As long as digital music copies are available through file sharing without payment, legally or illegally, consumers may choose not to pay for downloads from retail and other music delivery sites in our Liquid Music Network, which could harm our business.

We Might Not Be Able to Scale Our Technology Infrastructure to Meet Demand for Our Products and Services

Our success will depend on our ability to scale our technology infrastructure to meet the demand for our products and services. Adding this new capacity will be expensive, and we might not be able to do so successfully. In addition, we might not be able to protect our new or existing data centers from unexpected events as we scale our systems. To the extent that we do not address any capacity constraints effectively, our business would be harmed.

We Might Not Be Successful in Our Attempts to Keep Up With Rapid Technological Change and Evolving Industry Standards

The markets for our products and services are characterized by rapidly changing technology, evolving industry standards, changes in customer needs, emerging competition, and frequent new product and service introductions. Our future success will depend, in part, on our ability to:

- use leading technologies effectively;
- continue to develop our strategic and technical expertise;
- enhance our current products and services;
- develop new products and services that meet changing customer needs;
- advertise and market our products and services; and
- influence and respond to emerging industry standards and other technological changes.

This must be accomplished in a timely and cost-effective manner. We may not be successful in effectively using new technologies, developing new products or services or enhancing our existing products or services on a timely basis. These new technologies or enhancements may not achieve market acceptance. Our pursuit of necessary technological advances may require substantial time and expense. Finally, we may not succeed in adapting our services to new technologies as they

emerge.

Our Products and Services Might Contain Errors

We offer complex products and services. They may contain undetected errors when first introduced or when new versions are released. If we market products and services that have errors or that do not function properly, then we may experience negative publicity, loss of or delay in market acceptance, or claims against us by customers, any of which might harm our business.

We Might Have Liability for the Content of the Recorded Music That We Digitally Deliver

Because we digitally deliver recorded music to third parties, we might be sued for negligence, copyright or trademark infringement or other reasons. These types of claims have been brought, sometimes successfully, against providers of online products and services in the past. Others could also sue us for the content that is accessible from our website through links to other websites. These claims might include, among others, claims that by hosting, directly or indirectly, the websites of third parties, we are liable for copyright or trademark infringement or other wrongful actions by these third parties through these websites. Our insurance may not adequately protect us against these types of claims and, even if these claims do not result in liability, we could incur significant costs in investigating and defending against these claims.

We have taken steps to prevent these claims. For example, we have arrangements with companies that use our hosting services that will allow us to delete potentially infringing or misappropriating materials quickly and securely. We also have put into place indemnification agreements with music content providers, where practicable. Under the Digital Millenium Copyright Act of 1999, Internet service providers are insulated from several types of these claims, upon compliance with the requirement that they appoint an agent to receive claims relating to their service, and we have appointed an agent.

System Failures or Delays Might Harm Our Business

Our operations depend on our ability to protect our computer systems against damage from fire, water, power loss, telecommunications failures, computer viruses, vandalism and other malicious acts, and similar unexpected adverse events. Our corporate headquarters are located in northern California. California is currently experiencing power outages due to a shortage in the supply of power within the state. Although we maintain a comprehensive disaster recovery plan, if the power outages increase in severity, they could disrupt our operations. Interruptions or slowdowns in our services have resulted from the failure of our telecommunications providers to supply the necessary data communications capacity in the time frame we required, as well as from deliberate acts. Despite precautions we have taken, unanticipated problems affecting our systems could in the future cause temporary interruptions or delays in the services we provide. Our customers might become dissatisfied by any system failure or delay that interrupts our ability to provide service to them or slows our response time. Sustained or repeated system failures or delays would affect our reputation, which would harm our business. Slow response time or system failures could also result from straining the capacity of our software or hardware due to an increase in the volume of products and services delivered through our servers. While we carry business interruption insurance, it might not be sufficient to cover any serious or prolonged emergencies, and our business might be harmed.

We Might Be Unable to License or Acquire Technology

We rely on certain technologies that we license or acquire from third parties, including Dolby Laboratories Licensing Corporation, Fraunhofer

Institut, RSA Data Security, Inc. and Thomson Consumer Electronics Sales GmbH. These technologies are integrated with our internally developed software and used in our products, to perform key functions and to enhance the value of our platform. These third-party licenses or acquisitions may not

continue to be available to us on commercially reasonable terms or at all. Any inability to acquire these licenses or software on commercially reasonable terms might harm our business.

Difficulties Presented by International Economic, Political, Legal, Accounting and Business Factors Could Harm Our Business in International Markets

A key component of our strategy is to expand into international markets. The following risks are inherent in doing business on an international level and we have little or no control over them:

. unexpected changes in regulatory requirements;

. export restrictions;

. export controls relating to encryption technology;

. longer payment cycles;

. problems in collecting accounts receivable;

. political and economic instability; and

. potentially adverse tax consequences.

In addition, other factors that may also affect us and over which we have some control include the following:

. difficulties in staffing and managing international operations;

. differences in music rights reporting structures; and

. seasonal reductions in business activity.

We recently terminated our individual agreements in Japan, Korea, greater China and south east Asia. We may enter into similar arrangements in the future in these and other countries. We also establi60; Throughout this report, all references to "we," the "Company" refer to Euroseas and its subsidiaries. We use the term deadweight ton, or dwt, in describing the size of vessels. Dwt, expressed in metric tons, each of which is equivalent to 1,000 kilograms, refers to the maximum weight of cargo and supplies that a vessel can carry. Unless otherwise indicated, all references to "dollars" and "$" in this report are to, and amounts are presented in, U.S. dollars.

A. Selected Financial Data

SELECTED CONSOLIDATED FINANCIAL DATA

The following information sets forth selected historical financial data for Euroseas. We derived this information from our audited financial statements for the years ended December 31, 2006, 2007 and 2008 included in this annual report.

The information is only a summary and should be read in conjunction with our historical financial statements and related notes, and our Management's Discussion and Analysis of Financial Condition and Results of Operations contained elsewhere herein. The historical financial and other data presented for the years ended December 31, 2004 and 2005 have been derived from audited financial statements not included in this Annual Report and are provided for comparison purposes. The historical results included below and elsewhere in this annual report are not indicative of our future performance.

See next page for table of Euroseas Ltd. – Summary of Selected Historical Financials.

	Euroseas Ltd. – Summary of Selected Historical Financials				
	Year Ended December 31,				
	2004	2005	2006	2007	2008
Income Statement Data					
Voyage revenues	45,718,006	44,523,401	42,143,361	86,104,365	132,243,918
Commissions	(2,215,197)	(2,388,349)	(1,829,534)	(4,024,032)	(5,940,460)
Net revenue	43,502,809	42,135,052	40,313,827	82,080,333	126,303,458
Voyage expenses	(370,345)	(670,551)	(1,154,738)	(897,463)	(3,092,323)
Vessel operating expenses	(8,906,252)	(8,610,279)	(10,368,817)	(17,240,132)	(27,521,194)
Amortization drydocking and special survey expense and vessel depreciation (1)	(3,461,678)	(4,208,252)	(7,292,838)	(17,963,072)	(32,230,901)
Impairment loss	-	-	-	-	(25,113,364)
Management fees	(1,972,252)	(1,911,856)	(2,266,589)	(3,669,137)	(5,387,415)
Other general and administration expenses	-	(420,755)	(1,076,884)	(2,656,176)	(4,057,736)
Net gain on sale of vessels	2,315,477	-	4,445,856	3,411,397	-
Operating income	31,107,759	26,313,359	22,599,817	43,065,750	28,900,526
Interest and other financing costs	(708,284)	(1,495,871)	(3,398,858)	(4,850,239)	(2,930,737)
Interest income	187,069	460,457	870,046	2,357,633	3,168,501
Other income (loss)	25,221	(99,491)	(1,598)	90,920	(5,464,271)
Net income	30,611,765	25,178,454	20,069,407	40,664,064	23,674,018
Balance Sheet Data					
Current assets	16,461,159	25,350,707	9,975,596	118,307,463	92,538,220
Vessels, net	34,171,164	52,334,897	95,494,342	238,248,984	231,963,606
Deferred assets and other long term assets	2,205,178	1,855,829	12,035,321	14,634,384	16,114,600
Total assets	52,837,501	79,541,433	117,505,259	371,190,831	340,616,426
Current liabilities including current portion of long term debt	13,764,846	18,414,877	21,665,399	35,182,511	21,417,515
Long term debt, including current portion	13,990,000	48,560,000	74,950,000	81,590,000	56,015,000
Total liabilities	21,724,846	52,544,877	79,493,599	99,400,483	76,387,354
Common shares outstanding (adjusted for the 1-for-3 split)	9,918,056	12,260,387	12,620,150	30,261,113	30,575,611
Share capital	297,542	367,812	378,605	907,834	917,269
Total shareholders' equity	31,112,655	26,996,556	38,011,660	271,790,348	264,229,072
Other Financial Data					
Net cash provided by operating activities	34,208,693	20,594,782	20,968,824	48,958,771	74,283,741
Net cash provided by (used in) investing activities	6,756,242	(21,833,616)	(55,367,015)	(146,671,991)	(46,145,503)
	(33,567,500)	6,188,653	16,741,997	199,057,433	(58,422,367)

Net cash provided by (used in) financing activities						
Earnings per share, basic	3.09	2.34		1.60	1.89	0.78
Earnings per share, diluted	3.09	2.34		1.60	1.88	0.78
Dividends declared	25,435,501	30,175,223	(2)	9,465,082	20,278,538	34,664,699

3

Cash paid for common dividend / return of capital	26,962,500	46,875,223	(2)	9,465,082	20,278,538	34,547,949
Cash dividends / return of capital, declared per common share	2.72	4.67	(2)	0.75	1.00	1.13
Weighted average number of shares outstanding during period, basic	9,918,056	10,739,476		12,535,365	21,566,619	30,437,107
Weighted average number of shares outstanding during period, diluted	9,918,056	10,739,476		12,535,365	21,644,920	30,505,476

	2004	2005	2006	2007	2008
Other Fleet Data (3)					
Number of vessels	7.31	7.10	8.09	11.48	15.61
Calendar days	2,677	2,591	2,942	4,190	5,714
Available days	2,554	2,546	2,895	3,980	5,563
Voyage days	2,542	2,508	2,864	3,969	5,451
Utilization Rate (percent)	99.5%	98.5%	98.9%	99.7%	98.0%
			(In U.S. dollars per day per vessel)		
Average TCE rate (4)	17,839	17,485	14,312	21,468	23,693
Vessel Operating Expenses	3,327	3,323	3,524	4,115	4,816
Management Fees	737	738	770	875	943
G&A Expenses	-	162	366	634	710
Total Operating Expenses	4,064	4,223	4,660	5,624	6,469

(1) In 2004, the estimated scrap value of the vessels was increased from $170 to $300 per light ton to better reflect market price developments in the scrap metal market. The effect of this change in estimate was to reduce 2004 depreciation expense by $1,400,010 and increase 2004 net income by the same amount. In addition, in 2004, the estimated useful life of the vessel m/v Ariel was extended from 28 years to 30 years since the vessel performed drydocking and it was not expected to be sold until year - 2007 (m/v Ariel was sold in February 2007). In November 2008, the estimated useful life of the containerships and multipurpose vessels was increased to 30 years (from 25 years until then) in line with industry practice and intended use of such vessels; also, the estimated scrap value of the vessels was reduced from $300 to $250 per light ton to better reflect market price developments in the scrap metal market. The effect of this change was to reduce 2008 depreciation expenses by $836,200 and increase 2008 net income by the same amount.

(2) This amount reflects a dividend in the amount of $30,175,223 ($2.99 per share) and a return of capital in the amount of $16,700,000 ($1.68 per share). The total payment to shareholders made in 2005 is in excess of previously retained earnings because the Company decided to distribute to its original shareholders in advance of going public most of the profits relating to the Company's operations up to that time and to recapitalize the Company. This one-time dividend cannot be considered indicative of future dividend payments and the Company refers you to the other sections in this annual report for a clearer understanding of the Company's dividend policy.

(3) For the definition of calendar days, available days, voyage days and utilization rate see Item 5A-Operating Results.
(4) Time charter equivalent rate, or, "TCE rate", is determined by dividing voyage revenues less voyage expenses or time charter equivalent revenue or "TCE revenues" by the number of voyage days during the relevant time period. TCE revenues, a non-GAAP measure, provides additional meaningful information in conjunction with shipping revenues, the most directly comparable GAAP measure, because it assists Company management in making decisions regarding the deployment and use of its vessels and in evaluating their financial performance. TCE revenues and TCE rate is also a standard shipping industry performance measure used primarily to compare period-to-period changes in a shipping company's performance despite changes in the mix of charter types (i.e., spot charters, time charters and bareboat charters) under which the vessels may be employed between the periods (see also Item 5A-Operating Results).

Reconciliation of TCE revenues as reflected in the consolidated statement of income and calculation of TCE rate follow:

	2004	2005	2006	2007	2008
	(In U.S. dollars except TCE rates, expressed in U.S. dollars per day and voyage days)				
Voyage revenues	45,718,006	44,523,401	42,143,361	86,104,365	132,243,918
Voyage expenses	(370,345)	(670,551)	(1,154,738)	(897,463)	(3,092,323)
Time Charter Equivalent ("TCE") Revenues	45,347,661	43,852,850	40,988,623	85,206,902	129,151,595
Voyage days	2,542	2,508	2,864	3,969	5,451
Average TCE rate	17,839	17,485	14,312	21,468	23,693

B. Capitalization and Indebtedness

Not Applicable.

C. Reasons for the Offer and Use of Proceeds

Not Applicable.

D. Risk Factors

Any investment in our stock involves a high degree of risk. You should consider carefully the following factors, as well as the other information set forth in this annual report, before making an investment in our common stock. Some of the following risks relate principally to the industry in which we operate and our business in general. Other risks relate to the securities market for and ownership of our common stock. Any of the described risks could significantly and negatively affect our business, financial condition, operating results and common stock price. The following risk factors describe the material risks that are presently known to us.

Industry Risk Factors

The cyclical nature of the shipping industry may lead to volatile changes in freight rates which may reduce our revenues and net income.

We are an independent shipping company that operates in the drybulk, container and multipurpose shipping industry. Our profitability is dependent upon the freight rates we are able to charge. The supply of and demand for shipping capacity strongly influences freight rates. The demand for shipping capacity is determined primarily by the demand for the type of commodities carried and the distance that those commodities must be moved by sea. The demand for commodities is affected by, among other things, world and regional economic and political conditions (including developments in international trade, fluctuations in industrial and agricultural production and armed conflicts), environmental concerns, weather patterns, and changes in seaborne and other transportation costs. The size of the existing fleet in a particular market, the number of new vessel deliveries, the scrapping of older vessels and the number of vessels out of active service (i.e., laid-up, drydocked, awaiting repairs or otherwise not available for hire), determines the supply of shipping capacity, which is measured by the amount of suitable tonnage available to carry cargo. The cyclical nature of the shipping industry may lead to volatile changes in freight rates which may reduce our revenues and net income.

5

In addition to the prevailing and anticipated freight rates, factors that affect the rate of newbuilding, scrapping and laying-up include newbuilding prices, secondhand vessel values in relation to scrap prices, costs of bunkers and other operating costs, costs associated with classification society surveys, normal maintenance and insurance coverage, the efficiency and age profile of the existing fleet in the market and government and industry regulation of maritime transportation practices, particularly environmental protection laws and regulations. These factors influencing the supply of and demand for shipping capacity are outside of our control, and we may not be able to correctly assess the nature, timing and degree of changes in industry conditions. Some of these factors may have a negative impact on our revenues and net income.

Our future profitability will be dependent on the level of charter rates in the international drybulk and container shipping industry.

Charter rates for the international drybulk shipping industry reached record highs during 2004 and 2005; however, by the beginning of 2006 rates had declined. During 2006 and 2007, drybulk rates recovered and reached new historic highs in the fall of 2007 and stayed at historically high levels during the first eight months of 2008. However, since September 2008, drybulk charter rates have fallen dramatically. At the same time, containership rates, after reaching historic highs in the middle of 2005, declined by the end of the year and remained flat for most of 2006; they further declined until the end of 2006 but steadily recovered during 2007. Containership rates remained at about the same level since the end of 2007 - below the high levels achieved in the middle of 2005 – until September 2008, when they declined to historical low rates and have remained depressed since. Rates in drybulk or containership markets are influenced by the balance of demand for and supply of vessels and may remain depressed or further decline in the future. Rates for multipurpose vessels are influenced by both drybulk and containership market developments as multipurpose ships can carry either drybulk or containerized cargo.

Because the factors affecting the supply and demand for vessels are outside of our control and are unpredictable, the nature, timing, direction and degree of changes in industry conditions are unpredictable, and as a result so are the rates we can charter our vessels at. In addition, we may not be able to successfully charter our vessels in the future or renew existing charters at rates sufficient to allow us to meet our obligations or to pay dividends to our shareholders.

Some of the factors that influence demand for vessel capacity include:

- supply of and demand for drybulk commodities, as well as containerized cargo;
- changes in the exploration or production of energy resources, commodities, semi-finished and finished consumer and industrial products;
- global and regional economic and political conditions, including armed conflicts and terrorist activities; embargoes and strikes;
- the location of regional and global exploration, production and manufacturing facilities;
- availability of credit to finance international trade;
- the location of consuming regions for energy resources, commodities, semi-finished and finished consumer and industrial products;
- the distance drybulk and containerized commodities are to be moved by sea;
- environmental and other regulatory developments;

- currency exchange rates;

- changes in global production and manufacturing distribution patterns of finished goods that utilize drybulk and other containerized commodities;

6

- changes in seaborne and other transportation patterns; and
- weather.

Some of the factors that influence the supply of vessel capacity include:

- the number of newbuilding deliveries;
- the scrapping rate of older vessels;
- the price of steel and other materials;
- port and canal congestion;
- changes in environmental and other regulations that may limit the useful life of vessels;
- vessel casualties; and
- the number of vessels that are out of service.

We anticipate that the future demand for our drybulk, container and multipurpose vessels and the charter rates of the corresponding markets will be dependent upon economic recovery in the United States, Europe and Japan, among others, as well as continued economic growth in China, India and the overall world economy, seasonal and regional changes in demand, and changes to the capacity of the world fleet. The capacity of the world fleet seems likely to increase and economic growth may not continue. Adverse economic, political, social or other developments could also have a material adverse effect on our business and results of operations.

An over-supply of drybulk carrier and containership capacity may lead to further reductions in charter hire rates and profitability.

The market supply of drybulk carriers and especially containerships has been increasing, and the number of both the drybulk vessels and containerships on order have recently reached historic highs. The containership newbuildings are expected to continue being delivered in significant numbers over the next several years. The drybulk vessel newbuildings are expected to continue being delivered in 2009 at significantly higher rates than in 2006 and 2007, and it is anticipated that in 2010 and 2011 their delivery rate may increase even further. If the number of new ships delivered exceeds the number of vessels being scrapped and lost, vessel capacity will increase. An over-supply of drybulk carrier and containership capacity may result in a further reduction of charter hire rates. For instance, given that as of May 1, 2009, as reported by Clarkson Research Services Limited ("CRSL"), the capacity of the fully cellular worldwide container vessel fleet was approximately 12.5 million teu, with approximately 5.6 million teu, or, about 45% of the present fleet, of additional capacity on order, the growing supply of container vessels may exceed future demand, particularly in the short term. Similarly, as of May 1, 2009, as reported by CRSL, the capacity of the worldwide drybulk fleet was approximately 425.8 million dwt with another 295.3 million dwt, or about 69% of the present fleet, of additional capacity on order. If the supply of vessel capacity increases but the demand for vessel capacity does not increase correspondingly, charter rates and vessel values could materially decline.

If such a reduction occurs upon the expiration or termination of our drybulk carriers' and containerships' current charters, such as during 2009 or 2010 when the charters under which at least six of our containerships are currently deployed expire, we may only be able to recharter those drybulk carriers and containerships at reduced or unprofitable rates or we may not be able to charter these vessels at all. In fact, as of May 1, 2009, we have not been able to

re-charter three of our containership vessels that completed their charters at profitable rates; as a result, we have laid-up three vessels.

The value of our vessels may fluctuate, adversely affecting our earnings, liquidity and causing us to breach our secured credit agreements.

The market value of our vessels can fluctuate significantly. The market value of our vessels may increase or decrease depending on the following factors:

- general economic and market conditions affecting the shipping industry;
- supply of drybulk, container and multipurpose vessels;
- demand for drybulk, container and multipurpose vessels;
- types and sizes of vessels;
- other modes of transportation;
- cost of newbuildings;
- new regulatory requirements from governments or self-regulated organizations; and
- prevailing level of charter rates.

As vessels grow older, they generally decline in value. Due to the cyclical nature of the drybulk and container shipping industry, if for any reason we sell vessels at a time when prices have fallen, we could incur a loss and our business, results of operations, cash flow, financial condition and ability to pay dividends could be adversely affected.

In addition, we periodically re-evaluate the carrying amount and period over which long-lived assets are depreciated to determine if events have occurred which would require modification to their carrying values or their useful lives. A determination that a vessel's estimated remaining useful life or fair value has declined below its carrying amount could result in an impairment charge against our earnings and a reduction in our shareholders' equity. Any change in the assessed market value of any of our vessels might also cause a violation of the covenants of each secured credit agreement which in turn might restrict our cash and affect our liquidity. All of our credit agreements provide for a minimum security maintenance ratio. If the assessed market value of our vessels declines below certain thresholds, we will be deemed to have violated these covenants and may incur penalties for breach of our credit agreements. For example, these penalties could require us to prepay the shortfall between the assessed market value of our vessels and the value of such vessels required to be maintained pursuant to the secured credit agreement, or to provide additional security acceptable to the lenders in an amount at least equal to the amount of any shortfall. Furthermore, we may enter into future loans which may include various other covenants, in addition to the vessel-related ones, that may ultimately depend on the assessed values of our vessels. Such covenants could include, but are not limited to, maximum fleet leverage covenants and minimum fair net worth covenants.

An economic slowdown in the Asia Pacific region could materially reduce the amount and/or profitability of our business.

A significant number of the port calls made by our vessels involve the loading or discharging of raw materials and semi-finished products in ports in the Asia Pacific region. Since September 2008, demand for the services of our vessels has declined, due amongst other factors, to the credit crisis and the world economic slowdown. As a result, a further negative change in economic conditions in any Asia Pacific country, particularly in China, may have a significant adverse effect on our business, financial position and results of operations, as well as our future prospects. In particular, in recent years, China has been one of the world's fastest growing economies in terms of gross domestic product. Such growth may not be sustained and the Chinese economy may experience contraction in the future. Moreover, any continued weakness in the economies of the United States of America, the European Union or certain Asian countries may adversely effect economic growth in China and elsewhere. Our business, financial position and results of operations, as well as our future prospects, will likely be materially and adversely affected by an economic downturn in any of these countries.

Changes in the economic and political environment in China and policies adopted by the government to regulate its economy may have a material adverse effect on our business, financial condition and results of operations.

The Chinese economy differs from the economies of most countries belonging to the Organization for Economic Cooperation and Development, or OECD, in such respects as structure, government involvement, level of development, growth rate, capital reinvestment, allocation of resources, rate of inflation and balance of payments position. Prior to 1978, the Chinese economy was a planned economy. Since 1978, increasing emphasis has been placed on the utilization of market forces in the development of the Chinese economy. Annual and five year State Plans are adopted by the Chinese government in connection with the development of the economy. Although state-owned enterprises still account for a substantial portion of the Chinese industrial output, in general, the Chinese government is reducing the level of direct control that it exercises over the economy through State Plans and other measures. There is an increasing level of freedom and autonomy in areas such as allocation of resources, production, pricing and management and a gradual shift in emphasis to a "market economy" and enterprise reform. Limited price reforms were undertaken, with the result that prices for certain commodities are principally determined by market forces. Many of the reforms are unprecedented or experimental and may be subject to revision, change or abolition based upon the outcome of such experiments. The Chinese government may not continue to pursue a policy of economic reform. The level of imports to and exports from China could be adversely affected by the nature of the economic reforms pursued by the Chinese government, as well as by changes in political, economic and social conditions or other relevant policies of the Chinese government, such as changes in laws, regulations or export and

import restrictions, all of which could, adversely affect our business, operating results and financial condition.

We may become dependent on spot charters in the volatile shipping markets, which may result in decreased revenues and/or profitability.

Although about half of our vessels are currently under time charters, in the future, we may have more of these vessels and/or any newly acquired vessels on spot charters. The spot market is highly competitive and rates within this market are subject to volatile fluctuations, while time charters provide income at pre-determined rates over more extended periods of time. If we decide to spot charter our vessels, we may not be able to keep all our vessels fully employed in these short-term markets. In addition, we may not be able to predict whether future spot rates will be sufficient to enable our vessels to be operated profitably. A significant decrease in charter rates has affected and could continue affecting the value of our fleet and could adversely affect our profitability and cash flows with the result that our ability to pay debt service to our lenders and dividends to our shareholders could be adversely affected.

We are subject to regulation and liability under environmental laws that could require significant expenditures and affect our cash flows and net income.

Our business and the operation of our vessels are materially affected by government regulation in the form of international conventions, national, state and local laws and regulations in force in the jurisdictions in which the vessels operate, as well as in the country or countries of their registration. Because such conventions, laws, and regulations are often revised, we may not be able to predict the ultimate cost of complying with such conventions, laws and regulations or the impact thereof on the resale prices or useful lives of our vessels. Additional conventions, laws and regulations may be adopted which could limit our ability to do business or increase the cost of our doing business and which may materially adversely affect our operations. We are required by various governmental and quasi-governmental agencies to obtain certain permits, licenses, certificates and financial assurances with respect to our operations.

The operation of our vessels is affected by the requirements set forth in the International Maritime Organization's ("IMO's") International Management Code for the Safe Operation of Ships and Pollution Prevention ("ISM Code"). The ISM Code requires shipowners and bareboat charterers to develop and maintain an extensive "Safety Management System" that includes the adoption of a safety and environmental protection policy setting forth instructions and procedures for safe operation and describing procedures for dealing with emergencies. The failure of a shipowner or bareboat charterer to comply with the ISM Code may subject such party to increased liability, may decrease available insurance coverage for the affected vessels, and/or may result in a denial of access to, or detention in, certain ports. Currently, each of our vessels and Eurobulk Ltd., or Eurobulk, our affiliated ship management company, are ISM Code-certified, but we may not be able to maintain such certification indefinitely.

Although the United States of America is not a party, many countries have ratified and follow the liability scheme adopted by the IMO and set out in the International Convention on Civil Liability for Oil Pollution Damage, 1969, as amended (the "CLC"), and the Convention for the Establishment of an International Fund for Oil Pollution of 1971, as amended and the Regulations for the Prevention of Air Pollution from Ships to the International Convention for the Prevention of Pollution from Ships (as modified in 1978 and 1997), including Annex VI thereto. Under these conventions, a vessel's registered owner is strictly liable for pollution damage, including air pollution, caused on the territorial waters of a contracting state by discharge of persistent oil, subject to certain complete defenses. Many of the countries that have ratified the CLC have increased the liability limits through a 1992 Protocol to the CLC. The right to limit liability is also forfeited under the CLC where the spill is caused by the owner's actual fault or privity and, under the 1992 Protocol, where the spill is caused by the owner's intentional or reckless conduct. Vessels trading to contracting states must provide evidence of insurance covering the limited liability of the owner. In jurisdictions where the CLC has not been adopted, various legislative schemes or common law govern, and liability is imposed either on the basis of fault or in a manner similar to the CLC.

The United States Oil Pollution Act of 1990 ("OPA") established an extensive regulatory and liability regime for the protection and clean-up of the environment from oil spills. OPA affects all owners and operators whose vessels trade in the United States of America or any of its territories and possessions or whose vessels operate in waters of the United States of America, which includes the territorial sea of the United States of America and its 200 nautical mile exclusive economic zone. OPA allows for potentially unlimited liability without regard to fault of vessel owners, operators and bareboat charterers for all containment and clean-up costs and other damages arising from discharges or threatened discharges of oil from their vessels, including bunkers (fuel), in the U.S. waters. OPA also expressly permits individual states to impose their own liability regimes with regard to hazardous materials and oil pollution materials occurring within their boundaries.

While we do not carry oil as cargo, we do carry fuel oil (bunkers) in our drybulk carriers. We currently maintain, for each of our vessels, pollution liability coverage insurance of $1 billion per incident. If the damages from a catastrophic spill exceeded our insurance coverage, that would have a material adverse affect on our financial condition.

Capital expenditures and other costs necessary to operate and maintain our vessels may increase due to changes in governmental regulations, safety or other equipment standards.

Changes in governmental regulations, safety or other equipment standards, as well as compliance with standards imposed by maritime self-regulatory organizations and customer requirements or competition, may require us to make additional expenditures. In order to satisfy these requirements, we may, from time to time, be required to take our vessels out of service for extended periods of time, with corresponding losses of revenues. In the future, market conditions may not justify these expenditures or enable us to operate some or all of our vessels profitably during the remainder of their economic lives.

Increased inspection procedures and tighter import and export controls and new security regulations could increase costs and disrupt our business.

International shipping is subject to various security and customs inspection and related procedures in countries of origin and destination. Inspection procedures may result in the seizure of contents of our vessels, delays in the loading, offloading or delivery and the levying of customs duties, fines or other penalties against us.

International container shipping is subject to additional security and customs inspection and related procedures in countries of origin, destination and trans-shipment points. Since the events of September 11, 2001, U.S. authorities have increased container inspection rates. Government investment in non-intrusive container scanning technology has grown, and there is interest in electronic monitoring technology, including so-called "e-seals" and "smart" containers that would enable remote, centralized monitoring of containers during shipment to identify tampering with or opening of the containers, along with potentially measuring other characteristics such as temperature, air pressure, motion, chemicals, biological agents and radiation.

It is unclear what changes, if any, to the existing security procedures will ultimately be proposed or implemented, or how any such changes will affect the container shipping industry. These changes have the potential to impose additional financial and legal obligations on carriers and, in certain cases, to render the shipment of certain types of goods by container uneconomical or impractical. These additional costs could reduce the volume of goods shipped in containers, resulting in a decreased demand for container vessels. In addition, it is unclear what financial costs any new security procedures might create for container vessel owners, or whether companies responsible for the global traffic of containers at sea, referred to as container line operators, may seek to pass on certain of the costs associated with any new security procedures to vessel owners.

Rising fuel prices may adversely affect our profits.

Fuel (bunkers) is a significant, if not the largest, operating expense for many of our shipping operations when our vessels are under voyage charter. When a vessel is operating under a time charter, these costs are paid by the charterer. However fuel costs are taken into account by the charterer in determining the amount of time charter hire and therefore fuel costs also indirectly affect time charter rates. The price and supply of fuel is unpredictable and fluctuates based on events outside our control, including geopolitical developments, supply and demand for oil and gas, actions by OPEC and other oil and gas producers, war and unrest in oil producing countries and regions, regional production patterns and environmental concerns. Fuel prices have been at historically high levels for most of 2008, but shipowners have not really felt the effect of these high prices because the shipping markets have also been at high levels. As the shipping markets declined in the last three months of 2008 and into 2009, fuel prices fell too, thus reducing fuel costs and certain other components of operating expenses (e.g. the cost of lubricants, etc.). However, any increase in the price of fuel may adversely affect our profitability, especially if such increase is combined with lower drybulk and containership rates.

If our vessels fail to maintain their class certification and/or fail any annual survey, intermediate survey, dry-docking or special survey, that vessel would be unable to carry cargo, thereby reducing our revenues and profitability and violating certain covenants in our loan agreements.

The hull and machinery of every commercial vessel must be classed by a classification society authorized by its country of registry. The classification society certifies that a vessel is safe and seaworthy in accordance with the applicable rules and regulations of the country of registry of the vessel and the Safety of Life at Sea Convention ("SOLAS"). Our vessels are currently classed with Lloyd's Register of Shipping, Bureau Veritas and Nippon Kaiji Kyokai. ISM and International Ship and Port Facilities Security ("ISPS") certification have been awarded by Bureau Veritas and the Panama Maritime Authority to our vessels and Eurobulk.

A vessel must undergo annual surveys, intermediate surveys, drydockings and special surveys. In lieu of a special survey, a vessel's machinery may be on a continuous survey cycle, under which the machinery would be surveyed periodically over a five-year period. Every vessel is also required to be drydocked every two to three years for inspection of the underwater parts of such vessel.

If any vessel does not maintain its class and/or fails any annual survey, intermediate survey, drydocking or special survey, the vessel will be unable to carry cargo between ports and will be unemployable and uninsurable which could cause us to be in violation of certain covenants in our loan agreements. Any such inability to carry cargo or be employed, or any such violation of covenants, could have a material adverse impact on our financial condition and results of operations. That status could cause us to be in violation of certain covenants in our loan agreements.

Rising crew costs may adversely affect our profits.

Crew costs are a significant operating expense for many of our shipping operations. Crewing costs have reached recent highs and may continue at such rates. The cost of employing suitable crew is unpredictable and fluctuates based on events outside our control, including supply and demand and the wages paid by other shipping companies. Crew costs were at high levels in 2008, but shipowners did not really feel the effect of these high prices because the shipping markets were also at high levels until September 2008. Since then, shipping rates have declined significantly and crew salaries have remained unchanged. Any increase in crew costs may adversely affect our profitability especially if such increase is combined with lower drybulk and containership rates.

Maritime claimants could arrest our vessels, which could interrupt our cash flow.

Crew members, suppliers of goods and services to a vessel, shippers of cargo and other parties may be entitled to a maritime lien against that vessel for unsatisfied debts, claims or damages. In many jurisdictions, a maritime lien holder may enforce its lien by arresting a vessel through foreclosure proceedings. The arresting or attachment of one or more of our vessels could interrupt our cash flow and require us to pay large sums of funds to have the arrest lifted which would have a material adverse effect on our financial condition and results of operations.

In addition, in some jurisdictions, such as South Africa, under the "sister ship" theory of liability, a claimant may arrest both the vessel which is subject to the claimant's maritime lien and any "associated" vessel, which is any vessel owned or controlled by the same owner. Claimants could try to assert "sister ship" liability against one of our vessels for claims relating to another of our vessels.

Governments could requisition our vessels during a period of war or emergency, resulting in loss of earnings.

A government could requisition for title or seize our vessels. Requisition for title occurs when a government takes control of a vessel and becomes the owner. Also, a government could requisition our vessels for hire. Requisition for hire occurs when a government takes control of a vessel and effectively becomes the charterer at dictated charter rates. Generally, requisitions occur during a period of war or emergency. Government requisition of one or more of our vessels could have a material adverse effect on our financial condition and results of operations.

World events outside our control may negatively affect our ability to operate, thereby reducing our revenues and net income or our ability to obtain additional financing, thereby restricting the implementation of our business strategy.

Terrorist attacks such as the attacks on the United States of America on September 11, 2001, on London, England on July 7, 2005, on Mumbai, India in December 2008 and the response to these attacks, as well as the threat of future terrorist attacks, continue to cause uncertainty in the world financial markets and may affect our business, results of operations and financial condition. The continuing conflict in Iraq and Afghanistan may lead to additional acts of terrorism and armed conflict around the world, which may contribute to further economic instability in the global financial markets. These uncertainties could also have a material adverse effect on our ability to obtain additional financing on terms acceptable to us or at all. Terrorist attacks may also negatively affect our operations and financial condition and directly impact our vessels or our customers. Future terrorist attacks could result in increased volatility of the financial markets in the United States of America and globally and could result in an economic recession in the United States of America or the world. Any of these occurrences could have a material adverse impact on our financial condition and costs.

Disruptions in world financial markets and the resulting governmental action in the United States and in other parts of the world could have a material adverse impact on our results of operations, financial condition and cash flows, and could cause the market price of our common stock to further decline.

The United States and other parts of the world are exhibiting deteriorating economic trends and have been in a recession. For example, the credit markets in the United States have experienced significant contraction, deleveraging and reduced liquidity, and the United States federal government and state governments have implemented and are considering a broad variety of governmental action and/or new regulation of the financial markets. Securities and futures markets and the credit markets are subject to comprehensive statutes, regulations and other requirements. The SEC, other regulators, self-regulatory organizations and exchanges are authorized to take extraordinary actions in the event of market emergencies, and may effect changes in law or interpretations of existing laws.

Recently, a number of financial institutions have experienced serious financial difficulties and, in some cases, have entered bankruptcy proceedings or are in regulatory enforcement actions. The uncertainty surrounding the future of the credit markets in the United States and the rest of the world has resulted in reduced access to credit worldwide.

We face risks attendant to changes in economic environments, changes in interest rates, and instability in the banking and securities markets around the world, among other factors. Major market disruptions and the current adverse changes in market conditions and regulatory climate in the United States and worldwide may adversely affect our business or impair our ability to borrow amounts under our credit facilities or any future financial arrangements. We cannot predict how long the current market conditions will last. However, these recent and developing economic and governmental factors, together with the concurrent decline in charter rates and vessel values, may have a material adverse effect on our results of operations, financial condition or cash flows, and might cause the price of our common stock on the NASDAQ Global Select Market to decline.

Our operating results are subject to seasonal fluctuations, which could affect our operating results and the amount of available cash with which we could pay dividends.

We operate our vessels in markets that have historically exhibited seasonal variations in demand and, as a result, in charter hire rates. This seasonality may result in quarter-to-quarter volatility in our operating results which could affect the amount of dividends that we may pay to our shareholders from time to time. In addition, unpredictable weather patterns in these months tend to disrupt vessel scheduling and supplies of certain commodities. While this seasonality has not materially affected our operating results and cash available for distribution to our shareholders as dividends, it could materially affect our operating results in the future.

Maritime claimants could attach our assets under United States Supplemental Admiralty Rule B ("Rule B"), which could interrupt our financial condition, cash flows and results of operations.

It is possible that we could be sued and the plaintiff could use Rule B to attach our assets located in the United States. Rule B provides that where a defendant is not "found" for jurisdictional purposes within the United States federal district in which a Rule B action is commenced, a plaintiff with a valid maritime claim can, ex parte, attach or garnish the defendant's tangible or intangible property located in such federal district. Certain United States' courts have broadly defined what constitutes a maritime claim and this exposes defendants to a greater risk of attachment. Under Rule B, the property sought to be attached must be in the possession of the garnishee (such as a bank) and recently certain United States' courts have held that this can include Electronic Funds Transfers, or EFTs, passing through an intermediary money center bank (a substantial number of which are in the Southern District of New York), on their way to or from overseas financial institutions.

While we do not maintain an office or own property located in the United States, it is possible that our assets could be attached by a plaintiff pursuant to Rule B while passing through the United States. In particular, we frequently transact business in United States Dollars and attachments of EFTs passing through New York may unexpectedly freeze funds transfers to or from us. Attachments of our assets under Rule B could have a material adverse effect on our financial condition, cash flows and results of operations.

According to rulings by certain United States' courts, it may be possible to prevent Rule B attachments in the Southern District of New York by registering with the Secretary of State of New York as a foreign corporation licensed to do business in the State of New York and appointing an agent for service of process in the Southern District. However, after consideration, we have decided not to pursue such course of action. We may decide in the future to both register with the New York Secretary of State as a foreign corporation licensed to do business in New York and appoint an agent for service of process in the Southern District of New York and this may add certain costs to our operations.

Company Risk Factors

If we do not use our cash on hand to acquire vessels and expand our fleet, we may use it for general corporate purposes which may result in lower earnings.

We intend to use our cash on hand to acquire additional vessels and expand our fleet when we believe market conditions are favorable for purchasing such vessels. Our management will have the discretion to identify and acquire vessels. If our management is unable to identify and acquire vessels on terms acceptable to us, we may use our cash on hand for general corporate purposes. It may take a substantial period of time before we can locate and purchase suitable vessels. During this period, our cash on hand may be invested on a short-term basis and therefore may not yield returns at rates comparable to what a vessel might have earned.

We depend entirely on Eurobulk to manage and charter our fleet, which may adversely affect our operations if Eurobulk fails to perform its obligations.

We have no employees and we currently contract the commercial and technical management of our fleet, including crewing, maintenance and repair, to Eurobulk, our affiliated ship management company. We may lose Eurobulk's services or Eurobulk may fail to perform its obligations to us which could have a material adverse effect on our financial condition and results of our operations. Although we may have rights against Eurobulk if it defaults on its obligations to us, you will have no recourse against Eurobulk. Further, we expect that we will need to seek approval from our lenders to change Eurobulk as our ship manager.

Because Eurobulk is a privately held company, there is little or no publicly available information about it and there may be very little advance warning of operational or financial problems experienced by Eurobulk that may adversely affect us.

The ability of Eurobulk to continue providing services for our benefit will depend in part on its own financial strength. Circumstances beyond our control could impair Eurobulk's financial strength, and because Eurobulk is privately held it is unlikely that information about its financial strength would become public unless Eurobulk began to default on its obligations. As a result, there may be little advance warning of problems affecting Eurobulk, even though these problems could have a material adverse effect on us.

As of May 1, 2009, Friends Investment Company Inc. owns approximately 33.3% of our outstanding shares of common stock, which may limit your ability to influence our actions.

As of May 1, 2009 Friends Investment Company Inc., or "Friends", our largest shareholder, owns approximately 33.3% of the outstanding shares of our common stock. As a result of this share ownership and for so long as Friends owns a significant percentage of our outstanding common stock, Friends will be able to influence the outcome of any shareholder vote, including the election of directors, the adoption or amendment of provisions in our articles of incorporation or bylaws and possible mergers, corporate control contests and other significant corporate transactions. This concentration of ownership may have the effect of delaying, deferring or preventing a change in control, merger, consolidation, takeover or other business combination involving us. This concentration of ownership could also discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of us, which could in turn have an adverse effect on the market price of our common stock.

Our corporate governance practices are in compliance with, and are not prohibited by, the laws of the Republic of the Marshall Islands, and as such we are entitled to exemption from certain NASDAQ corporate governance standards. As a result, you may not have the same protections afforded to stockholders of companies that are subject to all of the NASDAQ corporate governance requirements.

Our Company's corporate governance practices are in compliance with, and are not prohibited by, the laws of the Republic of the Marshall Islands. Therefore, we are exempt from many of NASDAQ's corporate governance practices other than the requirements regarding the disclosure of a going concern audit opinion, submission of a listing agreement, notification of material non-compliance with NASDAQ corporate governance practices, and the establishment and composition of an audit committee and a formal written audit committee charter. For a list of the practices followed by us in lieu of NASDAQ's corporate governance rules, we refer you to the section of this annual report entitled "Board Practices—Corporate Governance" under Item 6.

We and our principal officers have affiliations with Eurobulk that could create conflicts of interest detrimental to us.

Our principal officers are also principals, officers and employees of Eurobulk, which is our ship management company. These responsibilities and relationships could create conflicts of interest between us and Eurobulk. Conflicts may also arise in connection with the chartering, purchase, sale and operations of the vessels in our fleet versus other vessels that are or may be managed in the future by Eurobulk. Circumstances in any of these instances may make one decision advantageous to us but detrimental to Eurobulk and vice versa. Eurobulk currently manages one vessel other than those owned by Euroseas, and to date has managed only vessels where the Pittas family was a minority shareholder, but never any vessel which had no Pittas family participation at all. However, it is possible that in the future Eurobulk may manage additional vessels which will not belong to Euroseas and in which the Pittas family may have controlling, little or even no power or participation and where conflicts such as those described above may arise. Eurobulk may not be able to resolve all conflicts of interest in a manner beneficial to us and our shareholders.

Companies affiliated with Eurobulk or our officers and directors may acquire vessels that compete with our fleet.

Companies affiliated with Eurobulk or our officers and directors own drybulk carriers and may acquire additional drybulk carriers, containerships or multipurpose vessels in the future. These vessels could be in competition with our fleet and other companies affiliated with Eurobulk might be faced with conflicts of interest with respect to their own interests and their obligations to us. Eurobulk, Friends and Aristides J. Pittas, our Chairman and Chief Executive Officer, have granted us a right of first refusal to acquire any drybulk vessel or containership which any of them may consider for acquisition in the future. In addition, Mr. Pittas will use his best efforts to cause any entity with respect to which he directly or indirectly controls to grant us this right of first refusal. Were we, however, to decline any such opportunity offered to us or we do not have the resources or desire to accept any such opportunity, Eurobulk, Friends and Aristides J. Pittas, and any of their respective Affiliates, could acquire such vessels.

Our officers do not devote all of their time to our business.

Our officers are involved in other business activities that may result in their spending less time than is appropriate or necessary in order to manage our business successfully. Our Chief Executive Officer, Chief Financial Officer, Chief Administrative Officer, Internal Auditor and Secretary are not employed directly by us, but rather their services are provided pursuant to our Master Management Agreement with Eurobulk. These officers may spend a material portion of their time providing services to Eurobulk and its affiliates on matters unrelated to us.

We are a holding company, and we depend on the ability of our subsidiaries to distribute funds to us in order to satisfy our financial obligations or to make dividend payments.

We are a holding company and our subsidiaries, which are all wholly-owned by us, conduct all of our operations and own all of our operating assets. We have no significant assets other than the equity interests in our wholly-owned subsidiaries. As a result, our ability to make dividend payments to you depends on our subsidiaries and their ability to distribute funds to us. If we are unable to obtain funds from our subsidiaries, we may be unable or our Board of Directors may exercise its discretion not to pay dividends.

We may not be able to pay dividends.

We currently intend to pay quarterly dividends to holders of our common stock, when, as and if declared by our Board of Directors. Our last dividend of $0.10 per share was declared in February 2009 for the results of the fourth quarter of 2008. However, we may not earn sufficient revenues or we may incur expenses or liabilities that would reduce or eliminate the cash available for distribution as dividends. Our loan agreements may also limit the amount of dividends

we can pay under some circumstances based on certain covenants included in the loan agreements.

14

In addition, the declaration and payment of dividends will be subject at all times to the discretion of our Board of Directors. The timing and amount of dividends will depend on our earnings, financial condition, cash requirements and availability, restrictions in our loan agreements, growth strategy, charter rates in the drybulk and container shipping industry, the provisions of Marshall Islands law affecting the payment of dividends and other factors. Marshall Islands law generally prohibits the payment of dividends other than from surplus (retained earnings and the excess of consideration received for the sale of shares above the par value of the shares), but if there is no surplus, dividends may be declared out of the net profits (basically, the excess of our revenue over our expenses) for the fiscal year in which the dividend is declared or the preceding fiscal year. Marshall Islands law also prohibits the payment of dividends while a company is insolvent or if it would be rendered insolvent upon the payment of a dividend. As a result, we may not be able to pay dividends.

If we are unable to fund our capital expenditures, we may not be able to continue to operate some of our vessels, which would have a material adverse effect on our business and our ability to pay dividends.

In order to fund our capital expenditures, we may be required to incur borrowings or raise capital through the sale of debt or equity securities. Our ability to access the capital markets through future offerings may be limited by our financial condition at the time of any such offering as well as by adverse market conditions resulting from, among other things, general economic conditions and contingencies and uncertainties that are beyond our control. Our failure to obtain the funds for necessary future capital expenditures would limit our ability to continue to operate some of our vessels and could have a material adverse effect on our business, results of operations and financial condition and our ability to pay dividends. Even if we are successful in obtaining such funds through financings, the terms of such financings could further limit our ability to pay dividends.

If we fail to manage our planned growth properly, we may not be able to successfully expand our market share.

We intend to continue to grow our fleet. Our growth will depend on:

- locating and acquiring suitable vessels;
- identifying and consummating acquisitions or joint ventures;
- integrating any acquired business successfully with our existing operations;
- enhancing our customer base;
- managing our expansion; and
- obtaining required financing on acceptable terms.

During periods in which charter rates are high, vessel values generally are high as well, and it may be difficult to consummate vessel acquisitions at favorable prices. When vessel prices are low, charter rates are also low and any vessel acquisition might require additional investment to cover shortfalls from operations until rates recover. In addition, growing any business by acquisition – especially if acquiring entire companies - presents numerous risks, such as undisclosed liabilities and obligations and difficulty experienced in (1) maintaining and obtaining additional qualified personnel, (2) managing relationships with customers and suppliers, and (3) integrating newly acquired operations into existing infrastructures. We may not be successful in executing our growth plans or that we will not incur significant expenses and losses in connection with the execution of those growth plans.

A decline in the market value of our vessels could lead to a default under our loan agreements and the loss of our vessels.

We have incurred secured debt under loan agreements for our vessels and currently expect to incur additional secured debt in connection with our acquisition of other vessels. If the market value of our fleet declines, we may not be in compliance with certain provisions of our existing loan agreements and we may not be able to refinance our debt or obtain additional financing on terms that are acceptable to us or at all. If we are unable to pledge additional collateral, our lenders could accelerate our debt and foreclose on our fleet.

Our existing loan agreements contain restrictive covenants that may limit our liquidity and corporate activities.

Our existing loan agreements impose operating and financial restrictions on us. These restrictions may limit our ability to:

- incur additional indebtedness;
- create liens on our assets;
- sell capital stock of our subsidiaries;
- make investments;
- engage in mergers or acquisitions;
- pay dividends;
- make capital expenditures;
- change the management of our vessels or terminate or materially amend the management agreement relating to each vessel; and
- sell our vessels.

Therefore, we may need to seek permission from our lenders in order to engage in some corporate actions. The lenders' interests may be different from our interests, and we may not be able to obtain the lenders' permission when needed. This may prevent us from taking actions that are in our best interest.

Servicing future debt would limit funds available for other purposes.

To finance our fleet, we have incurred secured debt under loan agreements for our vessels. We also currently expect to incur additional secured debt to finance the acquisition of additional vessels. We must dedicate a portion of our cash flow from operations to pay the principal and interest on our debt. These payments limit funds otherwise available for working capital expenditures and other purposes. As of December 31, 2008, we had total bank debt of approximately $56.02 million. As of March 31, 2009, we had repaid $3.20 million of our total bank debt and assumed $20.00 million in new debt to finance two vessel acquisitions (of which $10.00 million was drawn in April 2009), leaving us with total bank debt of $72.82 million. Our debt repayment schedule as of December 31, 2008 and of the new debt requires us to repay $29.25 million over the next two years. If we are unable to service our debt, it could have a material adverse effect on our financial condition, results of operations and cash flows.

A rise in interest rates could cause an increase in our costs and have a material adverse effect on our financial condition and results of operations. To finance vessel purchases, we have borrowed, and may continue to borrow, under loan agreements that provide for periodic interest rate adjustments based on indices that fluctuate with changes in market interest rates. If interest rates increase significantly, it would increase our costs of financing our acquisition of vessels, which could have a material adverse effect on our financial condition and results of operations. Any increase in debt service would also reduce the funds available to us to purchase other vessels.

Our ability to obtain additional debt financing may be dependent on the performance of our then existing charters and the creditworthiness of our charterers.

The actual or perceived credit quality of our charterers, and any defaults by them, may materially affect our ability to obtain the additional debt financing that we will require to purchase additional vessels or may significantly increase our costs of obtaining such financing. Our inability to obtain additional financing at all or at a higher than anticipated cost may materially affect our results of operations, cash flows and our ability to implement our business strategy.

As we expand our business, we may need to upgrade our operations and financial systems, and add more staff and crew. If we cannot upgrade these systems or recruit suitable employees, our performance may be adversely affected.

Our current operating and financial systems may not be adequate if we expand the size of our fleet, and our attempts to improve those systems may be ineffective. In addition, if we expand our fleet, we will have to rely on Eurobulk to recruit suitable additional seafarers and shoreside administrative and management personnel. Eurobulk may not be able to continue to hire suitable employees as we expand our fleet. If Eurobulk's unaffiliated crewing agent encounters business or financial difficulties, we may not be able to adequately staff our vessels. If we are unable to operate our financial and operations systems effectively or to recruit suitable employees, our performance may be materially adversely affected.

Because we obtain some of our insurance through protection and indemnity associations, we may also be subject to calls in amounts based not only on our own claim records, but also the claim records of other members of the protection and indemnity associations.

We may be subject to calls in amounts based not only on our claim records but also the claim records of other members of the protection and indemnity associations through which we receive insurance coverage for tort liability, including pollution-related liability. Our payment of these calls could result in significant expense to us, which could have a material adverse effect on our business, results of operations, cash flows, financial condition and ability to pay dividends.

Labor interruptions could disrupt our business.

Our vessels are manned by masters, officers and crews that are employed by third parties. If not resolved in a timely and cost-effective manner, industrial action or other labor unrest could prevent or hinder our operations from being carried out normally and could have a material adverse effect on our business, results of operations, cash flows, financial condition and ability to pay dividends.

In the highly competitive international drybulk and container shipping industry, we may not be able to compete for charters with new entrants or established companies with greater resources.

We employ our vessels in highly competitive markets that are capital intensive and highly fragmented. Competition arises primarily from other vessel owners, some of whom have substantially greater resources than us. Competition for the transportation of drybulk and container cargoes can be intense and depends on price, location, size, age, condition and the acceptability of the vessel and its managers to the charterers. Due in part to the highly fragmented market, competitors with greater resources could operate larger fleets through consolidations or acquisitions that may be able to offer better prices and fleets.

We will not be able to take advantage of potentially favorable opportunities in the current spot market with respect to vessels employed on time charters.

As of May 1, 2009, nine of the 16 vessels in our fleet are employed under time charters with remaining terms ranging between three months and 35 months. The percentage of our fleet that is under time charter contracts or short term spot contracts, or that is otherwise protected from market fluctuations (via Forward Freight Agreement, or FFA, contracts) represents approximately 70% of our vessel capacity in 2009. Although time charters provide relatively steady streams of revenue, vessels committed to time charters may not be available for spot charters during periods of increasing charter hire rates, when spot charters might be more profitable. If we cannot re-charter these vessels on time charters or trade them in the spot market profitably, our results of operations and operating cash flow may suffer. We may not be able to secure charter hire rates in the future that will enable us to operate our vessels profitably. As of

May 1, 2009, three of our containerships are laid-up.

We may be unable to attract and retain key management personnel and other employees in the shipping industry, which may negatively affect the effectiveness of our management and our results of operations.

Our success depends to a significant extent upon the abilities and efforts of our management team. Our success will depend upon our ability to hire additional employees and to retain key members of our management team. The loss of any of these individuals could adversely affect our business prospects and financial condition. Difficulty in hiring and retaining personnel could adversely affect our results of operations. We do not currently intend to maintain "key man" life insurance on any of our officers.

Risks involved with operating ocean-going vessels could affect our business and reputation, which may reduce our revenues.

The operation of an ocean-going vessel carries inherent risks. These risks include, among others, the possibility of:

- marine disaster;
- piracy;
- environmental accidents;
- grounding, fire, explosions and collisions;
- cargo and property losses or damage;
- business interruptions caused by mechanical failure, human error, war, terrorism, political action in various countries, labor strikes or adverse weather conditions; and
- work stoppages or other labor problems with crew members serving on our vessels.

Such occurrences could result in death or injury to persons, loss of property or environmental damage, delays in the delivery of cargo, loss of revenues from or termination of charter contracts, governmental fines, penalties or restrictions on conducting business, higher insurance rates, and damage to our reputation and customer relationships generally. Any of these circumstances or events could increase our costs or lower our revenues, which could result in reduction in the market price of our shares of common stock. The involvement of our vessels in an environmental disaster may harm our reputation as a safe and reliable vessel owner and operator.

The operation of drybulk carriers has certain unique operational risks.

The operation of certain ship types, such as drybulk carriers, has certain unique risks. With a drybulk carrier, the cargo itself and its interaction with the ship can be a risk factor. By their nature, drybulk cargoes are often heavy, dense, easily shifted, and react badly to water exposure. In addition, drybulk carriers are often subjected to battering treatment during unloading operations with grabs, jackhammers (to pry encrusted cargoes out of the hold), and small bulldozers. This treatment may cause damage to the vessel. Vessels damaged due to treatment during unloading procedures may be more susceptible to breach to the sea. Hull breaches in drybulk carriers may lead to the flooding of the vessels holds. If a drybulk carrier suffers flooding in its forward holds, the bulk cargo may become so dense and waterlogged that its pressure may buckle the vessels bulkheads leading to the loss of a vessel. If we are unable to adequately maintain our vessels we may be unable to prevent these events. Any of these circumstances or events could negatively impact our business, financial condition, results of operations and ability to pay dividends. In addition, the loss of any of our vessels could harm our reputation as a safe and reliable vessel owner and operator.

18

The operation of containerships has certain unique operational risks.

The operation of containerships has certain unique risks. Containerships operate at high speeds in order to move cargoes around the world quickly and minimize delivery delays. These high speeds can result in greater impact in collisions and groundings resulting in more damage to the vessel when compared to vessels operating at lower speeds. In addition, due to the placement of the containers on a containership, there is a greater risk that containers carried on deck will be lost overboard if an accident does occur. Furthermore, with the highly varied cargo that can be carried on a single containership, there can be additional difficulties with any clean-up operation following an accident. Also, we may not be able to correctly control the contents and condition of cargoes within the containers which may give rise to events such as customer complaints, accidents on-board the ships or problems with authorities due to carriage of illegal cargoes. Any of these circumstances or events could negatively impact our business, financial condition, results of operations and ability to pay dividends. In addition, the loss of any of our vessels could harm our reputation as a safe and reliable vessel owner and operator.

Our vessels may suffer damage and it may face unexpected drydocking costs, which could affect our cash flow and financial condition.

If our vessels suffer damage, they may need to be repaired at a drydocking facility. The costs of drydock repairs are unpredictable and may be substantial. We may have to pay drydocking costs that our insurance does not cover. The loss of earnings while these vessels are being repaired and reconditioned, as well as the actual cost of these repairs, would decrease our earnings.

We might have technical difficulties and face unexpected costs when re-activating vessels we put in lay-up.

As of May 1, 2009, three of our vessels are laid-up. Also if the current poor containership and multipurpose markets continue, it is likely that as our containership and multipurpose vessels complete their current charters, they will have difficulties finding employment and they may be laid-up too. We expect to reactivate any vessels we lay up when markets improve but we may face technical and operational problems in doing so that may result in higher than expected re-activation costs.

Purchasing and operating previously owned, or secondhand, vessels may result in increased operating costs and vessels off-hire, which could adversely affect our earnings.

Although we inspect the secondhand vessels prior to purchase, this inspection does not provide us with the same knowledge about their condition and cost of any required (or anticipated) repairs that it would have had if these vessels had been built for and operated exclusively by us. Generally, we do not receive the benefit of warranties on secondhand vessels.

In general, the cost of maintaining a vessel in good operating condition increases with the age of the vessel. As of May 1, 2009 the average age of our fleet was approximately 17 years. As our fleet ages, we will incur increased costs. Older vessels are typically less fuel efficient and more costly to maintain than more recently constructed vessels. Cargo insurance rates also increase with the age of a vessel, making older vessels less desirable to charterers. Governmental regulations and safety or other equipment standards related to the age of a vessel may also require expenditures for alterations or the addition of new equipment to our vessels and may restrict the type of activities in which our vessels may engage.

Governmental regulations, safety or other equipment standards related to the age of vessels may require expenditures for alterations, or the addition of new equipment, to our vessels and may restrict the type of activities in which the vessels may engage. As our vessels age, market conditions may not justify those expenditures or enable us to operate

our vessels profitably during the remainder of their useful lives. If we sell vessels, we are not certain that the price for which we sell them will equal their carrying amount at that time.

We are subject to certain risks with respect to our counterparties on contracts, and failure of such counterparties to meet their obligations could cause us to suffer losses or otherwise adversely affect our business.

We enter into, among other things, charterparty agreements. Such agreements subject us to counterparty risks. The ability of each of our counterparties to perform its obligations under a contract with us will depend on a number of factors that are beyond our control and may include, among other things, general economic conditions, the condition of the maritime and offshore industries, the overall financial condition of the counterparty, charter rates received for specific types of vessels, and various expenses. In addition, in depressed market conditions, our charterers may no longer need a vessel that is currently under charter or may be able to obtain a comparable vessel at lower rates. As a result, charterers may seek to renegotiate the terms of their existing charter parties or avoid their obligations under those contracts. Should a counterparty fail to honor its obligations under agreements with us, we could sustain significant losses which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

We may not have adequate insurance to compensate us adequately for damage to, or loss of, our vessels.

We procure hull and machinery insurance, protection and indemnity insurance, which includes environmental damage and pollution insurance and war risk insurance and freight, demurrage and defense insurance for our fleet. We generally do not maintain insurance against loss of hire (except currently for m/v YM Xingang I), which covers business interruptions that result in the loss of use of a vessel. We may not be adequately insured against all risks and we may not be able to obtain adequate insurance coverage for our fleet in the future. The insurers may not pay particular claims. Our insurance policies contain deductibles for which we will be responsible and limitations and exclusions which may increase our costs. Moreover, the insurers may default on any claims they are required to pay. If our insurance is not enough to cover claims that may arise, it may have a material adverse effect on our financial condition, results of operations and cash flows.

Our international operations expose us to risks of terrorism and piracy that may interfere with the operation of our vessels.

We are an international company and primarily conduct our operations outside the United States of America. Changing economic, political and governmental conditions in the countries where we are engaged in business or where our vessels are registered affect our operations. In the past, political conflicts, particularly in the Arabian Gulf, resulted in attacks on vessels, mining of waterways and other efforts to disrupt shipping in the area. Acts of terrorism and piracy have also affected vessels trading in regions such as the South China Sea and in the Gulf of Aden off the coast of Somalia. Throughout 2008 and early 2009, the frequency of piracy incidents has increased significantly, particularly in the Gulf of Aden off the coast of Somalia. If our vessels are the targets of such incidents, this could result in loss or damage of our vessels and a loss of operating revenue. If these piracy attacks result in regions in which our vessels are deployed being characterized by insurers as "war risk" zones, as the Gulf of Aden temporarily was in May 2008, or Joint War Committee "war and strikes" listed areas, premiums payable for such coverage could increase significantly and such insurance coverage may be more difficult to obtain. In addition, crew costs, including those due to employing onboard security guards, could increase in such circumstances. We may not be adequately insured to cover losses from these incidents, which could have a material adverse effect on us. Furthermore, detention hijacking as a result of an act of piracy against our vessels, or an increase in cost, or unavailability of insurance for our vessels, could have a material adverse impact on our business, financial condition and results of operations.

Obligations associated with being a public company require significant company resources and management attention.

We are subject to the reporting requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the other rules and regulations of the Commission, including the Sarbanes-Oxley Act of 2002. Section 404

of the Sarbanes-Oxley Act requires that we evaluate and determine the effectiveness of our internal control over financial reporting.

20

We work with our legal, accounting and financial advisors to identify any areas in which changes should be made to our financial and management control systems to manage our growth and our obligations as a public company. We evaluate areas such as corporate governance, corporate control, internal audit, disclosure controls and procedures and financial reporting and accounting systems. We will make changes in any of these and other areas, including our internal control over financial reporting, which we believe are necessary. However, these and other measures we may take may not be sufficient to allow us to satisfy our obligations as a public company on a timely and reliable basis. In addition, compliance with reporting and other requirements applicable to public companies will create additional costs for us and will require the time and attention of management. Our limited management resources may exacerbate the difficulties in complying with these reporting and other requirements while focusing on executing our business strategy. We may not be able to predict or estimate the amount of the additional costs we may incur, the timing of such costs or the degree of impact that our management's attention to these matters will have on our business.

Derivatives contracts margin requirements might restrict all our funds and significantly affect our operations.

FFA contracts and other derivative instruments may be used to hedge a vessel owner's exposure to the charter market by providing for the sale of a contracted charter rate along a specified route and period of time. Upon settlement, if the contracted charter rate is less than the average of the rates, as reported by an identified index, for the specified route and period, the seller of the FFA contract is required to pay the buyer an amount equal to the difference between the contracted rate and the settlement rate, multiplied by the number of days in the specified period. Conversely, if the contracted rate is greater than the settlement rate, the buyer is required to pay the seller the settlement sum. We have entered in several derivatives contracts, an interest rate swap as well as a number of FFA contracts, and we may enter in new ones that require us to post margin if the contract move against our positions. We may not have enough funds to cover such margin requirements and as a result our ability to operate our vessels may be significantly curtailed, we may be forced to close the contracts at a loss, we may be forced to sell some or all of our assets.

Exposure to currency exchange rate fluctuations will result in fluctuations in our cash flows and operating results.

We generate all our revenues in U.S. dollars, but our ship manager, Eurobulk, incurs approximately 35% of vessel operating expenses and we incur management fees and some general and administrative expenses in currencies other than the U.S. dollar. This difference could lead to fluctuations in our operating expenses, which would affect our financial results. Expenses incurred in foreign currencies increase when the value of the U.S. dollar falls, which would reduce our profitability and cash flows.

If the recent volatility in LIBOR continues, it could affect our profitability, earnings and cash flow.

LIBOR has recently been volatile, with the spread between LIBOR and the prime lending rate widening significantly at times. These conditions are the result of the recent disruptions in the international credit markets. Because the interest rates borne by our outstanding indebtedness fluctuate with changes in LIBOR, if this volatility were to continue, it would affect the amount of interest payable on our debt, which in turn, could have an adverse effect on our profitability, earnings and cash flow.

We depend upon a few significant customers for a large part of our revenues and the loss of one or more of these customers could adversely affect our financial performance.

We have historically derived a significant part of our revenues from a small number of charterers. During 2008, approximately 44% of our revenues derived from five charterers. During 2007, approximately 53% of our revenues derived from five charterers. During 2006, approximately 60% of our revenues derived from five charterers. If one or more of our charterers chooses not to charter our vessels or is unable to perform under one or more charters with us and we are not able to find a replacement charter, we could suffer a loss of revenues that could adversely affect our

financial condition and results of operations.

U.S. tax authorities could treat us as a "passive foreign investment company," which could have adverse U.S. federal income tax consequences to U.S. holders.

A foreign corporation will be treated as a "passive foreign investment company," or PFIC, for U.S. federal income tax purposes if either (1) at least 75% of its gross income for any taxable year consists of certain types of "passive income" or (2) at least 50% of the average value of the corporation's assets produce or are held for the production of those types of "passive income." For purposes of these tests, "passive income" includes dividends, interest, and gains from the sale or exchange of investment property and rents and royalties other than rents and royalties which are received from unrelated parties in connection with the active conduct of a trade or business. For purposes of these tests, income derived from the performance of services does not constitute "passive income." U.S. shareholders of a PFIC are subject to a disadvantageous U.S. federal income tax regime with respect to the income derived by the PFIC, the distributions they receive from the PFIC and the gain, if any, they derive from the sale or other disposition of their shares in the PFIC.

Based on our current method of operation, we do not believe that we have been, are or will be a PFIC with respect to any taxable year. In this regard, we treat the gross income we derive or are deemed to derive from our time chartering activities as services income, rather than rental income. Accordingly, we believe that our income from our time chartering activities does not constitute "passive income," and the assets that we own and operate in connection with the production of that income do not constitute passive assets.

There is, however, no direct legal authority under the PFIC rules addressing our method of operation. Accordingly, the U.S. Internal Revenue Service, or IRS, or a court of law may not accept our position, and there is a risk that the IRS or a court of law could determine that we are a PFIC. Moreover, we may constitute a PFIC for any future taxable year if there were to be changes in the nature and extent of our operations.

If the IRS were to find that we are or have been a PFIC for any taxable year, our U.S. shareholders will face adverse U.S. tax consequences. Under the PFIC rules, unless those shareholders make an election available under the United States Internal Revenue Code of 1986 (the "Code") (which election could itself have adverse consequences for such shareholders, as discussed in Item 10 of this annual report under "Taxation — United States Federal Income Taxation of U.S. Holders"), such shareholders would be liable to pay U.S. federal income tax at the then prevailing income tax rates on ordinary income plus interest upon excess distributions and upon any gain from the disposition of our shares, as if the excess distribution or gain had been recognized ratably over the shareholder's holding period of our shares. See "Taxation — United States Federal Income Taxation of U.S. Holders" in this annual report under Item 10 for a more comprehensive discussion of the U.S. federal income tax consequences to U.S. shareholders if we are treated as a PFIC.

Legislation has previously been proposed in the United States which would prevent dividends on our shares from qualifying for certain preferential rates for U.S. federal income tax purposes.

"Qualified dividend income" derived by non-corporate U.S. shareholders that are subject to U.S. federal income tax is currently through 2010 subject to U.S. federal income taxation at reduced rates. We expect that under current law, so long as our shares are traded on the NASDAQ Capital Market, the NASDAQ Global Select Market or the NASDAQ Global Market and we do not and have not qualified as a "passive foreign investment company" for U.S. federal income tax purposes, distributions treated as dividends for U.S. tax purposes on our shares will potentially be eligible (that is, eligible if certain conditions relating to the shareholder are satisfied) for treatment as qualified dividend income. In a previous session of the U.S. Congress, legislation was introduced which would have made it unlikely that such distributions on our shares would be eligible for such treatment. Under current law, the provisions relating the "qualified dividend income" are scheduled to expire on December 31, 2010. However, the Obama Administration's recent budget proposal would make the treatment of qualified dividend income permanent, but increase the maximum

rate of tax on such income to 20%.

We may have to pay tax on United States source income, which would reduce our earnings.

Under the Code, 50% of the gross shipping income of a vessel owning or chartering corporation, such as ourselves and our subsidiaries, that is attributable to transportation that begins or ends, but that does not both begin and end, in the United States may be subject to a 4% United States federal income tax without allowance for deduction, unless that corporation qualifies for exemption from tax under section 883 of the Code and the applicable Treasury Regulations promulgated thereunder.

We believe that we and each of our subsidiaries qualify for this statutory tax exemption and we have taken this position for United States federal income tax return reporting purposes. However, there are factual circumstances beyond our control that could cause us to lose the benefit of this tax exemption and thereby become subject to United States federal income tax on our United States source income. Due to the factual nature of the issues involved, we may not be able to maintain our tax-exempt status or that of any of our subsidiaries.

If we or our subsidiaries are not entitled to exemption under Section 883 for any taxable year, we or our subsidiaries could be subject for those years to an effective 2% United States federal income tax on the shipping income these companies derive during the year that are attributable to the transport or cargoes to or from the United States. The imposition of this taxation would have a negative effect on our business and would result in decreased earnings available for distribution to our shareholders.

We may not be exempt from Liberian taxation which would materially reduce our net income and cash flow by the amount of the applicable tax.

The Republic of Liberia enacted a new income tax act effective as of January 1, 2001 (the "New Act"). In contrast to the income tax law previously in effect since 1977 (the "Prior Law"), which the New Act repealed in its entirety, the New Act does not distinguish between the taxation of a non resident Liberian corporation, such as our Liberian subsidiaries, which conduct no business in Liberia and were wholly exempted from tax under the Prior Law, and the taxation of ordinary resident Liberian corporations.

In 2004, the Liberian Ministry of Finance issued regulations pursuant to which a non-resident domestic corporation engaged in international shipping, such as our Liberian subsidiaries, will not be subject to tax under the New Act retroactive to January 1, 2001 (the "New Regulations"). In addition, the Liberian Ministry of Justice issued an opinion that the New Regulations were a valid exercise of the regulatory authority of the Ministry of Finance. Therefore, assuming that the New Regulations are valid, our Liberian subsidiaries will be wholly exempt from Liberian income tax as under the Prior Law.

If our Liberian subsidiaries were subject to Liberian income tax under the New Act, they would be subject to tax at a rate of 35% on their worldwide income. As a result, their, and subsequently our, net income and cash flow would be materially reduced by the amount of the applicable tax. In addition, we, as shareholder of the Liberian subsidiaries, would be subject to Liberian withholding tax on dividends paid by the Liberian subsidiaries at rates ranging from 15% to 20%.

It may be difficult to enforce service of process and enforcement of judgments against us and our officers and directors.

We are a Marshall Islands corporation, and our executive offices are located outside of the United States in Maroussi, Greece. A majority of our directors and officers reside outside of the United States, and a substantial portion of our assets and the assets of our officers and directors are located outside of the United States. As a result, you may have difficulty serving legal process within the United States upon us or any of these persons. You may also have difficulty enforcing, both in and outside of the United States, judgments you may obtain in the U.S. courts against us or these persons in any action, including actions based upon the civil liability provisions of U.S. federal or state securities laws.

There is also substantial doubt that the courts of the Marshall Islands or Greece would enter judgments in original actions brought in those courts predicated on U.S. federal or state securities laws.

Risk Factors Relating To Our Common Stock

The trading volume for our common stock has been low, which may cause our common stock to trade at lower prices and make it difficult to sell your common stock.

Although our shares of common stock have traded on the NASDAQ Global Market since January 31, 2007 and on the NASDAQ Global Select Market since January 1, 2008, recently the trading volume has been lower. Our shares may not actively trade in the public market and any such limited liquidity may cause our common stock to trade at lower prices and make it difficult to sell your common stock.

The market price of our common stock has been and may in the future be subject to significant fluctuations.

The market price of our common stock has been and may in the future be subject to significant fluctuations as a result of many factors, some of which are beyond our control. Among the factors that have in the past and could in the future affect our stock price are:

- actual or anticipated fluctuations in quarterly and annual variations in our results of operations;
- changes in sales or earnings estimates or publication of research reports by analysts;

- shortfalls in our operating results from levels forecasted by securities analysts;
- speculation in the press or investment community about our business or the shipping industry;
- changes in market valuations of similar companies and stock market price and volume fluctuations generally;
- payment of dividends;
- strategic actions by us or our competitors such as mergers, acquisitions, strategic alliances or restructurings;
- changes in government and other regulatory developments;
- additions or departures of key personnel;
- general market conditions and the state of the securities markets; and
- domestic and international economic, market and currency factors unrelated to our performance.

The international drybulk and container shipping industry has been highly unpredictable. In addition, the stock markets in general, and the markets for drybulk and container shipping and shipping stocks in general, have experienced extreme volatility that has sometimes been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock. Our shares may trade at prices lower than you originally paid for such shares.

The market price of our common stock has recently, at times, dropped below $5.00 per share, and the last reported sale price on the Nasdaq Global Select Market on May 15, 2009 was $5.29 per share. If the market price of our common stock remains below $5.00 per share, under stock exchange rules, our shareholders will not be able to use such shares as collateral for borrowing in margin accounts. This inability to continue to use our common stock as collateral may lead to sales of such shares creating downward pressure on and increased volatility in the market price of our common stock.

In addition, under the rules of the Nasdaq Stock Market, listed companies have historically been required to maintain a share price of at least $1.00 per share and if the share price declines below $1.00 for a period of 30 consecutive business days, then the listed company would have a cure period of at least 180 days to regain compliance with the $1.00 per share minimum. In light of recently deteriorating market conditions, under a rule change recently approved by the Securities and Exchange Commission, the Nasdaq Stock Market has temporarily suspended the minimum share price requirement through April 19, 2009. Following the expiration of the suspension, in the event that our share price declines below $1.00 for a period of 30 consecutive business days, we may be required to take action, such as a reverse stock split, in order to comply with Nasdaq rules that may be in effect at the time.

Our Articles of Incorporation and Bylaws contain anti-takeover provisions that may discourage, delay or prevent (1) our merger or acquisition and/or (2) the removal of incumbent directors and officers.

Our current Articles of Incorporation and Bylaws contain certain anti-takeover provisions. These provisions include blank check preferred stock, the prohibition of cumulative voting in the election of directors, a classified board of directors, advance written notice for shareholder nominations for directors, removal of directors only for cause, advance written notice of shareholder proposals for the removal of directors and limitations on action by shareholders. These provisions, either individually or in the aggregate, may discourage, delay or prevent (1) our merger or acquisition by means of a tender offer, a proxy contest or otherwise, that a shareholder may consider in its best interest

and (2) the removal of incumbent directors and officers.

Future sales of our stock could cause the market price of our common stock to decline.

Sales of a substantial number of shares of our common stock in the public market, or the perception that these sales could occur, may depress the market price for our common stock. These sales could also impair our ability to raise additional capital through the sale of our equity securities in the future.

In 2007, we issued a total of 17,325,000 new shares as part of our three common stock offerings. Additionally, 248,463 and 171,998 shares were issued upon the exercise of our warrants in 2007, and, in 2008, respectively. In addition, as of May 1, 2009, 144,913 warrants remain outstanding. Friends, our largest shareholder, and Eurobulk Marine, Inc., our affiliate, have registered for resale all of their shares owned as of July 2, 2008 under our registration statement that was declared effective on July 2, 2008 which has resulted in these shares becoming freely tradable without restriction under the Securities Act.

We may issue additional shares of our stock in the future and our stockholders may elect to sell large numbers of shares held by them from time to time. Our amended and restated articles of incorporation authorize us to issue up to 100,000,000 shares of common stock and 20,000,000 shares of preferred stock.

Sales of a substantial number of any of the shares of common stock mentioned above may cause the market price of our common stock to decline.

Because the Republic of the Marshall Islands, where we are incorporated, does not have a well-developed body of corporate law, shareholders may have fewer rights and protections than under typical United States law, such as Delaware, and shareholders may have difficulty in protecting their interest with regard to actions taken by our Board of Directors.

Our corporate affairs are governed by our Articles of Incorporation and Bylaws and by the Marshall Islands Business Corporations Act (the "BCA"). The provisions of the BCA resemble provisions of the corporation laws of a number of states in the United States. However, there have been few judicial cases in the Republic of the Marshall Islands interpreting the BCA. The rights and fiduciary responsibilities of directors under the law of the Republic of the Marshall Islands are not as clearly established as the rights and fiduciary responsibilities of directors under statutes or judicial precedent in existence in certain U.S. jurisdictions. Stockholder rights may differ as well. For example, under Marshall Islands law, a copy of the notice of any meeting of the shareholders must be given not less than 15 days before the meeting, whereas in Delaware such notice must be given not less than 10 days before the meeting. Therefore, if immediate shareholder action is required, a meeting may not be able to be convened as quickly as it can be convened under Delaware law. Also, under Marshall Islands law, any action required to be taken by a meeting of shareholders may only be taken without a meeting if consent is in writing and is signed by all of the shareholders entitled to vote, whereas under Delaware law action may be taken by consent if approved by the number of shareholders that would be required to approve such action at a meeting. Therefore, under Marshall Islands law, it may be more difficult for a company to take certain actions without a meeting even if a majority of the shareholders approve of such action. While the BCA does specifically incorporate the non-statutory law, or judicial case law, of the State of Delaware and other states with substantially similar legislative provisions, public shareholders may have more difficulty in protecting their interests in the face of actions by the management, directors or controlling shareholders than would shareholders of a corporation incorporated in a U.S. jurisdiction.

Item 4.

Information on the Company

A. History and Development of the Company

Euroseas Ltd. is a Marshall Islands company incorporated in May 2005. We are a provider of worldwide ocean-going transportation services. We own and operate drybulk carriers that transport major bulks such as iron ore, coal and grains, and minor bulks such as bauxite, phosphate and fertilizers. We also own and operate containerships and multipurpose vessels that transport dry and refrigerated containerized cargoes, mainly including manufactured products and perishables. As of May 1, 2009, our fleet consisted of five drybulk carriers, comprised of three Panamax, one Handymax and one Handysize drybulk carriers, ten containerships and one multipurpose vessel. The total cargo carrying capacity of the five drybulk carriers is 296,479 deadweight tons, or dwt, and of the ten containerships is 273,687 dwt and 17,877 twenty-foot equivalent units, or teu. Our multipurpose vessel can carry 22,568 dwt and/or 950 teu. Three of our vessels were acquired before January 1, 2004 and were controlled by the Pittas family interests. On June 29, 2005, the shareholders of the three vessels (and of four additional vessels that have since been sold) transferred their shares in each of the vessels to Euroseas in exchange for shares in Friends, a 100% owner of Euroseas at that time. We have purchased fourteen additional vessels since June 2005, of which we sold one in January 2009.

On August 25, 2005, we raised approximately $17.5 million in net proceeds from the private placement of our securities to a number of institutional and accredited investors (the "Private Placement"). In the Private Placement, we issued 2,342,331 shares of common stock at a price of $9.00 per share (adjusted for the 1-for-3 reverse split of our common stock effected on October 6, 2006), as well as warrants to purchase an additional 585,589 shares of common stock. The warrants have a five year term and an exercise price of $10.80 per share (adjusted for the 1-for-3 reverse split of our common stock).

On February 5, 2007, we raised approximately $43.3 million in net proceeds from a follow-on common stock offering. On July 5, 2007, we raised approximately $73.0 million in net proceeds from a follow-on common stock offering. On November 9, 2007, we raised approximately $93.6 million in net proceeds from a follow-on common stock offering.

Our shares originally traded on the OTCBB under the symbol ESEAF.OB until October 5, 2006 and EUSEF.OB from October 6, 2006 to January 30, 2007. Our shares have traded on the NASDAQ Global Market under the symbol ESEA since January 31, 2007 and on the NASDAQ Global Select Market since January 1, 2008.

Our executive offices are located at 40 Ag. Konstantinou Ave., 151 24, Maroussi, Greece. Our telephone number is +30-211-1804005.

B. Business Overview

Our fleet consists of: (i) drybulk carriers that transport iron ore, coal, grain and other dry cargoes along worldwide shipping routes; (ii) containerships that transport container boxes providing scheduled service between ports; and (iii) multipurpose vessels that can carry either drybulk cargoes or containers. Please see information in the section "Our Fleet", below. During 2004, 2005, 2006, 2007 and 2008 we had a fleet utilization of 99.5%, 98.5%, 98.9%, 99.7% and 98.0%, respectively, our vessels achieved daily time charter equivalent rates of $17,839, $17,485, $14,313, $21,468 and $23,693, respectively, and we generated revenues of $45.72 million, $44.52 million, $42.14 million, $86.10 million and $132.24 million, respectively.

Our business strategy is focused on providing consistent shareholder returns by carefully selecting the timing and the structure of our investments in drybulk and containership vessels and by reliably, safely and competitively operating the vessels we own, through our affiliate, Eurobulk. Representing a continuous shipowning and management history that dates back to the 19th century, we believe that one of our advantages in the industry is our ability to select and safely operate drybulk and containership vessels of any age. We continuously evaluate sale and purchase opportunities, as well as long term employment opportunities for our vessels.

Our Fleet

As of May 15, 2009, the profile and deployment of our fleet is the following:

Name	Type	Dwt	TEU	Year Built	Employment	TCE Rate ($/day)
Dry Bulk Vessels						
ELENI P	Panamax	72,119		1997	Spot 'til late May-09 Expected TC 'til late May-10	$15,350
IRINI (*)	Panamax	69,734		1988	Baumarine Pool	
ARISTIDES N.P.	Panamax	69,268		1993	TC 'til Jan-10	$12,350
MONICA P (**)	Handymax	46,667		1998	Bulkhandling Pool	
GREGOS	Handysize	38,691		1984	Spot	
Total Dry Bulk Vessels	5	296,479				
Multipurpose Dry Cargo Vessels						
TASMAN TRADER	1	22,568	950	1990	TC 'til Mar-12	$9,500 'til Dec-10, $9,000 'til Mar-12
Container Carriers						
MAERSK NOUMEA	Intermediate	34,677	2,556	2001	TC 'til Aug-11 (3 annual options 'til Aug-14)	$16,800 'til Aug 11 $18,735 'til Aug 12 $19,240 'til Aug 13 $19,750 'til Aug 14
TIGER BRIDGE	Intermediate	31,627	2,228	1990	TC 'til Mar-10	$7,500
ARTEMIS	Intermediate	29,693	2,098	1987	Laid-up	
DESPINA P	Handy size	33,667	1,932	1990	Laid-up	

JONATHAN P (ex- OEL INTEGRITY)	Handy size	33,667	1,932	1990	Laid-up	
OEL TRANSWORLD (ex-CLAN GLADIATOR)	Handy size	30,007	1,742	1992	TC 'til Oct-09 'til Oct-10 (owner's option)	\$12,000 \$10,000 (owner's option)
YM XINGANG I	Handy size	23,596	1,599	1993	TC 'til Jul-09	\$26,650
MANOLIS P	Handy size	20,346	1,452	1995	TC 'til Oct-09	\$15,800

NINOS (ex-YM QINGDAO I)	Feeder	18,253	1,169	1990	TC 'til Apr-10	$8,060
KUO HSIUNG	Feeder	18,154	1,169	1993	TC 'til Dec-09 (option 'til Jun-10)	$4,100 'til Jun-09 $3,850 'til Jun-10
Total Container Carriers	10	273,687	17,877			
Fleet Grand Total	16	592,734	18,827			

(*) "Irini" is employed in the Baumarine spot pool that is managed by Klaveness, a major global charterer in the drybulk area.
(**) "Monica P" is employed in the Bulkhandling spot pool that is managed by Klaveness, a major global charterer in the drybulk area.

We plan to expand our fleet by investing in vessels in the drybulk, containership and multipurpose markets by targeting primarily mid-age vessels at the time of purchase under favorable market conditions. We also intend to take advantage of the cyclical nature of the market by buying and selling ships when we believe favorable opportunities exist. We employ our vessels in the spot and time charter market, through pool arrangements and under contracts of affreightment. Presently, seven of our containerships, our multipurpose vessel and one of our panamax bulkers are employed under time charters. One of our other panamax vessel, m/v Irini, is employed in the Baumarine pool that is managed by Klaveness, a major global charterer in the drybulk area. Our handymax vessel is employed in the Bulkhandling pool, also managed by Klaveness. In addition, our third panamax vessel and our handysize vessel are currently operating in the spot market.

As of May 1, 2009, approximately 70% of our ship capacity days in 2009 accounting for fixed spot employment in the first and second quarter of the year, and approximately 43% of our ship capacity days in 2010, are under time charter contracts or protected from market fluctuations (via FFA contracts).

Management of Our Fleet

The operations of our vessels are managed by Eurobulk Ltd., or Eurobulk, an affiliated company, under a Master Management Agreement with us and separate management agreements with each ship-owning company. Eurobulk was founded in 1994 by members of the Pittas family and is a reputable ship management company with strong industry relationships and experience in managing vessels. Under our master management agreement, Eurobulk is responsible for providing us with executive services and commercial management services, which include obtaining employment for our vessels and managing our relationships with charterers. Eurobulk also performs technical management services, which include managing day-to-day vessel operations, performing general vessel maintenance, ensuring regulatory and classification society compliance, supervising the maintenance and general efficiency of vessels, arranging our hire of qualified officers and crew, arranging and supervising drydocking and repairs, arranging insurance for vessels, purchasing stores, supplies, spares and new equipment for vessels, appointing supervisors and technical consultants and providing technical support and shoreside personnel who carry out the management functions described above and certain accounting services.

Our Master Management Agreement with Eurobulk is effective as of February 7, 2008 and has an initial term of 5 years until February 6, 2013. The Master Management Agreement cannot be terminated by Eurobulk without cause or under other limited circumstances, such as sale of the Company or Eurobulk or the bankruptcy of either party. This Master Management Agreement will automatically be extended after the initial period for an additional five year period unless terminated on or before the 90th day preceding the initial termination date. Pursuant to the Master Management Agreement, each new vessel we acquire in the future will enter into a separate five year management agreement with Eurobulk.

In exchange for providing us with the services described above, we pay Eurobulk 655 euros per vessel per day adjusted annually for inflation.

Our Competitive Strengths

We believe that we possess the following competitive strengths:

- Experienced Management Team. Our management team has significant experience in all aspects of commercial, technical, operational and financial areas of our business. Aristides J. Pittas, our Chairman and Chief Executive Officer, holds a dual graduate degree in Naval Architecture and Marine Engineering and Ocean Systems Management from the Massachusetts Institute of Technology. He has worked in various technical, shipyard and ship management capacities and since 1991 has focused on the ownership and operation of vessels carrying dry cargoes. Dr. Anastasios Aslidis, our Chief Financial Officer, holds a Ph.D. in Ocean Systems Management also from Massachusetts Institute of Technology and has over 20 years of experience, primarily as a partner at a Boston based international consulting firm focusing on investment and risk management in the maritime industry.

- Cost Effective Vessel Operations. We believe that because of the efficiencies afforded to us through Eurobulk, the strength of our management team and the quality of our fleet, we are, and will continue to be, a reliable, low cost vessel operator, without compromising our high standards of performance, reliability and safety. Despite the average age of our fleet being approximately 18 years during 2008, our total vessel operating expenses, including management fees and general and administrative expenses were $6,469 per day for the year ended December 31, 2008. We consider this amount to be among the lowest of the publicly listed drybulk shipping companies in the U.S. Our technical and operating expertise allows us to efficiently manage and transport a wide range of cargoes with a flexible trade route profile, which helps reduce ballast time between voyages and minimize off-hire days. Our professional, well-trained masters, officers and on board crews further help us to control costs and ensure consistent vessel operating performance. We actively manage our fleet and strive to maximize utilization and minimize maintenance expenditures. For the year ended December 31, 2008, our fleet utilization was 98.0% and since 2003 our utilization rate has averaged around of 99.0%.

- Strong Relationships with Customers and Financial Institutions. We believe Eurobulk and the Pittas family have developed strong industry relationships and have gained acceptance with charterers, lenders and insurers because of their long-standing reputation for safe and reliable service and financial responsibility through various shipping cycles. Through Eurobulk, we offer reliable service and cargo carrying flexibility that enables us to attract customers and obtain repeat business. We also believe that the established customer base and reputation of Eurobulk and the Pittas family helps us to secure favorable employment for our vessels with well known charterers.

Our Business Strategy

Our business strategy is focused on providing consistent shareholder returns by carefully timing and structuring acquisitions of drybulk carriers and containerships and by reliably, safely and competitively operating our vessels through Eurobulk. We continuously evaluate purchase and sale opportunities, as well as long term employment opportunities for our vessels.

- Renew and Expand our Fleet. We expect to grow our fleet in a disciplined manner through timely and selective acquisitions of quality vessels. We perform in-depth technical review and financial analysis of each potential acquisition and only purchase vessels as market conditions and developments present themselves. We continue to be focused on purchasing well-maintained secondhand vessels, which should provide a significant value proposition given the depressed price levels that exist currently. However, we will also consider purchasing newbuildings or newbuilding resales if the value proposition exists at the time. Furthermore, as part of our fleet renewal, we will continue to sell certain vessels when we believe it is in the best interests of the Company and our shareholders.

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Maintain Balanced Employment. We intend to strategically employ our fleet between time and spot charters. We actively pursue time charters to obtain adequate cash flow to cover as much as possible of our fleet's fixed costs, consisting of vessel operating expenses, management fees, general and administrative expenses, interest expense and drydocking costs for the upcoming 12-month period. We also use FFA contracts – as a substitute for time charter employment - to partly provide coverage for our drybulk vessels in order to increase the predictability of our revenues. We look to deploy the remainder of our fleet through spot charters, shipping pools or contracts of affreightment depending on our view of the direction of the markets and other tactical or strategic considerations. We believe this balanced employment strategy will provide us with more predictable operating cash flows and sufficient downside protection, while allowing us to participate in the potential upside of the spot market during periods of rising charter rates. As of May 1, 2009, on the basis of our fixed spot and existing time charters and FFA contracts, approximately 70% of our vessel capacity in 2009 and approximately 43% in 2010 are fixed, which will help protect us from market fluctuations, enable us to make significant principal and interest payments on our debt and pay dividends to our shareholders.

- Operate a Fleet in Two Sectors. While remaining focused on the dry cargo segment of the shipping industry, we intend to continue to develop a diversified fleet of drybulk carriers and containerships of up to Panamax size. A diversified drybulk fleet profile will allow us to better serve our customers in both major and minor drybulk trades, as well as to reduce any dependency on any one cargo, trade route or customer. We will remain focused on the smaller size ship segment of the container market, which has not experienced the same level of expansion in vessel supply that has occurred with larger containerships. A diversified fleet, in addition to enhancing the stability of our cash flows, will also help us to reduce our exposure to unfavorable developments in any one shipping sector and to benefit from upswings in any one shipping sector experiencing rising charter rates.

- Optimize Use of Financial Leverage. We will use bank debt to partly fund our vessel acquisitions and increase financial returns for our shareholders. We actively assess the level of debt we incur in light of our ability to repay that debt based on the level of cash flow generated from our balanced chartering strategy and efficient operating cost structure. Our debt repayment schedule as of December 31, 2008 plus the repayment schedule of $20.00 million of new debt that we assumed in early 2009 call for a reduction of more than 38% of our debt by the end of 2010. We expect this will increase our ability to borrow funds to make additional vessel acquisitions in order to grow our fleet and continue pay dividends to our shareholders.

Our Customers

Our major charterer customers during the last three years include Klaveness (Baumarine shipping pool), Sinochart, Cheng Lie, Yang Ming Lines and Italia Maritima. We are a relationship driven company, and our top five customers in 2008 include three of our top five customers from 2007 (Sinochart, Klaveness and Yang Ming Lines). Our top five customers accounted for approximately 44% of our total revenues in 2008, 53% of our total revenues in 2007 and 60% of our total revenues in 2006. In 2008, our largest five customers, Sinochart, Klaveness, ICI, Yang Ming Lines, and Italia Maritima, accounted for 13.80%, 8.8%, 7.9%, 7.3% and 6.3% of our total revenues, respectively.

	Year ended December 31,		
Charterer	2006	2007	2008
A	-	12.10%	13.80%
B	15.06%	15.07%	8.81%
C	-	-	7.88%
D	10.40%	12.53%	7.27%
E	-	-	6.25%
F	16.63%	7.60%	5.14%
G	12.67%	5.19%	4.38%
H	5.32%	-	-

The Dry Cargo and Containership Industries

Dry cargo shipping refers to the transport of certain commodities by sea between various ports in bulk or containerized form.

The drybulk commodities are often divided into two categories — major bulks and minor bulks. Major bulks include items such as coal, iron ore and grains, while minor bulks include items such as aluminum, phosphate rock, fertilizer raw materials, agricultural and mineral cargo, cement, forest products and some steel products, including scrap.

There are four main classes of drybulk carriers — Handysize, Handymax, Panamax and Capesize. These classes represent the sizes of the vessel carrying the cargo in terms of deadweight ton ("dwt") capacity, which is defined as the total weight including cargo that the vessel can carry when loaded to a defined load line on the vessel. Handysize vessels are the smallest of the four categories and include those vessels weighing up to 40,000 dwt. Handymax carriers are those vessels that weigh between 40,000 and 60,000 dwt, while Panamax vessels are those ranging from 60,000 dwt to 80,000 dwt. Vessels over 80,000 dwt are called Capesize vessels.

Drybulk carriers are ordinarily chartered either through a voyage charter or a time charter, under a longer term contract of affreightment or in pools. Under a voyage charter, the owner agrees to provide a vessel for the transport of cargo between specific ports in return for the payment of an agreed freight rate per ton of cargo or an agreed dollar lump sum amount. Voyage costs, such as canal and port charges and bunker expenses, are the responsibility of the owner. Under a time charter, the ship owner places the vessel at the disposal of a charterer for a given period of time in return for a specified rate (either hire per day or a specified rate per dwt capacity per month) with the voyage costs being the responsibility of the charterer. In both voyage charters and time charters, operating costs (such as repairs and maintenance, crew wages and insurance premiums), as well as drydockings and special surveys, are the responsibility of the ship owner. The duration of time charters varies, depending on the evaluation of market trends by the ship owner and by charterers. Occasionally, drybulk vessels are chartered on a bareboat basis. Under a bareboat charter, operations of the vessels and all operating costs are the responsibility of the charterer, while the owner only pays the financing costs of the vessel.

A contract of affreightment ("COA") is another type of charter relationship where a charterer and a ship owner enter into a written agreement pursuant to which identified cargo will be carried over a specified period of time. COA's benefit charterers by providing them with fixed transport costs for a commodity over an identified period of time. COA's benefit ship owners by offering ascertainable revenue over that same period of time and eliminating the uncertainty that would otherwise be caused by the volatility of the charter market. A shipping pool is a collection of similar vessel types under various ownerships, placed under the care of a single commercial manager. The manager markets the vessels as a single fleet and collects the earnings which are distributed to individual owners under a pre-arranged weighing system by which each entered vessel receives its share. Pools have the size and scope to combine voyage charters, time charters and contracts of affreightment with freight forward agreements for hedging purposes, to perform more efficient vessel scheduling thereby increasing fleet utilization.

Containership shipping refers to the transport of containerized trade which encompasses mainly the carriage of finished goods, but an increasing number of other cargoes in container boxes. Containerized trade is the fastest growing sector of seaborne trade. Containerships are further categorized by their size measured in twenty-foot equivalent units (teu) and whether they have their own gearing. The different categories of containerships are as follows. Post-panamax vessels are vessels with carrying capacity of more than 4,000 teu. Panamax vessels are vessels with carrying capacity from 3,000 to 4,000 teu. Intermediate containerships are vessels with carrying capacity from 2,000 to 3,000 teu. Handysize containerships are vessels with carrying capacity from 1,300 to 2,000 teu and are sometimes equipped with cargo loading and unloading gear. Finally, Feeder containerships are vessels with carrying

capacity from 500 to 1,300 teu and are usually equipped with cargo loading and unloading gear. Containerships are primarily employed in time charter contracts with liner companies, which in turn employ them as part of the scheduled liner operations. Feeder containership are put in liner schedules feeding containers to and from central regional ports (hubs) where larger containerships provide cross ocean or longer haul service. The length of the time charter contract can range from several months to years.

Our Competitors

We operate in markets that are highly competitive and based primarily on supply and demand. We compete for charters on the basis of price, vessel location, size, age and condition of the vessel, as well as on our reputation. Eurobulk arranges our charters (whether spot charters, time charters or shipping pools) through the use of Eurochart, an affiliated brokering company who negotiates the terms of the charters based on market conditions. We compete primarily with other shipowners of drybulk carriers in the Handysize, Handymax and Panamax drybulk carrier sectors and the containership sector. Ownership of drybulk carriers and containerships is highly fragmented and is divided among state controlled and independent shipowners. Some of our publicly listed competitors include Diana Shipping Inc. (NYSE: DSX), DryShips Inc. (NASDAQ: DRYS), Excel Maritime Carriers Ltd. (NYSE: EXM), Eagle Bulk Shipping Inc. (NASDAQ: EGLE), Genco Shipping and Trading Limited (NASDAQ: GSTL), Navios Maritime Holdings Inc. (NASDAQ: BULK), Danaos Corporation (NYSE: DAC) and Goldenport Holdings Inc. (LSE: GPRT).

Seasonality

Coal, iron ore and grains, which are the major bulks of the drybulk shipping industry, are somewhat seasonal in nature. The energy markets primarily affect the demand for coal, with increases during hot summer periods when air conditioning and refrigeration require more electricity and towards the end of the calendar year in anticipation of the forthcoming winter period. The demand for iron ore tends to decline in the summer months because many of the major steel users, such as automobile makers, reduce their level of production significantly during the summer holidays. Grains are completely seasonal as they are driven by the harvest within a climate zone. Because three of the five largest grain producers (the United States of America, Canada and the European Union) are located in the northern hemisphere and the other two (Argentina and Australia) are located in the southern hemisphere, harvests occur throughout the year and grains require drybulk shipping accordingly.

The containership industry seasonal trends are driven by the import patterns of manufactured goods and refrigerated cargoes by the major importers, such as the United States, Europe, Japan and others. The volume of containerized trade is usually higher in the fall in preparation for the holiday season. During this period of time, container shipping rates are higher and, as a result, the charter rates for containerships are higher. However, fluctuations due to seasonality in the container shipping industry are much less pronounced than in the drybulk shipping industry.

Environmental and Other Regulations

Government regulation significantly affects the ownership and operation of our vessels. Our vessels are subject to international conventions and national, state and local laws and regulations in force in the countries in which our vessels may operate or are registered.

A variety of governmental and private entities subject our vessels to both scheduled and unscheduled inspections. These entities include the local port authorities (U.S. Coast Guard, harbor master or equivalent), classification societies, flag state administration (country of registry) and charterers. Certain of these entities require us to obtain permits, licenses and certificates for the operation of our vessels. Failure to maintain necessary permits or approvals could require us to incur substantial costs or temporarily suspend operation of one or more of our vessels.

We believe that the heightened level of environmental and quality concerns among insurance underwriters, regulators and charterers is leading to greater inspection and safety requirements on all vessels and may accelerate the scrapping of older vessels throughout the industry. Increasing environmental concerns have created a demand for vessels that conform to the stricter environmental standards. We are required to maintain operating standards for all of our vessels that will emphasize operational safety, quality maintenance, continuous training of our officers and crews and compliance with U.S. and international regulations. We believe that the operation of our vessels is in substantial

compliance with applicable environmental laws and regulations; however, because such laws and regulations are frequently changed and may impose increasingly stricter requirements, such future requirements may limit our ability to do business, increase our operating costs, force the early retirement of our vessels, and/or affect their resale value, all of which could have a material adverse effect on our financial condition and results of operations.

31

Environmental Regulation – International Maritime Organization ("IMO")

The IMO has negotiated international conventions that impose liability for oil pollution in international waters and a signatory's territorial waters. In September 1997, the IMO adopted Annex VI to the International Convention for the Prevention of Pollution from Ships, or MARPOL Convention, to address air pollution from ships. Annex VI was ratified in May 2004, and became effective in May 2005. Annex VI sets limits on sulfur oxide and nitrogen oxide emissions from ship exhausts and prohibits deliberate emissions of ozone depleting substances, such as chlorofluorocarbons. Annex VI also includes a global cap on the sulfur content of fuel oil and allows for special areas to be established with more stringent controls on sulfur emissions. Our vessel manager has informed us that a plan to conform with the Annex VI regulations is in place and we believe we are in substantial compliance with Annex VI.

Additional or new conventions, laws and regulations may be adopted that could require the installation of expensive emission control systems and could adversely affect our business, results of operations, cash flows and financial condition. In October 2008, the IMO adopted amendments to Annex VI regarding nitrogen oxide and sulfur oxide emissions standards which are expected to enter into force on July 1, 2010. The amended Annex VI would reduce air pollution from vessels by, among other things, (i) implementing a progressive reduction of sulfur oxide emissions from ships, with the global sulfur cap reduced initially to 3.50% (from the current cap of 4.50%), effective from January 1, 2012, then progressively to 0.50%, effective from January 1, 2020, subject to a feasibility review to be completed no later than 2018; and (ii) establishing new tiers of stringent nitrogen oxide emissions standards for new marine engines, depending on their date of installation. Once these amendments become effective, we may incur costs to comply with these revised standards.

On October 9, 2008, the United States ratified the amended Annex VI to the MARPOL Convention, which went into effect on January 8, 2009. The U.S. Environmental Protection Agency, or EPA, and the state of California, however, have each proposed more stringent regulations of air emissions from ocean-going vessels. On July 24, 2008, the California Air Resources Board of the State of California, or CARB, approved clean-fuel regulations applicable to all vessels sailing within 24 miles of the California coastline whose itineraries call for them to enter any California ports, terminal facilities, or internal or estuarine waters. The new CARB regulations require such vessels to use low sulfur marine fuels rather than bunker fuel. By July 1, 2009, such vessels are required to switch either to marine gas oil with a sulfur content of no more than 1.5% or marine diesel oil with a sulfur content of no more than 0.5%. By 2012, only marine gas oil and marine diesel oil fuels with 0.1% sulfur will be allowed. CARB unilaterally approved the new regulations in spite of legal defeats at both the district and appellate court levels, but more legal challenges are expected to follow. If CARB prevails and the new regulations go into effect as scheduled on July 1, 2009, in the event our vessels were to travel within such waters, these new regulations would require significant expenditures on low-sulfur fuel and would increase our operating costs. Finally, although the more stringent CARB regime was technically superseded when the United States ratified and implemented the amended Annex VI, the possible declaration of various U.S. coastal waters as Emissions Control Areas may in turn bring U.S. emissions standards into line with the new CARB regulations, which would cause us to incur further costs.

In March 2006, the IMO amended Annex I to the MARPOL Convention, including a new regulation relating to oil fuel tank protection, which became effective August 1, 2007. The new regulation will apply to various ships delivered on or after August 1, 2010. It includes requirements for the protected location of the fuel tanks, performance standards for accidental oil fuel outflow, a tank capacity limit and certain other maintenance, inspection and engineering standards.

The IMO adopted the International Convention on Civil Liability for Bunker Oil Pollution Damage, or the Bunker Convention, to impose strict liability on ship owners for pollution damage in jurisdictional waters of ratifying states caused by discharges of bunker fuel. The Bunker Convention, which became effective on November 21, 2008, requires registered owners of ships over 1,000 gross tons to maintain insurance for pollution damage in an amount

equal to the limits of liability under the applicable national or international limitation regime (but not exceeding the amount calculated in accordance with the Convention on Limitation of Liability for Maritime Claims of 1976, as amended). With respect to non-ratifying states, liability for spills or releases of oil carried as fuel in ship's bunkers typically is determined by the national or other domestic laws in the jurisdiction where the events or damages occur.

In 2001, the IMO adopted the International Convention on the Control of Harmful Anti-fouling Systems on Ships, or the Anti-fouling Convention. The Anti-fouling Convention prohibits the use of organotin compound coatings to prevent the attachment of mollusks and other sea life to the hulls of vessels after September 1, 2003. The exteriors of vessels constructed prior to January 1, 2003 that have not been in drydock must, as of September 17, 2008, either not contain the prohibited compounds or have coatings applied to the vessel exterior that act as a barrier to the leaching of the prohibited compounds. Vessels of over 400 gross tons engaged in international voyages must obtain an International Anti-fouling System Certificate and undergo a survey before the vessel is put into service or when the anti-fouling systems are altered or replaced.

The operation of our vessels is also affected by the requirements set forth in the IMO's ISM Code. The ISM Code requires shipowners and bareboat charterers to develop and maintain an extensive "Safety Management System" that includes the adoption of a safety and environmental protection policy setting forth instructions and procedures for safe operation and describing procedures for dealing with emergencies. The failure of a shipowner or management company to comply with the ISM Code may subject such party to increased liability, may decrease available insurance coverage for the affected vessels, and may result in a denial of access to, or detention in, certain ports. Currently, each of our vessels is ISM Code-certified. However, we may not be able to maintain such certification indefinitely.

Environmental Regulation – The United States of America Oil Pollution Act of 1990 ("OPA")

OPA established an extensive regulatory and liability regime for the protection and cleanup of the environment from oil spills. OPA affects all shipowners and operators whose vessels trade in the United States of America, its territories and possessions or whose vessels operate in waters of the United States of America, which includes the territorial sea of the United States of America and its 200 nautical mile exclusive economic zone.

Under OPA, vessel owners, operators, charterers and management companies are "responsible parties" and are jointly, severally and strictly liable (unless the spill results solely from the act or omission of a third party, an act of God or an act of war) for all containment and clean-up costs and other damages arising from discharges or threatened discharges of oil from their vessels, including bunkers (fuel).

OPA was amended in 2006 to increase the limits of the liability of responsible parties for non-tank vessels to the greater of $950 per gross ton or $800,000 (subject to possible adjustment for inflation). These limits of liability do not apply if an incident was directly caused by violation of applicable United States federal safety, construction or operating regulations or by a responsible party's gross negligence or willful misconduct, or if the responsible party fails or refuses to report the incident or to cooperate and assist in connection with oil removal activities.

We currently maintain for each of our vessels pollution liability coverage insurance in the amount of $1 billion per incident. If the damages from a catastrophic pollution liability incident exceed our insurance coverage, the payment of those damages may materially decrease our net income.

OPA requires shipowners and operators of vessels to establish and maintain with the United States Coast Guard evidence of financial responsibility sufficient to meet their potential liabilities under OPA. In December 1994, the Coast Guard implemented regulations requiring evidence of financial responsibility for non-tank vessels in the amount of $900 per gross ton, which includes the OPA limitation on liability of $600 per gross ton and the U.S. Comprehensive Environmental Response, Compensation, and Liability Act, or CERCLA, liability limit of $300 per gross ton. On October 17, 2008, the U.S. Coast Guard regulatory requirements under OPA and CERCLA were amended to require evidence of financial responsibility in amounts that reflect the higher limits of liability imposed by the 2006 amendments to OPA, as described above. The increased amounts became effective on January 15, 2009. In addition, on September 24, 2008, the U.S. Coast Guard proposed adjustments to the limits of liability for non-tank vessels that would further increase the limits to the greater of $1,000 per gross ton or $848,000 and establish a procedure for adjusting the limits for inflation every three years. The U.S. Coast Guard is currently soliciting comments on the proposal. Under the regulations, vessel owners and operators may evidence their financial responsibility by showing proof of insurance, surety bond, self-insurance or guaranty. Under OPA, an owner or operator of a fleet of vessels is required only to demonstrate evidence of financial responsibility in an amount sufficient to cover the vessels in the fleet having the greatest maximum liability under OPA.OPA specifically permits individual states to impose their own liability regimes with regard to oil pollution incidents occurring within their boundaries, and some states have enacted legislation that impose strict liability on a person for removal costs and damages resulting from a discharge of oil or a release of a hazardous substance. These laws may be more stringent than U.S. federal law. In some cases, states, which have enacted such legislation, have not yet issued implementing regulations defining vessels owners' responsibilities under these laws. We currently comply, and intend to comply in the future, with all applicable state regulations in the ports where our vessels call.

Environmental Regulation – The United States of America Clean Water Act

The U.S. Clean Water Act, or CWA, prohibits the discharge of oil or hazardous substances in navigable waters and imposes strict liability in the form of penalties for any unauthorized discharges. The CWA also imposes substantial liability for the costs of removal, remediation and damages and compliments the remedies available under OPA and CERCLA.

Currently, under EPA regulations that have been in place since 1978, vessels are exempt from the requirement to obtain CWA permits for the discharge in U.S. ports of ballast water and other substances incidental to the normal operation of vessels. However, on March 30, 2005, the United States District Court for the Northern District of California ruled in Northwest Environmental Advocate v. EPA, 2005 U.S. Dist. LEXIS 5373, that the EPA exceeded its authority in creating an exemption for ballast water. On September 18, 2006, the court issued an order granting permanent injunctive relief to the plaintiffs, invalidating the blanket exemption in the EPA's regulations for all discharges incidental to the normal operation of a vessel as of September 30, 2008, and directing the EPA to develop a system for regulating all discharges from vessels by that date. Under the Court's ruling, shipowners and operators of vessels visiting U.S. ports would be required to comply with the CWA permitting program to be developed by the EPA or face penalties. The EPA appealed the District Court's decision, and the Ninth Circuit Court of Appeals affirmed the decision on July 23, 2008.

In response to the invalidation and removal of the EPA's vessel exemption by the Ninth Circuit, the EPA has enacted rules governing the regulation of ballast water discharges and other discharges incidental to the normal operation of vessels within U.S. waters. Under the new rules, which took effect February 6, 2009, commercial vessels 79 feet in length or longer (other than commercial fishing vessels), or Regulated Vessels, are required to obtain a CWA permit regulating and authorizing such normal discharges. This permit, which the EPA has designated as the Vessel General Permit for Discharges Incidental to the Normal Operation of Vessels, or VGP, incorporates the current U.S. Coast Guard requirements for ballast water management as well as supplemental ballast water requirements, and includes limits applicable to 26 specific discharge streams, such as deck runoff, bilge water and gray water.

34

For each discharge type, among other things, the VGP establishes effluent limits pertaining to the constituents found in the effluent, including best management practices, or BMPs, designed to decrease the amount of constituents entering the waste stream. Unlike land-based discharges, which are deemed acceptable by meeting certain EPA-imposed numerical effluent limits, each of the 26 VGP discharge limits is deemed to be met when a Regulated Vessel carries out the BMPs pertinent to that specific discharge stream. The VGP imposes additional requirements on certain Regulated Vessel types that emit discharges unique to those vessels. Administrative provisions, such as inspection, monitoring, recordkeeping and reporting requirements are also included for all Regulated Vessels.

On August 31, 2008, the District Court ordered that the date for implementation of the VGP be postponed from September 30, 2008 until December 19, 2008. This date was further postponed until February 6, 2009 by the District Court. Although the VGP became effective on February 6, 2009, the VGP application procedure, known as the Notice of Intent, or NOI, has yet to be finalized. Accordingly, Regulated Vessels will effectively be covered under the VGP from February 6, 2009 until June 19, 2009, at which time the "eNOI" electronic filing interface will become operational. Thereafter, owners and operators of Regulated Vessels must file their NOIs prior to September 19, 2009, or the Deadline. Any Regulated Vessel that does not file an NOI by the Deadline will, as of that date, no longer be covered by the VGP and will not be allowed to discharge into U.S. navigable waters until it has obtained a VGP. Any Regulated Vessel that was delivered on or before the Deadline will receive final VGP permit coverage on the date that the EPA receives such Regulated Vessel's complete NOI. Regulated Vessels delivered after the Deadline will not receive VGP permit coverage until 30 days after their NOI submission. Our fleet is composed entirely of Regulated Vessels, and we intend to submit NOIs for each vessel in our fleet as soon after June 19, 2009 as practicable.

In addition, pursuant to §401 of the CWA which requires each state to certify federal discharge permits such as the VGP, certain states have enacted additional discharge standards as conditions to their certification of the VGP. These local standards bring the VGP into compliance with more stringent state requirements, such as those further restricting ballast water discharges and preventing the introduction of non-indigenous species considered to be invasive. The VGP and its state-specific regulations and any similar restrictions enacted in the future will increase the costs of operating in the relevant waters.

Environmental Regulation – The United States of America Clean Air Act

The U.S. Clean Air Act of 1970, as amended by the Clean Air Act Amendments of 1977 and 1990, or the CAA, requires the EPA to promulgate standards applicable to emissions of volatile organic compounds and other air contaminants. Our vessels are generally not subject to vapor control and recovery requirements for certain cargoes when loading, unloading, ballasting, cleaning and conducting other operations in regulated port areas. The CAA also requires states to draft State Implementation Plans, or SIPs, designed to attain national health-based air quality standards in primarily major metropolitan and/or industrial areas. Several SIPs regulate emissions resulting from vessel loading and unloading operations by requiring the installation of vapor control equipment.Our vessels operating in covered port areas are already equipped with vapor recovery systems that satisfy these requirements. Although a risk exists that new regulations could require significant capital expenditures and otherwise increase our costs, based on the regulations that have been proposed to date, we believe that no material capital expenditures beyond those currently contemplated and no material increase in costs are likely to be required.

Greenhouse Gas Regulation

In February 2005, the Kyoto Protocol to the United Nations Framework Convention on Climate Change, which we refer to as the Kyoto Protocol, entered into force. Pursuant to the Kyoto Protocol, adopting countries are required to implement national programs to reduce emissions of certain gases, generally referred to as greenhouse gases, which are suspected of contributing to global warming. Currently, the emissions of greenhouse gases from international shipping are not subject to the Kyoto Protocol. However, the European Union has indicated that it intends to propose

an expansion of the existing European Union emissions trading scheme to include emissions of greenhouse gases from vessels. In the United States, the California Attorney General and a coalition of environmental groups in October 2007 petitioned the EPA to regulate greenhouse gas emissions from ocean-going vessels under the CAA. Any passage of climate control legislation or other regulatory initiatives by the IMO, European Union, the United States or other countries where we operate that restrict emissions of greenhouse gases could require us to make significant financial expenditures we cannot predict with certainty at this time.

Environmental Regulation – Other Environmental Initiatives

In 2005, the European Union adopted a directive on ship-source pollution, imposing criminal sanctions for intentional, reckless or negligent pollution discharges by ships. The directive could result in criminal liability for pollution from vessels in waters of European countries that adopt implementing legislation. Criminal liability for pollution may result in substantial penalties or fines and increased civil liability claims.

Our operations occasionally generate and require the transportation, treatment and disposal of both hazardous and non-hazardous solid wastes that are subject to the requirements of the U.S. Resource Conservation and Recovery Act, or RCRA, or comparable state, local or foreign requirements. In addition, from time to time we arrange for the disposal of hazardous waste or hazardous substances at offsite disposal facilities. If such materials are improperly disposed of by third parties, we may still be held liable for clean up costs under applicable laws.

The U.S. National Invasive Species Act, or NISA, was enacted in 1996 in response to growing reports of harmful organisms being released into U.S. ports through ballast water taken on by ships in foreign ports. Under NISA, the U.S. Coast Guard adopted regulations in July 2004 imposing mandatory ballast water management practices for all vessels equipped with ballast water tanks entering U.S. waters. These requirements can be met by performing mid-ocean ballast exchange, by retaining ballast water on board the ship, or by using environmentally sound alternative ballast water management methods approved by the U.S. Coast Guard. (However, mid-ocean ballast exchange is mandatory for ships heading to the Great Lakes or Hudson Bay, or vessels engaged in the foreign export of Alaskan North Slope crude oil.) Mid-ocean ballast exchange is the primary method for compliance with the Coast Guard regulations, since holding ballast water can prevent ships from performing cargo operations upon arrival in the United States, and alternative methods are still under development. Vessels that are unable to conduct mid-ocean ballast exchange due to voyage or safety concerns may discharge minimum amounts of ballast water (in areas other than the Great Lakes and the Hudson River), provided that they comply with recordkeeping requirements and document the reasons they could not follow the required ballast water management requirements. The Coast Guard is developing a proposal to establish ballast water discharge standards, which could set maximum acceptable discharge limits for various invasive species, and/or lead to requirements for active treatment of ballast water.

At the international level, the IMO adopted an International Convention for the control and Management of Ships' Ballast Water and Sediments in February 2004 (the "BWM Convention"). The Convention's implementing regulations call for a phased introduction of mandatory ballast water exchange requirements (beginning in 2009), to be replaced in time with mandatory concentration limits. The BWM Convention will not enter into force until

12 months after it has been adopted by 30 states, the combined merchant fleets of which represent not less than 35% of the gross tonnage of the world's merchant shipping. To date there has not been sufficient adoption of this standard for it to take force.

Vessel Security Regulations

Since the terrorist attacks of September 11, 2001, there have been a variety of initiatives intended to enhance vessel security. On November 25, 2002, the Maritime Transportation Security Act of 2002 ("MTSA"), came into effect. To implement certain portions of the MTSA, in July 2003, the U.S. Coast Guard issued regulations requiring the implementation of certain security requirements aboard vessels operating in waters subject to the jurisdiction of the United States of America. Similarly, in December 2002, amendments to the International Convention for the Safety of Life at Sea ("SOLAS") created a new chapter of the convention dealing specifically with maritime security. The new chapter went into effect in July 2004, and imposes various detailed security obligations on vessels and port authorities, most of which are contained in the newly created ISPS Code. Among the various requirements are:

- on-board installation of automatic information systems ("AIS"), to enhance vessel-to-vessel and vessel-to-shore communications;
- on-board installation of ship security alert systems;
- the development of vessel security plans;
- ship identification number to be permanently marked on a vessel's hull;

- continuous synopsis record kept onboard showing a vessel's history including the name of the ship and of the state whose flag the ship is entitled to fly, the date on which the ship was registered with that state, the ship's identification number, the port at which the ship is registered and the name of the registered owner(s) and their registered address; and
- compliance with flag state security certification requirements.

The U.S. Coast Guard regulations, intended to align with international maritime security standards, exempt non-U.S. vessels from MTSA vessel security measures provided such vessels have on board, by July 1, 2004, a valid International Ship Security Certificate ("ISSC") that attests to the vessel's compliance with SOLAS security requirements and the ISPS Code. Our vessels are in compliance with the various security measures addressed by the MTSA, SOLAS and the ISPS Code. We do not believe these additional requirements will have a material financial impact on our operations.

Vessel Security Regulations

Since the terrorist attacks of September 11, 2001, there have been a variety of initiatives intended to enhance vessel security. On November 25, 2002, the Maritime Transportation Security Act of 2002 ("MTSA"), came into effect. To implement certain portions of the MTSA, in July 2003, the U.S. Coast Guard issued regulations requiring the implementation of certain security requirements aboard vessels operating in waters subject to the jurisdiction of the United States of America. Similarly, in December 2002, amendments to the International Convention for the Safety of Life at Sea ("SOLAS") created a new chapter of the convention dealing specifically with maritime security. The new chapter went into effect in July 2004, and imposes various detailed security obligations on vessels and port authorities, most of which are contained in the newly created ISPS Code. Among the various requirements are:

- on-board installation of automatic information systems ("AIS"), to enhance vessel-to-vessel and vessel-to-shore communications;
- on-board installation of ship security alert systems;
- the development of vessel security plans; and
- compliance with flag state security certification requirements.

The U.S. Coast Guard regulations, intended to align with international maritime security standards, exempt non-U.S. vessels from MTSA vessel security measures provided such vessels have on board, by July 1, 2004, a valid International Ship Security Certificate ("ISSC") that attests to the vessel's compliance with SOLAS security requirements and the ISPS Code. Our vessels are in compliance with the various security measures addressed by the MTSA, SOLAS and the ISPS Code. We do not believe these additional requirements will have a material financial impact on our operations.

Inspection by Classification Societies

The hull and machinery of every commercial vessel must be classed by a classification society authorized by its country of registry. The classification society certifies that a vessel is safe and seaworthy in accordance with the applicable rules and regulations of the country of registry of the vessel and SOLAS. Our vessels are currently classed with Lloyd's Register of Shipping, Bureau Veritas and Nippon Kaiji Kyokai. ISM and International Ship and Port Facilities Security ("ISPS") certification have been awarded by Bureau Veritas and the Panama Maritime Authority to our vessels and Eurobulk, our ship management company.

37

A vessel must undergo annual surveys, intermediate surveys, drydockings and special surveys. In lieu of a special survey, a vessel's machinery may be on a continuous survey cycle, under which the machinery would be surveyed periodically over a five-year period. Every vessel is also required to be drydocked every two to three years for inspection of the underwater parts of such vessel. If any vessel does not maintain its class and/or fails any annual survey, intermediate survey, drydocking or special survey, the vessel will be unable to carry cargo between ports and will be unemployable and uninsurable which could cause us to be in violation of certain covenants in our loan agreements. Any such inability to carry cargo or be employed, or any such violation of covenants, could have a material adverse impact on our financial condition and results of operations.

The following table lists the next drydocking and special survey for the vessels in our current fleet.

Vessel	Next	Type
TASMAN TRADER	June 2010	Special Survey
NINOS	July 2010	Special Survey
ARTEMIS	April 2010	Drydocking
YM XINGANG I	February 2011	Drydocking
ARISTIDES N.P.	February 2011	Drydocking
KUO HSIUNG	April 2011	Drydocking
IRINI	June 2011	Drydocking
GREGOS	July 2009	Special Survey
MANOLIS P	April 2010	Special Survey
OEL TRANSWORLD	April 2010	Drydocking
DESPINA P	January 2011	Special Survey
JONATHAN P	December 2010	Special Survey
TIGER BRIDGE	November 2010	Special Survey
MAERSK NOUMEA	August 2009	Intermediate Survey
MONICA P	February 2011	Drydocking
ELENI P	October 2009	Drydocking

Risk of Loss and Liability Insurance

General

The operation of any cargo vessel includes risks such as mechanical failure, physical damage, collision, property loss, cargo loss or damage and business interruption due to political circumstances in foreign countries, hostilities and labor strikes. In addition, there is always an inherent possibility of marine disaster, including oil spills and other environmental mishaps, and the liabilities arising from owning and operating vessels in international trade. OPA, which imposes virtually unlimited liability upon shipowners, operators and bareboat charterers of any vessel trading in the exclusive economic zone of the United States of America for certain oil pollution accidents in the United States of

America, has made liability insurance more expensive for shipowners and operators trading in the United States of America market. While we believe that our present insurance coverage is adequate, not all risks can be insured, and there can be no guarantee that any specific claim will be paid, or that we will always be able to obtain adequate insurance coverage at reasonable rates.

Hull and Machinery Insurance

We procure hull and machinery insurance, protection and indemnity insurance, which includes environmental damage and pollution insurance and war risk insurance and freight, demurrage and defense insurance for our fleet. We do not maintain insurance against loss of hire, which covers business interruptions that result in the loss of use of a vessel.

Protection and Indemnity Insurance

Protection and indemnity insurance is provided by mutual protection and indemnity associations, or P&I Associations, which covers our third-party liabilities in connection with our shipping activities. This includes third-party liability and other related expenses of injury or death of crew, passengers and other third parties, loss or damage to cargo, claims arising from collisions with other vessels, damage to other third-party property, pollution arising from oil or other substances, and salvage, towing and other related costs, including wreck removal. Protection and indemnity insurance is a form of mutual indemnity insurance, extended by protection and indemnity mutual associations, or "clubs."

Our current protection and indemnity insurance coverage for pollution is $1 billion per vessel per incident. The 14 P&I Associations that comprise the International Group insure approximately 90% of the world's commercial tonnage and have entered into a pooling agreement to reinsure each association's liabilities. Our vessels are members of the UK Club. Each P&I Association has capped its exposure to this pooling agreement at $4.5 billion. As a member of a P&I Association, which is a member of the International Group, we are subject to calls payable to the associations based on our claim records as well as the claim records of all other members of the individual associations and members of the shipping pool of P&I Associations comprising the International Group.

C. Organizational structure

Euroseas is the sole owner of all outstanding shares of the subsidiaries listed in Note 1 of our consolidated financial statements under Item 18 and in Exhibit 8.1 to this annual report.

D. Property, plants and equipment

We do not own any real property. As part of the management services provided by Eurobulk during the period in which we conducted business to date, we have shared, at no additional cost, offices with Eurobulk. We do not have current plans to lease or purchase office space, although we may do so in the future.

Our interests in our vessels are owned through our wholly-owned vessel owning subsidiaries and these are our only material properties. Our vessels are subject to mortgages. Specifically:

- Searoute Maritime Ltd. incorporated in Cyprus on May 20, 1992, owner of the Cyprus flag 33,712 dwt drybulk carrier motor vessel Ariel, which was built in 1977 and acquired on March 5, 1993. Ariel was sold on February 22, 2007.

- Oceanopera Shipping Ltd. incorporated in Cyprus on June 26, 1995, owner of the Cyprus flag 34,750 dwt drybulk carrier motor vessel Nikolaos P, which was built in 1984 and acquired on July 22, 1996. The vessel was sold on February 12, 2009.

- Oceanpride Shipping Ltd. incorporated in Cyprus on March 7, 1998, owner of the Cyprus flag 26,354 dwt drybulk carrier motor vessel John P, which was built in 1981 and acquired on March 7, 1998. John P was sold on July 5, 2006.

- Alcinoe Shipping Ltd. incorporated in Cyprus on March 20, 1997, owner of the Cyprus flag 26,354 dwt drybulk carrier motor vessel Pantelis P, which was built in 1981 and acquired on June 4, 1997. Pantelis P was sold on May 31, 2006. On February 22, 2007, Alcinoe Shipping Ltd. acquired the 38,691 dwt Cyprus flag drybulk motor vessel Gregos, which was built in 1984. On June 13, 2007, m/v Gregos was transferred to Gregos Shipping Limited incorporated in the Marshall Islands and its flag was changed to the flag of the Marshall Islands.

- Alterwall Business Inc. incorporated in Panama on January 15, 2001, owner of the Panama flag 18,253 dwt container carrier motor vessel Ninos (ex YM Qingdao 1), which was built in 1990 and acquired on February 16, 2001.

- Allendale Investment S.A. incorporated in Panama on January 22, 2002, owner of the Panama flag 18,154 dwt container carrier motor vessel Kuo Hsiung, which was built in 1993 and acquired on May 13, 2002.

- Diana Trading Ltd. incorporated in the Marshall Islands on September 25, 2002, owner of the Marshall Islands flag 69,734 dwt drybulk carrier motor vessel Irini, which was built in 1988 and acquired on October 15, 2002.

- Salina Shipholding Corp., incorporated in the Marshall Islands on October 20, 2005, owner of the Marshall Islands flag 29,693 dwt container carrier motor vessel Artemis, which was built in 1987 and acquired on November 25, 2005.

- Xenia International Corp., incorporated in the Marshall Islands on April 6, 2006, owner of the Marshall Islands flag 22,568 dwt / 950 teu multipurpose motor vessel Tasman Trader, which was built in 1990 and acquired on April 27, 2006.

- Prospero Maritime Inc., incorporated in the Marshall Islands on July 21, 2006, owner of the Marshall Islands flag 69,268 dwt drybulk motor vessel Aristides N.P., which was built in 1993 and acquired on September 4, 2006.

- Xingang Shipping Ltd., incorporated in Liberia on October 16, 2006, owner of the Liberian flag 23,596 dwt container carrier YM Xingang I, which was built in February 1993 and acquired on November 15, 2006.

- Manolis Shipping Ltd., incorporated in Marshall Islands on March 16, 2007, owner of the Marshall Islands flag 20,346 dwt container carrier motor vessel Manolis P, which was built in 1995 and acquired on April 12, 2007.

- Eternity Shipping Company, incorporated in the Marshall Islands on May 17, 2007, owner of the Marshall Islands flag 30,007 dwt / 1,742 teu container carrier motor vessel OEL Transworld (ex Clan Gladiator), which was built in 1992 and acquired on June 13, 2007.

- Emmentaly Business Inc., incorporated in Panama on July 4, 2007, owner of the Panamanian flag 33,667 dwt / 1,932 teu container carrier motor vessel Jonathan P, which was built in 1990 and acquired on August 7, 2007. On April 16, 2008, motor vessel Jonathan P was renamed to OEL Intergrity; OEL Intergrity was renamed back to Jonathan P on March 5, 2009.

- Pilory Associates Corp., incorporated in Panama on July 4, 2007, owner of the Panamanian flag 33,667 dwt / 1,932 teu container carrier motor vessel Despina P, which was built in 1990 and acquired on August 13, 2007.

- Tiger Navigation Corp., incorporated in Marshall Islands on August 29, 2007, owner of the Marshall Islands flag 31,627 dwt / 2,228 teu container carrier motor vessel Tiger Bridge, which was built in 1990 and acquired on October 4, 2007.

- Trust Navigation Corp., incorporated in Liberia on October 1, 2007, owner of the Liberian flag 64,873 dwt drybulk carrier motor vessel Ioanna P, which was built in 1984 and acquired on November 1, 2007. The vessel was sold on January 12, 2009.

- Noumea Shipping Ltd, incorporated in Marshall Islands on May 14, 2008, owner of the Marshall Islands flag 34,677 DWT / 2,556 TEU container vessel motor vessel Maersk Noumea, which was built in 2001 and acquired on May 22, 2008.

- Saf-Concord Shipping Ltd., incorporated in Liberia on June 8, 2008, owner of the Liberian flag 46,667 dwt drybulk carrier motor vessel Monica P, which was built in 1998 and acquired on January 19, 2009.

- Eleni Shipping Ltd., incorporated in Liberia on February 11, 2009, owner of the Liberian flag 72,119 dwt drybulk carrier motor vessel Eleni P, which was built in 1997 and acquired on March 6, 2009.

40

As of December 31, 2008, our vessels, m/v Ninos and m/v Kuo Hsiung, were collateral for a loan with an outstanding balance of $5,500,000. Our vessel, m/v Artemis, was collateral for a loan with an outstanding amount of $5,000,000. Our vessel, m/v Tasman Trader, was collateral for a loan with an outstanding balance of $5,600,000. Our vessel, m/v Aristides N.P., was collateral for a loan with an outstanding balance of $11,275,000. Our vessels, m/v YM Xingang I, m/v Gregos and m/v Irini, were collateral for a loan with an outstanding balance of $12,000,000. Our vessel, m/v Manolis P, was collateral for a loan with an outstanding amount of $9,040,000. Our vessels, m/v Ioanna P and m/v Tiger Bridge, were collateral for a loan with an outstanding amount of $7,600,000. On January 19, 2009 we took a loan of $10,000,000 to partly finance the acquisition of m/v Monica P and such vessel is collateral thereunder. Similarly, on April 30, 2009 we drew a loan of $10,000,000 to partly finance the acquisition of m/v Eleni P and such vessel is collateral thereunder.

Item 4A. Unresolved Staff Comments

None.

Item 5. Operating and Financial Review and Prospects

The following discussion should be read in conjunction with our financial statements and footnotes thereto contained in this annual report. This discussion contains forward-looking statements, which are based on our assumptions about the future of our business. Our actual results may differ materially from those contained in the forward-looking statements. Please read "Forward-Looking Statements" for additional information regarding forward-looking statements used in this annual report. Reference in the following discussion to "our" and "us" refer to Euroseas, our subsidiaries and the predecessor operations of Euroseas, except where the context otherwise indicates or requires.

We are a Marshall Islands company incorporated in May 2005. We are a provider of worldwide ocean-going transportation services. We own and operate drybulk carriers that transport major bulks such as iron ore, coal and grains, and minor bulks such as bauxite, phosphate and fertilizers. We also own and operate containerships and multipurpose vessels that transport dry and refrigerated containerized cargoes, mainly including manufactured products and perishables. As of May 1, 2009, our fleet consisted of five drybulk carriers, comprised of three Panamax, one Handymax and one Handysize drybulk carriers, ten containerships and one multipurpose vessel. The total cargo carrying capacity of the five drybulk carriers is 296,479 deadweight tons, or dwt, and of the ten containerships is 273,687 dwt and 17,877 twenty-foot equivalent units, or teu. Our multipurpose vessel can carry 22,568 dwt and/or 950 teu.

We actively manage the deployment of our fleet between spot market voyage charters, which generally last from several days to several weeks, and time charters, which can last up to several years. Some of our vessels may participate in shipping pools, or, in some cases participate in contracts of affreightment. As of May 1, 2009, two of our vessels participated in shipping pools. We also use FFA contracts to provide partial coverage for our drybulk vessels - as a substitute for time charters - in order to increase the predictability of our revenues.

Vessels operating on time charters provide more predictable cash flows but can yield lower profit margins than vessels operating in the spot market during periods characterized by favorable market conditions. Vessels operating in the spot market generate revenues that are less predictable but may enable us to achieve increased profit margins during periods of high vessel rates although we are exposed to the risk of declining vessel rates, which may have a materially adverse impact on our financial performance. Vessels operating in pools benefit from better scheduling, and thus increased utilization, and better access to contracts of affreightment due to the larger commercial operation of the pool. We are constantly evaluating opportunities to increase the number of our vessels deployed on time charters or to participate in shipping pools (if available for our vessels), however we only expect to enter into additional time

charters or shipping pools if we can obtain contract terms that satisfy our criteria. Containerships are employed almost exclusively on time charter contracts. We carefully evaluate the length and the rate of the time charter contract at the time of fixing or renewing a contract considering market conditions, trends and expectations.

We constantly evaluate vessel purchase opportunities to expand our fleet accretive to our earnings and cash flow, as well as, sale opportunities of certain of our vessels.

A. Operating results

Factors Affecting Our Results of Operations

We believe that the important measures for analyzing trends in the results of our operations consist of the following:

Calendar days. We define calendar days as the total number of days in a period during which each vessel in our fleet was in our possession including off-hire days associated with major repairs, drydockings or special or intermediate surveys. Calendar days are an indicator of the size of our fleet over a period and affect both the amount of revenues and the amount of expenses that we record during that period.

Available days. We define available days as the total number of days in a period during which each vessel in our fleet was in our possession net of off-hire days associated with scheduled repairs, drydockings or special or intermediate surveys. The shipping industry uses available days to measure the number of days in a period during which vessels were available to generate revenues.

Voyage days. We define voyage days as the total number of days in a period during which each vessel in our fleet was in our possession net of off-hire days associated with scheduled and unscheduled repairs, drydockings or special or intermediate surveys or days waiting to find employment. The shipping industry uses voyage days to measure the number of days in a period during which vessels actually generate revenues.

Fleet utilization. We calculate fleet utilization by dividing the number of our voyage days during a period by the number of our available days during that period. The shipping industry uses fleet utilization to measure a company's efficiency in finding suitable employment for its vessels and minimizing the amount of days that its vessels are off-hire for reasons such as unscheduled repairs or days waiting to find employment.

Spot Charter Rates. Spot charter rates are volatile and fluctuate on a seasonal and year to year basis. The fluctuations are caused by imbalances in the availability of cargoes for shipment and the number of vessels available at any given time to transport these cargoes.

Time Charter Equivalent ("TCE"). A standard maritime industry performance measure used to evaluate performance is the daily time charter equivalent, or daily TCE. Daily TCE revenues are voyage revenues minus voyage expenses divided by the number of voyage days during the relevant time period. Voyage expenses primarily consist of port, canal and fuel costs that are unique to a particular voyage, which would otherwise be paid by a charterer under a time charter. We believe that the daily TCE neutralizes the variability created by unique costs associated with particular voyages or the employment of drybulk carriers on time charter or on the spot market (containership are chartered on a time charter basis) and presents a more accurate representation of the revenues generated by our vessels.

Basis of Presentation and General Information

We use the following measures to describe our financial performances:

Voyage revenues. Our voyage revenues are driven primarily by the number of vessels in our fleet, the number of voyage days during which our vessels generate revenues and the amount of daily charter hire that our vessels earn under charters, which, in turn, are affected by a number of factors, including our decisions relating to vessel acquisitions and disposals, the amount of time that we spend positioning our vessels, the amount of time that our vessels spend in drydock undergoing repairs, maintenance and upgrade work, the age, condition and specifications of our vessels, levels of supply and demand in the transportation market, the number of vessels on time charters, spot charters and in pools and other factors affecting charter rates in both the drybulk carrier and containership markets.

Commissions. We pay commissions on all chartering arrangements of 1.25% to Eurochart, one of our affiliates, plus additional commission of usually up to 5% to other brokers involved in the transaction. These additional commissions, as well as changes to charter rates will cause our commission expenses to fluctuate from period to period. Eurochart also receives a fee equal to 1% calculated as stated in the relevant memorandum of agreement for any vessel bought or sold by it on our behalf.

Voyage expenses. Voyage expenses primarily consist of port, canal and fuel costs that are unique to a particular voyage which would otherwise be paid by the charterer under a time charter contract, as well as commissions. Under time charters, the charterer pays voyage expenses whereas under spot market voyage charters, we pay such expenses. The amounts of such voyage expenses are driven by the mix of charters undertaken during the period.

Vessel operating expenses. Vessel operating expenses include crew wages and related costs, the cost of insurance, expenses relating to repairs and maintenance, the costs of spares and consumable stores, tonnage taxes and other miscellaneous expenses. Our vessel operating expenses, which generally represent fixed costs, have historically changed in line with the size of our fleet. Other factors beyond our control, some of which may affect the shipping industry in general (including, for instance, developments relating to market prices for insurance or inflationary increases) may also cause these expenses to increase.

Management fees. These are the fees that we pay to Eurobulk, our affiliated ship manager, under our management agreement with Eurobulk for the technical and commercial management that Eurobulk performs on our behalf. The fee, as of May 1, 2009, is 655 Euros per vessel per day and is payable monthly in advance adjusted annually for inflation on January 1st.

Vessel depreciation. We depreciate our vessels on a straight-line basis with reference to the cost of the vessel, age and scrap value as estimated at the date of acquisition. Depreciation is calculated over the remaining useful life of the vessel, which is estimated to range from 25 to 30 years from the date of original construction. Remaining useful lives of property are periodically reviewed and revised to recognize changes in conditions, new regulations or other reasons. Revisions of estimated lives are recognized over current and future periods.

Amortization of deferred drydocking and special survey expense. Our vessels are required to be drydocked approximately every 30 to 60 months for major repairs and maintenance that cannot be performed while the vessels are trading. We capitalize the costs associated with drydockings as they occur and amortize these costs on a straight-line basis over the period between drydockings. Costs capitalized as part of the drydocking include: actual costs incurred at the drydock yard; cost of travel, lodging and subsistence of our personnel sent to the drydocking site to supervise; and the cost of hiring a third party to oversee a drydocking. We believe that these criteria are consistent with industry practice and that our policy of capitalization reflects the economics and market values of the vessels. Commencing January 1, 2006, we revised our policy to exclude the cost of hiring riding crews and the cost of parts

used by riding crews from amounts capitalized as drydocking cost. We have not restated any historical financial statements because we determined that the impact of such a revision is not material to our operating income and net income for any periods presented. Starting January 1, 2009, we changed the method of accounting for drydocking and special survey expenses to the direct expense method as this method eliminates the significant amount of time and subjectivity to determine which costs and activities related to drydocking and special survey should be deferred.

Interest expense. We traditionally finance vessel acquisitions partly with debt on which we incur interest expense. The interest rate we pay is generally linked to the 3-month LIBOR rate, although from time to time we utilize fixed rate loans or could use interest rate swaps to eliminate our interest rate exposure. Interest due is expensed in the period it is accrued. Loan costs are amortized over the period of the loan; the un-amortized portion is written-off if the loan is prepaid early.

Other general and administrative expenses. We incur expenses consisting mainly of executive compensation, professional fees, directors' liability insurance and reimbursement of our directors' and officers' travel-related expenses. General and administrative expenses increased once we became a public company due to the duties typically associated with public companies. We acquire executive services, our Chief Executive Officer, Chief Financial Officer, Chief Administrative Officer, Internal Auditor and Secretary, through Eurobulk as part of our Master Management Agreement.

In evaluating our financial condition, we focus on the above measures to assess our historical operating performance and we use future estimates of the same measures to assess our future financial performance. In addition, we use the amount of cash at our disposal and our total indebtedness to assess our short term liquidity needs and our ability to finance additional acquisitions with available resources (see also discussion under "Capital Expenditures" below). In assessing the future performance of our present fleet, the greatest uncertainty relates to the spot market performance which affects those of our vessels that are not employed under fixed time charter contracts. Decisions about the acquisition of additional vessels or possible sales of existing vessels are based on financial and operational evaluation of such action and depend on the overall state of the drybulk, containership and multipurpose vessel market, the availability of purchase candidates, available employment and our general assessment of economic prospects for the sectors in which we operate.

Results from Operations

Year ended December 31, 2008 compared year ended December 31, 2007.

Voyage revenues. Voyage revenues for the period were $132.24 million, up 53.6% compared to the same period in 2007 during which voyage revenues amounted to $86.10 million. This increase was primarily due to the higher charter rates our vessels achieved in 2008 as compared to 2007, especially in the drybulk market, and to the larger fleet we operated. In 2008, we operated an average of 15.61 vessels, a 36.0% increase over the average of 11.48 vessels we operated during 2007. Our fleet of 15.61 vessels had throughout the period 113 unscheduled off-hire days and 151 days of scheduled off-hire for the drydocking of five vessels, generating an average TCE rate per vessel of $23,693 per day compared to $21,468 per day per vessel for the same period in 2007. The average TCE rate our vessels achieve is a combination of the time charter rate earned by our vessels under time charter contracts, which is not influenced by market developments during the duration of the charter, and the TCE rate earned by our vessels employed in the spot market which is influenced by market developments. Shipping rates in the first nine months of 2008 were on average stronger compared to the first nine months of 2007, but rates fell by more than 90% in the last three months of the year and were significantly weaker than the last three months of 2007. Our vessels that operated in the spot market or came off time charter contracts and had to be rechartered were negatively influenced by the depressed market levels during the fourth quarter of 2008.

Commissions. Commissions for the period were $5.94 million. At 4.49% of voyage revenues, commissions were slightly lower than in 2007; for the year ended December 31, 2007, commissions amounted to $4.02 million, or 4.67% of voyage revenues. The main reason for this reduction is that voyage revenues in 2008 include a larger contribution from the amortization of the fair value of below market charters (a $6.14 million increase in 2008 as compared to a $0.55 million reduction in 2007) against which no commission is charged.

Voyage expenses. Voyage expenses for the year were $3.09 million related to expenses for certain voyage charters. For the year ended December 31, 2007, voyage expenses amounted to $0.90 million. Because our vessels are generally chartered under time charter contracts, voyage expenses represent a small fraction (2.3% and 1.0% in 2008 and 2007, respectively) of voyage revenues; in 2008, we had more voyage charters than in 2007 which resulted in higher voyage expenses.

Vessel operating expenses. Vessel operating expenses were $27.52 million in 2008 compared to $17.24 million for 2007. This difference was due to the higher average number of vessels we operated in 2008, specifically, an average of 15.61 vessels in 2008 compared to 11.48 vessels in 2007. Daily vessel operating expenses per vessel increased between the two periods to $4,816 per day in 2008 compared to $4,115 per day in 2007, a 17.0% increase, reflecting primarily higher crew and lubricant costs and higher exchange rate of the euro and other currencies with respect to the U.S. dollar.

Management fees. These are part of the fees we pay to Eurobulk under our Master Management Agreement. During 2008, Eurobulk charged us 630 Euros per day per vessel totalling $5.39 million for the period, or $943 per day per vessel. In 2007, management fees amounted to $3.67 million, or $875 per day per vessel based on the daily rate per vessel of 628 Euros. The increase on a per day basis is solely due to the higher Euro exchange rate in 2008 as compared to 2007. The increase in the management fees paid in 2008 also resulted from an increase in the average number of vessels we owned during the period; in 2008, we owned 15.61 vessels compared to an average of 11.48 vessels we owned during 2007.

Other general and administrative expenses. These are expenses we pay as part of our operation as a public company and include the fixed portion of our management agreement fees, legal and auditing fees, directors' and officers' liability insurance and other miscellaneous corporate expenses. In 2008, we had a total of $4.06 million of general and administrative expenses as compared to $2.66 million in 2007. The increase is mainly due to higher incentive non-cash compensation of approximately $0.80 million in 2008 for incentives awards given to certain officers, directors and other key persons as well as higher management fees we paid to Eurobulk for executive services of approximately $0.49 million in 2008; the remaining increase of approximately $0.11 million is due to various other miscellaneous expenses.

Amortization of drydocking and special survey expense, vessel depreciation. Amortization and depreciation for the period was $32.23 million. This consists of $28.28 million of depreciation and $3.95 million of amortization of deferred drydocking expenditures. Comparatively, depreciation and amortization for the same period in 2007 amounted to $16.42 million and $1.54 million, respectively, for a total of $17.96 million. Depreciation in 2008 was higher than in 2007 because of the higher average number of vessels and also because full year depreciation was charged for vessels bought in 2007 and depreciation for one vessel bought in 2008. Amortization in 2008 is also higher than the same period in 2007 due to five vessels that underwent drydocking or special survey during 2008 plus the full effect of the amortization of the seven vessels that underwent drydocking or special survey in 2007.

Impairment loss. This is an impairment loss for two vessels classified as held for sale as of December 31, 2008. The impairment loss of $25.11 million represents the excess carrying values of the vessels over their fair value which was calculated based on the agreed sale prices of the vessels less the cost to sell them. There was no impairment for any other vessel in 2008, as the undiscounted cash flow test performed as of December 31, 2008 determined that the carrying amounts of our vessels held for use were recoverable. In 2007, there were no events or changes in circumstances indicating that the carrying amount of any vessels may not be recoverable and as a result no impairment was assessed.

Net gain or loss from vessel sales. There was no vessel sale in 2008 compared to one vessel sold in 2007 for a gain of $3.41 million.

Interest and other financing costs, net. Interest and other financing income, net for the period were $0.24 million. Of this amount, $2.93 million relates to interest incurred, loan fees and expenses paid and deferred loan fees written-off during the period, offset by $3.17 million of interest income during the period. Comparatively, during the same period in 2007, net interest and finance costs amounted to $2.49 million, comprised of $4.85 million of interest incurred and loan fees and offset by $2.36 million of interest income. Interest incurred and loan fees were lower in 2008 due to the

lower loan amount outstanding as a result of no new loans being assumed in 2008 and the repayment of loans outstanding as of December 31, 2007. Interest income was higher in 2008 due to the uninvested proceeds from the follow-on common stock offering of November 2007; of the net proceeds of the that offering amounting to approximately $93.55 million, only $43.58 million was invested for the acquisition of m/v Maersk Noumea with the rest producing interest income. Interest income in 2007 was also the result of the above and two additional follow-on common stock offerings earlier in 2007 the proceeds of which were invested by November 2007 and as a result produced lower interest income.

Investments and Foreign Exchange Gains or Losses. In 2008, we had a $7,888 foreign exchange gain compared to a $7,824 foreign exchange loss in 2007. In 2008, we had a realized gain from investments in trading securities of $81,193 and an unrealized loss of $2.39 million, as the share price of the securities we held declined by about 75% during 2008, compared to an unrealized gain from investments in trading securities of $98,744 in 2007. Our investments in trading securities produced $0.32 million in dividend income in 2008; we had no dividend income in 2007.

Derivatives losses. In 2008, we had a realized loss of $77,105 from an interest rate swap contract that we entered in July 2008. We had unrealized losses of $3.40 million, net, from the same interest rate swap and six Forward Freight Agreement ("FFA") contracts that we entered into in December 2008 since the market moved against our positions under the interest rate swap and most of the FFA contracts during the remainder of the year. Specifically, interest 5-year swap rates declined since July 2008, and the drybulk market FFA contract rates for 2009 and 2010 increased during December 2008 resulting in unrealized losses of $2.18 million and $1.22 million, net, respectively. In 2007, we had no derivative contracts.

Net income. As a result of the above, net income for the year ended on December 31, 2008 was $23.67 million compared to $40.66 million for the same period in 2007, representing an decrease of 41.8%.

Year ended December 31, 2007 compared year ended December 31, 2006.

Voyage revenues. Voyage revenues for the period were $86.10 million, up 104.3% compared to the same period in 2006 during which voyage revenues amounted to $42.14 million. This increase was primarily due to the significantly higher charter rates our vessels achieved in 2007 as compared to 2006, especially in the drybulk market, and to the larger fleet we operated. In 2007, we operated an average of 11.48 vessels, a 41.9% increase over the average of 8.09 vessels we operated during 2006. Our fleet of 11.48 vessels had throughout the period 11 unscheduled off-hire days and 210 days of scheduled off-hire for the drydocking of seven vessels, generating an average TCE rate per vessel of $21,468 per day compared to $14,313 per day per vessel for the same period in 2006. The average TCE rate our vessels achieve is a combination of the time charter rate earned by our vessels under time charter contracts, which is not influenced by market developments, and the TCE rate earned by our vessels employed in the spot market which is influenced by market developments. Shipping markets in 2007 were on average stronger compared to 2006, especially in the second half of 2007 when the drybulk market reached all time high levels. The higher average market rates during 2007 positively influenced the earnings of our vessels employed in the spot market.

Commissions. Commissions for the period were $4.02 million. At 4.67% of voyage revenues, commissions were slightly higher than in the same period in 2006; for the year ended December 31, 2006, commissions amounted to $1.83 million, or 4.34% of voyage revenues. The higher level of commissions in 2007 is partly due to the fact that more vessels operated in the spot market and the higher level of commissions of certain time charters related to the vessels acquired in 2007.

Voyage expenses. Voyage expenses for the year were $0.90 million related to expenses for certain voyage charters. For the year ended December 31, 2006, voyage expenses amounted to $1.15 million. Because our vessels are generally chartered under time charter contracts, voyage expenses represent a small fraction (1.0% and 2.7% in 2007 and 2006, respectively) of voyage revenues; in 2006, we had more voyage charters than in 2007 which resulted in higher voyage expenses.

Vessel operating expenses. Vessel operating expenses were $17.24 million for the period compared to $10.37 million for the same period in 2006. This difference was due to the higher average number of vessels we operated in 2007, specifically an average of 11.48 vessels in 2007 compared to 8.09 vessels in 2006. Daily vessel operating expenses per vessel increased between the two periods to $4,115 per day in 2007 compared to $3,524 per day in 2006, a 16.8%

increase, reflecting primarily higher crew and lubricant costs and higher exchange rate of the euro and other currencies with respect to the U.S. dollar.

Management fees. These are part of the fees we pay to Eurobulk under our Master Management Agreement. As of December 31, 2007, Eurobulk charged us 630 Euros per day per vessel totalling $3.67 million for the period, or $875 per day per vessel. For the same period in 2006, management fees amounted to $2.27 million, or $770 per day per vessel based on the daily rate per vessel of 608.33 Euros. The Euro exchange rate has been on average about 10% higher in 2007 as compared to 2006. The increase in the management fees paid in 2007 also resulted from an increase in the average number of vessels we owned during the period; in 2007, we owned 11.48 vessels compared to an average of 8.09 vessels we owned during 2006.

Other general and administrative expenses. These are expenses we pay as part of our operation as a public company and include the fixed portion of our management agreement fees, legal and auditing fees, directors' and officers' liability insurance and other miscellaneous corporate expenses. In 2007, we had a total of $2.66 million of general and administrative expenses as compared to $1.08 million in 2006. The increase is mainly due to higher audit fees of approximately $0.25 million in 2007 inclusive of the audit of our internal controls over financial reporting, the cost required for us to implement internal controls for financial reporting to comply with Section 404 of the Sarbanes-Oxley Act of approximately $0.23 million as well as higher management fees we paid to Eurobulk for executive services of approximately $0.10 million in 2007, and $0.82 million for the cost of non-cash compensation of stock incentives awards given to certain officers, directors and other key persons.

Amortization of drydocking and special survey expense and vessel depreciation. Amortization and depreciation for the period was $17.96 million. This consists of $16.42 million of depreciation and $1.54 million of amortization of deferred drydocking expenditures. Comparatively, depreciation and amortization for the same period in 2006 amounted to $6.28 million and $1.01 million, respectively, for a total of $7.29 million. Depreciation in 2007 was higher than in 2006 because of the higher average number of vessels and also because the depreciation associated with vessels bought in 2007 (the one vessel sold in 2007 was fully depreciated). Amortization in 2007 is also higher than the same period in 2006 due to seven vessels that underwent drydocking or special survey during 2007 plus the full effect of the amortization of the two vessels that underwent drydocking or special survey in 2006.

Net gain or Loss from vessel sales. There was one vessel sold in 2007 for a gain of $3.41 million compared to two vessel sales in 2006 for a gain of $4.45 million.

Interest and other financing costs, net. Interest and other financing costs, net for the period were $2.49 million. Of this amount, $4.85 million relates to interest incurred, loan fees and expenses paid and deferred loan fees written-off during the period, offset by $2.36 million of interest income during the period. Comparatively, during the same period in 2006, net interest and finance costs amounted to $2.53 million, comprised of $3.40 million of interest incurred and loan fees and offset by $0.87 million of interest income. Interest incurred and loan fees were higher in 2007 due to the higher loan amount outstanding as a result of the new loans undertaken in June 2007 and November 2007. Interest income was higher in 2007 due the proceeds from three follow-on common stock offerings. As of December 31, 2007, the net proceeds of the last offering, amounting to approximately $93.6 million, were not invested.

Trading Securities and Foreign Exchange Gains or Losses. In 2007, we had a $7,824 foreign exchange loss compared to a $1,598 foreign exchange loss in 2006. In 2007, we had unrealized gain from investments in trading securities of $98,744. We had no such gain in 2006.

Net income. As a result of the above, net income for the year ended on December 31, 2007 was $40.66 million compared to $20.07 million for the same period in 2006, representing an increase of 102.6%.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America, or U.S. GAAP. The preparation of those financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting policies are those that reflect significant judgments or uncertainties, and potentially result in materially different results under different assumptions and conditions. We have described below what we believe are our most critical accounting policies that involve a high degree of judgment and the methods of their application.

Depreciation

We record the value of our vessels at their cost (which includes acquisition costs directly attributable to the vessel and expenditures made to prepare the vessel for its initial voyage) less accumulated depreciation. We depreciate our vessels on a straight-line basis over their estimated useful lives, estimated to range from 25 to 30 years from date of initial delivery from the shipyard. We believe that the 25 to 30 year range of depreciable life is consistent with that of other ship owners. As of December 31, 2006, one of our vessels had already reached an age of 29 years and continued to be employed (this vessel, m/v Ariel, was sold for further trading in February 2007). Depreciation is based on cost less the estimated residual scrap value. In 2004, the estimated scrap value of the vessels was increased from $170 to $300 per LWT to better reflect market price developments in the scrap metal market (see Item 3A Selected Consolidated Financial Data). In November 2008, the estimated useful life of the containerships and multipurpose vessels was increased to 30 years (from 25 years until then) in line with industry practice and the intended use of such vessels; also, the estimated scrap value of the vessels was reduced from $300 to $250 per light ton to better reflect market price developments in the scrap metal market. An increase in the useful life of the vessel or in the residual value would have the effect of decreasing the annual depreciation charge and extending it into later periods. A decrease in the useful life of the vessel or in the residual value would have the effect of increasing the annual depreciation charge.

Revenue and expense recognition

Revenues are generated from voyage and time charter agreements. If a charter agreement exists, the price is fixed, service is provided and the collection of the related revenue is reasonably assured, revenues are recorded over the term of the charter as service is provided and recognized on a pro-rata basis over the duration of the voyage or time charter adjusted for the off-hire days that a vessel spends undergoing repairs, maintenance or upgrade work. A voyage is deemed to commence upon the later of the completion of discharge of the vessel's previous cargo or the time it receives a contract that is not cancelable and is deemed to end upon the completion of discharge of the current cargo. A time charter contract is deemed to commence from the time of the delivery of the vessel to an agreed port and is deemed to end upon the re-delivery of the vessel at an agreed port. We generally enter into a charter agreement for the vessel's next voyage or time charter prior to the time of discharge of the previous cargo or completion of previous time charter. We do not begin recognizing voyage or time charter revenue until a charter contract has been agreed to both by us and the customer, even if the vessel has discharged its cargo or completed the previous time charter and it is sailing to the anticipated load port for its next voyage or to the port it will be delivered to the next charterer. Demurrage income, which is included in voyage revenues, represents payments received from the charterer when loading or discharging time exceeded the stipulated time in the voyage charter and is recognized when earned. Probable losses on voyages are provided for in full at the time such losses can be estimated.

For the Company's vessels operating in chartering pools, revenues and voyage expenses are pooled and allocated to each pool's participants on a time charter equivalent basis in accordance with an agreed-upon formula. For vessels that simultaneously participate in spot chartering pools and cargo pools (pools of contracts of affreightment, also called, short funds; in the Company's case, participation in cargo pools requires participation in spot chartering pools), a combined time charter equivalent revenue is provided by the operator of the vessel and cargo pools. Revenues and voyage expenses are recognized during the period services were performed, the collectability has been reasonably assured, an agreement with the pool exists and price is determinable.

Charter fees received in advance are recorded as a liability (deferred revenue) until charter services are rendered.

48

Vessels operating expenses comprise all expenses relating to the operation of the vessels, including crewing, insurance, repairs and maintenance, stores, lubricants, spares and consumables, professional and legal fees and miscellaneous expenses. Vessel operating expenses are incurred when the vessel is chartered under a voyage charter and are recognized as incurred; payments in advance of services or use are recorded as prepaid expenses. Voyage expenses comprise all expenses relating to particular voyages, including bunkers, port charges, canal tolls, and agency fees. Voyage expenses are recognized on a pro-rata basis over the estimated length of the each voyage. The impact of recognizing voyage expenses on a pro-rata basis over the length of the each voyage is not materially different on a quarterly and annually basis from a method of recognizing such expenses as incurred.

Deferred drydock costs

Our vessels are required to be drydocked approximately every 30 to 60 months for major repairs and maintenance that cannot be performed while the vessels are trading. Up to December 31, 2008, we capitalized the costs associated with drydockings as they occurred and amortized these costs on a straight-line basis over the period between drydockings. Costs capitalized as part of the drydocking included actual costs incurred at the drydock yard, cost of travel, lodging and subsistence of our personnel sent to the drydocking site to supervise and the cost of hiring a third party to oversee a drydocking. These criteria were consistent with industry practice and the policy of capitalization reflected the economics and market values of the vessels. Commencing January 1, 2006, we revised our policy to exclude the cost of hiring riding crews and the cost of parts used by riding crews from amounts capitalized as drydocking cost. We have not restated any historical financial statements because we determined that the impact of such a revision is not material to our operating income and net income for any periods presented. As of January 1, 2009, the Company elected to change the method of accounting for drydocking and special survey expenses to the direct expense method as this method eliminates the significant amount of time and subjectivity to determine which costs and activities related to drydocking and special survey should be deferred.

Fair value of time charter acquired

We record all identified tangible and intangible assets or any liabilities associated with the acquisition of a vessel at fair value. Where vessels are acquired with existing time charters, the Company determines the present value of the difference between: (i) the contractual charter rate and (ii) the prevailing market rate for a charter of equivalent duration. In discounting the charter rate differences in future periods, the Company uses its Weighted Average Cost of Capital (WACC) adjusted to account for the credit quality of the charterer. The capitalized above-market (assets) and below-market (liabilities) charters are amortized as a reduction and increase, respectively, to voyage revenues over the remaining term of the charter.

Impairment of long-lived assets

We evaluate the carrying amounts and periods over which long-lived assets are depreciated to determine if events have occurred which would require modification to their carrying values or useful lives. In evaluating useful lives and carrying values of long-lived assets, we review certain indicators of potential impairment, such as undiscounted projected operating cash flows, vessel sales and purchases, business plans and overall market conditions. We determine undiscounted projected net operating cash flows for each vessel and compare it to the vessel carrying value. When the estimate of undiscounted cash flows, excluding interest charges, expected to be generated by the use of the asset is less than its carrying amount, we should evaluate the asset for an impairment loss. In the event that impairment occurred, we would determine the fair value of the related asset and we record a charge to operations calculated by comparing the asset's carrying value to the estimated fair market value. We estimate fair market value primarily through the use of third party valuations performed on an individual vessel basis.

The carrying values of the Company's vessels may not represent their fair market value at any point in time since the market prices of second-hand vessels tend to fluctuate with changes in charter rates and the cost of newbuildings.

The Company did not note for 2006 and 2007, any events or changes in circumstances indicating that the carrying amount of its vessels may not be recoverable. However, in the fourth quarter of 2008, market conditions changed significantly as a result of the credit crisis and resulting slowdown in world trade. Since the end of the third quarter of 2008, the charter rates in the drybulk and containership market have declined significantly and vessel values must have also declined (there have been scarce transactions to document that) both as a result of a slowdown in the availability of global credit and the significant deterioration in charter rates. These are conditions that the Company considers to be indicators of potential impairment. The Company performed the undiscounted cash flow test as of December 31, 2008. We determine undiscounted projected net operating cash flows for each vessel and compare it to the vessel's carrying value. This assessment is made at the individual vessel level since separately identifiable cash flow information for each vessel is available. In developing estimates of future cash flows, the Company made assumptions about future charter rates, utilization rates, ship operating expenses, future dry docking costs and the estimated remaining useful lives of the vessels. These assumptions are based on historical trends as well as future expectations in line with the Company's historical performance and our expectations for future fleet utilization under our current fleet deployment strategy. The Company determined that the carrying amounts of its vessels held for use were recoverable. The Company recorded an impairment loss for two of its vessels that are classified as held for sale as of December 31, 2008. The impairment loss for these assets was measured on the basis of their fair market value as per the agreed sale price less cost to sell them and estimated at $25,113,364. This amount is presented in the "Impairment loss" line in the "Operating Expenses" section of the "Consolidated Statements of Income".

Our impairment test exercise is highly sensitive on variances in the time charter rates, fleet effective utilization rate, estimated scrap values, future drydocking costs and estimated vessel operating costs. Our current analysis, which involved also a sensitivity analysis by assigning possible alternative values to these inputs, indicates that there is no impairment of individual long lived assets. However, there can be no assurance as to how long term charter rates and vessel values will remain at their currently low levels or whether they will improve by any significant degree. Charter rates may remain at depressed levels for some time which could adversely affect our revenue and profitability, and future assessments of vessel impairment.

Stock incentive plan awards

We include share-based compensation in "Other general and administrative expenses" in the consolidated statements of income. Share-based compensation represents vested and nonvested restricted shares granted to employees and to non-employee directors, for their services as directors, as well as to non-employees. These shares are measured at their fair value equal to the market value of the Company's common stock on the grant date. The shares that do not contain any future service vesting conditions are considered vested shares and a total fair value of such shares is expensed on the grant date. The shares that contain a time-based service vesting condition are considered nonvested shares on the grant date and a total fair value of such shares recognized on a straight-line basis over the requisite service period. In addition, nonvested awards granted to non-employees are measured at its then-current fair value as of the financial reporting dates until non-employees complete the service.

Investments

We classify unrestricted publicly traded investments as trading securities and record them at fair value. For trading securities, the Company records unrealized gains or losses resulting from changes in fair value of its investment in trading securities between measurement dates as a component of "Gain (loss) on investments". In accordance with SFAS No. 157 "Fair Value Measurements", the Company determines the fair value of its investments in trading securities using quoted market prices in active markets for the same securities (Level 1 under the SFAS No. 157 hierarchy (see Note 16)). The Company determines the cost of trading securities sold by using the First-In-First-Out ("FIFO") method. Purchases of, or proceeds from, the sale of trading securities are classified as cash flows from operating activities. The Company has adopted SFAS No. 159, "The Fair Value Option for Financial Assets and

Financial Liabilities" ("SFAS No. 159") which allows the classification of purchases of, or proceeds from, the sale of trading securities to be classified to cash flows from operating activities or cash flows from investing activities based upon the Company's intent with respect to these securities.

Derivative financial instruments

We record every derivative instrument (including certain derivative instruments embedded in other contracts) in the balance sheet as either an asset or liability measured at its fair value with changes in the instruments' fair value recognized in other comprehensive impact or earnings depending whether specific hedge accounting criteria are met at the inception of the hedge in accordance with SFAS No 133 "Accounting for Derivative Instruments and Hedging Activities".

For the year ended December 31, 2008, the interest rate swaps and the Freight Forward Agreement ("FFA") contracts were not designated as hedging instruments and did not qualify for hedge accounting treatment. Accordingly, all gains or losses have been recorded in the consolidated statement of income. There were no interest rate swaps or FFA contracts for the year ended December 31, 2007.

Recent Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 is effective for financial assets and liabilities in fiscal years beginning after November 15, 2007 and for non-financial assets and liabilities in fiscal years beginning after March 15, 2008. The Company has evaluated the potential impact from the adoption of SFAS No. 157 on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In February 2008, the FASB issued FASB Staff Position ("FSP") FASB 157-2 "Effective Date of FASB Statement No. 157" ("FSP FASB 157-2"). FSP FASB 157-2, which was effective upon issuance, delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for items recognized or disclosed at fair value at least once a year, to fiscal years beginning after November 15, 2008. FSP FASB 157-2 also covers interim periods within the fiscal years for items within the scope of this FSP. The Company has evaluated the potential impact from the adoption of FSP FASB 157-2 on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In February 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" (SFAS No. 159") which provides the option to report certain financial assets and liabilities at fair value, with the intent to mitigate volatility in financial reporting that can occur when related assets and liabilities are recorded on different bases. SFAS No. 159 amends FASB Statement No. 95, "Statement of Cash Flows" ("SFAS No. 95") and FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). SFAS No. 159 specifies that cash flows from trading securities, including securities for which an entity has elected the fair value option, should be classified in the statement of cash flows based on the nature of and purpose for which the securities were acquired. Before this amendment, SFAS No. 95 and SFAS No. 115 specified that cash flows from trading securities must be classified as cash flows from operating activities. This statement is effective for the Company beginning January 1, 2008. Upon adoption, the Company will be classifying proceeds from sales of trading securities within the statement of cash flows as an operating or investing activity based on the intention for which any securities are acquired. The Company elected not to adopt any fair value options offered by SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal

years beginning after December 15, 2008, and will be adopted by the Company in the first quarter of fiscal 2009. The Company has evaluated the potential impact from the adoption of SFAS No. 141(R) on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51 ("SFAS No. 160")." SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the non-controlling interest, changes in a parent's ownership interest, and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, and will be adopted by the Company in the first quarter of fiscal 2009. The Company has evaluated the potential impact from the adoption of SFAS No. 160 on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In March 2008 the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS No. 161"). The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS No. 161 only requires additional disclosures about derivatives, and as such, it will have no effect on the Company's consolidated results of operations, cash flows and financial condition and concluded that the effect is not material.

In May 2008 the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("FASB No. 162"). The new standard identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This statement is effective sixty days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The Company has evaluated the potential impact from the adoption of SFAS No. 162 on the Company's consolidated results of operations, cash flows and financial condition and concluded that the effect is not material.

In June 2008, the FASB issued Staff Position No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). This Staff Position states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share ("EPS") pursuant to the two-class method. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period EPS data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings and selected financial data) to conform with the provisions of this Staff Position. Early application is not permitted. We do not expect the adoption of this accounting guidance to impact our EPS.

B. Liquidity and Capital Resources

Historically, our sources of funds have been equity provided by our shareholders, operating cash flows and long-term borrowings. Our principal use of funds has been capital expenditures to establish and expand our fleet, maintain the quality of our vessels, comply with international shipping standards and environmental laws and regulations, fund working capital requirements, make principal repayments on outstanding loan facilities, and pay dividends. We expect to rely upon funds raised from our follow-on common stock offering in November 2007, operating cash flows, long term borrowings, as well as future offerings to implement our growth plan and meet our liquidity needs going forward. In our opinion our working capital is sufficient for our present requirements.

Cash Flows

As of December 31, 2008, we had a cash balance of $73.85 million, funds due from a related company of $4.68 million and $6.98 million of restricted cash and cash in restricted retention accounts. Amounts due from such related company represent net disbursements and collections made by our fleet manager, Eurobulk, on behalf of the ship-owning companies during the normal course of operations for which they have the right of offset. Amounts due from such related company mainly consist of advances to our fleet manager of funds to pay for all anticipated vessel expenses. The amount of $4.68 million due from such related company as of December 31, 2008 therefore consists entirely of such deposits. Interest earned on funds deposited in related party accounts is credited to the account of the ship-owning companies or Euroseas. Working capital is current assets minus current liabilities, including the current portion of long term debt. We had a working capital surplus of $71.89 million including the current portion of long term debt which was $12.45 million as of December 31, 2008. All of the $34.66 million dividend declared was paid as of December 31, 2008, except for $0.12 million that was accrued and will be paid at the time the underlying restricted stock of incentive awards vest. We consider our liquidity sufficient for our operations. We expect to finance all our working capital requirements from cash generated from operations and proceeds from our November 2007 follow-on common stock offering.

Net cash from operating activities.

Our net cash from operating activities for 2008 was $74.28 million. This represents the net amount of cash, after expenses, generated by chartering our vessels. Eurobulk, on our behalf, collects our chartering revenues and pays our chartering expenses. Net income for the period was $23.61 million, which was increased by $33.07 million of depreciation and amortization and $25.11 million impairment loss amongst other adjustments. In 2007, net cash flow from operating activities was $48.96 million based on a contribution of net income of $40.66 million reduced by a gain of $3.41 million from the sale of m/v Ariel and increased by $18.03 million of depreciation and amortization amongst other adjustments.

Net cash from investing activities.

In 2008, we purchased one vessel for $43.58 million and advanced $1.82 million as a deposit for the purchase of another vessel that was completed in January 2009; also, we had to increase the restricted cash and the cash we had in retention accounts by $0.74 million. In 2007, we purchased seven vessels for a total cash outflow of $149.50 million, we received proceeds of $5.22 million from the sale of m/v Ariel, and we had to put in retention accounts and increase restricted cash by $2.39 million to satisfy requirements of our new loan facilities for a total of funds used in investment activities of $146.67 million. It is our strategy to expand and renew our fleet by pursuing selective acquisitions. At the same time, we sell vessels in order to renew our fleet or take advantage of opportune market conditions.

Net cash used in financing activities.

In 2008, net cash used in financing activities amounted to $58.42 million. These funds consisted primarily of $34.55 million of dividends paid and $25.58 million of loan repayments. We also had proceeds from shares issued $1.81 million and paid $0.11 million for stock offering expenses. In 2007, net cash provided by financing activities amounted to $199.06 million. This is accounted for by the $214.22 million raised in three follow-on common stock offerings (after underwriter discounts) and via outstanding warrants exercised. This amount was reduced by $20.28 million of dividends, $1.41 million of offering expenses and $0.11 million of loan arrangement fees paid and further increased by net borrowings of $6.64 million.

Debt Financing

We operate in a capital intensive industry which requires significant amounts of investment, and we fund a major portion of this investment through long term debt. We maintain debt levels we consider prudent based on our market expectations, cash flow, interest coverage and percentage of debt to capital. We did not draw any new loans in 2008.

As of December 31, 2008, we had seven outstanding loans with a combined outstanding balance of $56.02 million. These loans have maturity dates between 2010 and 2015. Our long-term debt as of December 31, 2008 comprises bank loans granted to our vessel-owning subsidiaries. A description of our loans as of December 31, 2008 is provided in Note 9 of our attached financial statements. In 2009, we plan to repay approximately $12.45 million of the above debt. In January and April of 2009, we drew two additional loans of $10.00 million each to partly finance our acquisition of m/v Monica P and m/v Eleni P. A description of these loans is provided below in "Item 8 – Financial Information, B - Significant Changes".

The loan agreements contain covenants.

Our loans have various covenants such as minimum requirements regarding the hull ratio cover (the ratio of fair value of vessel to outstanding loan less cash in retention accounts) and restrictions as to changes in management and ownership of the vessel shipowning companies, distribution of profits or assets (i.e. limiting dividends in some loans to 60% of profits, or, not permitting dividend payment or other distributions in cases that an event of default has occurred), additional indebtedness and mortgage of vessels without the lender's prior consent, sale of vessels, maximum fleet-wide leverage, sale of capital stock of our subsidiaries, ability to make investments and other capital expenditures, entering in mergers or acquisitions, minimum cash balance requirements and minimum cash retention accounts (restricted cash). If we are found to be in default of any covenants we might be required to provide supplemental collateral to the lenders, usually in the form of restricted cash. Increases in restricted cash required to satisfy loan covenants, would reduce funds available for investment or working capital and could have a negative impact on our operations. If we cannot correct any violated covenants, we might be required to repay all or part of our loans, which, in turn, might require us to sell one or more of our vessels under distressed conditions. We are not in default of any credit facility covenant as of December 31, 2008.

Capital Expenditures

We make capital expenditures from time to time in connection with our vessel acquisitions. Our most recent vessel acquisitions consist of one handymax drybulk carrier, m/v Monica P, which was delivered to us in January 2009, and a panamax drybulk carrier, m/v Eleni P, which was delivered to us in March 2009. In 2008, we acquired one containership, m/v Maersk Noumea, which was delivered to us in May 2008. We financed m/v Maersk Noumea with 100% equity. We financed m/v Monica P and m/v Eleni P with equity and a $10.00 million loan each. Of our seven acquisitions during 2007, four were financed with 100% equity while the remaining three were financed with equity and debt.

Five of our vessels in our operating fleet underwent scheduled drydocking or special survey in 2008. In 2009, three additional vessels are scheduled to undergo a special survey, intermediate survey or drydocking. This process of recertification may require us to reposition these vessels from a discharge port to shipyard facilities, which will reduce our operating days during the period. The loss of earnings associated with the decrease in operating days, together with the capital needs for repairs and upgrades, is expected to result in increased cash flow needs. We expect to fund these expenditures with cash on hand.

Dividends

On February 6, 2009, the Company announced the declaration of its fourteenth consecutive dividend since its private placement in August 2005. This dividend of $0.10 per share of common stock was paid on or about March 20, 2009 to all shareholders of record as of March 12, 2009. This follows the Company's prior dividend declarations of $0.20 per share of common stock on November 12, 2008, $0.32 per share of common stock on August 5, 2008, $0.31 per share of common stock on May 8, 2008, $0.30 per share of common stock, on February 7, 2008, $0.29 per share of common stock on October 16, 2007, $0.25 per share of common stock on July 17, 2007, $0.24 per share of common

stock on May 8, 2007, $0.22 per share of common stock on January 8, 2007, $0.21 per share of common stock on November 9, 2006, $0.18 per share of common stock on August 7, 2006, $0.18 per share of common stock on May 9, 2006, $0.18 per share of common stock on February 7, 2006 and $0.21 per share of common stock on November 2, 2005. The aggregate amount of all such dividends paid was $70.02 million; an additional $0.12 million will be paid if and when unvested restricted incentive stock awards vest.

C. Research and development, patents and licenses, etc.

Not applicable.

D. Trend information

Our results of operations depend primarily on the charter hire rates that we are able to realize. Charter hire rates paid for drybulk, containership and multipurpose carriers are primarily a function of the underlying balance between vessel supply and demand.

The demand for drybulk carrier, containership and multipurpose vessel capacity is determined by the underlying demand for commodities transported in these vessels, which in turn is influenced by trends in the global economy. One of the main reasons for the resurgence in drybulk and containerized trade has been the growth in imports by China of iron ore, coal and steel products during the last five years and exports of finished goods. Demand for drybulk carrier and containership capacity is also affected by the operating efficiency of the global fleet, with port congestion, which has been a feature of the market in 2004, the first half of 2005 and again in late 2006, 2007 and most of 2008, absorbing additional tonnage especially in the drybulk market. During the last three months of 2008 and the first three months of 2009, drybulk and containerized trade was severely affected by the world economic slowdown and the lack of bank credit to finance trade.

The supply of drybulk carriers, containerships and multipurpose vessels is dependent on the delivery of new vessels and the removal of vessels from the global fleet, either through scrapping or loss. Based on CRSL, as of May 1, 2009, the global drybulk carrier orderbook amounted to approximately 295.3 million dwt, or about 69.4% of the existing fleet, with more than half of the vessels on the orderbook scheduled to be delivered by the end of 2010, however, there is increasing indication that the credit crisis, the significant slowdown of the economies and decline of the shipping markets might result in a substantial number of orderbook cancellations. Containership orderbook (including multipurpose vessels) amounted to approximately 6.09 million teu, or about 44.5% of the existing fleet with most vessels, again, expected to be delivered in 2009 and 2010. The level of scrapping activity is generally a function of scrapping prices in relation to current and prospective charter market conditions, as well as operating, repair and survey costs. The average age at which a vessel is scrapped over the last ten years has been between 26 and 27 years, with smaller vessels scrapped at later age. During strong markets, the average age at which the vessels are scrapped increases; during 2004, 2005, 2006, 2007, and the first nine months of 2008 the majority of the handysize and handymax bulkers and feedership, handysize and intermediate size containerships that were scrapped were in excess of 30 years of age. During the same period Panamax drybulk carriers were scrapped at an average age of 29 years. However, the scrapping rate increased significantly (especially of drybulk carriers) and the average age decreased since the beginning of the October of 2008 when shipping rates declined significantly. Declining shipping charter hire rates have a negative impact on our earnings when our vessels are employed in the spot market or when they are to be re-chartered after completing a time charter contract. As of May 1, 2009, approximately 70% of our ship capacity days in 2009, including fixed spot employment in the first and second quarter of the year, and approximately 43% of our ship capacity days in 2010, are under time charter contracts or protected from market fluctuations (via FFA contracts).

E. Off-balance Sheet Arrangements

As of December 31, 2008 we did not have any off-balance sheet arrangements.

F. Tabular Disclosure of Contractual Obligations

Contractual Obligations and Commitments

Contractual obligations are set forth in the following table as of December 31, 2008:

In U.S. dollars	Total	Less Than One Year	One to Three Years	Three to Five Years	More Than Five Years
Bank debt (1)	$ 56,015,000	$ 12,450,000	$ 20,700,000	$ 17,025,000	$ 5,840,000
Interest Payments (2)	$ 8,659,501	$ 2,700,378	$ 3,667,833	$ 1,981,210	$ 310,080
Vessel Management fees (3)	$ 13,885,151	$ 4,967,651	$ 6,560,425	$ 2,173,016	$ 184,059
Other Management fees (4)	$ 4,980,957	$ 1,150,000	$ 2,422,159	$ 1,408,798	—
Derivative contracts (5)	$ 1,239,833	$ 296,558	$ 943,275	—	—

(1) Two additional loans of $10 million each were drawn in January and April 2009 to partly finance the acquisition of vessels m/v Monica P and m/v Eleni P. These loans have margins of 2.50-2.70% over LIBOR and are to be repaid in 5 years with a $5.00 million and $4.60 million balloon payment, respectively (see "Item 8B – Significant Changes" below).

(2) Assuming the amortization of the loans as of December 31, 2008 described above and an estimated average effective interest rate of about 3.86%, 3.90%, 3.85% and 3.80% p.a. for the four periods, respectively, based on an underlying assumption for LIBOR of 3.00% p.a. Also includes our obligation to make payments required as of December 31, 2008 under our interest rate swap agreement. We have assumed forward LIBOR rates of 1.27%, 1.65%, 2.33%, 2.55% and 2.70% for years 1 to 5, respectively, based on the LIBOR yield curve as of December 31, 2008 to estimate our payments under the interest rate swap agreement (see Item 11).

(3) Refers to our obligation for management fees of 655 Euros per day per vessel (approximately $851.50) for the sixteen vessels owned by Euroseas as of December 31, 2008 under the initial five-year management contract each shipowning company signs with Eurobulk when a vessel is acquired; the rate of these agreements is set in the Master Management Agreement which expires on February 6, 2013. For years two to five we have assumed no changes in the number of vessels, an inflation rate of 3.5% per year and no changes in this US Dollar to Euro exchange rate (assumed approximately at 1.30 USD/Euro). We have used the delivery date of m/v Ioanna P to its buyers and the delivery date of m/v Monica P to our subsidiary, Saf-Concord Shipping Ltd., as both sale and purchase agreements were signed before December 31, 2008 (January 12, 2009 and January 19, 2009, respectively).

(4) Refers to our obligation for management fees of $1,150,000 per year under our Master Management Agreement with Eurobulk for the cost of providing management services to Euroseas as a public company. This fee is adjusted for inflation in Greece during the previous calendar year every January 1st. From January 1, 2010 on, we have assumed an inflation rate of 3.5% per year. The agreement expires on February 6, 2013.

(5) Refers to our obligation to make payments required as of December 31, 2008 under our six FFA contracts. We have used the FFA rates as of December 31, 2008 to estimate the payments required under our FFA contracts (see Item 11).

G. Safe Harbor

See section "Forward-Looking Statements" at the beginning of this annual report.

56

Item 6. Directors, Senior Management and Employees

A. Directors and Senior Management

The following sets forth the name and position of each of our directors and executive officers.

Name	Age	Position
Aristides J. Pittas	49	Chairman, President and CEO; Class A Director
Dr. Anastasios Aslidis	49	CFO and Treasurer; Class A Director
Aristides P. Pittas	57	Vice Chairman; Class A Director
Stephania Karmiri	41	Secretary
Panagiotis Kyriakopoulos	48	Class B Director
George Skarvelis	48	Class B Director
George Taniskidis	48	Class C Director
Gerald Turner	61	Class C Director

Aristides J. Pittas has been a member of our Board of Directors and our Chairman and Chief Executive Officer since our inception on May 5, 2005. Since 1997, Mr. Pittas has also been the President of Eurochart S.A., our affiliate. Eurochart is a shipbroking company specializing in chartering and selling and purchasing ships. Since 1997, Mr. Pittas has also been the President of Eurotrade, a ship operating company and our affiliate. Since January 1995, Mr. Pittas has been the President and Managing Director of Eurobulk, our affiliated ship management company. He resigned as Managing Director of Eurobulk in June 2005. Eurobulk is a ship management company that provides ocean transportation services. From September 1991 to December 1994, Mr. Pittas was the Vice President of Oceanbulk Maritime SA, a ship management company. From March 1990 to August 1991, Mr. Pittas served both as the Assistant to the General Manager and the Head of the Planning Department of Varnima International SA, a shipping company operating tanker vessels. From June 1987 until February 1990, Mr. Pittas was the head of the Central Planning department of Eleusis Shipyards S.A. From January 1987 to June 1987, Mr. Pittas served as Assistant to the General Manager of Chios Navigation Shipping Company in London, a company that provides ship management services. From December 1985 to January 1987, Mr. Pittas worked in the design department of Eleusis Shipyards S.A. where he focused on shipbuilding and ship repair. Mr. Pittas has a B.Sc. in Marine Engineering from University of Newcastle - Upon-Tyne and a MSc in both Ocean Systems Management and Naval Architecture and Marine Engineering from the Massachusetts Institute of Technology.

Dr. Anastasios Aslidis has been our Chief Financial Officer and Treasurer and member of our Board of Directors since September 2005. Prior to joining Euroseas, Dr. Aslidis was a partner at Marsoft, an international consulting firm focusing on investment and risk management in the maritime industry. Dr. Aslidis has more than

20 years of experience in the maritime industry. Between 2003 and 2005, he worked on financial risk management methods for shipowners and banks lending to the maritime industry, especially as pertaining to compliance to the Basel II Capital Accords. He also served as consultant to the Boards of Directors of shipping companies (public and private) advising in strategy development, asset selection and investment timing. Between 1993 and 2003, as part of his tenure at Marsoft, he worked on various projects including development of portfolio and risk management methods for shipowners, establishment of investments funds and structuring private equity in the maritime industry and business development for Marsoft's services. Between 1989 and 1993, Dr. Aslidis worked on economic modeling of the offshore drilling industry and on the development of a trading support system for the drybulk shipping industry on behalf of a major European shipowner. Dr. Aslidis holds a diploma in Naval Architecture and Marine Engineering from the National Technical University of Athens (1983), M.S. in Ocean Systems Management (1984) and Operations

Research (1987) from the Massachusetts Institute of Technology, and a Ph.D. in Ocean Systems Management (1989) also from Massachusetts Institute of Technology.

Aristides P. Pittas has been a member of our Board of Directors since our inception on May 5, 2005 and our Vice Chairman since September 1, 2005. Mr. Pittas has been a shareholder in over 70 oceangoing vessels during the last 20 years. Since February 1989, Mr. Pittas has been the Vice President of Oceanbulk Maritime SA, a ship management company. From November 1987 to February 1989, Mr. Pittas was employed in the supply department of Drytank SA, a shipping company. From November 1981 to June 1985, Mr. Pittas was employed at Trust Marine Enterprises, a brokerage house as a sale and purchase broker. From September 1979 to November 1981, Mr. Pittas worked at Gourdomichalis Maritime SA in the operation and Freight Collection department. Mr. Pittas has a B.Sc in Economics from Athens School of Economics.

Stephania Karmiri has been our Secretary since our inception on May 5, 2005. Since July 1995, Mrs. Karmiri has been executive secretary to Eurobulk, our affiliated ship management company. Eurobulk is a ship management company that provides ocean transportation services. At Eurobulk, Mrs. Karmiri has been responsible for dealing with sale and purchase transactions, vessel registrations/deletions, bank loans, supervision of office administration and office/vessel telecommunication. From May 1992 to June 1995, she was secretary to the technical department of Oceanbulk Maritime SA, a ship management company. From 1988 to 1992, Mrs. Karmiri served as assistant to brokers for Allied Shipbrokers, a company that provides shipbroking services to sale and purchase transactions. Mrs. Karmiri has taken assistant accountant and secretarial courses from Didacta college.

Panagiotis Kyriakopoulos has been a member of our Board of Directors since our inception on May 5, 2005. Since July 2002, he has been the Chief Executive Officer of New Television S.A., one of the leading Mass Media Companies in Greece, running television and radio stations. From July 1997 to July 2002 he was the C.E.O. of the Hellenic Post Group, the Universal Postal Service Provider, having the largest retail network in Greece for postal and financial services products. From March 1996 until July 1997, Mr. Kyriakopoulos was the General Manager of ATEMKE SA, one of the leading construction companies in Greece listed on the Athens Stock Exchange. From December 1986 to March 1996, he was the Managing Director of Globe Group of Companies, a group active in the areas of shipowning and management, textiles and food and distribution. The company was listed on the Athens Stock Exchange. From June 1983 to December 1986, Mr. Kyriakopoulos was an assistant to the Managing Director of Armada Marine S.A., a company active in international trading and shipping, owning and managing a fleet of 12 vessels. Presently he is a member of the Board of Directors of the Hellenic Post and General Secretary of the Hellenic Private Television Owners Union. He has also been an investor in the shipping industry for more than 20 years. Mr. Kyriakopoulos has a B.Sc. degree in Marine Engineering from the University of Newcastle upon Tyne and a MSc. degree in Naval Architecture and Marine Engineering with specialization in Management from the Massachusetts Institute of Technology.

George Skarvelis has been a member of our Board of Directors since our inception on May 5, 2005. He has been active in shipping since 1982. In 1992, he founded Marine Spirit S.A., a ship management company. Between 1999 and 2003, Marine Spirit acted as one of the crewing managers for Eurobulk. From 1986 until 1992, Mr. Skarvelis was operations director at Markos S. Shipping Ltd. From 1982 until 1986, he worked with Glysca Compania Naviera, a management company of five vessels. Over the years Mr. Skarvelis has been a shareholder in numerous shipping companies. He has a B.Sc. in economics from the Athens University Law School.

George Taniskidis has been a member of our Board of Directors since our inception on May 5, 2005. He is the Chairman and Managing Director of Millennium Bank and a member of the Board of Directors of BankEuropa (subsidiary bank of Millennium Bank in Turkey). He is a member of the Executive Committee of the Hellenic Banks Association. From 2003 until 2005, he was a member of the Board of Directors of Visa International Europe, elected by the Visa issuing banks of Cyprus, Malta, Portugal, Israel and Greece. From 1990 to 1998, Mr. Taniskidis worked at XIOSBANK (until its acquisition by Piraeus Bank in 1998) in various positions, with responsibility for the bank's credit strategy and network. Mr. Taniskidis studied Law in the National University of Athens and in the University of Pennsylvania Law School, where he received a L.L.M. After law school, he joined the law firm of Rogers & Wells in

New York, where he worked until 1989 and was also a member of the New York State Bar Association. He is also a member of the Young Presidents Organization.

Gerald Turner has been a member of our Board of Directors since our inception on May 5, 2005. Since 1999, he has been the Chairman and Managing Director of AON Turner Reinsurance Services. From 1987 to 1999, he was the Chairman and sole owner of Turner Reinsurance services. From 1977 to 1987, he was the Managing Director of E.W. Payne Hellas (member of the Sedgwik group).

Family Relationships

Aristides P. Pittas is the cousin of Aristides J. Pittas, our CEO.

B. Compensation

Executive Compensation

We have no direct employees. The services of our Chief Executive Officer, Chief Financial Officer, Chief Administrative Officer, Internal Auditor and Secretary are provided by Eurobulk. In July 2005, we entered into a written services agreement with Eurobulk where we paid $500,000 per year, before bonuses, adjusted annually for Greek inflation to account for the increased management cost associated with us being a public company. As of October 1, 2006, these services are now provided to us under our Master Management Agreement with Eurobulk. Under this Master Management Agreement, as amended in July 2007 and February 2008, for the services of our executives, Mr. Aristides J. Pittas, Dr. Anastasios Aslidis, Mr. Symeon Pariaros and Mrs. Stephania Karmiri, and, our internal auditor, we pay Eurobulk $1,100,000 per year starting January 1, 2008, before bonuses, adjusted annually every January 1st for Greek inflation. On January 1, 2009, the management fee for executive services was adjusted to $1,150,000 to account for inflation in Greece. In 2005, 2006, 2007 and 2008 we paid $250,000, $508,750, $608,750 and $1,100,000, respectively.

Director Compensation

Our directors who are also our employees or have executive positions or beneficially own greater than 10% of the outstanding common stock will receive no compensation for serving on our Board or its committees.

Directors who are not our employees, do not have any executive position and do not beneficially own greater than 10% of the outstanding common stock will receive the following compensation: an annual retainer of $10,000, plus $2,500 for attending the quarterly meeting of the Board of Directors, plus an additional retainer of $5,000, if serving as Chairman of the Audit Committee.

All directors are reimbursed reasonable out-of-pocket expenses incurred in attending meetings of our Board of Directors or any committee of our Board of Directors.

Equity Incentive Plan

In August 2006, we adopted an equity incentive plan which entitles our Board of Directors to grant to our directors, officers and key employees awards in the form of (i) incentive stock options, (ii) non-qualified stock options, (iii) stock appreciation rights, (iv) dividend equivalent rights, (v) restricted stock, (vi) unrestricted stock, (vii) restricted stock units and (viii) performance shares. The aggregate number of shares of common stock with respect to which options or restricted shares may at any time be granted under the plan are 600,000 shares of Common Stock. The plan is administered by our Board of Directors. The plan does not have any set term. However, the Board of Directors may not grant any incentive stock options after the tenth anniversary of the adoption of the Plan. This plan was terminated and replaced by a substantially similar plan in October 2007 that entitles our Board of Directors to grant awards under the plan to directors, officers and key employees of the Company and its affiliates.

On December 18, 2007, the Board of Directors awarded 135,000 shares of restricted stock to the directors, officers and key employees of our manager, Eurobulk Ltd., 50% of which vested on December 20, 2007 and the remainder which vested on December 15, 2008. On February 7, 2008, the Board of Directors awarded 150,000 shares of restricted stock to the directors, officers and key employees of our manager, Eurobulk Ltd., 50% of which vested on

August 7, 2008 and the remainder which will vest on August 7, 2009. On November 12, 2008, the Board of Directors awarded 160,000 shares of restricted stock to the directors, officers and key employees of our manager, Eurobulk Ltd., 50% of which will vest on November 16, 2009 and the remainder which will vest on November 16, 2010. Vesting of the awards is conditioned on continuous employment throughout the period to the vesting date.

59

C. Board Practices

The term of our Class A directors expires in 2011. The term of our Class B directors expires in 2009 and the term of our Class C directors expires in 2010.

Audit Committee

We currently have an audit committee comprised of three independent members of our Board of Directors. The Audit Committee is responsible for reviewing the Company's accounting controls and the appointment of the Company's outside auditors. The members of the Audit Committee are Mr. Panos Kyriakopoulos (Chairman and audit committee "financial expert" as such term is defined under SEC regulations), Mr. Gerald Turner and Mr. George Taniskidis. Our Board of Directors does not have separate compensation or nominations committees, and instead, the entire Board of Directors performs those responsibilities.

Code of Ethics

We have adopted a code of ethics that complies with the applicable guidelines issued by the SEC. Our code of ethics is posted on our website: http://www.euroseas.gr under "Corporate Governance."

Corporate Governance

Our Company's corporate governance practices are in compliance with, and are not prohibited by, the laws of the Republic of the Marshall Islands. Therefore, we are exempt from many of NASDAQ's corporate governance practices other than the requirements regarding the disclosure of a going concern audit opinion, submission of a listing agreement, notification of material non-compliance with NASDAQ corporate governance practices, and the establishment and composition of an audit committee and a formal written audit committee charter. The practices followed by us in lieu of NASDAQ's corporate governance rules are described below.

- We are not required under Marshall Islands law to maintain a board of directors with a majority of independent directors, and we cannot guarantee that we will always in the future maintain a board of directors with a majority of independent directors.

- In lieu of a compensation committee comprised of independent directors, our Board of Directors will be responsible for establishing the executive officers' compensation and benefits. Under Marshall Islands law, compensation of the executive officers is not required to be determined by an independent committee.

- In lieu of a nomination committee comprised of independent directors, our Board of Directors will be responsible for identifying and recommending potential candidates to become board members and recommending directors for appointment to board committees. Shareholders may also identify and recommend potential candidates to become candidates to become board members in writing. No formal written charter has been prepared or adopted because this process is outlined in our bylaws.

- In lieu of obtaining an independent review of related party transactions for conflicts of interests, consistent with Marshall Islands law requirements, a related party transaction will be permitted if: (i) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors and the Board of Directors in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, or, if the votes of the disinterested directors are insufficient to constitute an act of the Board of Directors as defined in Section 55 of the Marshall Islands Business Corporations Act, by unanimous vote of the disinterested directors; or (ii) the material facts as to his relationship or interest are disclosed and the

shareholders are entitled to vote thereon, and the contract or transaction is specifically approved in good faith by a simple majority vote of the shareholders; or (iii) the contract or transaction is fair as to the Company as of the time it is authorized, approved or ratified, by the Board of Directors, a committee thereof or the shareholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

- As a foreign private issuer, we are not required to solicit proxies or provide proxy statements to NASDAQ pursuant to NASDAQ corporate governance rules or Marshall Islands law. Consistent with Marshall Islands law, we will notify our shareholders of meetings between 15 and 60 days before the meeting. This notification will contain, among other things, information regarding business to be transacted at the meeting. In addition, our bylaws provide that shareholders must give us advance notice to properly introduce any business at a meeting of the shareholders. Our bylaws also provide that shareholders may designate in writing a proxy to act on their behalf.

- In lieu of holding regular meetings at which only independent directors are present, our entire board of directors, a majority of whom are independent, will hold regular meetings as is consistent with the laws of the Republic of the Marshall Islands.

- The Board of Directors adopted an equity incentive plan in October 2007 which replaced the prior equity incentive plan. Shareholder approval was not necessary to terminate the original equity incentive plan or to establish a new equity incentive plan since Marshall Islands law permits the Board of Directors to take these actions. The Company has filed the appropriate documentation with the Nasdaq Global Market reflecting this event.

Other than as noted above, we are in full compliance with all other applicable NASDAQ corporate governance standards.

D. Employees

We have no salaried employees, although we reimburse our fleet manager, Eurobulk, for the salaries of our CEO, CFO, CAO, internal auditor and Secretary. Eurobulk also ensures that all seamen have the qualifications and licenses required to comply with international regulations and shipping conventions, and that all our vessels employ experienced and competent personnel. As of December 31, 2008, approximately 145 officers and 240 crew members served on board the vessels in our fleet.

E. Share Ownership

The following table sets forth certain information the ownership of our common stock by each of our directors and executive officers, and all of our directors and executive officers as a group as of May 1, 2009.

Name of Beneficial Owner(1)	Number of Shares of Voting Stock Beneficially Owned	Percent of Voting Stock
Friends Investment Company Inc.(2)	10,174,117	33.3%
Aristides J. Pittas(3)	110,000	*
George Skarvelis(4)	15,000	*
George Taniskidis(5)	15,000	*
Gerald Turner(6)	15,000	*
Panagiotis Kyriakopoulos(7)	15,000	*
Aristides P. Pittas(8)	20,000	*
Anastasios Aslidis(9)	61,500	*
Stefania Karmiri (10)	—	*

Simos Pariaros (11)	5,000	*
All directors and officers and 5% owners as a group	10,430,617	34.1%

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* Indicates less than 1.0%.

(1) Beneficial ownership is determined in accordance with the Rule 13d-3(a) of the Securities Exchange Act of 1934, as amended, and generally includes voting or investment power with respect to securities. Except as subject to community property laws, where applicable, the person named above has sole voting and investment power with respect to all shares of common stock shown as beneficially owned by him/her.

61

(2) Includes 10,174,117 shares of common stock held of record by Friends. A majority of the shareholders of Friends are members of the Pittas family. Investment power and voting control by Friends resides in its Board of Directors which consists of five directors, a majority of whom are members of the Pittas family. Actions by Friends may be taken by a majority of the members on its Board of Directors.

(3) Does not include 1,282,964 shares of common stock held of record by Friends, by virtue of Mr. Pittas' ownership interest in Friends. Also does not include 52,542 shares of common stock held of record by Eurobulk Marine Holdings, Inc. ("Eurobulk Marine"), by virtue of Mr. Pittas' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Pittas disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 20,000 shares vesting on August 11, 2009, 20,000 shares vesting on November 16, 2009 and 20,000 shares vesting on November 16, 2010.

(4) Does not include 539,228 shares of common stock held of record by Friends, by virtue of Mr. Skarvelis' ownership interest in Friends. Also does not include 22,083 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Skarvelis' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Skarvelis disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(5) Does not include 31,588 shares of common stock held of record by Friends, by virtue of Mr. Taniskidis' ownership in Friends. Also does not include 1,294 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Taniskidis' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Taniskidis disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(6) Does not include 144,472 shares of common stock held of record by Friends, by virtue of Mr. Turner's ownership interest in Friends. Also does not include 5,917 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Turner's ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Turner disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(7) Does not include 61,045 shares of common stock held of record by Friends, by virtue of Mr. Kyriakopoulos' ownership in Friends. Also does not include 2,500 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Kyriakopoulos' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Kyriakopoulos disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(8) Does not include 876,692 shares of common stock held of record by Friends, by virtue of Mr. Pittas' ownership interest in Friends. Also does not include 35,904 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Pittas' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Pittas disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 5,000 shares

vesting on August 11, 2009, 5,000 shares vesting on November 16, 2009 and 5,000 shares vesting on November 16, 2010.

(9) Includes 12,500 shares vesting on August 11, 2009, 12,500 shares vesting on November 16, 2009 and 12,500 shares vesting on November 16, 2010.

(10) Does not include 2,138 shares of common stock held of records by Friends, by virtue of Mrs. Karmiri's ownership in Friends. Also does not include 88 shares of common stock held of record by Eurobulk Marine, by virtue of Mrs. Karmiri's ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mrs. Karmiri disclaims beneficial ownership except to the extent of her pecuniary interest.

(11) Includes 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

All of the shares of our common stock have the same voting rights and are entitled to one vote per share.

Equity Incentive Plan

See section 6(B) of this annual report, "Directors, Senior Management and Employees—Compensation."

Options

No options were granted during the fiscal year ended December 31, 2008. There are currently no options outstanding to acquire any of our shares.

Warrants

In connection with our Private Placement in August 2005, we issued warrants to purchase 585,589 shares of our common stock. The warrants have a five year term and an exercise price of $10.80 per share. During 2007, 248,463 of the above warrants were exercised and an additional 192,213 warrants were exercised in 2008. As of May 1, 2009, there are 144,913 warrants outstanding. We do not currently have any other outstanding warrants.

Item 7. Major Shareholders and Related Party Transactions

A. Major Stockholders

The following table sets forth certain information regarding the beneficial ownership of our voting stock as of May 1, 2009 by each person or entity known by us to be the beneficial owner of more than 5% of the outstanding shares of our voting stock, each of our directors and executive officers, and all of our directors and executive officers as a group. All of our shareholders, including the shareholders listed in this table, are entitled to one vote for each share of stock held.

Name of Beneficial Owner(1)	Number of Shares of Voting Stock Beneficially Owned	Percent of Voting Stock
Friends Investment Company Inc.(2)	10,174,117	33.3%
Aristides J. Pittas(3)	110,000	*
George Skarvelis(4)	15,000	*
George Taniskidis(5)	15,000	*
Gerald Turner(6)	15,000	*
Panagiotis Kyriakopoulos(7)	15,000	*
Aristides P. Pittas(8)	20,000	*
Anastasios Aslidis(9)	61,500	*
Stefania Karmiri (10)	—	*
Simos Pariaros (11)	5,000	*
All directors and officers and 5% owners as a group	10,430,617	34.1%

* Indicates less than 1.0%.

(1) Beneficial ownership is determined in accordance with the Rule 13d-3(a) of the Securities Exchange Act of 1934, as amended, and generally includes voting or investment power with respect to securities. Except as subject to community property laws, where applicable, the person named above has sole voting and investment power with respect to all shares of common stock shown as beneficially owned by him/her.

(2) Includes 10,174,117 shares of common stock held of record by Friends. A majority of the shareholders of Friends are members of the Pittas family. Investment power and voting control by Friends resides in its Board of Directors which consists of five directors, a majority of whom are members of the Pittas family. Actions by Friends may be taken by a majority of the members on its Board of Directors.

63

(3) Does not include 1,282,964 shares of common stock held of record by Friends, by virtue of Mr. Pittas' ownership interest in Friends. Also does not include 52,542 shares of common stock held of record by Eurobulk Marine Holdings, Inc. ("Eurobulk Marine"), by virtue of Mr. Pittas' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Pittas disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 20,000 shares vesting on August 11, 2009, 20,000 shares vesting on November 16, 2009 and 20,000 shares vesting on November 16, 2010.

(4) Does not include 539,228 shares of common stock held of record by Friends, by virtue of Mr. Skarvelis' ownership interest in Friends. Also does not include 22,083 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Skarvelis' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Skarvelis disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(5) Does not include 31,588 shares of common stock held of record by Friends, by virtue of Mr. Taniskidis' ownership in Friends. Also does not include 1,294 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Taniskidis' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Taniskidis disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(6) Does not include 144,472 shares of common stock held of record by Friends, by virtue of Mr. Turner's ownership interest in Friends. Also does not include 5,917 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Turner's ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Turner disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(7) Does not include 61,045 shares of common stock held of record by Friends, by virtue of Mr. Kyriakopoulos' ownership in Friends. Also does not include 2,500 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Kyriakopoulos' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Kyriakopoulos disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 2,500 shares vesting on August 11, 2009, 2,500 shares vesting on November 16, 2009 and 2,500 shares vesting on November 16, 2010.

(8) Does not include 876,692 shares of common stock held of record by Friends, by virtue of Mr. Pittas' ownership interest in Friends. Also does not include 35,904 shares of common stock held of record by Eurobulk Marine, by virtue of Mr. Pittas' ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mr. Pittas disclaims beneficial ownership except to the extent of his pecuniary interest. Includes 5,000 shares vesting on August 11, 2009, 5,000 shares vesting on November 16, 2009 and 5,000 shares vesting on November 16, 2010.

(9)

Includes 12,500 shares vesting on August 11, 2009, 12,500 shares vesting on November 16, 2009 and 12,500 shares vesting on November 16, 2010.

(10) Does not include 2,138 shares of common stock held of records by Friends, by virtue of Mrs. Karmiri's ownership in Friends. Also does not include 88 shares of common stock held of record by Eurobulk Marine, by virtue of Mrs. Karmiri's ownership interest in Eurobulk Marine. Eurobulk Marine was an investor in our Private Placement in August 2005. Friends and Eurobulk Marine are each controlled by members of the Pittas family. Mrs. Karmiri disclaims beneficial ownership except to the extent of her pecuniary interest.

(11) Includes 2,500 shares vesting November 16, 2009 and 2,500 shares vesting on November 16, 2010.

B. Related Party Transactions

The operations of our vessels are managed by Eurobulk, an affiliated ship management company, under a Master Management Agreement with us and separate management agreements with each shipowning company. Under our Master Management Agreement, Eurobulk is responsible for all aspects of management and compliance for the Company, including the provision of the services of our Chief Executive Officer, Chief Financial Officer, Chief Administrative Officer, Internal Auditor and Secretary. Eurobulk is also responsible for all commercial management services, which include obtaining employment for our vessels and managing our relationships with charterers. Eurobulk also performs technical management services, which include managing day-to-day vessel operations, performing general vessel maintenance, ensuring regulatory and classification society compliance, supervising the maintenance and general efficiency of vessels, arranging our hire of qualified officers and crew, arranging and supervising dry docking and repairs, arranging insurance for vessels, purchasing stores, supplies, spares and new equipment for vessels, appointing supervisors and technical consultants and providing technical support and shoreside personnel who carry out the management functions described above and certain accounting services. Eurobulk also currently manages one other vessel not owned by us.

Our Master Management Agreement with Eurobulk is effective as of February 7, 2008 and has an initial term of 5 years until February 6, 2013. The Master Management Agreement cannot be terminated by Eurobulk without cause or under other limited circumstances, such as sale of the Company or Eurobulk or the bankruptcy of either party. This Master Management Agreement will automatically be extended after the initial period for an additional five year period unless terminated on or before the 90th day preceding the initial termination date. Pursuant to the Master Management Agreement, each new vessel we acquire in the future will enter into a separate management agreement with Eurobulk. Under the Master Management Agreement, we pay Eurobulk since January 1, 2009 a fixed cost of $1,150,000 annually, adjusted for Greek inflation every January 1st, and a per ship per day cost of €655 (or $851.50 based on $1.30/euro exchange rate) adjusted annually for inflation (every January 1st). Eurobulk has received fees for management and executive compensation expenses of $1,972,252, $2,161,856, $2,775,339, $4,277,887 and $6,487,415 for years ended December 31, 2004, 2005, 2006, 2007 and 2008, respectively.

We receive chartering and sale and purchase services from Eurochart, an affiliate, and pay a commission of 1.25% on charter revenue and 1% on vessel sale price. We pay additional commissions to major charterers and their brokers as well that usually range from 3.75% to 5.00%. Eurochart has received chartering and vessel sale commissions of $604,717, $536,180, $588,149, $1,177,916 and $1,663,526 for years ended December 31, 2004, 2005, 2006, 2007 and 2008, respectively. Eurochart also received 1% commission for vessel acquisitions we did from the sellers of the vessels that we acquired.

We engaged Eurotrade S.A., a company controlled by certain members of the Pittas family, to act on our behalf and enter into six FFA contracts in December 2008 using its existing FFA trading account arrangements with Royal Bank of Scotland ("RBS"), until we establish our own separate FFA trading account. These six FFA contracts are for a total of 480 vessel-equivalent days for calendar year 2009 and 485 days for 2010 of a modern panamax size vessel. In January 2009, we set up our own FFA trading account with Banque de Paris – Paribas ("BNP") and subsequent FFA contracts have been entered into via this account. We intend to transfer the RBS contracts to our own account with BNP as soon as practical. We do not have any legal obligations to Eurotrade to cover any margin requirements for these contracts but we may provide such margin if required. The Company did not pay any fees to Eurotrade S.A. for these arrangements.

More Maritime Agencies Inc. are crewing agents and Sentinel Marine Services Inc. are insurance brokering companies and affiliates to whom we will pay a fee of $50 per crew member per month and a commission on premium not exceeding 5%, respectively.

Aristides J. Pittas, Euroseas' President, Chief Executive Officer and Chairman, has provided personal guarantees for some of Euroseas' debts. Eurobulk has provided corporate guarantees for all debts. Additionally, Aristides J. Pittas is currently the Chairman of each of Eurochart, Eurotrade and Eurobulk, all of which are our affiliates.

We have entered into a registration rights agreement with Friends, our largest shareholder, pursuant to which we granted Friends the right, under certain circumstances and subject to certain restrictions, to require us to register under the Securities Act shares of our common stock held by Friends. Under the registration rights agreement, Friends has the right to request us to register the sale of shares held by it on its behalf and may require us to make available shelf registration statements permitting sales of shares into the market from time to time over an extended period. In addition, Friends has the ability to exercise certain piggyback registration rights in connection with registered offerings initiated by us. As of July 2, 2008, all of Friends' shares of Euroseas (9,539,211 shares) and all of Eurobulk Marine Holdings Inc.'s shares of Euroseas (416,668 shares) were registered under our F-3 registration statement.

Eurobulk, Friends Investment Company Inc. and Aristides J. Pittas, our Chairman and Chief Executive Officer, have granted us a right of first refusal to acquire any drybulk vessel or containership which any of them may consider for acquisition in the future. In addition, Mr. Pittas has granted us a right of first refusal to accept any chartering out opportunity for a drybulk vessel or containership which may be suitable for any of our vessels, provided that we have a suitable vessel, properly situated and available, to take advantage of the chartering out opportunity. Mr. Pittas has also agreed to use his best efforts to cause any entity he directly or indirectly controls to grant us this right of first refusal.

C. Interests of Experts and Counsel

Not Applicable.

Item 8. Financial information

A. Consolidated Statements and Other Financial Information

See Item 18.

Legal Proceedings

To our knowledge, there are no material legal proceedings to which we are a party or to which any of our properties are subject, other than routine litigation incidental to our business. In our opinion, the disposition of these lawsuits should not have a material impact on our consolidated results of operations, financial position and cash flows.

Dividend Policy

Our policy is to declare regular quarterly dividends to shareholders each February, May, August and November in amounts the Board of Directors may from time to time determine are appropriate. The exact timing and amount of dividend payments will be determined by our Board of Directors and will be dependent upon our earnings, financial condition, cash requirement and availability, restrictions in its loan agreements, growth strategy, the provisions of Marshall Islands law affecting the payment of distributions to shareholders and other factors, such as the acquisition of additional vessels.

The payment of dividends is not guaranteed or assured, and may be discontinued at any time at the discretion of our Board of Directors. Because we are a holding company with no material assets other than the stock of its subsidiaries, our ability to pay dividends will depend on the earnings and cash flow of its subsidiaries and their ability to pay dividends to us. If there is a substantial decline in the drybulk, containership or multipurpose charter market, our earnings would be negatively affected, thus limiting its ability to pay dividends. Marshall Islands law generally prohibits the payment of dividends other than from surplus or while a company is insolvent or would be rendered

insolvent upon the payment of such dividends. Dividends may be declared in conformity with applicable law by, and at the discretion of, our Board of Directors at any regular or special meeting. Dividends may be declared and paid in cash, stock or other property of Euroseas.

Euroseas paid $26,962,500, $46,875,223 (consisting of $30,175,223 of dividends and $16,700,000 as return of capital), $9,465,082, $20,278,538 and $34,547,950 in 2004, 2005, 2006, 2007 and 2008, respectively. While Euroseas has paid dividends on an annual basis during the time it has been a private company, it has paid dividends on a quarterly basis since it has become a public company. Since our Private Placement in August 2005, we declared and paid dividends of $2,650,223 for the third quarter of 2005, $2,271,620 for each of the fourth quarter of 2005, first quarter of 2006 and second quarter of 2006, $2,650,223 for the third quarter of 2006, $2,776,433 for the fourth quarter of 2006, $4,409,321 for the first quarter of 2007, $6,052,064 for the second quarter of 2007, $7,040,717 for the third quarter of 2007 and $9,128,334 for the fourth quarter of 2007, $9,433,373 for the first quarter of 2008, $9,808,346 for the second quarter of 2008, $6,177,897 for the third quarter of 2008, and $3,080,774 for the fourth quarter of 2008. Dividends of $116,750 have accrued and will be paid if and when unvested incentive stock awards vest. The most recent dividend for the fourth quarter of 2008 was declared and paid in 2009 (see Item 8.B(a) below).

B. Significant Changes

After December 31, 2008, the following significant events occurred:

a) On February 6, 2009, the Board of Directors declared a cash dividend of $0.10 per share of Euroseas Ltd. common stock. Such cash dividend was paid on or about March 20, 2009 to the holders of record of shares of Euroseas Ltd. common stock as of March 12, 2009.

b) On December 23, 2008, a subsidiary of the Company agreed to sell and on January 12, 2009 delivered to its buyers M/V "Ioanna P" for a gross price of $3.85 million less 4% sales commissions.

c) On January 28, 2009, a subsidiary of the Company agreed to sell and on February 12, 2009 delivered to its buyers M/V "Nikolaos P" (see Note 4) for a gross price of $2.4 million less 2% sales commissions.

d) On December 3, 2008, a subsidiary of the Company purchased the 46,667 dwt drybulk carrier M/V "Solar Europe" (renamed M/V "Monica P"), built in 1998 in Japan, for $18 million. The vessel was delivered to a subsidiary of the Company on January 19, 2009. The acquisition was financed with $8 million from the Company's cash balance and $10 million of bank debt secured by the vessel. The debt is payable in 20 consecutive quarterly installments of $250,000 and with a $5 million balloon payment together with the last installment. The margin of the loan is 2.50% above LIBOR.

e) On February 10, 2009, a subsidiary of the Company purchased the 72,119 dwt drybulk carrier M/V "Glorious Wind" (renamed M/V "Eleni P") built in 1997 in Japan, for $18.38 million. The vessel was delivered to the Company on March 6, 2009. The Company financed the acquisition with cash reserves from its balance sheet, and subsequently, arranged for a loan of $10 million. The loan is payable in 10 consecutive semiannual installments, two in the amount of $100,000, two in the amount of $400,000, two in the amount of $600,000 and four in the amount of $800,000 and with a $4.6 million balloon payment to be paid together with the last installment. The margin of the loan is 2.50% above LIBOR for the $5.4 million repaid throughout the 5 years and 2.70% above LIBOR for the balloon payment. The loan was drawn in April 2009.

Item 9. The Offer and Listing

A. Offer and Listing Details

The trading market for shares of our common stock is the NASDAQ Global Select Market, on which our shares trade under the symbol "ESEA". The following table sets forth the high and low closing prices for shares of our common

stock since our listing originally in the OTCBB (under symbols ESEAF.OB and EUSEF.OB), since January 31, 2007 on the NASDAQ Global Market and since January 1, 2008 on the NASDAQ Global Select Market. The prices below have been adjusted for the reverse 1-for-3 common stock split that was effected on October 6, 2006.

Period	Low	High
Year ended Dec. 31, 2006	6.70	18.93
2nd quarter 2006	8.82	18.93
3rd quarter 2006	8.55	9.15
4th quarter 2006	6.70	9.00
Year ended Dec. 31, 2007	7.00	20.79
1st quarter 2007	7.00	10.00
2nd quarter 2007	10.35	15.75
3rd quarter 2007	11.80	16.91
4th quarter 2007	11.75	20.79
Year ended Dec. 31, 2008	3.12	16.80
1st quarter 2008	9.60	14.08
2nd quarter 2008	12.32	16.80
3rd quarter 2008	7.97	13.40
4th quarter 2008	3.12	7.83
October 2008	3.90	7.83
November 2008	3.12	5.80
December 2008	3.60	5.54
2009*	3.51	5.95
1st quarter 2009	3.51	5.82
2nd quarter 2009	3.57	5.95(*)
January 2009	4.25	5.82
February 2009	4.23	5.52
March 2009	3.51	4.74
April 2009	3.57	4.86
May 2009	4.85	5.95(*)

* Through May 15, 2009

B. Plan of Distribution

Not Applicable.

C. Markets

The trading market for shares of our common stock is the NASDAQ Global Select Market, on which our shares trade under the symbol "ESEA". Our shares began trading on the NASDAQ Global Market on January 31, 2007 and on the NASDAQ Global Select Market on January 1, 2008. Prior to such date, our shares traded on the OTCBB under the symbol "ESEAF.OB" until October 5, 2006 and then under the symbol "EUSEF.OB" until January 30, 2007.

68

D. Selling Shareholders

Not Applicable.

E. Dilution

Not Applicable.

F. Expenses of the Issue

Not Applicable.

Item 10. Additional Information

A. Share Capital

Not Applicable.

B. Articles of Incorporation, as amended, and Bylaws

We refer you to the Section of our F-3 Registration Statement (File No. 333-152089) entitled "Description of Capital Stock" and Exhibits 3.1 (Articles of Incorporation), 3.2 (Bylaws) and 3.3 (Amendment to Articles of Incorporation) thereto as filed on July 2, 2008 with the SEC, incorporated by reference herein.

C. Material Contracts

We have no material contracts, other than contracts entered into in the ordinary course of business, to which the Company or any member of the group is a party.

D. Exchange Controls

Under Marshall Islands law, there are currently no restrictions on the export or import of capital, including foreign exchange controls or restrictions that affect the remittance of dividends, interest or other payments to non-resident holders of our shares.

E. Taxation

The following is a discussion of the material Marshall Islands, Liberian and United States federal income tax considerations applicable to us and U.S. Holders and Non-U.S. Holders, each as discussed below, of our common stock. The following discussion is based upon the provisions of the United States Internal Revenue Code of 1986, as amended, or the Code, existing and proposed United States Treasury Department regulations, administrative rulings, pronouncements and judicial decisions, all as of the date of this Annual Report.

Marshall Islands Tax Considerations

We are incorporated in the Marshall Islands. Under current Marshall Islands law, we are not subject to tax on income or capital gains, and no Marshall Islands withholding tax will be imposed upon payments of dividends by us to our stockholders.

Liberian Tax Considerations

The Republic of Liberia enacted a new income tax act effective as of January 1, 2001 (the "New Act"). In contrast to the income tax law previously in effect since 1977 (the "Prior Law"), which the New Act repealed in its entirety, the New Act does not distinguish between the taxation of a non resident Liberian corporation, such as our Liberian subsidiaries, which conduct no business in Liberia and was wholly exempted from tax under the Prior Law, and the taxation of ordinary resident Liberian corporations.

In 2004, the Liberian Ministry of Finance issued regulations pursuant to which a non-resident domestic corporation engaged in international shipping, such as our Liberian subsidiaries, will not be subject to tax under the New Act retroactive to January 1, 2001 (the "New Regulations"). In addition, the Liberian Ministry of Justice issued an opinion that the New Regulations were a valid exercise of the regulatory authority of the Ministry of Finance. Therefore, assuming that the New Regulations are valid, our Liberian subsidiaries will be wholly exempt from Liberian income tax as under the Prior Law.

If our Liberian subsidiaries were subject to Liberian income tax under the New Act, they would be subject to tax at a rate of 35% on their worldwide income. As a result, their, and subsequently our, net income and cash flow would be materially reduced by the amount of the applicable tax. In addition, we, as shareholder of the Liberian subsidiaries, would be subject to Liberian withholding tax on dividends paid by the Liberian subsidiaries at rates ranging from 15% to 20%.

United States Federal Income Tax

The following are the material United States federal income tax consequences to us of our activities and to U.S. Holders and Non-U.S. Holders, each as defined below, of our common stock. The following discussion of United States federal income tax matters is based on the United States Internal Revenue Code of 1986, or the Code, judicial decisions, administrative pronouncements, and existing and proposed regulations issued by the United States Department of the Treasury, all of which are subject to change, possibly with retroactive effect. This discussion is based in part upon Treasury Regulations promulgated under Section 883 of the Code. The discussion below is based, in part, on the description of our business as described in "Business" above and assumes that we conduct our business as described in that section. References in the following discussion to "we" and "us" are to Euroseas and its subsidiaries on a consolidated basis.

United States Federal Income Taxation of Our Company

Taxation of Operating Income: In General

Unless exempt from United States federal income taxation under the rules discussed below, a foreign corporation is subject to United States federal income taxation in respect of any income that is derived from the use of vessels, from the hiring or leasing of vessels for use on a time, voyage or bareboat charter basis, from the participation in a pool, partnership, strategic alliance, joint operating agreement, code sharing arrangements or other joint venture it directly or indirectly owns or participates in that generates such income, or from the performance of services directly related to those uses, which we refer to as "shipping income," to the extent that the shipping income is derived from sources within the United States. For these purposes, 50% of shipping income that is attributable to transportation that begins or ends, but that does not both begin and end, in the United States constitutes income from sources within the United States, which we refer to as "U.S.-source shipping income."

Shipping income attributable to transportation that both begins and ends in the United States is considered to be 100% from sources within the United States. We are not permitted by law to engage in transportation that produces income which is considered to be 100% from sources within the United States.

Shipping income attributable to transportation exclusively between non-United States ports will be considered to be 100% derived from sources outside the United States. Shipping income derived from sources outside the United States will not be subject to any United States federal income tax.

In the absence of exemption from tax under Section 883, our gross U.S.-source shipping income would be subject to a 4% tax imposed without allowance for deductions as described below.

Exemption of Operating Income from United States Federal Income Taxation

Under Section 883 of the Code, we will be exempt from United States federal income taxation on our U.S.-source shipping income if:

- we are organized in a foreign country (our "country of organization") that grants an "equivalent exemption" to corporations organized in the United States; and

either

- more than 50% of the value of our stock is owned, directly or indirectly, by "qualified stockholders," individuals who are "residents" of our country of organization or of another foreign country that grants an "equivalent exemption" to corporations organized in the United States, which we refer to as the "50% Ownership Test," or

- our stock is "primarily and regularly traded on an established securities market" in our country of organization, in another country that grants an "equivalent exemption" to United States corporations, or in the United States, which we refer to as the "Publicly-Traded Test."

The Marshall Islands, Liberia, Cyprus and Panama, the jurisdictions where we and our ship-owning subsidiaries were incorporated during 2008 each grants an "equivalent exemption" to United States corporations. Therefore, we will be exempt from United States federal income taxation with respect to our U.S.-source shipping income if we satisfy either the 50% Ownership Test or the Publicly-Traded Test.

We believe that we satisfied the 50% Ownership Test for our 2007 taxable year and we intend to take this position on our United States federal income tax return. For the 2008 taxable year and each taxable year thereafter, we anticipate that we will satisfy the Publicly-Traded Test.

Taxation in Absence of Exemption

To the extent the benefits of Section 883 are unavailable, our U.S.-source shipping income, to the extent not considered to be "effectively connected" with the conduct of a United States trade or business, as described below, would be subject to a 4% tax imposed by Section 887 of the Code on a gross basis, without the benefit of deductions. Since under the sourcing rules described above, no more than 50% of our shipping income would be treated as being derived from United States sources, the maximum effective rate of United States federal income tax on our shipping income would never exceed 2% under the 4% gross basis tax regime.

To the extent the benefits of the Section 883 exemption are unavailable and our U.S.-source shipping income is considered to be "effectively connected" with the conduct of a United States trade or business, as described below, any such "effectively connected" U.S.-source shipping income, net of applicable deductions, would be subject to the United States federal corporate income tax currently imposed at rates of up to 35%. In addition, we may be subject to the 30% "branch profits" taxes on earnings effectively connected with the conduct of such trade or business, as determined after allowance for certain adjustments, and on certain interest paid or deemed paid attributable to the conduct of its United States trade or business.

Our U.S.-source shipping income would be considered "effectively connected" with the conduct of a United States trade or business only if:

- We have, or are considered to have, a fixed place of business in the United States involved in the earning of shipping income; and

- substantially all of our U.S.-source shipping income is attributable to regularly scheduled transportation, such as the operation of a vessel that follows a published schedule with repeated sailings at regular intervals between the same points for voyages that begin or end in the United States.

We do not intend to have, or permit circumstances that would result in having any vessel operating to the United States on a regularly scheduled basis. Based on the foregoing and on the expected mode of our shipping operations and other activities, we believe that none of our U.S.-source shipping income are or will be "effectively connected"

with the conduct of a United States trade or business.

71

United States Taxation of Gain on Sale of Vessels

Regardless of whether we qualify for exemption under Section 883, we will not be subject to United States federal income taxation with respect to gain realized on a sale of a vessel, provided the sale is considered to occur outside of the United States under United States federal income tax principles. In general, a sale of a vessel will be considered to occur outside of the United States for this purpose if title to the vessel, and risk of loss with respect to the vessel, pass to the buyer outside of the United States. It is expected that any sale of a vessel by us will be considered to occur outside of the United States.

United States Federal Income Taxation of U.S. Holders

As used herein, the term "U.S. Holder" means a beneficial owner of common stock that is a United States citizen or resident, United States corporation or other United States entity taxable as a corporation, an estate the income of which is subject to United States federal income taxation regardless of its source, or a trust if a court within the United States is able to exercise primary jurisdiction over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust.

This discussion does not purport to deal with the tax consequences of owning common stock to all categories of investors, some of which, such as dealers in securities, investors whose functional currency is not the United States dollar and investors that own, actually or under applicable constructive ownership rules, 10% or more of our common stock, may be subject to special rules. This discussion deals only with holders who hold the common stock as a capital asset. You are encouraged to consult your own tax advisors concerning the overall tax consequences arising in your own particular situation under United States federal, state, local or foreign law of the ownership of common stock.

If a partnership holds our common stock, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. If you are a partner in a partnership holding our common stock, you are encouraged to consult your tax advisor.

Distributions

Subject to the discussion of passive foreign investment companies below, any distributions made by us with respect to our common stock to a U.S. Holder will generally constitute dividends, which may be taxable as ordinary income or "qualified dividend income" as described in more detail below, to the extent of our current or accumulated earnings and profits, as determined under United States federal income tax principles. Distributions in excess of our earnings and profits will be treated first as a nontaxable return of capital to the extent of the U.S. Holder's tax basis in his common stock on a dollar-for-dollar basis and thereafter as capital gain. Because we are not a United States corporation, U.S. Holders that are corporations will not be entitled to claim a dividends received deduction with respect to any distributions they receive from us. Dividends paid with respect to our common stock will generally be treated as "passive category income" or, in the case of certain types of U.S. Holders, "general category income" for purposes of computing allowable foreign tax credits for United States foreign tax credit purposes.

Dividends paid on our common stock to a U.S. Holder who is an individual, trust or estate (a "U.S. Individual Holder") will generally be treated as "qualified dividend income" that is taxable to such U.S. Individual Holders at preferential tax rates (through 2010) provided that (1) we are not a passive foreign investment company for the taxable year during which the dividend is paid or the immediately preceding taxable year (which we do not believe we are, have been or will be), (2) our common stock is readily tradable on an established securities market in the United States (such as the NASDAQ Global Select Market, on which our common stock is listed), and (3) the U.S. Individual Holder has owned the common stock for more than 60 days in the 121-day period beginning 60 days before the date on which the common stock becomes ex-dividend. There is no assurance that any dividends paid on our common

stock will be eligible for these preferential rates in the hands of a U.S. Individual Holder. Dividends paid on our stock prior to the date on which our stock became listed on the NASDAQ Global Select Market were not eligible for these preferential rates. Legislation has been previously introduced in the U.S. Congress which, if enacted in its present form, would preclude our dividends from qualifying for such preferential rates prospectively from the date of the enactment. Any dividends paid by us which are not eligible for these preferential rates will be taxed as ordinary income to a U.S. Individual Holder.

Special rules may apply to any "extraordinary dividend" generally, a dividend in an amount which is equal to or in excess of ten percent of a stockholder's adjusted basis (or fair market value in certain circumstances) in a share of common stock paid by us. If we pay an "extraordinary dividend" on our common stock that is treated as "qualified dividend income," then any loss derived by a U.S. Individual Holder from the sale or exchange of such common stock will be treated as long-term capital loss to the extent of such dividend.

Sale, Exchange or other Disposition of Common Stock

Assuming we do not constitute a passive foreign investment company for any taxable year, a U.S. Holder generally will recognize taxable gain or loss upon a sale, exchange or other disposition of our common stock in an amount equal to the difference between the amount realized by the U.S. Holder from such sale, exchange or other disposition and the U.S. Holder's tax basis in such stock. Such gain or loss will be treated as long-term capital gain or loss if the U.S. Holder's holding period is greater than one year at the time of the sale, exchange or other disposition. Such capital gain or loss will generally be treated as U.S.- source income or loss, as applicable, for U.S. foreign tax credit purposes. A U.S. Holder's ability to deduct capital losses is subject to certain limitations.

Passive Foreign Investment Company Status and Significant Tax Consequences

Special United States federal income tax rules apply to a U.S. Holder that holds stock in a foreign corporation classified as a passive foreign investment company for United States federal income tax purposes. In general, we will be treated as a passive foreign investment company with respect to a U.S. Holder if, for any taxable year in which such holder held our common stock, either:

- at least 75% of our gross income for such taxable year consists of passive income (e.g., dividends, interest, capital gains and rents derived other than in the active conduct of a rental business); or

- at least 50% of the average value of the assets held by the corporation during such taxable year produce, or are held for the production of, passive income.

For purposes of determining whether we are a passive foreign investment company, we will be treated as earning and owning our proportionate share of the income and assets, respectively, of any of our subsidiary corporations in which we own at least 25% of the value of the subsidiary's stock. Income earned, or deemed earned, by us in connection with the performance of services would not constitute passive income. By contrast, rental income would generally constitute "passive income" unless we were treated under specific rules as deriving our rental income in the active conduct of a trade or business.

Based on our current operations and future projections, we do not believe that we are, nor do we expect to become, a passive foreign investment company with respect to any taxable year. Although there is no legal authority directly on point, and we are not relying upon an opinion of counsel on this issue, our belief is based principally on the position that, for purposes of determining whether we are a passive foreign investment company, the gross income we derive or are deemed to derive from the time chartering and voyage chartering activities of our wholly-owned subsidiaries should constitute services income, rather than rental income. Correspondingly, such income should not constitute passive income, and the assets that we or our wholly-owned subsidiaries own and operate in connection with the production of such income, in particular, the vessels, should not constitute passive assets for purposes of determining whether we are a passive foreign investment company. We believe there is substantial legal authority supporting our position consisting of case law and Internal Revenue Service pronouncements concerning the characterization of income derived from time charters and voyage charters as services income for other tax purposes. However, in the absence of any legal authority specifically relating to the statutory provisions governing passive foreign investment companies, the Internal Revenue Service or a court could disagree with our position. In addition, although we intend

to conduct our affairs in a manner to avoid being classified as a passive foreign investment company with respect to any taxable year, we cannot assure you that the nature of our operations will not change in the future.

If we were to be classified as a PFIC in any taxable year, a U.S. Holder (i) would generally be required to treat any gain on sales of our shares held by him as ordinary income and pay an interest charge on the value of the deferral of their United States federal income tax attributable to such gain and (ii) could also be subject to an interest charge on distributions paid by us.

The above results may be eliminated if a "mark-to-market" election or "qualified electing fund" election is available and a U.S. Holder validly makes such an election. If a U.S. Holder makes a "qualified electing fund" election, then generally, in lieu of the foregoing treatment, our earnings would be currently included in the U.S. Holder's gross income. If a "mark-to-market" election is made, such holder generally will be required to take into account the difference, if any, between the fair market value and its adjusted tax basis in shares at the end of each taxable year as ordinary income or ordinary loss (to the extent of any net mark-to-market gain previously included in income). In addition, any gain from a sale or other disposition of shares will be treated as ordinary income, and any loss will be treated as ordinary loss (to the extent of any net mark-to-market gain previously included in income).

United States Federal Income Taxation of "Non-U.S. Holders"

A beneficial owner of common stock that is not a U.S. Holder is referred to herein as a "Non-U.S. Holder."

Dividends on Common Stock

Non-U.S. Holders generally will not be subject to United States federal income tax or withholding tax on dividends received from us with respect to our common stock, unless that income is effectively connected with the Non-U.S. Holder's conduct of a trade or business in the United States. If the Non-U.S. Holder is entitled to the benefits of a United States income tax treaty with respect to those dividends, that income is taxable only if it is attributable to a permanent establishment maintained by the Non-U.S. Holder in the United States.

Sale, Exchange or Other Disposition of Common Stock

Non-U.S. Holders generally will not be subject to United States federal income tax or withholding tax on any gain realized upon the sale, exchange or other disposition of our common stock, unless:

- the gain is effectively connected with the Non-U.S. Holder's conduct of a trade or business in the United States. If the Non-U.S. Holder is entitled to the benefits of an income tax treaty with respect to that gain, that gain is taxable only if it is attributable to a permanent establishment maintained by the Non-U.S. Holder in the United States; or

- the Non-U.S. Holder is an individual who is present in the United States for 183 days or more during the taxable year of disposition and other conditions are met.

If the Non-U.S. Holder is engaged in a United States trade or business for United States federal income tax purposes, the income from the common stock, including dividends and the gain from the sale, exchange or other disposition of the stock that is effectively connected with the conduct of that trade or business will generally be subject to regular United States federal income tax in the same manner as discussed in the previous section relating to the taxation of U.S. Holders. In addition, if you are a corporate Non-U.S. Holder, your earnings and profits that are attributable to the effectively connected income, which are subject to certain adjustments, may be subject to an additional branch profits tax at a rate of 30%, or at a lower rate as may be specified by an applicable income tax treaty.

Backup Withholding and Information Reporting

In general, dividend payments, or other taxable distributions, made within the United States to you will be subject to information reporting requirements. Such payments will also be subject to backup withholding tax if you are a non-corporate U.S. Holder and you:

- fail to provide an accurate taxpayer identification number;

- are notified by the Internal Revenue Service that you have failed to report all interest or dividends required to be shown on your federal income tax returns; or
- in certain circumstances, fail to comply with applicable certification requirements.

Non-U.S. Holders may be required to establish their exemption from information reporting and backup withholding by certifying their status on IRS Form W-8BEN, W-8ECI or W-8IMY, as applicable.

If you sell your common stock to or through a United States office or broker, the payment of the proceeds is subject to both United States backup withholding and information reporting unless you certify that you are a non-U.S. person, under penalties of perjury, or you otherwise establish an exemption. If you sell your common stock through a non-United States office of a non-United States broker and the sales proceeds are paid to you outside the United States then information reporting and backup withholding generally will not apply to that payment. However, United States information reporting requirements, but not backup withholding, will apply to a payment of sales proceeds, even if that payment is made to you outside the United States, if you sell your common stock through a non-United States office of a broker that is a United States person or has some other contacts with the United States.

Backup withholding tax is not an additional tax. Rather, you generally may obtain a refund of any amounts withheld under backup withholding rules that exceed your income tax liability by filing a refund claim with the Internal Revenue Service.

We encourage each stockholder to consult with his, her or its own tax advisor as to particular tax consequences to it of holding and disposing of Euroseas shares, including the applicability of any state, local or foreign tax laws and any proposed changes in applicable law.

F. Dividends and paying agents

Not Applicable.

G. Statement by experts

Not Applicable.

H. Documents on display

We file reports and other information with the SEC. These materials, including this annual report and the accompanying exhibits, may be inspected and copied at the public reference facilities maintained by the Commission at 100 F Street, N.E., Washington, D.C. 20549, or from the SEC's website http://www.sec.gov. You may obtain information on the operation of the public reference room by calling 1 (800) SEC-0330 and you may obtain copies at prescribed rates.

I. Subsidiary Information

Not Applicable.

Item 11. Quantitative and Qualitative Disclosures about Market Risk

In the normal course of business, we face risks that are non-financial or non-quantifiable. Such risks principally include country risk, credit risk and legal risk. Our operations may be affected from time to time in varying degrees by these risks but their overall effect on us is not predictable. We have identified the following market risks as those which may have the greatest impact upon our operations:

Interest Rate Fluctuation Risk

The international drybulk, containership and multipurpose vessel industry is capital intensive, requiring significant amounts of investment. Much of this investment is financed by long term debt. Our debt usually contains interest rates that fluctuate with LIBOR. In 2008, we entered into an interest rate swap contract for a nominal of amount of $25.0 million in order to manage interest costs and the risks associated with changing interest rates. Under the terms of the swap, Eurobank makes a quarterly payment to the Company based on 3-month LIBOR less 3.99% on the relevant amount if the 3-month LIBOR is greater than 3.99%. If 3-month LIBOR is less than 3.99%, Eurobank receives an amount from the Company based on 3.99% less the 3-month LIBOR for the relevant amount. If LIBOR is equal to 3.99% no amount is due or payable to the Company. The swap is effective from July 14, 2008 to July 14, 2013. This swap contract does not cover our entire debt and thus increasing interest rates could adversely impact future earnings.

As at December 31, 2008, we had $56.02 million of floating rate debt outstanding with margins over LIBOR ranging from 0.80% to 1.25%. In addition, in January and April of 2009, we assumed additional total debt of $20.00 million to partly finance our latest vessel acquisitions. Our interest expense is affected by changes in the general level of interest rates. As an indication of the extent of our sensitivity to interest rate changes, an increase of 100 basis points would have decreased our net income and cash flows in the twelve-month period to December 31, 2008 by approximately $717,000 assuming the same debt profile throughout the year.

The following table sets forth the sensitivity of our loans, including the two loans we drew in 2009, and the interest rate swap in U.S. dollars to a 100 basis points increase in LIBOR during the next five years. Specifically, the interest we will have to pay for our loans will increase but net payments we will have to make under our interest rate swap contract will decrease.

Year Ended December 31,	Amount in $(loans)	Amount in $ (swap)
2009	661,000	(250,000)
2010	585,000	(250,000)
2011	430,000	(250,000)
2012	342,000	(250,000)
2013 and thereafter	379,000	(134,000)

Charter Rate Fluctuation Risk

In December 2008, we entered into FFA contracts to hedge our exposure to the drybulk market. These are futures contracts on an index of the earnings of a typical drybulk vessel of certain type and size (i.e. a modern panamax drybulk carrier). Selling such a contract for a specific period entitles you to receive the agreed upon daily rate (index level) for the period in exchange for the actual daily rate (index level) for each of the days of the period. Sale of FFA contracts is designed to secure a certain level of revenues in conjunction with our drybulk vessels operating in the spot market under the expectation that the amount the vessels earn in the spot market is correlated to the daily rate (index level) that we have to pay to settle the FFA contracts. However, there are risks that the hedge may not work in the intended way because the vessels, even when employed in the spot market, are chartered for short periods of time (as opposed to earning the daily rate that is used for the settlement of the FFA contract), are employed in routes possibly different from the one(s) used in the index and are of different size from the vessel assumed in the index.

As of December 31, 2008, we have sold six FFA contracts for a total of 480 days in 2009 for an average daily rate of approximately $11,350, and 485 days in 2010 for an average daily rate of approximately $11,430 on the Baltic Panamax 4-TC index. The contracts are to be settled monthly. There is also a margin maintenance requirement (over and above a base margin) based on marking the contract to market. The table below shows the sensitivity of our FFA contracts and margin requirements for an increase of $1,000/day in the Baltic Panamax 4-TC index. Specifically, the mark-to-market value of our FFA contracts will decrease and the amount we will have to post as margin will increase.

Year Ended December 31,	Change in Fair Value in $
2009	(480,000)
2010	(485,000)
Margin	Amount in $
Increase in margin	965,000

As of May 1, 2009, we have entered into FFA contracts for a total of 580 days for the remainder of 2009 at an average daily rate of approximately $12,260 and 1,055 days for 2010 at an average daily rate of approximately$12,820.

Inflation Risk

The general rate of inflation has been relatively low in recent years and as such its associated impact on costs has been minimal. We do not believe that inflation has had, or is likely to have in the foreseeable future, a significant impact on expenses. Should inflation increase, it will increase our expenses and subsequently have a negative impact on our earnings.

Foreign Exchange Rate Risk

The international drybulk and containership shipping industry's functional currency is the U.S. Dollar. We generate all of our revenues in U.S. dollars, but incur approximately 25% of our vessel operating expenses in 2008 in currencies other than U.S. dollars. In addition, our management fee is denominated in euros (630 euros per vessel per day in 2008), and, certain general and administrative expenses (about 14% in 2008) were in euros. At December 31, 2008, approximately 30% of our outstanding accounts payable were denominated in currencies other than the U.S. dollar, mainly in Euros. We do not use currency exchange contracts to reduce the risk of adverse foreign currency movements but we believe that our exposure from market rate fluctuations is unlikely to be material. Net foreign exchange gain for the year to December 31, 2008 were $7,888.

Item 12. Description of Securities Other than Equity Securities

Not Applicable.

77

PART II

Item 13. Defaults, Dividend Arrearages and Delinquencies

None.

Item 14. Material Modifications to the Rights of Security Holders and Use of Proceeds

None.

Item 15. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

Pursuant to Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934 (the "Exchange Act"), the Company's management, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of December 31, 2008. The term disclosure controls and procedures are defined under SEC rules as controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives.

Based on that evaluation, our Chief Executive Officer and Chief Financial Officer has concluded that our disclosure controls and procedures are effective, as of December 31, 2008.

(b) Management's Annual Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting as such term is identified in Exchange Act Rule 13a-15(f) and 15d-15(f). Internal control over financial reporting is a process designed by, or under the supervision of, the issuer's principal executive and principal financial officers, or persons performing similar functions, and effected by the issuer's board of directors, management and other personnel, 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 and includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets; (ii) 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 are being made only in accordance with the authorization of its management and directors; and (iii) 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 its consolidated financial statements.

Our management, with the participation of Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, the Company used the control criteria framework of the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") published in its report entitled Internal Control-Integrated Framework. As a result of its assessment, the Chief Executive Officer and Chief Financial Officer concluded that the Company's internal controls over financial reporting are effective as of December 31, 2008.

(c) Attestation Report of the Registered Public Accounting Firm

Deloitte. Hadjipavlou, Sofianos and Cambanis S.A., or "Deloitte", an independent registered public accounting firm, as auditors of our consolidated financial statements for the year ended December 31, 2008, has issued the following attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2008:

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Euroseas Ltd and Subsidiaries, Majuro, the Republic of Marshall Islands

We have audited the internal control over financial reporting of Euroseas Ltd and subsidiaries (the "Company") as of December 31, 2008, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company'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, included in the accompanying "Management's Annual Report on Internal Control Over Financial Reporting". Our responsibility is to express an opinion on 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, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, 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 by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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 the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the 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, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

79

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2008 of the Company and our report dated May 15, 2009 expressed an unqualified opinion on those financial statements.

/s/ Deloitte. Hadjipavlou, Sofianos & Cambanis S.A.
Athens, Greece
May 15, 2009

(d) Changes in Internal Control over Financial Reporting

No change in the Company's internal control over financial reporting occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Item 16A. Audit Committee Financial Expert

Our Board of Directors has determined that all the members of our Audit Committee qualify as financial experts and they are all considered to be independent according to the SEC rules. Mr. Panos Kyriakopoulos serves as the chairman of our Audit Committee with Mr. Gerald Turner and Mr. George Taniskidis as members.

Item 16B. Code of Ethics

We have adopted a code of ethics that applies to officers and employees. Our code of ethics is posted in our website: http://www.euroseas.gr under "Corporate Governance".

Item 16C. Principal Accountant Fees and Services

Our principal auditors, Deloitte Hadjipavlou, Sofianos & Cambanis S.A. have charged us for audit, audit-related and non-audit services as follows:

	2008 (dollars in thousands)	2007 (dollars in thousands)
Audit Fees	$ 546	$ 753
Further assurance / audit related fees	-	-
Tax fees	-	-
Other fees / expenses	-	-
Total	$ 546	$ 753

Audit fees relate to regular audit services and audit of our internal controls and services required for follow-on common stock offerings, our shelf registration filings and filings on Form S-8.

The audit committee is responsible for the appointment, replacement, compensation, evaluation and oversight of the work of the independent registered public accounting firm. As part of this responsibility, the Audit Committee pre-approves the audit and non-audit services performed by the independent registered public accounting firm in order to assure that they do not impair the auditor's independence from the Company. The Audit Committee has adopted a policy which sets forth the procedures and the conditions pursuant to which services proposed to be performed by the independent registered public accounting firm may be pre-approved.

All audit services and other services provided by Deloitte Hadjipavlou, Sofianos & Cambanis S.A., after the formation of our audit committee in November 2005 were pre-approved by the audit committee.

Item 16D. Exemptions from the Listing Standards for Audit Committees

Not Applicable.

Item 16E. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

Not Applicable.

Item 16 F. Change in Registrant's Certifying Accountant

None.

Item 16G. Corporate Governance

Our Company's corporate governance practices are in compliance with, and are not prohibited by, the laws of the Republic of the Marshall Islands. Therefore, we are exempt from many of NASDAQ's corporate governance practices other than the requirements regarding the disclosure of a going concern audit opinion, submission of a listing agreement, notification of material non-compliance with NASDAQ corporate governance practices, and the establishment and composition of an audit committee and a formal written audit committee charter. The practices followed by us in lieu of NASDAQ's corporate governance rules are described below.

We are not required under Marshall Islands law to maintain a board of directors with a majority of independent directors, and we cannot guarantee that we will always in the future maintain a board of directors with a majority of independent directors.

In lieu of a compensation committee comprised of independent directors, our Board of Directors will be responsible for establishing the executive officers' compensation and benefits. Under Marshall Islands law, compensation of the executive officers is not required to be determined by an independent committee.

In lieu of a nomination committee comprised of independent directors, our Board of Directors will be responsible for identifying and recommending potential candidates to become board members and recommending directors for appointment to board committees. Shareholders may also identify and recommend potential candidates to become candidates to become board members in writing. No formal written charter has been prepared or adopted because this process is outlined in our bylaws.

In lieu of obtaining an independent review of related party transactions for conflicts of interests, consistent with Marshall Islands law requirements, a related party transaction will be permitted if: (i) the material facts as to his or her relationship or interest and as to the contract or transaction are disclosed or are known to the Board of Directors and the Board of Directors in good faith authorizes the contract or transaction by the affirmative votes of a majority of the disinterested directors, or, if the votes of the disinterested directors are insufficient to constitute an act of the Board of Directors as defined in Section 55 of the Marshall Islands Business Corporations Act, by unanimous vote of the disinterested directors; or (ii) the material facts as to his relationship or interest are disclosed and the shareholders are entitled to vote thereon, and the contract or transaction is specifically approved in good faith by a simple majority vote of the shareholders; or (iii) the contract or transaction is fair as to the Company as of the time it is authorized, approved or ratified, by the Board of Directors, a committee thereof or the shareholders. Common or interested directors may be counted in determining the presence of a quorum at a meeting of the Board of Directors or of a committee which authorizes the contract or transaction.

As a foreign private issuer, we are not required to solicit proxies or provide proxy statements to NASDAQ pursuant to NASDAQ corporate governance rules or Marshall Islands law. Consistent with Marshall Islands law, we will notify our shareholders of meetings between 15 and 60 days before the meeting. This notification will contain, among other things, information regarding business to be transacted at the meeting. In addition, our bylaws provide that shareholders must give us advance notice to properly introduce any business at a meeting of the shareholders. Our bylaws also provide that shareholders may designate in writing a proxy to act on their behalf.

In lieu of holding regular meetings at which only independent directors are present, our entire board of directors, a majority of whom are independent, will hold regular meetings as is consistent with the laws of the Republic of the Marshall Islands.

The Board of Directors adopted an equity incentive plan in October 2007 which replaced the prior equity incentive plan. Shareholder approval was not necessary to terminate the original equity incentive plan or to establish a new equity incentive plan since Marshall Islands law permits the Board of Directors to take these actions. The Company has filed the appropriate documentation with the Nasdaq Global Select Market reflecting this event.

OTHER THAN AS NOTED ABOVE, WE ARE IN FULL COMPLIANCE WITH ALL OTHER APPLICABLE NASDAQ CORPORATE GOVERNANCE STANDARDS.

PART III

ItemFinancial Statements
17.

See Item 18

ItemFinancial Statements
18.

The following financial statements set forth on pages F-1 through F-5 are filed as part of this annual report.

ItemExhibits
19.

1.1	Articles of Incorporation of Euroseas Ltd.(7)
1.2	Bylaws of Euroseas Ltd.(7)
1.3	Amendment to Articles of Incorporation of Euroseas Ltd.(7)
2.1	Specimen Common Stock Certificate(7)
2.2	Form of Securities Purchase Agreement(1)
2.3	Form of Registration Rights Agreement(1)
2.4	Form of Warrant(1)
2.5	Registration Rights Agreement between Euroseas Ltd. and Friends Investment Company Inc., dated November 2, 2005(2)
4.1	Form of Lock-up Agreement(1)
4.2	Loan Agreement between Diana Trading Ltd., as borrower, and Oceanopera Shipping Limited, as corporate guarantor, and HSBC Bank plc, as the lender, dated October 16, 2002 for the amount of 5,900,000(1)
4.3	Loan Agreement between Diana Trading Ltd., as borrower, and HSBC Bank plc, as lender, for the amount of $4,200,000 dated May 9, 2005(1)
4.	
4.4	Loan Agreement dated May 16, 2005 between EFG Eurobank Ergasias S.A., as lender, and Alcinoe Shipping Limited, Oceanopera Shipping Limited, Oceanpride Shipping Limited, and Searoute Maritime Limited, as borrowers, for the amount of $13,500,000(1)
4.5	Secured Loan Facility Agreement dated May 24, 2005 between Allendale Investments S.A. and Alterwall Business Inc. as borrowers, Fortis Bank (Nederland) N.V. and others as lenders, and Fortis Bank (Nederland) N.V. as agent and security trustee for $20,000,000(1)
4.6	Form of Standard Ship Management Agreement(1)
4.7	Agreement between Eurobulk Ltd. and Eurochart S.A., for the provision of exclusive brokerage services, dated December 20, 2004(1)
4.8	Form of Current Time Charter(1)
4.9	Amended and Restated Master Management Agreement between Euroseas Ltd. and Eurobulk Ltd. dated as of July 17, 2007, as amended February 7, 2008 (7)
4.10	Addendum No. 1 to Amendment to Amended and Restated Master Management Agreement between Euroseas Ltd. and Eurobulk Ltd. dated as of February 7, 2009 (10)
4.11	Loan Agreement between Salina Shipping Corp., as borrower, and Calyon, as lender, for the amount of USD$15,500,000 dated December 28, 2005(3)
4.12	Loan Agreement between Xenia International Corp., as borrower, and Fortis Bank N.V./S.A., Athens Branch and others, as lenders, for the amount of USD$8,250,000 dated June 30, 2006(4)
4.13	

	Loan Agreement between Prospero Maritime Inc., as borrower, and Calyon, as lender, for the amount of USD$15,500,000 dated August 30, 2006(4)
4.14	Euroseas 2007 Equity Incentive Plan(9)
4.15	Loan Agreement between Xingang Shipping Ltd., as borrower, and HSBC Bank plc, as lender, for the amount of USD$20,000,000 dated November 14, 2006(5)
4.16	Form of Right of First Refusal(6)
4.17	Form of Advisory Agreement(6)
4.18	Loan Agreement between Manolis Shipping Limited, as borrower, and EFG Eurobank Ergasias S.A., as lender, for the amount of USD$10,000,000 dated June 7, 2007(7)
4.19	Loan Agreement between Trust Navigation Corp., as borrower and EFG Eurobank Ergasias S.A., as lender, for the amount of USD$15,000,000 dated October 29, 2007 (7)

4.20 Amendment to Loan Agreement between Trust Navigation Corp., as borrower and EFG Eurobank Ergasias S.A., as lender, dated December 30, 2008 (10)
4.21 Form of Senior Security Debt Indenture(8)
4.22 Form of Subordinated Debt Security Indenture(8)
4.23 Loan Agreement between Saf-Concord Shipping Ltd., as borrower and EFG Eurobank Ergasias S.A., as lender, for the amount of USD$10,000,000 dated January 9, 2009 (10)
4.24 Loan Agreement between Eleni Shipping Ltd., as borrower and Calyon, as lender, for the amount of USD$10,000,000 dated April 30, 2009 (10)
8.1 Subsidiaries of the Registrant(10)
12.1 Rule 13a-14(a)/15d-14(a) Certification of Chief Executive Officer(10)
12.2 Rule 13a-14(a)/15d-14(a) Certification of Chief Financial Officer(10)
13.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(10)
13.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002(10)
15.1 Consent of Deloitte, Hadjipavlou, Sofianos & Cambanis S.A.(10)

(1) Filed as an Exhibit to the Company's Registration Statement (File No. 333-129145) on October 20, 2005.
(2) Filed as an Exhibit to the Company's Amendment No.1 to Registration Statement (File No. 333-129145) on December 5, 2005.
(3) Filed as an Exhibit to the Company's Amendment No. 2 to Registration Statement (File No. 333-129145) on January 19, 2006.
(4) Filed as an Exhibit to the Company's Post-Effective Amendment No. 1 to Registration Statement (File No. 333-12945) on September 12, 2006.
(5) Filed as an Exhibit to the Company's Registration Statement (File No. 333-138780) on November 16, 2006.
(6) Filed as an Exhibit to the Company's Amendment No. 1 to Registration Statement (File No. 333-138780) on January 10, 2007.
(7) Filed as an Exhibit to the Company's Annual Report on Form 20-F (File No. 001-33283) on May 13, 2008.
(8) Filed as an Exhibit to the Company's Registration Statement (File No. 333-152089) on July 2, 2008.
(9) Filed as an Exhibit to the Company's Post-Effective Amendment No. 1 to Registration Statement (File No. 333-148124) on July 17, 2008.
(10) Filed herewith.

SIGNATURES

The Registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign on its behalf.

EUROSEAS LTD.
(Registrant)

By: /s/ Aristides J. Pittas
Aristides J. Pittas
Chairman, President and CEO

Date: May 18, 2009

Euroseas Ltd. and Subsidiaries
Consolidated financial statements
December 31, 2007 and 2008

Index to consolidated financial statements

	Pages
Report of Independent Registered Public Accounting Firm	F-2
Consolidated Balance Sheets as of December 31, 2007 and 2008	F-3
Consolidated Statements of Income for the Years Ended December 31, 2006, 2007 and 2008	F-4
Consolidated Statements of Shareholders' Equity for the Years Ended December 31, 2006, 2007 and 2008	F-5
Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2007 and 2008	F-6
Notes to the Consolidated Financial Statements	F-8

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of
Euroseas Ltd and Subsidiaries, Majuro, Republic of the Marshall Islands

We have audited the accompanying consolidated balance sheets of Euroseas Ltd and subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2008. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Euroseas Ltd and subsidiaries as of December 31, 2008 and 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2008, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 15, 2009 expressed an unqualified opinion on the Company's internal control over financial reporting.

/s/ Deloitte. Hadjipavlou, Sofianos & Cambanis S.A.
Athens, Greece
May 15, 2009

Euroseas Ltd. and Subsidiaries
Consolidated balance sheets
December 31, 2007 and 2008
(All amounts, except share data, expressed in U.S. Dollars)

	Notes	2007	2008
Assets			
Current assets			
Cash and cash equivalents		104,135,320	73,851,191
Trade accounts receivable, net of allowance of $0 and $408,893		1,174,045	1,233,895
Other receivables		741,081	1,439,628
Due from related company	8	5,291,197	4,678,750
Inventories	3	1,903,678	2,011,973
Restricted cash		1,739,879	2,181,264
Vessels held for sale	4	-	6,067,020
Trading securities	16	2,891,658	771,727
Derivatives	10, 16	-	61,670
Prepaid expenses		430,605	241,102
Total current assets		118,307,463	92,538,220
Fixed assets			
Vessels, net	4	238,248,984	231,963,606
Advances for vessel acquisitions		-	1,821,798
Long-term assets			
Restricted cash		4,500,000	4,800,000
Deferred charges, net	5	5,529,870	7,771,342
Derivatives	10, 16	-	68,038
Fair value of above market time charter acquired	7	4,604,514	1,653,422
Total long-term assets		252,883,368	248,078,206
Total assets		371,190,831	340,616,426
Liabilities and shareholders' equity			
Current liabilities			
Long-term debt, current portion	9	25,575,000	12,450,000
Trade accounts payable		3,789,764	2,283,488
Accrued expenses	6	2,043,585	1,206,466
Accrued dividends		-	116,750
Deferred revenues		3,774,162	4,533,601
Derivatives	10,16	-	827,210
Total current liabilities		35,182,511	21,417,515
Long-term liabilities			
Long-term debt, net of current portion	9	56,015,000	43,565,000
Derivatives	10, 16	-	2,700,028
Fair value of below market time charters acquired	7	8,202,972	8,704,811
Total long-term liabilities		64,217,972	54,969,839
Total liabilities		99,400,483	76,387,354
Commitments and contingencies	12	-	-

Shareholders' equity		
Common stock (par value $0.03, 100,000,000 shares authorized, 30,261,113 and 30,575,611 issued and outstanding)	907,834	917,269
Preferred shares (par value $0.01, 20,000,000 shares authorized, no shares issued and outstanding)	-	-
Additional paid-in capital	231,147,700	234,567,670
Retained earnings	39,734,814	28,744,133
Total shareholders' equity	271,790,348	264,229,072
Total liabilities and shareholders' equity	371,190,831	340,616,426

The accompanying notes are an integral part of these consolidated financial statements.

F-3

Euroseas Ltd. and Subsidiaries
Consolidated statements of income
Years ended December 31, 2006, 2007 and 2008
(All amounts, except for share data, expressed in U.S. Dollars)

	Notes	2006	2007	2008
Revenues				
Voyage revenue		42,143,361	86,104,365	132,243,918
Commissions	8, 15	(1,829,534)	(4,024,032)	(5,940,460)
Net revenue		40,313,827	82,080,333	126,303,458
Operating expenses				
Voyage expenses	15	1,154,738	897,463	3,092,323
Vessel operating expenses	15	10,368,817	17,240,132	27,521,194
Amortization of dry-docking and special survey expense and vessel depreciation	4, 5	7,292,838	17,963,072	32,230,901
Impairment loss	4	-	-	25,113,364
Management fees	8	2,266,589	3,669,137	5,387,415
Other general and administrative expenses		1,076,884	2,656,176	4,057,736
Net gain on sale of vessels	4	(4,445,856)	(3,411,397)	-
Total operating expenses		17,714,010	39,014,583	97,402,933
Operating income		22,599,817	43,065,750	28,900,525
Other income/(expenses)				
Interest and other financing costs		(3,398,858)	(4,850,239)	(2,930,737)
Change in fair value of derivatives	10	-	-	(3,474,635)
Foreign exchange gain/(loss)		(1,598)	(7,824)	7,888
Realized gain on investments		-	-	81,193
Unrealized gain (loss) on investments		-	98,744	(2,393,983)
Dividend income		-	-	315,266
Interest income		870,046	2,357,633	3,168,501
Other expenses, net		(2,530,410)	(2,401,686)	(5,226,507)
Net income		20,069,407	40,664,064	23,674,018
Earnings per share - basic	14	1.60	1.89	0.78
Weighted average number of shares outstanding during the year, basic	14	12,535,365	21,566,619	30,437,107
Earnings per share - diluted	14	1.60	1.88	0.78
Weighted average number of shares outstanding during the year, diluted	14	12,535,365	21,644,920	30,505,476

The accompanying notes are an integral part of these consolidated financial statements.

Euroseas Ltd. and Subsidiaries
Consolidated statements of shareholders' equity
Years ended December 31, 2006, 2007 and 2008
(All amounts, except share data, expressed in U.S. Dollars)

	Comprehensive Income	Number of Shares	Common Stock Amount	Preferred Shares Amount	Paid - in Capital	Retained Earnings	Total
Balance, January 1, 2006		12,260,387	367,812	-	17,883,781	8,744,963	26,996,556
Net income	20,069,407					20,069,407	20,069,407
Issuance of shares, net of issuance costs		359,763	10,793	-	(793)	-	10,000
Reversal of unutilized accrued offering expenses					400,779		400,779
Dividends declared and paid ($0.75 per share)			-	-		(9,465,082)	(9,465,082)
Balance, December 31, 2006		12,620,150	378,605	-	18,283,767	19,349,288	38,011,660
Net income	40,664,064					40, 664,064	40,664,064
Issuance of shares in public offerings, net of issuance costs		17,325,000	519,750	-	209,367,229	-	209,886,979
Issuance of shares for warrants exercised		248,463	7,454	-	2,675,947	-	2,683,401
Issuance of restricted shares for stock incentive award and share-based compensation		67,500	2,025	-	820,757	-	822,782
Dividends declared and paid ($1.00 per share)			-	-		(20,278,538)	(20,278,538)
Balance, December 31, 2007		30,261,113	907,834	-	231,147,700	39,734,814	271,790,348
Net income	23,674,018					23,674,018	23,674,018
Issuance of shares for warrants		171,998	5,160	-	1,805,762	-	1,810,922

exercised						
Issuance of restricted shares for stock incentive award and share-based compensation	142,500	4,275	-	1,614,208	-	1,618,483
Dividends declared ($1.13 per share)		-	-		(34,664,699)	(34,664,699)
Balance, December 31, 2008	30,575,611	917,269	-	234,567,670	28,744,133	264,229,072

The accompanying notes are an integral part of these consolidated financial statements.

F-5

Euroseas Ltd. and Subsidiaries
Consolidated statements of cash flows
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

	2006	2007	2008
Cash flows from operating activities:			
Net income	20,069,407	40,664,064	23,674,018
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation of vessels	6,277,328	16,423,092	28,284,752
Impairment loss	-	-	25,113,364
Amortization of deferred charges	1,090,111	1,612,696	4,031,290
Amortization of fair value of time charters	(351,369)	548,254	(6,144,507)
Gain on sale of vessels	(4,445,856)	(3,411,397)	-
Share-based compensation	-	822,782	1,618,484
Investment in trading securities, net	-	(2,792,914)	(192,859)
(Gain) loss on trading securities	-	(98,744)	2,312,790
Loss on derivatives	-	-	3,397,530
Changes in operating assets and liabilities:			
(Increase)/decrease in:			
Trade accounts receivable	(332,098)	(671,888)	(183,791)
Prepaid expenses	(156,933)	(188,047)	189,503
Other receivables	37,439	(472,217)	(698,547)
Inventories	(344,440)	(1,187,547)	(108,295)
Due from related company	363,461	(2,641,936)	612,446
Increase/(decrease) in:			
Trade accounts payable	197,531	1,920,051	(2,189,320)
Accrued expenses	(602,002)	1,074,809	(870,284)
Deferred revenue	(12,557)	2,292,720	883,380
Drydocking expenses paid	(821,198)	(4,935,007)	(5,446,213)
Net cash provided by operating activities	20,968,824	48,958,771	74,283,741
Cash flows from investing activities:			
Purchase of vessels	(53,830,357)	(149,502,254)	(43,582,320)
Advance for vessel purchase	-	-	(1,821,798)
Cash paid for above-market charter acquired	(7,923,480)	-	-
Change in restricted cash	(2,765,672)	(2,393,258)	(741,385)
Proceeds from sale of vessels	9,152,494	5,223,521	-
Net cash used in investing activities	(55,367,015)	(146,671,991)	(46,145,503)
Cash flows from financing activities:			
Issuance of share capital	10,000	527,204	5,030
Net proceeds from shares issued	-	213,692,072	1,805,892
Dividends paid/return of capital	(9,465,082)	(20,278,538)	(34,547,949)
Loan arrangement fees paid	(151,250)	(110,000)	-
Deferred offering expenses paid	(41,671)	(1,413,305)	(110,340)
Proceeds from long-term debts	43,750,000	25,000,000	-
Repayment of long-term debts	(17,360,000)	(18,360,000)	(25,575,000)
Net cash provided by (used in) financing activities	16,741,997	199,057,433	(58,422,367)

(Consolidated statements of cash flows continues on the next page)

Euroseas Ltd. and Subsidiaries
Consolidated statements of cash flows
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

(Continued)

Net increase (decrease) in cash and cash equivalents	(17,656,194)	101,344,213	(30,284,129)
Cash and cash equivalents at beginning of year	20,447,301	2,791,107	104,135,320
Cash and cash equivalents at end of year	2,791,107	104,135,320	73,851,191
Cash paid for interest	3,081,676	4,570,773	3,161,197
Non cash items:			
Increase in payables from dry-docking expenses	-	835,000	683,044
Fair value of below market charters acquired	1,649,572	9,675,481	9,597,438
Reversal of unutilized accrued offering expenses	400,779	-	-
Other increase in accrued expenses and deferred charges	458,329	-	143,505

The accompanying notes are an integral part of these consolidated financial statements.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

1. Basis of Presentation and General Information

Euroseas Ltd. (the "Company") was formed on May 5, 2005 under the laws of the Republic of the Marshall Islands to consolidate the beneficial owners of the ship owning companies in existence at that time (see list below). On June 28, 2005, the beneficial owners exchanged all their shares in the ship-owning companies for shares in Friends Investment Company Inc., a newly formed Marshall Islands company. On June 29, 2005, Friends Investment Company Inc. then exchanged all the shares in the ship-owning companies for shares in Euroseas Ltd., thus, becoming the sole shareholder of Euroseas Ltd.

On August 25, 2005, Euroseas Ltd. sold 2,342,331 common shares at $9.00 per share in an institutional private placement, together with 0.25 of detachable warrants for each common share to acquire up to 585,589 common shares. The total proceeds, net of issuance costs of $3,500,309, amounted to $17,510,400. The warrants allow their holders to acquire one share of Euroseas Ltd. stock at a price of $10.80 per share and are exercisable for a period of five years from the issue of the warrant.

On August 25, 2005, as a condition to the institutional private placement described above, the Company and Cove Apparel, Inc. (Cove, an unrelated party and public shell corporation) signed an Agreement and Plan of Merger (the "Merger Agreement"). The Merger Agreement provided for the merger of Cove and Euroseas Acquisition Company Inc., a Delaware corporation and a wholly-owned subsidiary of Euroseas Ltd. formed on June 21, 2005, with the current stockholders of Cove receiving 0.0034323 shares of Euroseas Ltd. common shares for each share of Cove common stock they owned. Euroseas Ltd., as part of the merger, filed a registration statement with the Securities and Exchange Commission (SEC) to register the shares issued in the merger to the Cove stockholders.

The SEC declared effective on February 3, 2006 the Company's registration statement on Form F-4 that registered the Euroseas Ltd. common shares issued to Cove shareholders. The SEC also declared effective on February 3, 2006 the Company's registration statement on Form F-1 that registered the re-sale of the 2,342,331 Euroseas Ltd. common shares and 585,589 Euroseas Ltd. common shares issuable upon the exercise of the warrants issued in connection with the institutional private placement as well as 272,868 Euroseas Ltd. common shares that were issued to certain Cove shareholders as part of the merger with Cove.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

1. Basis of Presentation and General Information - continued

On March 27, 2006, Euroseas Ltd. consummated the merger with Cove and, as a result, Cove merged into Euroseas Acquisition Company Inc., and the separate corporate existence of Cove ceased. The Cove stockholders received Euroseas Ltd. common shares and received dividends totaling to $140,334 related to dividends previously declared by Euroseas Ltd. Euroseas Acquisition Company Inc. changed its name to Cove Apparel, Inc. Also, following the completion of the merger, the common stock of Cove was de-listed and no longer traded on the OTC Bulletin Board. On the date of the merger, Cove had cash of $10,000, had no other assets and had no liabilities. Cove was dissolved in March 2008.

Euroseas Ltd. common shares were approved to trade on March 2, 2006 and started trading on the OTC Bulletin Board on May 5, 2006. On October 6, 2006, the Company effected a 1-for-3 reverse split of its common stock. On January 31, 2007 upon the pricing of the Company's follow-on common stock offering of 5,750,000 shares. Euroseas Ltd. common share started trading on the NASDAQ Global Market. The total proceeds of the follow-on common stock offering, net of issuance costs of $4,122,289, amounted to $43,315,220. On June 29, 2007 the Company priced, and, on July 5, 2007 completed an additional follow-on offering of 5,750,000 shares of common stock. The total proceeds of this follow-on offering, net of issuance costs of $4,609,428, amounted to $73,015,572. On November 6, 2007 the Company priced, and, on November 9, 2007 completed an additional follow-on offering of 5,825,000 shares of common stock. The total proceeds of this follow-on offering, net of issuance costs of $5,468,812, amounted to $93,556,187.

The operations of the vessels are managed by Eurobulk Ltd. (the "manager"), a corporation controlled by members of the Pittas family. The Pittas family is the controlling shareholders of Friends Investment Company Inc. which owns 33.3% of the Company's shares and of Eurobulk Marine Holdings Inc. which owns another 1.3% of the Company's shares as of December 31, 2008.

The manager has an office in Greece located at 40 Ag. Konstantinou Ave, Maroussi, Athens, Greece. The manager provides the Company with a wide range of shipping services such as technical support and maintenance, insurance consulting, chartering, financial and accounting services, as well as executive management services, in consideration for fixed and variable fees (see Note 8).

The Company is engaged in the ocean transportation of dry bulk and containers through ownership and operation of dry bulk and container carriers owned by the following ship-owning companies:

- Searoute Maritime Ltd. incorporated in Cyprus on May 20, 1992, owner of the Cyprus flag 33,712 DWT bulk carrier motor vessel (M/V) "Ariel", which was built in 1977 and acquired on March 5, 1993. M/V "Ariel" was sold on February 22, 2007.

- Oceanopera Shipping Ltd. incorporated in Cyprus on June 26, 1995, owner of the Cyprus flag 34,750 DWT bulk carrier M/V "Nikolaos P", which was built in 1984 and acquired on July 22, 1996. M/V "Nikolaos P" was sold in February 2009 (see Note 17).

- Oceanpride Shipping Ltd. incorporated in Cyprus on March 7, 1998, owner of the Cyprus flag 26,354 DWT bulk carrier M/V "John P", which was built in 1981 and acquired on March 7, 1998. M/V "John P" was sold on July 5, 2006.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

1. Basis of Presentation and General Information - continued

- Alcinoe Shipping Ltd. incorporated in Cyprus on March 20, 1997, owner of the Cyprus flag 26,354 DWT bulk carrier M/V "Pantelis P", which was built in 1981 and acquired on June 4, 1997. M/V "Pantelis P" was sold on May 31, 2006. On February 22, 2007, Alcinoe Shipping Ltd. acquired the 38,691 DWT Cyprus flag drybulk carrier M/V "Gregos", which was built in 1984. On June 13, 2007, M/V Gregos was transferred to Gregos Shipping Limited incorporated in the Marshall Islands and its flag was changed to the flag of the Marshall Islands.

- Allendale Investment S.A. incorporated in Panama on January 22, 2002, owner of the Panama flag 18,154 DWT container carrier M/V "Kuo Hsiung", which was built in 1993 and acquired on May 13, 2002.

- Alterwall Business Inc. incorporated in Panama on January 15, 2001, owner of the Panama flag 18,253 DWT container carrier M/V "Ninos" (previously named M/V "Quingdao I") which was built in 1990 and acquired on February 16, 2001.

- Diana Trading Ltd. incorporated in the Marshall Islands on September 25, 2002, owner of the Marshall Islands flag 69,734 DWT bulk carrier M/V "Irini", which was built in 1988 and acquired on October 15, 2002.

- Salina Shipholding Corp., incorporated in the Marshall Islands on October 20, 2005, owner of the Marshall Islands flag 29,693 DWT container carrier M/V "Artemis", which was built in 1987 and acquired on November 25, 2005.

- Xenia International Corp., incorporated in the Marshall Islands on April 6, 2006, owner of the Marshall Islands flag 22,568 DWT / 950 TEU multipurpose M/V "Tasman Trader", which was built in 1990 and acquired on April 27, 2006.

- Prospero Maritime Inc., incorporated in the Marshall Islands on July 21, 2006, owner of the Marshall Islands flag 69,268 DWT dry bulk M/V "Aristides N.P.", which was built in 1993 and acquired on September 4, 2006.

- Xingang Shipping Ltd., incorporated in Liberia on October 16, 2006, owner of the Liberian flag 23,596 DWT container carrier M/V "YM Xingang I" , which was built in February 1993 and acquired on November 15, 2006.

- Manolis Shipping Ltd., incorporated in the Marshall Islands on March 16, 2007, owner of the Marshall Islands flag 20,346 DWT / 1,452 TEU container carrier M/V "Manolis P", which was built in 1995 and acquired on April 12, 2007.

- Eternity Shipping Company, incorporated in the Marshall Islands on May 17, 2007, owner of the Marshall Islands flag 30,007 DWT / 1,742 TEU container carrier M/V "Clan Gladiator", which was built in 1992 and acquired on June 13, 2007. On May 9, 2008, M/V "Clan Gladiator" was renamed M/V "OEL Transworld".

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

1. Basis of Presentation and General Information - continued

- Emmentaly Business Inc., incorporated in Panama on July 4, 2007, owner of the Panamanian flag 33,667 DWT / 1,932 TEU container carrier M/V "Jonathan P", which was built in 1990 and acquired on August 7, 2007. On April 16, 2008, M/V "Jonathan P" was renamed M/V "OEL Integrity"; on March 5, 2009, the vessel was renamed again M/V "Jonathan P" upon the expiration of its charter with OEL.

- Pilory Associates Corp., incorporated in Panama on July 4, 2007, owner of the Panamanian flag 33,667 DWT / 1,932 TEU container carrier M/V "Despina P", which was built in 1990 and acquired on August 13, 2007.

- Tiger Navigation Corp., incorporated in Marshall Islands on August 29, 2007, owner of the Marshall Islands flag 31,627 DWT / 2,228 TEU container carrier M/V "Tiger Bridge", which was built in 1990 and acquired on October 4, 2007.

- Trust Navigation Corp., incorporated in Liberia on October 1, 2007, owner of the Liberian flag 64,873 DWT bulk carrier M/V "Ioanna P", which was built in 1984 and acquired on November 1, 2007. M/V "Ioanna P" was sold in January 2009 (see Note 17).

- Noumea Shipping Ltd, incorporated in Marshall Islands on May 14, 2008, owner of the Marshall Islands flag 34,677 DWT / 2,556 TEU container vessel M/V "Maersk Noumea", which was built in 2001 and acquired on May 22, 2008.

During the years ended December 31, 2006, 2007 and 2008, the following charterers individually accounted for more than 10% of the Company's voyage and time charter revenues as follows:

	Year ended December 31,		
Charterer	2006	2007	2008
A	-	12.10%	13.80%
B	15.06%	15.07%	8.81%
C	10.40%	12.53%	7.27%
D	16.63%	7.60%	5.14%
E	12.67%	5.19%	4.38%

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Significant Accounting Policies

The accompanying consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America. The following are the significant accounting policies adopted by the Company:

Principles of consolidation

The accompanying consolidated financial statements included the accounts of Euroseas Ltd. and its subsidiaries. Inter-company transactions were eliminated on consolidation.

Use of estimates

The preparation of the accompanying consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosures of contingent assets and liabilities at the date of the consolidated financial statements, and the stated amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Other comprehensive income

The Company presents separately comprehensive income, if any, and its components in shareholders' equity. The Company has no other comprehensive income and, accordingly, comprehensive income equals net income for all periods presented.

Foreign currency translation

The Company's functional currency is the U.S. dollar. Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing at the balance sheet date. Income and expenses denominated in foreign currencies are translated into U.S. dollars at exchange rates prevailing at the date of the transaction. The resulting exchange gains and/or losses on settlement or translation are included in the accompanying consolidated statements of operations.

Cash equivalents

Cash equivalents are time deposits or other certificates purchased with an original maturity of three months or less.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Significant Accounting Policies - Continued

Restricted Cash

Restricted cash reflects deposits with certain banks that can only be used to pay the current loan installments or are required to be maintained as a certain minimum cash balance per mortgaged vessel.

Trade accounts receivable

The amount shown as trade accounts receivable, at each balance sheet date, includes estimated recoveries from each voyage or time charter. At each balance sheet date, the Company provides for doubtful accounts on the basis of specific identified doubtful receivables. At and for the years ended December 31, 2007 and 2008, we recorded a provision for doubtful accounts for $0 and $408,893, respectively.

Inventories

Inventories are stated at the lower of cost and market value. Inventories are valued using the FIFO (First-In First-Out) method.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

Vessels

Vessels are stated at cost which comprises the vessels' contract price, costs of major repairs and improvements upon acquisition, direct delivery and other acquisition expenses less accumulated depreciation. Subsequent expenditures for conversions and major improvements are also capitalized when they appreciably extend the life, increase the earning capacity or improve the efficiency or safety of the vessels otherwise these amounts are charged to expense as incurred. In November 2008, the estimated useful life of the containerships and multipurpose vessels was increased to 30 years (from 25 years until then) in line with industry practice and intended use of such vessels; also, the estimated scrap value of the vessels was reduced from $300 to $250 per light ton to better reflect market price developments in the scrap metal market. The effect of this change was to reduce 2008 depreciation expenses by $836,200 and increase 2008 net income by the same amount.

Expenditures for vessel repair and maintenance are charged against income in the period incurred.

Depreciation

Depreciation is calculated on a straight line basis with reference to the cost of the vessel, age and scrap value as estimated at the date of acquisition. Depreciation is calculated over the remaining useful life of the vessel, which is estimated to range from 25 to 30 years from the completion of its construction. Remaining useful lives of property are periodically reviewed and revised to recognize changes in conditions and such revisions, if any, are recognized over current and future periods.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

Revenue and expense recognition

Revenues are generated from voyage and time charter agreements. If a charter agreement exists, the price is fixed, service is provided and the collection of the related revenue is reasonably assured, revenues are recorded over the term of the charter as service is provided and recognized on a pro-rata basis over the duration of the voyage or time charter adjusted for the off-hire days that a vessel spends undergoing repairs, maintenance or upgrade work. A voyage is deemed to commence upon the later of the completion of discharge of the vessel's previous cargo or the time it receives a contract that is not cancelable and is deemed to end upon the completion of discharge of the current cargo. A time charter contract is deemed to commence from the time of the delivery of the vessel to an agreed port and is deemed to end upon the re-delivery of the vessel at an agreed port. We generally enter into a charter agreement for the vessel's next voyage or time charter prior to the time of discharge of the previous cargo or completion of previous time charter. We do not begin recognizing voyage or time charter revenue until a charter contract has been agreed to both by us and the customer, even if the vessel has discharged its cargo or completed the previous time charter and it is sailing to the anticipated load port for its next voyage or to the port it will be delivered to the next charterer. Demurrage income, which is included in voyage revenues, represents payments received from the charterer when loading or discharging time exceeded the stipulated time in the voyage charter and is recognized when earned. Probable losses on voyages are provided for in full at the time such losses can be estimated.

For the Company's vessels operating in chartering pools, revenues and voyage expenses are pooled and allocated to each pool's participants on a time charter equivalent basis in accordance with an agreed-upon formula, which is determined by points awarded to each vessel in the pool based on the vessel's age, design and other performance characteristics. For vessels that simultaneously participate in spot chartering pools and cargo pools (pools of contracts of affreightment, also called, short funds; in the Company's case, participation in cargo pools requires participation in spot chartering pools), a combined time charter equivalent revenue is provided by the operator of the vessel and cargo pools. Revenues and voyage expenses are recognized during the period services were performed, the collectability has been reasonably assured, an agreement with the pool exists and price is determinable.

Charter fees received in advance is recorded as a liability (deferred revenue) until charter services are rendered.

Vessels operating expenses comprise all expenses relating to the operation of the vessels, including crewing, insurance, repairs and maintenance, stores, lubricants, spares and consumables, professional and legal fees and miscellaneous expenses. Vessel operating expenses are recognized as incurred; payments in advance of services or use are recorded as prepaid expenses. Voyage expenses are incurred when the vessel is chartered under a voyage charter and comprise all expenses relating to particular voyages, including bunkers, port charges, canal tolls, and agency fees. Voyage expenses are expensed as incurred.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

Drydocking and special survey expenses

Drydocking and special survey expenses are deferred and amortized over the estimated period to the next scheduled drydocking or special survey, which are generally two and a half years and five years, respectively. Unamortized drydocking and special survey expenses of vessels that are sold are written-off to income in the year of the vessel's sale.

Pension and retirement benefit obligations – crew

The ship-owning companies employ the crews on board the vessels under short-term contracts (usually up to 9 months). Accordingly, they are not liable for any pension or post retirement benefits.

Financing costs

Loan arrangement fees are deferred and amortized to interest expense over the duration of the underlying loan using the effective interest method. Unamortized fees relating to loan repaid or refinanced are expensed in the period the repayment or refinancing occurs.

Assets held for sale

It is the Company's policy to dispose of vessels when suitable opportunities occur and not necessarily to keep them until the end of their useful life. The Company classifies a vessel as being held for sale when: management has committed to a plan to sell the vessel; the vessel is available for immediate sale in its present condition; an active program to locate a buyer and other actions required to complete the plan to sell the vessel has been initiated; the sale of the vessel is probable, and transfer of the asset is expected to qualify for recognition as a completed sale within one year; the vessel is being actively marketed for sale at a price that is reasonable in relation to its current fair value and actions required to complete the plan indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn.

Long-lived assets classified as held for sale are measured at the lower of their carrying amount or fair value less cost to sell. These vessels are not depreciated once they meet the criteria to be classified as held for sale.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

Fair value of time charter acquired

The Company records all identified tangible and intangible assets or any liabilities associated with the acquisition of a vessel at fair value. Where vessels are acquired with existing time charters, the Company determines the present value of the difference between: (i) the contractual charter rate and (ii) the prevailing market rate for a charter of equivalent duration. In discounting the charter rate differences in future periods, the Company uses its Weighted Average Cost of Capital (WACC) adjusted to account for the credit quality of the charterer. The capitalized above-market (assets) and below-market (liabilities) charters are amortized as a reduction and increase, respectively, to voyage revenues over the remaining term of the charter.

Stock incentive plan awards

Share-based compensation represents vested and unvested restricted shares granted to employees and to non-employee directors, for their services as directors, as well as to non-employees and are included in "Other general and administrative expenses" in the consolidated statements of income. These shares are measured at their fair value equal to the market value of the Company's common stock on the grant date. The shares that do not contain any future service vesting conditions are considered vested shares and a total fair value of such shares is expensed on the grant date. The shares that contain a time-based service vesting condition are considered unvested shares on the grant date and a total fair value of such shares recognized on a straight-line basis over the requisite service period. In addition, unvested awards granted to non-employees are measured at its then-current fair value as of the financial reporting dates until non-employees complete the service (Note 13).

Investments

The Company classifies unrestricted publicly traded investments as trading securities and records them at fair value. The Company records unrealized gains or losses resulting from changes in fair value of its investment in trading securities between measurement dates as a component of "Gain (loss) on investments". In accordance with SFAS No. 157 "Fair Value Measurements", the Company determines the fair value of its investments in trading securities using quoted market prices in active markets for the same securities (Level 1 under the SFAS No. 157 hierarchy (see Note 16). The Company determines the cost of trading securities sold by using the First-In-First-Out ("FIFO") method. Purchases of, or proceeds from, the sale of trading securities are classified as cash flows from operating activities. The Company has adopted SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" ("SFAS No. 159") which allows the classification of purchases of, or proceeds from, the sale of trading securities to be classified to cash flows from operating activities or cash flows from investing activities based upon the Company's intent with respect to these securities.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

Impairment of long-lived assets

Impairment loss is recognized on a long-lived assets used in operations when indicators of impairment are present and the carrying amount of the long-lived asset is not recoverable from the undiscounted cash flows estimated to be generated by the asset and the asset's carrying amount is less than its fair value. In determining fair value and future benefits derived from use of long-lived assets, the Company performs an analysis of the anticipated undiscounted future net cash flows of the related long-lived assets. If the carrying value of the related asset exceeds its undiscounted future net cash flows, the carrying value is reduced to its fair value. Various factors including future charter rates and vessel operating costs are included in this analysis. The Company did not note for 2006 and 2007, any events or changes in circumstances indicating that the carrying amount of its vessels may not be recoverable. However, in the fourth quarter of 2008, market conditions changed significantly as a result of the credit crisis and resulting slowdown in world trade. Charter rates for both drybulk carriers and containership vessels fell significantly and values of assets were significantly affected although there were limited transactions to confirm that. The Company considered these market developments as indicators of potential impairment of the carrying amount of its assets. The Company performed the undiscounted cash flow test as of December 31, 2008 for its vessels held for use and determined that the carrying amount of those vessels were not impaired. The Company recorded an impairment loss for two of its vessels that are classified as held for sale as of December 31, 2008. The impairment loss for these assets was measured on the basis of their fair value less costs to sell and amounted to $25,113,364. This amount is presented in the "Impairment loss" line in the "Operating Expenses" section of the "Consolidated Statements of Income".

Derivative financial instruments

Every derivative instrument (including certain derivative instruments embedded in other contracts) are recorded in the balance sheet as either an asset or liability measured at its fair value with changes in the instruments' fair value recognized as a component in other comprehensive income or earnings depending on whether specific hedge accounting criteria are met at the inception of the hedge in accordance with SFAS No 133 "Accounting for Derivative Instruments and Hedging Activities".

For the year ended December 31, 2008, the interest rate swaps and the Freight Forward Agreement ("FFA") contracts were not designated as hedging instruments and did not qualify for hedge accounting treatment. Accordingly, all gains or losses have been recorded in the consolidated statement of income. There were no interest rate swaps or FFA contracts for the years ended December 31, 2006 and 2007.

Earning per common share

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares outstanding during the period. The weighted-average number of common shares outstanding does not include any potentially dilutive securities or any unvested restricted shares of common stock. These unvested restricted shares, although classified as issued and outstanding at December 31, 2008, are considered contingently returnable until the restrictions lapse and will not be included in the basic net income per

share calculation until the shares are vested.

Diluted net income per share gives effect to all potentially dilutive securities. The Company's outstanding warrants and unvested restricted shares were potentially dilutive securities during the twelve months ended December 31, 2007 and 2008 (Note 14).

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

Segment reporting

The Company reports financial information and evaluates its operations by charter revenue and not by the length of ship employment for its customers, i.e. spot or time charters. The Company does not use discrete financial information to evaluate the operating results for each such type of charter. Although revenue can be identified for these types of charters, management cannot and does not identify expenses, profitability or other financial information for these charters. As a result, management, including the chief operating decision maker, reviews operating results solely by revenue per day and operating results of the fleet and thus the Company has determined that it operates under one reporting segment. Furthermore, when the Company charters a vessel to a charterer, the charterer is free to trade the vessel worldwide and, as a result, the disclosure of geographical information is impracticable.

Fair Value of Financial Instruments

The estimated fair values of the Company's financial instruments such as trade receivables, trade accounts payable and cash and cash equivalents approximate their individual carrying amounts as of December 31, 2007 and 2008, due to their short-term maturity (see SFAS No. 157, "Fair Value Instruments" in Recent Accounting Pronouncements section below).

The fair value of the interest rate swaps is the estimated amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates and the creditworthiness of the counterparty for assets and creditworthiness of the Company for liabilities.

The fair value of the Freight Forward Agreement ("FFA") contracts is the amount the Company would receive or pay to terminate these agreements at the reporting date, taking into account current broker quoted rates for same contracts and the creditworthiness of the counterparty for assets and creditworthiness of the Company for liabilities (see Note 16 - Financial Instruments for additional disclosure on the fair values of interest rate swap agreements and FFA contracts).

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

Recent accounting pronouncements

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 is effective for financial assets and liabilities in fiscal years beginning after November 15, 2007 and for non-financial assets and liabilities in fiscal years beginning after March 15, 2008. The Company has evaluated the potential impact from the adoption of SFAS No. 157 on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In February 2008, the FASB issued FASB Staff Position ("FSP") FASB 157-2 "Effective Date of FASB Statement No. 157" ("FSP FASB 157-2"). FSP FASB 157-2, which was effective upon issuance, delays the effective date of SFAS 157 for nonfinancial assets and liabilities, except for items recognized or disclosed at fair value at least once a year, to fiscal years beginning after November 15, 2008. FSP FASB 157-2 also covers interim periods within the fiscal years for items within the scope of this FSP. The Company has evaluated the potential impact from the adoption of SFAS No. 157-2 on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In February 2007, FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115" (SFAS No. 159") which provides the option to report certain financial assets and liabilities at fair value, with the intent to mitigate volatility in financial reporting that can occur when related assets and liabilities are recorded on different bases. SFAS No. 159 amends FASB Statement No. 95, "Statement of Cash Flows" ("SFAS No. 95") and FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS No. 115"). SFAS No. 159 specifies that cash flows from trading securities, including securities for which an entity has elected the fair value option, should be classified in the statement of cash flows based on the nature of and purpose for which the securities were acquired. Before this amendment, SFAS No. 95 and SFAS No. 115 specified that cash flows from trading securities must be classified as cash flows from operating activities. This statement is effective for the Company beginning January 1, 2008. Upon adoption, the Company will be classifying proceeds from sales of trading securities within the statement of cash flows as an operating or investing activity based on the intention for which any securities are acquired. The Company elected not to adopt any of the fair value options offered by SFAS No. 159.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008, and will be adopted by the Company in the first quarter of fiscal 2009. The Company has evaluated the potential impact from the adoption of SFAS No. 141(R) on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

F-20

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

2. Summary of Significant Accounting Policies - Continued

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements—an amendment of Accounting Research Bulletin No. 51 ("SFAS No. 160")." SFAS No. 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the non-controlling interest, changes in a parent's ownership interest, and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008, and will be adopted by the Company in the first quarter of fiscal 2009. The Company has evaluated the potential impact from the adoption of SFAS No. 160 on the Company's consolidated results of operations and financial condition and concluded that the effect is not material.

In March 2008 the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities" ("SFAS No. 161"). The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. SFAS No. 161 only requires additional disclosures about derivatives, and as such, it will have no effect on the Company's consolidated results of operations, cash flows and financial condition and concluded that the effect is not material.

In May 2008 the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" ("FASB No. 162"). The new standard identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements. This statement is effective sixty days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles". The Company has evaluated the potential impact of the adoption of SFAS No. 162 on the Company's consolidated results of operations, cash flows and financial condition and concluded that the effect is not material.

In June 2008, the FASB issued Staff Position No. EITF 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities" ("FSP EITF 03-6-1"). This Staff Position states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. All prior-period earnings per share ("EPS") data presented shall be adjusted retrospectively (including interim financial statements, summaries of earnings and selected financial data) to conform with the provisions of this Staff Position. Early application is not permitted. We do not expect the adoption of this accounting guidance to impact our EPS.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

3. Inventories

This consisted of the following:

	2007	2008
Lubricants	1,232,341	1,410,063
Victualling	145,767	164,708
Bunkers	525,570	437,202
Total	1,903,678	2,011,973

4. Vessels, net

The amounts in the accompanying consolidated balance sheets are as follows:

	Costs	Accumulated Depreciation	Net Book Value
Balance, January 1, 2005	55,760,394	(21,589,230)	34,171,164
-Depreciation for the year		(2,657,914)	(2,657,914)
-Purchase of vessel	20,821,647	-	20,821,647
Balance, December 31, 2005	76,582,041	(24,247,144)	52,334,897
Balance, January 1, 2006	76,582,041	(24,247,144)	52,334,897
-Depreciation for the year	-	(6,277,328)	(6,277,328)
-Purchase of vessels	55,479,929	-	55,479,929
-Vessels held for sale	(6,119,713)	4,336,873	(1,782,840)
-Sale of vessels	(12,411,482)	8,151,166	(4,260,316)
Balance, January 1, 2007	113,530,775	(18,036,433)	95,494,342
-Depreciation for the year	-	(16,423,092)	(16,423,092)
-Purchase of vessels	159,177,734	-	159,177,734
Balance, December 31, 2007	272,708,509	(34,459,525)	238,248,984
-Depreciation for the year	-	(28,284,752)	(28,284,752)
-Purchase of vessel	53,179,758	-	53,179,758
-Vessels held for sale	(45,620,268)	14,439,884	(31,180,384)
Balance, December 31, 2008	280,267,999	(48,304,393)	231,963,606

The Company acquired seven vessels during 2007 (M/V "Gregos", M/V "Manolis P", M/V "OEL Transworld", M/V "Despina P", M/V "Jonathan P", M/V "Tiger Bridge" and M/V "Ioanna P") for an aggregate purchase price plus costs required to make the vessels available for use of $159,177,734. M/V "Tiger Bridge" and M/V "Ioanna P" were acquired with below market charters with estimated fair value of $9,675,481 (see Note 7 below). During 2008, the Company acquired M/V "Maersk Noumea" for a purchase price of $53,179,758 with a below market charter with estimated fair value of $9,597,438 (see Note 7 below). The Company made payments equal to the purchase price less the fair value of the below market charters to acquire the vessels.

F-22

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

4. Vessels, net - Continued

On February 22, 2007, Searoute Maritime Ltd., a wholly-owned subsidiary of the company, sold M/V "Ariel", a handysize bulk carrier of 33,712 DWT built in 1977 for a gross price of $5,350,000 with 2% sales commissions resulting in a gain of $3,411,397. M/V "Ariel" was classified as "held for sale" as of December 31, 2006.

In October and November 2008, the Company decided to dispose of two of its vessels. The Company completed the sale of the two vessels in January and February of 2009. The Company determined that the carrying values of the two vessels exceeded their fair values which were calculated on the basis of the agreed price to sell the vessels. Consequently, the Company recorded an impairment loss of $25,113,364, which represents the excess of the carrying values of the assets over their fair values, less cost to sell. The impairment loss is recorded as a separate line item ("Impairment loss") in the Income Statement for 2008. The carrying value of the assets that are held for sale is separately presented in the Balance Sheet in the caption "Assets held for sale," and these assets are no longer depreciated.

5. Deferred Charges, net

This consisted of:

	2006	2007	2008
Balance, beginning of year	1,855,829	1,291,844	5,529,870
Additions	972,448	5,880,007	6,272,762
Amortization of drydocking and special survey expenses	(1,015,510)	(1,539,981)	(3,946,149)
Amortization of loan arrangement fees	(74,601)	(72,715)	(85,141)
Unamortized portion of drydocking and special survey expenses written-off upon sale of vessels	(446,322)	(29,285)	-
Balance, end of year	1,291,844	5,529,870	7,771,342

The additions of $972,448 in 2006 consisted of loan financing fees of $151,250 and drydocking and special survey expenses of $821,198 for two vessels, M/V "Nikolaos P" and M/V "Kuo Hsiung". The additions of $5,880,007 in 2007 consisted of loan financing fees of $110,000 and drydocking and special survey expenses of $5,770,007 for seven vessels, M/V "Artemis", M/V "Ninos", M/V "Tasman Trader", M/V "Gregos", M/V "Manolis P", M/V "Despina P" and M/V "OEL Integrity" (ex M/V "Jonathan P"). The additions of $6,272,762 in 2008 consisted of deferred financing fees of $143,505 and $6,129,257 of drydocking and special survey expenses for five vessels, M/V "Irini", M/V "Kuo Hsiung", M/V "Aristides NP", M/V "YM Xingang I" and M/V "Tiger Bridge".

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

6. Accrued Expenses

The accrued expenses account consisted of:

	2007	2008
Accrued follow-on offering expenses	193,919	-
Accrued payroll expenses	152,843	262,370
Accrued interest	498,317	182,716
Accrued general and administrative expenses	503,560	48,000
Accrued commissions	385,525	204,531
Other accrued expenses	309,421	508,849
Total	2,043,585	1,206,466

7. Fair Value of Above or Below Market Time Charters Acquired

M/V "Tasman Trader" was acquired on April 27, 2006 with an outstanding time charter terminating on December 17, 2008 with a charter rate of $8,850 per day and M/V "Aristides N.P." was acquired on September 4, 2006 with an outstanding time charter contract terminating on November 8, 2006 with a charter rate of $19,750 per day. These charter rates were below the market rates for equivalent time charters prevailing at the time the foregoing vessels were acquired. The present values of the below the market charters were estimated by the Company at $1,237,072 and $412,500, respectively, and were recorded as liabilities in the consolidated balance sheets. Net voyage revenues included $318,872 as amortization of the below market rate charters for M/V "Tasman Trader" and $412,500 for M/V "Aristides N.P." for the year ended December 31, 2006 and $465,503 and $452,697 for M/V "Tasman Trade" for the year ended December 31, 2007 and 2008, respectively. The unamortized below market rate charter for M/V "Tasman Trader" was $452,697 and $0 and none for M/V "Aristides N.P." as of December 31, 2007 and 2008, respectively, and is recorded as a liability in the consolidated balance sheets.

M/V "YM Xingang I" was acquired on November 15, 2006 with an outstanding time charter terminating on July 21, 2009 with a charter rate of $26,650 per day. This charter rate was above the market rates for equivalent time charters prevailing at the time. The present value of the above the market charter was estimated by the Company at $7,923,480, and was recorded as an asset in the consolidated balance sheets. Net voyage revenues included a reduction of $380,003, $2,938,963 $2,951,092 as amortization of the above market rate charter for M/V "YM Xingang I" for the years ended December 31, 2006, 2007 and 2008, respectively. The remaining unamortized above market rate charter was $4,604,514 and $1,653,422 as of December 31, 2007 and 2008, respectively, and is recorded as a long term asset in the consolidated balance sheets.

7. Fair Value of Above or Below Market Time Charters Acquired - continued

M/V "Tiger Bridge" was acquired on October 4, 2007 with an outstanding time charter terminating on August 4, 2009 with a charter rate of $16,500 per day. This charter rate was below the market rates for equivalent time charters prevailing at the time. The present value of the below-market charter was estimated by the Company at $2,263,924, and was recorded as a liability in the consolidated balance sheets. Net voyage revenues included $298,946 and $1,226,012 as amortization of the below-market rate charter for M/V "Tiger Bridge" for the year ended December 31, 2007 and 2008, respectively. The remaining unamortized below market rate charter was $1,964,977 and $738,965 as of December 31, 2007 and 2008, respectively and is recorded as a liability in the consolidated balance sheets.

M/V "Ioanna P" was acquired on November 1, 2007 with an outstanding time charter terminating on August 4, 2008 with a charter rate of $35,500 per day. This charter rate was below the market rates for equivalent time charters prevailing at the time. The present value of the below-market charter was estimated by the Company at $7,441,558 and was recorded as a liability in the consolidated balance sheets. Net voyage revenues included $1,626,260 and $5,785,298 as amortization of the below-market rate charter for M/V "Ioanna P" for the year ended December 31, 2007 and 2008, respectively. The remaining unamortized below market rate charter was $5,785,298 and $0 as of December 31, 2007 and 2008, respectively.

M/V "Maersk Noumea" was acquired on May 22, 2008 with an outstanding time charter terminating on August 2011 with a charter rate of $16,800 per day plus three one-year consecutive optional extensions at $18,735, $19,240 and $19,750 per day respectively. This charter rate was below the market rates for equivalent time charters prevailing at the time. The present value of the below-market charter plus the optional periods was estimated by the Company at $9,597,438 and was recorded as a liability in the consolidated balance sheets. Net voyage revenues included $1,631,592 as amortization of the below-market rate charter for M/V "Maersk Noumea" for the year ended December 31, 2008. The remaining unamortized below market rate charter was $7,965,846 as of December 31, 2008.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

8. Related Party Transactions

The Company's vessel owning companies are parties to management agreements with Eurobulk Ltd. ("Management Company"), which is controlled by members of the Pittas family, whereby the Management Company provides technical and commercial vessel management for a fixed daily fee of an average of Euro 608 for 2006, average of Euro 628 for 2007 and Euro 630 for 2008 under the Company's Master Management Agreement (see below). Vessel management fees paid to the Management Company amounted to $2,266,589, $3,669,137 and $5,387,415 in 2006, 2007 and 2008, respectively. These agreements were renewed on January 31, 2005 and amended in August and October 2006 with an initial term of five years and will automatically be extended after the initial term until terminated by the parties. Termination is not effective until two months following notice having been delivered in writing by either party after the expiration of the initial five-year period. An annual adjustment of the management fee due to inflation as provided under the management agreement took effect on the annual anniversary of the agreement on January 31, 2006 increasing the management fee by Euro 20 per vessel per day to Euro 610 and on January 31, 2007 to Euro 630 per vessel per day. Eurobulk Ltd. agreed not to adjust the daily management fee for inflation in 2008. The Company's master management agreement with Eurobulk - effective as of October 1, 2006 and with an initial term of five years until September 30, 2011 – was amended and renewed for five years on February 7, 2008 with effect from January 1, 2008. Future inflation adjustments will take effect on January 1. The management fee was adjusted for inflation and agreed at Euro 655 per vessel per day for 2009 taking effect on January 1, 2009.

In addition to the vessel management services, Eurobulk provides us with management services for the Company's needs as a public company. In 2006, compensation for such services to us as a public company was $508,750, incremental to the management fee. The Euroseas Board of Directors approved an increase of the management services fee to $700,000 per year starting July 1, 2007, resulting in total cost for such services in 2007 of $608,750. On February 7, 2008, as part of the amended and renewed master management agreement, the Board of Directors approved a further increase to this component of the management fee to $1,100,000 per year starting on January 1, 2008 to be adjusted for inflation every January 1. This fee was adjusted for inflation and agreed at $1,150,000 for 2009 starting on January 1, 2009.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

8. Related Party Transactions - Continued

Amounts due to or from related parties represent net disbursements and collections made on behalf of the vessel-owning companies by the Management Company during the normal course of operations for which a right of off-set exists. As of December 31, 2007 and 2008, the amount due from related companies was $5,291,197 and $4,678,750, respectively. Based on the master management agreement between Euroseas Ltd. and Euroseas' shipowning subsidiaries and Eurobulk Ltd. an estimate of the quarter's operating expenses, expected drydock expenses, vessel management fee and fee for management executive services is to be advanced in the beginning of quarter to Eurobulk Ltd. For the fleet as of December 31, 2008 this advance is estimated between $7,500,000 and $9,000,000 excluding any advances needed for drydock expenses and is paid in advance around the beginning of each quarter. Interest earned on funds deposited in related party accounts is credited to the account of the ship-owning companies or Euroseas Ltd.

The Company uses brokers for various services, as is industry practice. Eurochart S.A., an affiliated company controlled by certain members of the Pittas family, provides vessel sale and purchase services, and chartering services to the Company whereby the Company pays commission of 1% of the vessel sales price and 1.25% of charter revenues. Commission expenses for vessel sales for the years ended December 31, 2007 and 2006 were $53,500 and $96,000, respectively, incurred for the sale of M/V "Ariel" in 2007, and, sale of M/V "Pantelis P" and M/V "John P" in 2006; there were no sales of vessels in 2008. Eurochart S.A. also received 1% commission for vessel acquisitions from the sellers of the vessels that the Company acquired. Commissions to Eurochart S.A. for chartering services were $492,149, $1,124,416 and $1,663,526 in 2006, 2007 and 2008, respectively.

Certain members of the Pittas family, together with another unrelated ship management company, have formed a joint venture with the insurance broker Sentinel Maritime Services Inc., and with a crewing agent More Maritime Agencies Inc. The shareholders' percentage participation in these joint ventures was 78% in 2006 and 2007 and 78.7% in 2008. Sentinel Maritime Services Inc. is paid a commission on premium not exceeding 5%; More Maritime Agencies Inc. is paid a fee of $50 per crew member per month. Total fees charged by Sentinel Marine Services Inc. and More Maritime Agencies Inc. were $60,750 and $79,495, in 2006, and, $67,900 and $117,145 in 2007 and $111,325 and $171,442 in 2008, respectively. These amounts are recorded in "Vessel operating expenses" under "Operating expenses".

The Company has authorized Eurotrade S.A., a company controlled by certain members of the Pittas family, to act on its behalf and enter into six FFA contracts in December 2008 using its existing FFA trading account arrangements with Royal Bank of Scotland ("RBS"), until the Company establishes its own separate FFA trading account. These six FFA contracts are for a total of 480 vessel-equivalent days for calendar year 2009 and 485 days for 2010 of a modern panamax size vessel. The Company collects the difference between the spot rate and the contract rate if the spot rate is lower or will pay it if it is higher. Settlement takes place monthly. As of December 31, 2008, the fair value of these contracts resulted in a $1,216,083 unrealized loss which has been included in the statement of income. The Company does not have any legal obligations to Eurotrade to cover any margin requirements. The Company did not pay any fees to Eurotrade S.A. for its services.

F-27

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

9. Long-Term Debt

This consisted of bank loans of the ship-owning companies and is as follows:

Borrower		December 31, 2007	December 31, 2008
Diana Trading Limited	(a)	$ 2,100,000	$ -
Alcinoe Shipping Limited (2006)/ Oceanpride Shipping Limited/ Searoute Maritime Ltd/ Oceanopera Shipping Ltd	(b)	2,600,000	-
Alterwall Business Inc./ Allendale Investments S.A	(c)	7,950,000	5,500,000
Salina Shipholding Corp.	(d)	8,500,000	5,000,000
Xenia International Corp	(e)	6,660,000	5,600,000
Prospero Maritime Inc.	(f)	13,100,000	11,275,000
Xingang Shipping Ltd. / Alcinoe Shipping Ltd	(g)	16,000,000	12,000,000
Manolis Shipping Ltd.	(h)	9,680,000	9,040,000
Trust Navigation Corp. / Tiger Navigation Co.	(i)	15,000,000	7,600,000
		81,590,000	56,015,000
Less: Current portion		(25,575,000)	(12,450,000)
Long-term portion		$ 56,015,000	$ 43,565,000

The future annual loan repayments are as follows:

To December 31:	
2009	12,450,000
2010	14,450,000
2011	6,250,000
2012	5,710,000
2013	11,315,000
Thereafter	5,840,000
Total	$ 56,015,000

F-28

Euroseas Ltd. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

9. Long-Term Debt - continued

(a) This consisted of a loan amounting to $4,900,000 and $1,000,000 drawn in 2002. The loan was payable in twenty-four consecutive quarterly installments of $220,000 each, and a balloon payment of $620,000 payable together with the final quarterly installment paid in October 2008. The interest was based on LIBOR plus 1.6% per annum.

An additional loan of $4,200,000 was drawn on May 9, 2005. The loan was payable in twelve consecutive quarterly installments consisting of four installments of $450,000 each, and eight installments of $300,000 each with the final installment paid in May 2008. The interest was based on LIBOR plus 1.25% per annum.

(b) Alcinoe Shipping Ltd., Oceanpride Shipping Ltd., Searoute Maritime Ltd. and Oceanopera Shipping Ltd. drew, in 2005, $13,500,000 against a loan facility for which they were jointly and severally liable. The loan was payable in twelve consecutive quarterly installments consisting of two installments of $2,000,000 each, one installment of $1,500,000, nine installments of $600,000 each and a balloon payment of $2,600,000 payable with the final installment paid in May 2008. The interest was based on LIBOR plus 1.5% per annum.

The Company made two additional early repayments for a total of $3,000,000 from the sales proceeds of M/V "John P" and M/V "Pantelis P" in June 2006 and July 2006. The Company also negotiated a revised repayment schedule starting July 1, 2006, which provides for payment of $300,000 per quarter and a balloon payment of $2,000,000 payable with the final installment paid in the second quarter of 2008. After the sale of the above mentioned vessels in 2006 and the sale of M/V "Ariel" in February 2007, Oceanopera Shipping Ltd., the owner of M/V "Nikolaos P" remained the sole liable entity for this loan facility until it was fully repaid in May 2008.

(c) Allendale Investments S.A. and Alterwall Business Inc. drew $20,000,000 on May 26, 2005 against a loan facility for which they are jointly and severally liable. The loan is payable in twenty-four unequal consecutive quarterly installments of $1,500,000 each in the first year, $1,125,000 each in the second year, $775,000 each in the third year, $450,000 each in the fourth through sixth years and a balloon payment of $1,000,000 payable with the final installment due in May 2011. The interest is based on LIBOR plus 1.25% per annum as long as the outstanding loan amount remains below 60% of the fair market value (FMV) of M/V "Ninos" and M/V "Kuo Hsiung" and plus 1.375% if the outstanding loan amount is above 60% of the FMV of such vessels.

(d) This is a $15,500,000 loan drawn by Salina Shipholding Corp. on December 30, 2005. The loan is payable in ten consecutive semi-annual installments consisting of six installments of $1,750,000 each and four installments of $650,000 each and a balloon payment of $2,400,000 payable with the final installment due in January 2011. The interest is based on LIBOR plus a margin that ranges between 0.9%-1.1%, depending on the asset cover ratio. The loan is secured with the following: (i) first priority mortgage over M/V "Artemis", (ii) first assignment of earnings and insurance of M/V "Artemis", (iii) a corporate guarantee of Euroseas Ltd., (iv) a minimum cash balance equal to an amount of no less than $300,000 in an account Salina Shipholding Corp. maintains with the bank, and (v) overall liquidity (cash and cash equivalents) of $300,000 for each of the Company's vessels throughout the life of the facility.

F-29

Euroseas Ltd. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

9. Long-Term Debt - continued

(e) This is an $8,250,000 loan drawn by Xenia International Corp. on June 30, 2006. The loan is payable in twenty three consecutive quarterly installments consisting of $265,000 each and a balloon payment of $2,155,000 payable with the final quarterly installment due in March 2012. The interest is based on LIBOR plus a margin of 0.95%. The loan is secured with the following: (i) first priority mortgage over M/V "Tasman Trader", (ii) first assignment of earnings and insurance of M/V "Tasman Trader", (iii) a corporate guarantee of Euroseas Ltd., and (iv) overall liquidity (cash and cash equivalents) of $300,000 for each of the Company's vessels throughout the life of the facility.

(f) This is a $15,500,000 loan drawn by Prospero Maritime Inc. on September 4, 2006. The loan is payable in fourteen consecutive semi-annual installments consisting of two installments of $1,200,000 each, one installment of $1,000,000 each and eleven installments of $825,000 each and a balloon payment of $3,025,000 payable with the final semi-annual installment due in September 2013. The interest is based on LIBOR plus a margin that ranges between 0.9%-0.95%, depending on the asset cover ratio. The loan is secured with the following: (i) first priority mortgage over M/V "Aristides N.P.", (ii) first assignment of earnings and insurance of M/V "Aristides N.P.", (iii) a corporate guarantee of Euroseas Ltd., (iv) a minimum cash balance equal to an amount of no less than $300,000 in an account Prospero Maritime Inc. maintains with the bank, and (v) overall liquidity (cash and cash equivalents) of $300,000 for each of the Company's vessels throughout the life of the facility.

(g) This is a $20,000,000 loan drawn by Xingang Shipping Ltd. on November 15, 2006; Alcinoe Shipping Ltd., owner of the M/V "Gregos", became a guarantor to the loan in March 2007. The loan is payable in eight consecutive quarterly installments of $1.0 million each, the first of which is due in February 2007, followed by four consecutive quarterly installments of $750,000 each, followed by sixteen consecutive installments of $250,000 each and a balloon payment of $5.0 million payable with the final quarterly installment due in November 2013. The interest was based on LIBOR plus a margin of 0.935% initially; after Alcinoe Shipping Ltd. became a guarantor the rate became 0.90%. The loan is secured with the following: (i) first priority mortgage over M/V "YM Xingang I", (ii) first assignment of earnings and insurance, (iii) a corporate guarantee of Euroseas Ltd. and (iv) a third mortgage on M/V "Irini" also financed by the same bank.

(h) This is a $10,000,000 loan drawn by Manolis Shipping Ltd. on June 11, 2007. The loan is payable in thirty-two consecutive quarterly installments of $160,000 each, the first of which is due in September 2007, plus a balloon payment of $4,880,000 payable with the final quarterly installment in June 2015. The interest is based on LIBOR plus a margin of 0.80% if the ratio of the outstanding loan to the vessel value is below 55%, otherwise the margin is 0.90%. The loan is secured with the following: (i) first priority mortgage over M/V "Manolis P", (ii) first assignment of earnings and insurance, (iii) a corporate guarantee of Euroseas Ltd. and (iv) a minimum cash balance equal to an amount of no less than $300,000 in an account Manolis Shipping Ltd. maintains with the bank. Other covenants and guarantees are similar to the rest of the loans of the Company.

Euroseas Ltd. and Subsidiaries
Notes to Unaudited Condensed Consolidated Financial Statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

9. Long-Term Debt - continued

(i) This is a $15,000,000 loan drawn by Trust Navigation Corp. on November 1, 2007. In December 2008, vessel M/V "Tiger Bridge" owned by the Company's wholly owned subsidiary, Tiger Navigation Corp., was added as collateral. The loan is payable in four consecutive quarterly installments of $1,850,000 each, the first of which is due in February 2008, followed by four consecutive quarterly installments of $750,000 each, followed by four consecutive quarterly installments of $550,000 each, plus a balloon payment of $2,400,000 payable with the final quarterly installment in November 2010. The interest is based on LIBOR plus a margin of 0.90%. The loan is secured with the following: (i) first priority mortgage over M/V "Ioanna P", (ii) first assignment of earnings and insurance, (iii) a corporate guarantee of Euroseas Ltd. and (iv) a minimum cash balance equal to an amount of no less than $300,000 in an account Trust Navigation Corp. maintains with the bank. Other covenants and guarantees are similar to the rest of the loans of the Company.

In addition to the terms specific to each loan described above, all the above loans are secured with one or more of the following:

- first priority mortgage over the respective vessels on a joint and several basis.
- first assignment of earnings and insurance.
- a personal guarantee of one shareholder.
- a corporate guarantee of Euroseas Ltd.
- a pledge of all the issued shares of each borrower.

The loan agreements contain covenants such as minimum requirements regarding the hull ratio cover (the ratio of fair value of vessel to outstanding loan less cash in retention accounts), restrictions as to changes in management and ownership of the vessel shipowning companies, distribution of profits or assets (i.e. limiting dividends in some loans to 60% of profits, or, not permitting dividend payment or other distributions in cases that an event of default has occurred), additional indebtedness and mortgage of vessels without the lender's prior consent, sale of vessels, maximum fleet-wide leverage, sale of capital stock of our subsidiaries, ability to make investments and other capital expenditures, entering in mergers or acquisitions, minimum cash balance requirements and minimum cash retention accounts (restricted cash). The loans agreements also require the Company to make deposits in retention accounts with certain banks that can only be used to pay the current loan installments. Minimum cash balance requirements are in addition to cash held in retention accounts. These cash deposits amounted to $6,239,879 and $6,981,264 as of December 31, 2007 and 2008, respectively, and are shown as "Restricted cash" under "Current Assets" and "Long-Term Assets" in the consolidated balance sheets. The Company is not in default of any of the foregoing covenants.

Interest expense for the years ended December 31, 2006, 2007 and 2008 amounted to $3,324,257, $4,777,524 and $2,845,596, respectively. At December 31, 2008, LIBOR for the Company's loans was on average approximately 1.6% and the average interest rate on our debt was approximately 2.6%.

Euroseas Ltd. and subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

10. Derivative Financial Instruments

The losses for the period ended December 31, 2008 arose from an interest rate swap entered into in July 2008 and six FFA contracts entered in December 2008 that did not meet the criteria for hedge accounting treatment. The Company did not enter into any derivative transaction in 2006 or 2007. The FFA contracts were entered into by Eurotrade S.A., a related party, on the account of the Company (see Note 8 – "Related Party Transactions").

Effective July 14, 2008, the Company entered into an interest rate swap with EFG Eurobank – Ergasias S.A. ("Eurobank") on a notional amount of $25.0 million in order to manage interest costs and the risk associated with changing interest rates. Under the terms of the swap, Eurobank makes a quarterly payment to the Company based on 3-month LIBOR less 3.99% on the relevant amount if the 3-month LIBOR is greater than 3.99%. If 3-month LIBOR is less than 3.99%, Eurobank receives an amount from the Company based on 3.99% less the 3-month LIBOR for the relevant amount. If LIBOR is equal to 3.99% no amount is due or payable to the Company. The swap is effective from July 14, 2008 to July 14, 2013. The interest rate swap did not qualify for hedge accounting as of December 31, 2008. The Company follows SFAS No. 157 to calculate the fair value of the swap (see Note 16). A realized loss of ($77,105) and an unrealized loss of ($2,181,447) are included under "Change in fair value of derivatives" in the Consolidated statements of income. As of December 31, 2008, a current liability of $471,559 and a long term liability of $1,709,888 are included under the "Derivatives" heading in the respective sections in the "Consolidated balance sheets" of the Company.

In December 2008, the Company sold six FFA contracts on the Baltic Panamax Index ("BPI") for Calendar Year 2009 and 2010 totaling 480 and 485 days, respectively, at an average time charter equivalent date of approximately $11,350 and $11,430 per day, respectively. The contracts are settled on a monthly basis using the average of the BPI for the days of the month the BPI is published. The Company will receive a payment if the average BPI for the month is below the contract rate equal to the difference of the contract rate less the average BPI for the month times the number of contract days sold (for example, January 2009 was settled based on 40 days as 40 of the 480 days sold by the Company referred to January 2009); if the average BPI for the month is greater than the contract rate the Company will make a payment equal to the difference of the average BPI for the month less the contract rate times the number of contract days sold. The FFA contract did not qualify for hedge accounting as of December 31, 2008. The Company follows SFAS No. 157 to calculate the fair value of the FFA contracts (see Note 16). An unrealized loss of ($1,216,083) is included under "Change in fair value of derivatives" in the Consolidated statements of income. As of December 31, 2008, a current asset of $61,670, a long-term asset of $68,038, a current liability of $355,651 and a long-term liability of $990,140 are included under the "Derivatives" heading in the respective sections in the "Consolidated balance sheets" of the Company.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

11. Income Taxes

Under the laws of the countries of the companies' incorporation and/or vessels' registration, the companies are not subject to tax on international shipping income, however, they are subject to registration and tonnage taxes, which have been included in Vessel operating expenses in the accompanying consolidated statements of income.

Pursuant to the Internal Revenue Code of the United States (the "Code"), U.S. source income from the international operations of ships is generally exempt from U.S tax if the company operating the ships meets certain requirements. Among other things, in order to qualify for this exemption, the company operating the ships must be incorporated in a country, which grants an equivalent exemption from income taxes to U.S corporations. All the company's ship-operations subsidiaries satisfy this particular criterion. In addition, more than 50% of the value of the stock must be owned, directly or indirectly, by individuals who are residents as defined in the countries of incorporation or another foreign country that grants an equivalent exemption to U.S corporations, the "50% Ownership Test", or, the stock is "primarily and regularly traded on an established securities market" in our country of organization, in another country that grants an "equivalent exemption" to United States corporations, or in the United States, the "Publicly-Traded Test". These companies also satisfied the "50% Ownership Test" requirement for 2006 and 2007. In addition, the management of the Company believes that by virtue of the special rule applicable to situations where the ship operating companies are beneficially owned by a publicly-traded company like the Company, the "Publicly-Traded Test" was satisfied for 2008 and thereafter, but no assurance can be given that this will remain so, since continued compliance with this rule is subject to factors outside the Company's control.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

12. Commitments and Contingencies

(a) There are no material legal proceedings to which the Company is a party or to which any of its properties are subject, other than routine litigation incidental to the Company's business. In the opinion of the management, the disposition of these lawsuits should not have a material impact on the consolidated results of operations, financial position and cash flows.
(b) The distribution of the net earnings by one of the chartering pools which has one of the Company's vessels in its pool has not yet been finalized for the year ended December 31, 2008. The effect on the Company's income resulting from a subsequent reallocation of pool income on the results for the year is not significant.
(c) Future minimum long-term time charter revenue net of commissions, based on non-cancelable time charter contracts as of December 31, 2008 will be $17.2 million for 2009, $9.6 million for 2010, $5.5 million for 2011 and $0.5 million for 2012 assuming the scheduled drydockings and special surveys (20-25 days every two and a half years) and one additional offhire day per quarter to account for any unscheduled off-hire time.

13. Stock Incentive Plan

On July 17, 2007, the Board of Directors terminated the Company's 2006 Stock Incentive Plan without making any awards. On October 25, 2007, the Board of Directors approved the Company's 2007 Stock Incentive Plan (the "Plan"). The Plan is administered by the Board of Directors which can make awards totaling in aggregate up to 600,000 shares over the next 10 years. The persons eligible to receive awards under the Plan are officers, directors, and executive, managerial, administrative and professional employees of the Company or Eurobulk or Eurochart, (collectively, "key persons") as the Board, in its sole discretion, shall select based upon such factors as the Board shall deem relevant. Awards may be made under the Plan in the form of incentive stock options, non-qualified stock options, stock appreciation rights, dividend equivalent rights, restricted stock, unrestricted stock, restricted stock units and performance shares. The Board awarded 135,000 unvested restricted shares to 12 key persons on December 18, 2007 of which 50% vested on December 20, 2007 and the remaining vested on December 15, 2008 subject to continuous employment with the Company. Awards to officers and directors amounted to 80,000 shares; the remaining 55,000 shares were awarded to employees of Eurobulk. An additional award of 150,000 unvested restricted shares was made to the same 12 key persons on February 7, 2008 of which 50% vested on August 7, 2008 and the remaining 50% will vest on August 7, 2009; awards to officers and directors amounted to 95,000 shares and the remaining 55,000 shares were awarded to employees of Eurobulk. Another award of 160,000 unvested restricted shares was made to the same 12 and an additional two (a total of 14) key persons on November 12, 2008 of which 50% will vest on November 16, 2009 and 50% on November 16, 2010; awards to officers and directors amounted to 100,000 shares and the remaining 60,000 shares were awarded to employees of Eurobulk.

All unvested restricted shares are conditional upon the grantee's continued service as an employee of the Company, Eurobulk or as a director until the applicable vesting date. The grantee does not have the right to vote such unvested restricted shares until they vest or exercise any right as a shareholder of these shares, however, the unvested shares will accrue dividends as declared and paid which will be retained by the Company until the share vest at which time they are payable to the grantee. As of December 31, 2007 and 2008 the unvested restricted shares accrued dividends of $0 and $116,750, respectively. As unvested restricted share grantees accrue dividends on awards that are expected to vest, such dividends are charged to retained earnings.

F-34

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

13. Stock Incentive Plan - continued

The Company estimates the forfeitures of unvested restricted shares to be immaterial. The Company will, however, re-evaluate the reasonableness of its assumption at each reporting period.

The compensation cost that has been charged against income for those plans was $0, $822,782 and $1,618,484 for the years ended December 31, 2006, 2007 and 2008, respectively. The Company has used the straight-line method to recognize the cost of the awards.

A summary of the status of the Company's unvested shares as of December 31, 2008, and changes during the years ended December 31, 2006, 2007 and 2008, are presented below:

Unvested Shares	Shares	Weighted-Average Grant-Date Fair Value	
Unvested at December 31, 2006	-		-
Granted	135,000	$	1,602,450
Vested	67,500	$	801,225
Forfeited	-		-
Unvested at December 31, 2007	67,500	$	801,225
Granted	310,000	$	2,290,000
Vested	(142,500)	$	(1,626,225)
Forfeited	-		-
Unvested at December 31, 2008	235,000	$	1,465,000

As of December 31, 2008, there was $1,103,165 of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the Plan based on the closing stock price of $4.30 on December 31, 2008 used for the valuation of the shares awarded to non-employees. That cost is expected to be recognized over a weighted-average period of 0.788 years. The total fair value of shares vested during the year ended December 31, 2007 was $797,925 and the recognized portion of the unvested shares was $24,857. The total fair value of shares vested during the year ended December 31, 2008 was $1,422,900 and the recognized portion of the unvested shares was $195,584.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

14. Earnings Per Share

Basic and diluted earnings per common share are computed as follows:

	2006	2007	2008
Income:			
Net income	20,069,407	40,664,064	23,674,018
Basic earnings per share:			
Weighted average common shares – Outstanding	12,535,365	21,566,619	30,437,107
Basic earnings per share	1.60	1.89	0.78
Effect of dilutive securities			
Warrants	-	78,301	18,932
Unvested incentive stock awards	-	-	49,437
Weighted average common shares – Outstanding	12,535,365	21,644,920	30,505,476
Diluted earnings per share	1.60	1.88	0.78

During the year ended December 31, 2006, the exercise price of then outstanding 585,589 warrants was above the average market price of the Company's shares. Consequently, the Company's warrants were anti-dilutive and not included in the computation of diluted earnings per share for the year ended December 31, 2006. During the year ended December 31, 2007, 248,463 warrants were exercised for gross proceeds of $2,683,400. During the year ended December 31, 2008, 192,213 warrants were exercised resulting in the issuance of 171,998 common shares for gross proceeds of $1,810,922. As of December 31, 2008, the Company has outstanding warrants that entitle their holders to purchase 144,913 shares of common stock at an exercise price of $10.80 per share.

In 2006, 2007 and 2008, the Company declared dividends of $9,465,082 ($0.75 per share), $20,278,538 ($1.00 per share) and $34,664,699 ($1.13 per share), respectively.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

15. Voyage, Vessel Operating Expenses and Commissions

These consisted of:

	Year ended December 31,		
	2006	2007	2008
Voyage expense			
Port charges and canal dues	289,496	335,091	789,303
Bunkers	845,123	547,046	2,274,908
Agency fees	20,119	15,326	28,112
Total	1,154,738	897,463	3,092,323
Vessel operating expenses			
Crew wages and related costs	5,132,985	8,152,303	11,012,931
Insurance	1,591,986	2,256,024	3,517,437
Repairs and maintenance	314,132	481,557	795,138
Lubricants	808,338	1,815,340	2,583,617
Spares and consumable stores	1,811,691	3,235,221	5,435,171
Professional and legal fees	31,488	74,050	46,011
Others	678,197	1,225,637	4,130,889
Total	10,368,817	17,240,132	27,521,194

Commission consisted of commissions charged by:

	Year ended December 31,		
	2006	2007	2008
Third parties	1,337,385	2,899,616	4,276,934
Related parties (see Note 8)	492,149	1,124,416	1,663,526
	1,829,534	4,024,032	5,940,460

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

16. Financial Instruments

The principal financial assets of the Company consist of cash on hand and at banks, trading securities, interest rate swaps, FFA contracts and accounts receivable due from charterers. The principal financial liabilities of the Company consist of long-term loans, FFA contracts and accounts payable due to suppliers.

Interest rate risk

The Company entered into interest rate swap contracts as economic hedges to its exposure to variability in its floating rate long term debt. Under the terms of the interest rate swaps the Company and the bank agreed to exchange, at specified intervals the difference between a paying fixed rate and floating rate interest amount calculated by reference to the agreed principal amounts and maturities. Interest rate swaps allow the Company to convert long-term borrowings issued at floating rates into equivalent fixed rates. Even though the interest rate swaps were entered into for economic hedging purposes, the derivatives described below do not qualify for accounting purposes as fair value hedges, under FASB Statement No. 133, Accounting for derivative instruments and hedging activities, as the Company does not have currently written contemporaneous documentation, identifying the risk being hedged, and both on a prospective and retrospective basis perform an effectiveness test supporting that the hedging relationship is highly effective. Consequently, the Company recognizes the change in fair value of these derivatives in the consolidated statements of income.

Concentration of credit risk

Financial instruments, which potentially subject the Company to significant concentration of credit risk consist primarily of cash and trade accounts receivable. The Company places its temporary cash investments, consisting mostly of deposits, with high credit qualified financial institutions. The Company performs periodic evaluation of the relative credit standing of these financial institutions that are considered in the Company's investment strategy. The Company limits its credit risk with accounts receivable by performing ongoing credit evaluations of its customers' financial condition and generally does not require collateral for its accounts receivable.

Fair value of financial instruments

The carrying values of cash, accounts receivable and accounts payable are reasonable estimates of their fair value due to the short term nature of these financial instruments. The fair value of long term bank loans bearing interest at variable interest rates approximates the recorded values. Additionally, the Company considers the creditworthiness when determining the fair value of the credit facilities. The carrying value approximates the fair market value of the floating rate loans. The fair value of the Company's interest rate swaps was the estimated amount the Company would pay to terminate the swap agreements at the reporting date, taking into account current interest rates and the current creditworthiness of the Company and its counter parties. The fair value of trading securities and FFA contracts is based on the closing price on the last day of the reporting period.

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

16. Financial Instruments - continued

The Company follows SFAS No. 157, which establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosure about fair value measurements. This statement enables the reader of the financial statements to assess the inputs used to develop those measurements by establishing a hierarchy for ranking the quality and reliability of the information used to determine fair values. The statement requires that assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1: Quoted market prices in active markets for identical assets or liabilities;
Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data;
Level 3: Unobservable inputs that are not corroborated by market data.

The fair value of the Company's investments in trading securities and FFA contracts are determined based on quoted prices in active markets and therefore are considered Level 1 of the fair value hierarchy as defined in SFAS No. 157.

The Company's interest rate swap agreements are based on LIBOR swap rates. LIBOR swap rates are observable at commonly quoted intervals for the full terms of the swaps and therefore are considered Level 2 items. The fair values of the interest rate swap determined through Level 2 of the fair value hierarchy as defined in SFAS No. 157 are derived principally from or corroborated by observable market data. Inputs include quoted prices for similar assets, liabilities (risk adjusted) and market-corroborated inputs, such as market comparables, interest rates, yield curves and other items that allow value to be determined. As of December 31, 2008 no fair value measurements for assets or liabilities under Level 3 were recognized in the Company's consolidated financial statements.

	Fair Value Measurement at Reporting Date Using			
	Total, December 31, 2008	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets				
Trading securities	$ 771,727	$ 771,727	-	-
FFA contracts, current and long-term portion	$ 129,708	$ 129,708		-
Liabilities				
Interest rate swaps, current and long-term portion	$ 2,181,447	-	$ 2,181,447	-
FFA contracts, current and long-term portion	$ 1,345,791	$ 1,345,791	-	-

Euroseas Ltd. and Subsidiaries
Notes to the consolidated financial statements
Years ended December 31, 2006, 2007 and 2008
(All amounts expressed in U.S. Dollars)

17. Subsequent Events

a) On February 6, 2009, the Board of Directors declared a cash dividend of $0.10 per Euroseas Ltd. common share. Such cash dividend was paid on or about March 20, 2009 to the holders of record of Euroseas Ltd. common shares as of March 12, 2009.

b) On January 12, 2009, a subsidiary of the Company delivered to its buyers M/V "Ioanna P" (see Note 4). The Company decided to sell the vessel in November 2008 and entered into a memorandum of agreement to sell it on December 23, 2008 for a gross price of $3.85 million less 4% sales commissions.

c) On February 12, 2009, a subsidiary of the Company delivered to its buyers M/V "Nikolaos P" (see Note 4). The Company decided to sell the vessel in November 2008 and entered into a memorandum of agreement to sell it on January 28, 2009 for a gross price of $2.4 million less 2% sales commissions.

d) On December 3, 2008, a subsidiary of the Company agreed to purchase the 46,667 dwt drybulk carrier M/V "Solar Europe" (renamed M/V "Monica P"), built in 1998 in Japan, for $18 million. The vessel was delivered to a subsidiary of the Company on January 19, 2009. The acquisition was financed with $8 million from the Company's cash balance and $10 million of bank debt secured by the vessel. The debt is payable in 20 consecutive quarterly installments of $250,000 and with a $5 million balloon payment alongside the last installment. The margin of the loan is 2.50% above LIBOR.

e) On February 10, 2009, a subsidiary of the Company agreed to purchase the 72,119 dwt drybulk carrier M/V "Glorious Wind" (renamed M/V "Eleni P") built in 1997 in Japan, for $18.38 million. The vessel was delivered to the Company on March 6, 2009. The Company financed the acquisition with cash reserves from its balance sheet, and, subsequently, arranged for a bank loan for $10 million secured by the vessel which was drawn in the April 2009. The loan is payable in 10 consecutive semiannual installments, two in the amount of $100,000, two in the amount of $400,000, two in the amount of $600,000 and four in the amount of $800,000 and with a $4.6 million balloon payment to be paid together with the last installment. The margin of the loan is 2.50% above LIBOR for the $5.4 million repaid throughout the 5 years and 2.70% above LIBOR for the amount of the balloon payment.