

PRIVATE MEDIA GROUP INC  
Form 10-Q  
June 28, 2013

**U.S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

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

For the quarterly period ended. June 30, 2012

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 000-25067

**PRIVATE MEDIA GROUP, INC.**

(Exact Name of Registrant as Specified in its Charter)

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Nevada  
(State or other jurisdiction of

87-0365673  
(I.R.S. Employer

incorporation or organization)

Identification Number)

Calle de la Marina 16-18, Floor 18, Suite D, 08005 Barcelona, Spain

(Address of European principal executive offices)

34-93-620-8090

(Issuer'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 past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer

Accelerated Filer

Non-accelerated filer

Smaller Reporting Company

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

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date

Class  
Common Stock, par value \$.001

Outstanding at June 26, 2013  
27,806,211

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

	December 31, 2011 EUR	June 30, (Unaudited) 2012 EUR	2012 USD
	(in thousands)		
<b>ASSETS</b>			
Cash and cash equivalents	179	358	455
Trade accounts receivable net	2,293	2,027	2,574
Inventories (Note 2)	761	633	804
Deferred income tax asset	455	455	578
Prepaid expenses and other current assets	134	200	254
Current assets held for shareholder claims	427		
<b>TOTAL CURRENT ASSETS</b>	<b>4,249</b>	<b>3,673</b>	<b>4,665</b>
Library of photographs and videos	4,879	3,720	4,724
Property, plant and equipment	1,519	1,245	1,581
Other assets	403	380	483
Non-current assets held for shareholder claims	488		
<b>TOTAL ASSETS</b>	<b>11,538</b>	<b>9,018</b>	<b>11,453</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
Short-term borrowings	2,388	2,731	3,217
Current portion of long-term borrowings	258	325	413
Accounts payable trade	4,151	3,956	5,024
Income taxes payable	759	758	963
Deferred income taxes	150	150	191
Accrued other liabilities	7,435	6,835	8,680
Current liabilities held for shareholder claims	546		
<b>TOTAL CURRENT LIABILITIES</b>	<b>15,687</b>	<b>14,755</b>	<b>18,488</b>
Contingent consideration payable	330		
Long-term borrowings	1,792	1,610	2,296
<b>TOTAL LIABILITIES</b>	<b>17,809</b>	<b>16,365</b>	<b>2,296</b>
<b>SHAREHOLDERS' EQUITY</b>			
\$4.00 Series A Convertible Preferred Stock 10,000,000 shares authorized, none issued and outstanding at December 31, 2011 and June 30, 2012, respectively			
Common Stock, \$.001 par value, 100,000,000 shares authorized 21,805,825 and 24,259,869 issued and outstanding at December 31, 2011 and June 30, 2012, respectively			
Additional paid-in capital	869	871	1,106
Retained earnings	30,468	30,796	39,111
Accumulated other comprehensive income	(32,095)	(32,958)	(41,857)
	(5,513)	(6,056)	(7,691)

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TOTAL SHAREHOLDERS EQUITY	(6,271)	(7,347)	(9,331)
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	11,538	9,018	11,453

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## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED STATEMENTS OF INCOME (LOSS)

## AND COMPREHENSIVE INCOME (LOSS)

	Three months ended June 30, (unaudited)		Six months ended June 30, (unaudited)		
	2011	2012	2011	2012	2012
	EUR	EUR	EUR	EUR	USD
	(in thousands)				
Net sales	1,965	1,755	4,220	3,457	4,390
Cost of sales	1,399	1,349	2,903	2,637	3,349
Gross profit	566	406	1,317	820	1,041
Selling, general and administrative expenses	1,582	276	3,268	1,541	1,957
Operating income (loss)	(1,016)	130	(1,951)	(721)	(916)
Interest expense	71	72	173	140	178
Interest income	2		2		
Income (loss) before income taxes	(1,085)	58	(2,122)	(861)	(1,094)
Income tax (benefit)				2	3
Loss from continuing operations	(1,085)	58	(2,122)	(863)	(1,097)
Profit (loss) from discontinued operations	23				
Net income (loss)	(1,108)	58	(2,122)	(863)	(1,097)
Other comprehensive income (loss):					
Foreign currency translation adjustments	217	(876)	535	(543)	(690)
Comprehensive income (loss)	(891)	(818)	(1,587)	(1406)	(1,787)
Net income (loss) per share from continuing operations:					
Basic	(0.05)	(0.00)	(0.10)	(0.04)	(0.05)
Diluted	(0.05)	(0.00)	(0.10)	(0.04)	(0.05)
Net income (loss) per share:					
Basic	(0.05)	(0.00)	(0.10)	(0.04)	(0.05)
Diluted	(0.05)	(0.00)	(0.10)	(0.04)	(0.05)

## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30, (unaudited)		
	2011 EUR	2012 EUR	2012 USD
	(in thousands)		
<b>Cash flows from operating activities:</b>			
Net income (loss)	(2,122)	(863)	(1,096)
<b>Adjustment to reconcile net income (loss) to net cash flows provided by operating activities:</b>			
Provisions for doubtful debts	207	10	13
Loss on disposal of property, plant and equipment		28	36
Amortization of other intangible assets	58	25	32
Amortization of web pages	932	233	296
Amortization of photographs and video	2,190	1,454	1,847
Depreciation	284	194	246
<b>Changes in operating assets and liabilities:</b>			
Trade accounts receivable	469	256	325
Inventories	60	128	163
Prepaid expenses and other current assets	22	(66)	(84)
Trade accounts payable	(1,679)	(195)	(248)
Income taxes payable	(74)		
Accrued other liabilities	327	(230)	(292)
Net cash flow from operating activities	675	974	1,238
<b>Cash flows from investing activities:</b>			
Investment in library of photographs and videos	(383)	(295)	(375)
Other capital expenditure	(354)	(181)	(230)
Investment in other assets	34	(2)	(3)
Net cash flow from investing activities	(704)	(478)	(608)
<b>Cash flows from financing activities:</b>			
Short-term borrowings additions	69	327	415
Short-term borrowings repayments	(434)	(115)	(146)
Long-term borrowings additions		196	249
Long-term borrowings repayments	(243)	(182)	(231)
Net cash flow from financing activities	(608)	226	287
Foreign currency translation adjustments	535	(543)	(690)
<b>Net increase (decrease) in cash and cash equivalents</b>	(101)	179	227
<b>Cash and cash equivalents at beginning of the period</b>	370	179	227
<b>Cash and cash equivalents at end of the period</b>	269	358	454
Cash paid for interest	117	37	47
Cash paid for taxes	74	2	3

## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common stock		Additional	Retained	Accumulated	Total
	Shares	Amounts	paid-in	earnings	other	shareholders
		EUR	capital	EUR	comprehensive	equity
			EUR		income	EUR
					EUR	
Balance at January 1, 2011	20,815,825	869	30,468	(2,771)	(4,824)	23,742
Conversion of exchangeable shares	990,000					
Translation adjustment					(689)	(689)
Net loss				(29,324)		(29,324)
Balance at December 31, 2011	21,805,825	869	30,468	(32,095)	(5,513)	(6,271)
Shares issued for settlement of shareholder claims	2,454,044	2	328			330
Translation adjustment					(543)	(543)
Net loss				(863)		(863)
Balance at June 30, 2012	24,259,869	871	30,796	(32,958)	(6,056)	(7,347)

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**PRIVATE MEDIA GROUP, INC.**

**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. Basis of Presentation**

Private Media Group, Inc. ( the Company, we or our ) is a holding company with subsidiaries engaged in the acquisition, refinement and distribution of video and photo rights for adult feature magazines and movies through distribution channels including hard copy, broadcast, Internet Protocol Television, the Internet, and mobile phones.

The accompanying unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ( U.S. GAAP ) for interim financial information. Accordingly they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position and results of operations have been included. Operating results for the six month period ended June 30, 2012 are not necessarily indicative of the results that may be expected for the year ended December 31, 2012. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s annual report on Form 10-K for the year ended December 31, 2011.

Solely for the convenience of the reader, the accompanying consolidated financial statements as of June 30, 2012 and for the six months then ended have been translated from the euro ( EUR ) into United States dollars ( USD ) at the rate of EUR 0.79 per USD 1.00 the interbank exchange rate on June 30, 2012. The translations should not be construed as a representation that the amounts shown could have been, or could be, converted into US dollars at that or any other rate.

In each of the past three years the Company has experienced losses from operations. At June 30, 2012, the Company had cash and cash equivalents of EUR 358,000 and a working capital deficit of EUR 11,082,000. As a result of the Company s operating losses and financial condition, there is substantial doubt as to its ability to continue as a going concern. The Company s ability to continue as a going concern is based on its ability to generate or obtain sufficient cash to meet its obligations on a timely basis and ultimately to attain profitable operations. The Company expects future growth, reductions in costs and expenses and a return to profitability provided it is successful in achieving the following objectives:

continuing to evolve its internet platforms, including: its newly built signature property and membership platform private.com;

the successful marketing of its affiliate programs for all of its properties to compete aggressively for, and attract, affiliate traffic;

continuing the rollout of its content on cable and IPTV video-on-demand platforms;

continued development of distribution channels to enable its library to be accessible on new distribution platforms including, for example, internet-enabled televisions;

consolidating, streamlining and restructuring its operations into an efficient business; and

outsourcing of non-cost-effective parts of its operations.

However, the uncertainty of the availability of these options raises substantial doubt about the Company s ability to continue as a going concern. The Company s financial statements have been presented on the basis that it is a going concern, which contemplates the realization of assets, and the satisfaction of liabilities in the normal course of business.





## PRIVATE MEDIA GROUP, INC.

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

During the second quarter of 2012, the Company entered into and consummated settlement agreements and releases with the former shareholders of two of its operating units: (i) Game Link LLC and its affiliate, eLine, LLC (collectively Game Link ); and (ii) Entruphema Inc. and its affiliate Sureflix Digital Distribution Inc., (collectively Sureflix ) whereby the Company transferred back to the former shareholders all of the outstanding capital stock of the respective companies. For the year ended December 31, 2011, the assets and liabilities of Game Link and Sureflix are classified as assets and liabilities held for shareholder claims. The operating results relating to Game Link and Sureflix were provided for in full and disclosed separately on the consolidated statements of income (loss) as operations held for settlement of claims for the year ended December 31, 2011. The operating results from the three months and six months ended June 30, 2011 have been restated to reflect the operations of Game Link and Sureflix as discontinued operations.

**2. Inventories**

Inventories consist of the following:

	December 31, 2011 EUR	June 30, 2012 EUR
	(in thousands)	
Magazines for sale and resale	164	71
DVDs	597	562
	761	633

**3. Fair value measurements**

The Company accounts for certain assets and liabilities at fair value. The hierarchy below lists the three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 inputs are based upon unadjusted quoted prices for identical instruments traded in active markets.

Level 2 inputs are based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques (such as a Black-Scholes or Lattice model) for which all significant inputs are observable in the market or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 inputs are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability. The fair values are therefore determined using model-based techniques, including option pricing models and discounted cash flow models.

*Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis*

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The Company measures certain assets, such as goodwill, other intangible assets and developed website technology at fair value on a nonrecurring basis when they are deemed to be impaired. The fair values are determined based on valuation techniques using the best information available and may include quoted market prices, market comparables, and discounted cash flow projections. An impairment charge is recorded when the cost of the asset exceeds its fair value.

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## PRIVATE MEDIA GROUP, INC.

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

The Company did not have any assets that required evaluation for fair value measurement on a non-recurring basis for the three months and six months ended June 30, 2012. The following table presents the Company's assets and liabilities measured at fair value on a nonrecurring basis for the year ended December 31, 2011:

	For the year ended December 31, 2011				
	Level 1 EUR	Level 2 EUR	Level 3 EUR (in thousands)	Fair Value EUR	Gains (Losses) EUR
Goodwill (a)			9,204		(9,204)
Other intangible assets (b)			4,847		(4,847)
Long-lived assets (c)			1,577	488	(1,089)
<b>Total</b>			<b>15,628</b>	<b>488</b>	<b>(15,140)</b>

- (a) Measurement relates to impairment reviews performed with respect to the Company's eCommerce businesses and the Company's video distribution company in the Benelux countries.
- (b) Measurement relates to impairment reviews performed with respect to the Company's eCommerce businesses in North America and broadcast asset.
- (c) Measurement relates to impairment reviews performed with respect to the Company's eCommerce businesses in North America.

*Assets and Liabilities Measured at Fair Value on a Recurring Basis*

During the six-months ended June 30, 2012, the Company issued shares to the former owners of two North American wholly-owned subsidiaries. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011. As a result of the issuance of these shares, the value of the contingent consideration does not require judgment as at December 31, 2011 or June 30, 2012 and, as a result there are no liabilities to be measured at fair value on a recurring basis for the year ended December 31, 2011 or June 30, 2012.

The following table provides a reconciliation between the beginning and ending balances of items measured at fair value on a recurring basis that used significant unobservable inputs (Level 3).

	Contingent Consideration Payable EUR (in thousands)
Balance at January 1, 2011	514
Change in fair value recorded in earnings	(184)
Balance at December 31, 2011	330
Final settlement of contingent consideration	(330)

Balance at June 30, 2012

nil

## PRIVATE MEDIA GROUP, INC.

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

**4. Earnings (loss) per share**

The following table sets forth the computation of basic and diluted earnings per share:

	Three-months ended June 30,		Six-months ended June 30,	
	2011	2012	2011	2012
<b>Numerator continuing operations: (EUR in thousands)</b>				
Net income (loss) from continuing operations	(1,085)	58	(2,122)	(863)
<b>Numerator net income (loss): (EUR in thousands)</b>				
Net income (loss)	(1,108)	58	(2,122)	(863)
<b>Denominator:</b>				
Denominator for basic earnings per share	weighted average			
shares outstanding	22,005,824	22,511,404	22,005,824	22,511,404
<b>Effect of dilutive securities:</b>				
Common stock warrants, convertible notes, options and other dilutive securities				
Denominator for diluted earnings per share				
shares and assumed conversions				
<b>Earnings (loss) per share from continuing operations, in EUR</b>				
Basic	(0.05)	(0.00)	(0.10)	(0.04)
Diluted	(0.05)	(0.00)	(0.10)	(0.04)
<b>Earnings (loss) per share, (in EUR)</b>				
Basic	(0.05)	(0.00)	(0.10)	(0.04)
Diluted	(0.05)	(0.00)	(0.10)	(0.04)

For the three and six months ended June 30, 2011, basic earnings per share include exchangeable shares equivalent to 1,300,000 and 1,190,000 shares of common stock outstanding, respectively.

**5. Stock-based compensation**

In 2009, the Company implemented a new Equity Incentive Plan (the 2009 EIP) to replace the Employee Stock Option Plan (the 1999 Plan) which expired on March 31, 2009. The compensation cost for stock based compensation charged against income for each of the three-month periods ended June 30, 2011 and June 30, 2012 was nil.

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### *The 1999 Plan*

The 1999 Plan, which was in effect until its expiration on March 1, 2009, allowed the Company to grant options to purchase common stock to designated employees, executive officers, directors, consultants, advisors and other corporate and divisional officers of the Company. The 1999 Plan authorized the Company to grant stock options exercisable for up to an aggregate of 2,400,000 shares of common stock. No additional stock options may be granted under the 1999 Plan, following its expiration, on March 1, 2009. At June 30, 2012, options for 4,334 shares were still outstanding under the 1999 Plan.

### *The 2009 EIP*

The 2009 EIP became effective on December 16, 2009. It allows the Company to grant incentive stock options, non-statutory stock options, restricted stock, unrestricted stock and other equity-based awards, such as stock appreciation rights, phantom stock awards, and restricted stock units, which we refer to collectively as Awards. The Company is authorized to issue up to 2,066,667 shares of its common stock pursuant to Awards granted. Shares pursuant to Awards that have expired or are forfeited will be returned to the 2009 EIP. At June 30, 2012, Awards for 2,065,667 shares were available for future grant under the 2009 EIP and Awards for 1,000 shares had been granted and were outstanding.

The Company may grant Awards under the 2009 EIP to employees, directors and consultants of the Company. No Awards may be granted after the 2009 EIP expires on December 15, 2019. The purchase price (exercise price) of option shares must be at least equal to the fair market value of such shares on the date the stock option is granted or such later date the Company may specify. Each Award may provide that it is exercisable in full or in installments, and each Award is exercisable from the date of grant or any later date specified in the Award. Awards must expire within a period of ten years from the date of grant or such shorter period as is determined by the Company.

## PRIVATE MEDIA GROUP, INC.

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

A summary of stock option activity for the six month period ended June 30, 2012 is as follows:

	Number of Shares	Weighted- Average Exercise Price in USD	Weighted- Average Remaining Life in Years	Aggregate Intrinsic Value <sup>1</sup> in Thousands of USD
Outstanding January 1, 2012	5,334	3.28		
Granted				
Exercised				
Forfeited				
Outstanding June 30, 2012	5,334	3.28	1.0	
Exercisable June 30, 2012	5,334	3.28	1.0	

Stock-based compensation cost for stock awards is measured based on the closing fair market value of the Company's common stock on the date of grant.

Stock-based compensation cost for option awards is measured on the date of grant using the Black-Scholes option pricing model. The following general assumptions are used: a) expected volatility is based on historical volatility of our stock, b) expected life is determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior, c) risk-free interest rate is based on the U.S. Treasury yield curve in effect at the time of grant and d) dividend yield is zero based on the Company's current dividend policy. During the six-month periods ended June 30, 2011 and 2012 no grants were made.

As of June 30, 2012, there was no unrecognized compensation cost related to nonvested option granted under the 2009 EIP. The total fair value of all options vested and outstanding at June 30, 2011 and 2012 was USD 22,000 and USD 1,000, respectively.

## 6. Income Taxes

The Company's subsidiaries file income tax returns in numerous tax jurisdictions, including the United States, several U.S. states and several non-U.S. jurisdictions, primarily in Europe. Management believes there are no other factors that will significantly impact the amount of tax benefits recognized in the Company's financial statements within the 12-month period from the balance sheet date. The Company has substantially concluded all U.S. Federal and State income tax matters for years up to and including 2008 and 2007 respectively, and all foreign income tax matters for years up to 2004.

The Company's practice is to recognize interest and penalties related to income tax matters in interest and other expenses respectively. Interest and penalties amounting to EUR 367,000 were accrued as of June 30, 2012, of which nil was recognized as interest expense during the three month period then ended.



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<sup>1</sup> The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options that were in-the-money at June 30, 2012.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

In this section, unless the context indicates otherwise, all references herein to Private Media, the Company, we, our or us refer collectively to Private Media Group, Inc. and its subsidiaries.

You should read this section together with the consolidated financial statements and the notes and the other financial data in this Quarterly Report and in conjunction with management's discussion and analysis of financial condition and results of operations included in our Annual Report on Form 10-K for the year ended December 31, 2011. The matters that we discuss in this section, with the exception of historical information, are forward-looking statements within the meaning of the Private Securities Reform Act of 1995. These statements include forward-looking statements both with respect to us, specifically, and the adult entertainment industry, in general. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, estimates, potential or could or thereof or other comparable terminology. Such forward-looking statements are subject to risks, uncertainties and other factors which could cause our actual results to differ materially from those expressed or implied by such forward-looking statements. Potential risks and uncertainties relate to factors such as: (1) the timing of the introduction of new products and services and the extent of their acceptance in the market; (2) our expectations of growth in demand for our products and services; (3) our ability to successfully implement expansion and acquisition plans; (4) the impact of expansion on our revenue, cost basis and margins; (5) our ability to respond to changing technology and market conditions; (6) the effects of regulatory developments and legal proceedings with respect to our business; (7) the impact of exchange rate fluctuations; and (8) our ability to obtain additional financing. For a more complete list of factors that may cause results to differ materially from our expectations, please refer to the Risk Factors section of our Annual Report for 2011 filed on Form 10-K. We caution investors not to place significant reliance on the forward-looking statements contained in this Quarterly Report. These statements, like all statements in this Quarterly Report, speak only as of the date of this Quarterly Report (unless another date is indicated) and we undertake no obligation to update or revise forward-looking statements.

**Overview**

We acquire worldwide rights to adult media produced for us by independent producers and then process this content into products suitable for popular physical media formats such as print publications, DVDs, digital media platforms (such as internet websites, mobile telephony and transactional television), and broadcasting (which includes cable, satellite and IPTV). Our branded adult media is available at physical retail locations and through electronic retailers as well as on mobile devices, transaction television platforms and over the Internet. In addition, we provide adult entertainment films to thousands of major hotels around the world. To a lesser extent, in addition to branded adult media products, we also market and distribute branded leisure and novelty products oriented to the adult entertainment lifestyle and generate additional sales through the licensing of our *Private* trademark to third parties.

On January 20, 2009 we expanded our Internet operations through the acquisition of Game Link LLC and its affiliates. Game Link is engaged in digital distribution of adult content over the Internet and in eCommerce development, primarily in the United States. On October 29, 2009 we continued the expansion of our digital media platform through the acquisition of Sureflex and its affiliates. These companies, based in Canada, were engaged in the business of digital distribution of premium gay adult content.

As described elsewhere in this Quarterly Report, after a change in management during the first quarter of 2012, and as part of new management's plan to reorganize and recapitalize this Company, we divested ourselves of the Game Link and Sureflex companies during the fiscal quarter ended June 30, 2012. Although the disposition of Game Link and Sureflex was consummated in 2012, for accounting purposes, the assets and liabilities of Game Link and Sureflex are listed as assets/liabilities held for shareholder claims in the consolidated balance sheets included in this Quarterly Report. Accordingly, net sales, cost of sales, selling, general and administrative expenses, etc. of the Game Link and Sureflex companies are not included in the consolidated income statement line items for the three and six month periods ended June 30, 2012.

Commencing in July 2010 and continuing through 2011, former management was engaged in a number of lawsuits with its major shareholders and certain creditors. In addition, former management was involved in a proxy contest involving both the 2010 and 2011 annual meetings of shareholders (the 2011 annual meeting was eventually held in January 2012). The various lawsuits and shareholder proceedings negatively affected the Company's operations and financial condition in 2011 and 2012.

We operate in a highly competitive market that is subject to numerous new and on-going changes in business, economic and competitive conditions. Although we believe our brand and our products are well-established in the adult entertainment industry, we compete with numerous entities selling adult-oriented products via any type of distribution network, including the Internet. Over the past few years, the adult entertainment industry and the media formats in which adult content is disseminated have undergone significant change. The introduction of a large number of free content internet sites that allow users to access large libraries of content free of charge has created an even more challenging environment where both sales volume and margins have decreased substantially. In addition, the recent recession has shown that the adult industry is not immune to economic cycles.

We generate revenues primarily through:

internet e-commerce, subscriptions and licensing;

the broadcasting of movies through IPTV (Internet Protocol Television), cable, satellite and hotel television programming;

sales of DVDs and magazines; and

sales of adult mobile content (wireless).

Over time, we expect net sales from DVDs and magazines to continue to decline as a percentage of net sales in relation to total net sales from the Internet, broadcasting and wireless. We expect net sales from Internet and direct-to-consumer digital sales to be the principal area of growth during the coming years.

We generally provide extended payment terms to our established distributors of between 90 and 180 days. Although our extended payment terms increase our exposure to accounts receivable write-offs, we believe our risk is minimized by our generally long-term relationships with our distributors.

Our primary expenses include:

web page development costs;

acquisition and licensing of content for our library of photographs and videos;

printing, processing and duplication costs; and

selling, general and administrative expenses.

Over the years, our cost of sales has fluctuated relative to net sales due to our use of new mediums for the dissemination of our products, such as the Internet, broadcasting and wireless and the different cost structure of those new mediums. We also incur significant web page development expenses annually in connection with the amortization of our library of photographs and movies and capitalized development costs. We amortize these assets on a straight-line basis for periods of between three and five years.

### **Critical Accounting Estimates**

#### *General*

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements

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requires us to make estimates and judgments that affect the reported amount of assets and liabilities revenues and expenses. On an ongoing basis, we evaluate our estimates, including those related to impairment of the library of photographs and videos and other long lived assets, allowances for doubtful debts, income taxes and contingencies and litigation. Accounts receivable and sales related to certain products are, in accordance with industry practice, subject to distributors' right of return to unsold items. We base our estimates on historical experience and on various assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily available from other sources. Management periodically reviews such estimates. Actual results may differ from these estimates as a result of unexpected changes in trends.

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We believe the following critical accounting policies are significantly affected by judgments and estimates used in the preparation of our consolidated financial statements.

*Recognition of Revenue*

The Company's primary sources of revenue are the sale of content delivered via the Internet, broadcasting, DVD and magazines and mobile phones.

Internet video-on-demand offerings are sold directly via the Company's websites and are paid for almost exclusively by credit card. The Company recognizes revenue from video-on-demand when the service is rendered and collectability is reasonably assured, specifically, when the customer's credit card is charged, which is, in most cases, simultaneous with delivery of the on-demand video. Credit card payments accelerate cash flow and reduce the Company's collection risk, subject to the merchant bank's right to hold back cash pending settlement of the transactions.

Revenues from the sale of subscriptions to the Company's internet website are deferred and recognized ratably over the subscription period.

IPTV and satellite and cable broadcasting revenues are recognized upon delivery when the following conditions have been met (i) license period of the arrangement has begun and the customer can begin its exploitation, exhibition, or sale (ii) the arrangement fee is fixed or determinable and (iii) collection of the arrangement fee is reasonably assured. Such revenues may be generated by either a fixed license fee or as an agreed percentage of sales, based on sales reported each month by the Company's IPTV, cable and satellite affiliates. The affiliates do not report actual monthly sales for each of their systems to the Company until several months after the month of service ends. This practice requires management to make monthly revenue estimates based on historical experience for each affiliated system. Revenue is subsequently adjusted to reflect the actual amount earned upon receipt. Adjustments made to adjust revenue from estimated to actual have historically been immaterial.

DVDs and magazines (physical products) are sold both to wholesalers, on firm sale basis, and via national newsstand distributors, with the right to return. Our physical products are generally produced in multiple languages and the principal market is in Europe. Revenues from the sale of physical products where distributors are not granted rights-of-return are recognized upon transfer of title, which generally occurs upon delivery. Revenues from the sale of physical products under consignment agreements with distributors are recognized based upon reported sales by the Company's distributors. Revenues from the sale of physical products under agreements that grant distributors rights-of-return are recognized upon transfer of title, which generally occurs on delivery, net of an allowance for returned product. Distributors with the right to return are primarily national newsstand distributors. Most of our products are bi-monthly (six issues per year) and remain on sale at a newsstand for a period of several months. Normally, all unsolds are reported to us within a period of four to six months from delivery. There are normally two to four national newsstand distributors for all newspapers and periodicals operating in each country. The Company uses specific return percentages per title and distributor based on estimates and historical data. The percentages vary up to 80%. Percentages are reviewed on an on-going basis. In view of the high retail price, the margin and the physical quality of the magazines and the fact that the content has a very long shelf-life since it is not particularly linked to time, trends, fashion or current events, the Company historically has collected the returns from newsstands, repackaged them, and then made them available for sale again. The Company operates scheduled re-distribution of returned magazines, via national newsstand distributors, together with DVDs as magazine/DVD packs as a way of increasing DVD distribution. Since the national newsstand distributors have the right to return, the DVD packs are returned in order to be sold via an additional scheduled re-distribution. Magazine returns not re-distributed as per above are sold on a firm sale basis to wholesalers as back issues at a lower price than new issues. The Company has historically sold all returned copies at an average price higher than, or equal, to cost.

Revenues from mobile content (wireless) sales are recognized based on sales reported each month by mobile operators via aggregators. The aggregators do not report actual monthly sales for each of their operators to the Company for several months after the month of service ends. This practice requires management to make monthly revenue estimates based on historical experience for each affiliated system. Revenue is subsequently adjusted to reflect the actual amount earned upon receipt. Adjustments made to adjust revenue from estimated to actual have historically been immaterial.

#### *Accounts receivable*

We are required to estimate the collectability of our trade receivables and notes receivable. A considerable amount of judgment is required in assessing the ultimate realizable value of these receivables including the current credit-worthiness of each customer. Significant changes in required reserves have been recorded in the past and may occur in the future due to the current market environment.

Management reviews the allowance for doubtful accounts on at least a quarterly basis and adjusts the balance based on their estimate of the collectability of specific accounts as well as a reserve for a portion of other accounts which have been outstanding for more than six months. This estimate is based on historical losses and information about specific customers. After collection attempts have failed, the Company writes off the specific account.

#### *Goodwill and Other Intangible Assets*

Goodwill represents the excess of the purchase price paid over the fair value of the net assets of businesses acquired.

Other Intangible Assets represents the value attributable to: a) Customer base, which was acquired from two of the Company's former distributors in the U.S. and in Canada in 2001 and 2003, respectively, for which the amortization expense is calculated on a straight-line basis over 10 years for each acquisition; b) Broadcasting asset, which was acquired in 2003 and which, at the time of acquisition, was deemed to have an indefinite life and therefore not subject to amortization; and c) Trade and Domain names which, at the time of acquisition, were deemed to have an indefinite life and therefore not subject to amortization.

Goodwill and indefinite lived intangible assets are reviewed annually for impairment (or more frequently if indicators of impairment arise). Further separable intangible assets that are not deemed to have an indefinite life are amortized over their expected useful lives.

During the year ended December 31, 2011, the Company had impairment charges of EUR 12,279,000 as a result of the divestiture of Game Link and Sureflix. During the second quarter of 2012 the Company divested itself of Game Link and Sureflix in consideration for certain releases, but not for any cash or similar consideration. Accordingly the remaining related goodwill associated with Game Link and Sureflix was provided against in full as at December 31, 2011. Since the Game Link and Sureflix write-off was recorded in 2011, no impairment charges were recognized with respect to those companies and in the three and six month periods ended June 30, 2012.

#### *Impairment of Long-Lived Assets*

The Company evaluates the carrying value of its long-lived assets when events or circumstances indicate the carrying value may not be recoverable through the estimated undiscounted cash flows from the use of the asset. An impairment loss is then measured as the amount by which the carrying value of the asset exceeds its estimated fair value. In 2011 the Company had impairment charges of EUR 1,089,000 related to the divestment of Game Link and Sureflix.

#### *Inventories*

Inventories are valued at the lower of cost or market, with cost principally determined on an average basis. Inventories principally consist of DVD's and magazines held for sale or resale. The inventory is written down to the estimated market value based upon assumptions about future demand and market conditions. If actual market conditions are less favorable than those anticipated by management, write-downs may be required.

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**Results of Operations*****Three months ended June 30, 2012 compared to the three months ended June 30, 2011***

*Net sales.* Net sales for the three months ended June 30, 2012 ( the fiscal 2012 quarter ) decreased by EUR 210,000, or by 11%, compared to net sales for the three months ended June 30, 2011 ( the fiscal 2011 quarter ). Net sales decreased as a result of decreased sales from each of our four principal revenue sources (broadcast, mobile/wireless, DVD/magazines, and Internet/e-commerce). The decrease in net sales was attributable to both (i) the disruption in the Company's operations as prior management was involuntarily replaced, and (ii) trends in the adult entertainment industry. During the first quarter of 2012, the Company's shareholders voted to remove and replace most of the prior directors on the Board of Directors, the former Chief Executive Officer was terminated, and the Company appointed a new executive management team. This involuntary transition of management resulted in significant disruption to our operations, which affected our net sales and our relations with some of our customers. During the fiscal 2012 quarter and continuing through the rest of 2012, new management had to spend a significant amount of time to settle various lawsuits and other legal proceedings initiated under prior management, to settle creditor and shareholder disputes (including the pending and threatened actions involving Game Link and Sureflix), to implement new operating procedures, and to re-establish this company's historic operations and its relationships with some of its customers. The disruption caused by the management change affected our marketing efforts, our production of new video and print content, and otherwise generally negatively affected operations in the fiscal 2012 quarter and in subsequent quarters. In addition, net sales were negatively affected by trends in the adult entertainment industry in general (such as the proliferation of free adult content provided over the Internet), which reduced our Internet sales, and contributed to the continuing decline of DVD and magazine sales.

Even though we experienced a year-over-year reduction in net sales as described above, when compared to the first quarter of 2012, net sales for the second quarter of 2012 remained relatively unchanged with a small decrease of approximately 3%.

*Cost of Sales.* Our cost of sales consisted primarily of the cost of operating our Internet, broadcasting and wireless businesses, the cost of printing, processing and duplication, and the amortization of our library and websites. Cost of sales decreased by EUR 50,000 in the fiscal 2012 quarter due to the decrease in net sales. However, our cost of sales as a percentage of net sales for the three months ended June 30, 2012 increased from 71% for the three months ended June 30, 2011 to 77%, despite a decrease in the amortization of our library and websites in the fiscal 2012 quarter. Amortization of library does not vary with sales since it reflects the amortization of our investments in content which has been available for sale for a period of three to five years. The main reasons for the increase in our cost of sales as a percentage of net sales resulted from a change in our content acquisition strategy during the fourth quarter of 2011 which continued into the fourth quarter of 2012 where the Company entered into a revenue share license agreement for some of its new content. For this content, the costs of distribution and the percentage of revenue share (license fee) are expensed as cost of sales, thereby increasing cost of sales.

*Gross Profit.* In the three months ended June 30, 2012, our gross profit decreased by EUR 160,000 compared to our gross profit for the three months ended June 30, 2011. The decrease in gross profits reflected both the decrease in net sales and the decrease in gross margins.

*Selling, general and administrative expenses.* Our selling, general and administrative expenses for the three months ended June 30, 2012 decreased by EUR 1,306,000 (from EUR 1,582,000 to EUR 276,000) from the fiscal 2011 quarter principally as a result of large foreign currency translation adjustments made during the June 30, 2012 fiscal quarter. Fluctuations in exchange rates between the euro and the dollar can affect the comparability of our results from one period to another. Income statement amounts are translated into euros using the average exchange rate for the period, while our balance sheet is translated at the period-end exchange rate. For the three months ended June 30, 2012, the average U.S. dollar to euro exchange rate fluctuated significantly and was 5.7% higher than for the three months ended June 30, 2011. This arises from large foreign currency denominated liabilities that are revalued on a period end basis. These foreign exchange fluctuations were substantially resolved by year end. Net of these foreign exchange fluctuations, selling, general and administrative expenses were in line with the expenses for the first quarter of 2012.

Because of the material foreign currency translation fluctuations in the fiscal 2012 quarter, our selling, general and administrative expenses for the June 30, 2012 fiscal quarter do not reflect our actual, and anticipated, on-going selling, general and administrative expenses and should not be compared to such expenses in the fiscal quarter ended June 30, 2011. Excluding the foregoing foreign currency translation adjustments, the actual amount of selling, general and administrative expenses we incurred during the June 30, 2012 is estimated to be approximately EUR 1,200,000. Our actual selling, general and administrative expenses (excluding the currency translation adjustments) decreased in the fiscal 2012 quarter compared to the same quarter in the prior year primarily because of new management's cost savings initiatives which included reduced salary expenses both from the change of senior management and a reduction in the overall number of employees.

*Operating income/loss.* We reported operating income of EUR 130,000 for the fiscal 2012 quarter, compared to an operating loss of EUR 1,016,000 for the three months ended June 30, 2011. However, if not for the above described foreign currency translation adjustments that materially reduced our selling, general and administrative expenses, we would have incurred an operating loss. We estimate that, excluding the foreign currency translation adjustments, our operating loss would have been slightly less than the operating loss incurred in the fiscal 2011 quarter. Our estimated operating loss for the three month period ended June 30, 2012 decreased compared to the loss in the prior year's period due to the reductions in our actual selling, general and administrative expenses.

*Interest expense.* Interest expense represented interest on our institutional line of credit and bank borrowings. Interest expense in the fiscal 2012 quarter remained relatively unchanged compared to the fiscal 2011 quarter.

*Net Income/loss.* We reported a net loss of EUR 1,108,000 for the three months ended June 30, 2011, compared to net income of EUR 58,000 for the three months ended June 30, 2012. However, the net income is solely due to the foreign currency translation adjustment that materially reduced our selling, general and administrative expenses in 2012. Taking into account the effects of the foreign currency translation adjustments, we had a comprehensive net loss in the fiscal 2012 quarter of EUR 818,000, compared to a comprehensive net loss of EUR 891,000 in the same period in 2011.

***Six months ended June 30, 2012 compared to the six months ended June 30, 2011***

*Net sales.* Net sales for the six months ended June 30, 2012 (the fiscal 2012 period) decreased by EUR 763,000, or by 18%, compared to net sales for the six months ended June 30, 2011 (the fiscal 2011 period). Net sales decreased as a result of decreased sales from each of our four principal revenue sources (broadcast, mobile/wireless, DVD/magazines, and Internet/e-commerce). As described above with respect to the fiscal quarter ended June 30, 2012, the decrease in net sales in the 2012 six-month period was attributable to both (i) the disruption in the Company's operations as prior management was involuntarily replaced, (ii) the amount of time new management spent resolving various lawsuits, creditor issues, and legal proceedings that arose under prior management, and (iii) trends in the adult entertainment industry.

During the fiscal 2012 period as compared to the fiscal 2011 six month period, Internet sales remained broadly unchanged. Broadcasting sales in the fiscal 2012 period decreased compared to the fiscal 2011 period primarily because of fewer newly released titles. Wireless sales decreased due principally to the decline in on-portal sales. DVD and magazine sales decreased by primarily because a temporary interruption in the production of magazines that resulted from supplier-related problems during the first quarter. These problems were rectified during the second quarter of 2012. Additionally, weak DVD and magazine sales resulted from an industry-wide softness in DVD and magazine sales as consumer viewed more of their content over the Internet (including the free content sites).

*Cost of Sales.* Our cost of sales consisted primarily of the cost of operating our Internet, broadcasting and wireless businesses, the cost of printing, processing and duplication, and the amortization of our library and websites. Cost of sales decreased by EUR 266,000 in the fiscal 2012 period due to the decrease in net sales. However, our cost



of sales as a percentage of net sales for the six months ended June 30, 2012 increased from 69% for the six months ended June 30, 2011 to 76%. The main reasons for the increase in our cost of sales as a percentage of net sales resulted from a change in our content acquisition strategy during the fourth quarter of 2011 which continued into the fourth quarter of 2012 where the Company entered into a revenue share license agreement for some of its new content. For this content, the costs of distribution and the percentage of revenue share (license fee) are expensed as cost of sales, thereby increasing cost of sales.

*Gross Profit.* In the six months ended June 30, 2012, our gross profit decreased by EUR 497,000 compared to our gross profit for the six months ended June 30, 2011. The decrease in gross profits reflected both the decrease in net sales and the decrease in gross margins.

*Selling, general and administrative expenses.* Our selling, general and administrative expenses for the six months ended June 30, 2012 decreased by EUR 1,727,000 (from EUR 3,268,000 to EUR 1,541,000) for the fiscal 2011 period principally as a result of significant fluctuations in foreign currency rates during the June 30, 2012 fiscal quarter. In addition, selling, general and administrative expenses were also reduced as a result of the commencement of new management's initiatives to implement cost savings measures. Because of the foreign currency translation adjustments made in the fiscal 2012 quarter, our selling, general and administrative expenses for the six months ended June 30, 2012 do not reflect our actual, and anticipated, on-going selling, general and administrative expenses and, likewise, should not be compared to such expenses for the fiscal months ended June 30, 2011. Excluding the foregoing currency exchange adjustments, the actual amount of selling, general and administrative expenses we incurred during the six months ended June 30, 2012 is estimated to be approximately EUR 2,500,000.

*Operating income/loss.* We reported an operating loss of EUR 1,951,000 for the six months ended June 30, 2011 compared to an operating loss of EUR 721,000 for the six months ended June 30, 2012. However, if not for the currency translation adjustments that materially reduced our reported selling, general and administrative expenses as described above, we would have incurred a larger operating loss. We estimate that, excluding the currency translation adjustment, our operating loss would have been slightly less than the operating loss incurred in the fiscal 2011 period. Our estimated actual operating loss for the six month period ended June 30, 2012 (excluding the effects of the currency translation adjustments) decreased compared to the loss in the prior year's six month period due to the reductions in selling, general and administrative expenses.

*Interest expense.* Interest expense in the fiscal 2012 six-month period decreased by EUR 33,000 compared to the fiscal 2011 period due to a reduction of the accrual on the Consipio promissory note which note was repaid on December 28, 2012.

*Net Income/loss.* We reported a net loss of EUR 2,122,000 for the six months ended June 30, 2011, compared to net loss of EUR 863,000 for the six months ended June 30, 2012. However, the net loss for the six-month period ended June 30, 2012 understates our actual net loss because of the foreign currency translation adjustment that materially reduced the amount of selling, general and administrative expenses we recorded in 2012.

### **Liquidity and Capital Resources**

We reported a working capital deficit of EUR 11.1 million at June 30, 2012, compared to a working capital deficit of EUR 11.4 million as of December 31, 2011. However, over EUR 8 million of the current liabilities outstanding at both June 30, 2012 and December 31, 2011 represented liabilities owed to creditors who sued prior management and this Company and who in January 2012 voted to replace most of the Company's directors. As further discussed below, subsequent to June 30, 2012, the Company reached an agreement with these creditors, pursuant to which the creditors agreed to convert over EUR 8 million of current liabilities into equity (both common stock and 6% Series B Convertible Redeemable Preferred Stock (Series B Preferred Stock)).

### *Operating Activities*

For the six months ended June 30, 2012, the Company had net cash provided by operating activities of EUR 974,000 despite its net loss of EUR 863,000. The principal reason for this was the adjustments made to reconcile non-cash expenses reflected in the Company's net loss. The principal non-cash expenses consisted of amortization of photographs and videos (EUR 1,454,000), amortization of web pages (EUR 233,000), and depreciation (EUR 194,000).

### *Investing Activities*

The Company used EUR 478,000 of net cash in investing activities during the six months ended June 30, 2012. The investing activities were principally capital expenditures of EUR 181,000 and investment in library of photographs and videos of EUR 295,000. We anticipate that investments in our library of videos and photographs will increase in the future as we return to a normal content production schedule as part of our new management's business plan.

### *Financing Activities*

Net cash flow from financing activities for the six-month period ended June 30, 2012 was EUR 226,000, as the amount of our long- and short-term borrowings exceeded the repayments of borrowings.

### *Liquidity*

In each of the past three years we have experienced net losses from operations. At June 30, 2012, we had cash and cash equivalents of EUR 358,000 and a working capital deficit of EUR 11,082,000. As a result, there is substantial doubt as to our ability to continue as a going concern. Our ability to continue as a going concern is based on our ability to generate or obtain sufficient cash to meet our obligations on a timely basis and ultimately to attain profitable operations. Although our operations currently generate positive cash flow, the amount of cash we generate is not sufficient to repay the amount of short-term borrowings, accounts payable, and other short-term obligations. As a result, management has sought to restructure certain borrowings, raise additional debt or equity financing (which funding would be used in large part to repay outstanding liabilities), and repay outstanding indebtedness through the issuance of equity. As discussed below, since the fiscal quarter ended June 30, 2012, the new management of this Company has achieved several of the foregoing goals and has managed to substantially reduce the amount of the Company's outstanding liabilities.

Following the Company's annual meeting of shareholders on January 18, 2012 we replaced most of our directors and replaced our prior senior executive officers. Since then, new management has implemented a number of steps to improve our cash flow, reduce our working capital deficit, and to increase our liquidity. These steps include the following:

As part of a larger settlement with Consipio, in December 2012, we issued 800,000 shares of our newly created Series B Preferred Stock (at EUR 10.00 per share) to Consipio as payment in full for liabilities in excess of EUR 8,000,000. The liabilities that were repaid by means of this equity issuance included the entire outstanding balance of the promissory note, the legal fees and costs that the Nevada State Court ordered us to pay, the legal fees and costs we were required to pay Consipio because of the New York lawsuit, and amounts that we owed to third parties, which obligations were acquired by Consipio. The foregoing settlement both reduced the amount of our cash obligations and ended the litigation (which resulted in significant savings of future legal and other fees related to the litigation);

We settled \$450,000 of attorneys' fees and costs that the Nevada State Court order us to pay to Tisbury Services Inc. by issuing to Tisbury 3,000,000 unregistered shares of Common Stock, and a five-year, contingent warrant;

We restructured a EUR 1,073,500 debt that one of our subsidiaries owed to a European bank under a defaulted loan that we had guaranteed. Under the new terms, the loan now bears interest at a rate of 3% per annum, with interest payments due annually at the end of each calendar year. The repayment dates for the unpaid principal balance have been extended, so that the outstanding principal amount must be repaid as follows: (i) EUR 350,000 is due on January 1, 2016, (ii) EUR 350,000 is due on January 1, 2017, and the balance, (iii) EUR 373,500 is due on January 1, 2018. As a result, our current cash payment obligations have been substantially reduced;

We have settled and paid certain outstanding professional fees (principally legal fees) that were incurred by prior management at a discount;

In February 2013, in order to settle some of the liabilities prior management accrued (including the foregoing legal fees), we borrowed a total of EUR 800,000 from three unaffiliated foreign lenders. The loans bear interest at a rate of 9.9% per annum and are due and payable on December 31, 2014. Interest is payable quarterly in arrears. Our obligations under the loans are secured by a lien on trademarks and certain motion pictures in our film library. These loans enabled us to repay many of prior management's debts at a discount, thereby reducing our trade accounts payable and other short-term obligations; and

We have reduced our on-going selling, general and administrative expenses by reducing the amount of office space we use in our current headquarters and by closing our redundant office in Spain. In addition, we have substantially reduced the Company's headcount. The foregoing reduction in headcount and the reduction in rental expenses are expected to save the Company an estimated EUR 741,000 annually.

We currently have no additional availability under our existing credit facilities. The existence of a going concern exception by our auditors may make it more difficult to obtain additional bank financing if and when required. If additional funds are raised through the issuance of equity securities, our shareholders' percentage ownership will be reduced, they may experience additional dilution, or these newly issued equity securities may have rights, preferences, or privileges senior to those of the current holders of our common stock. Additional financing may not be available when needed on terms favorable to us, or at all. If adequate funds are not available or are not available on acceptable terms, we may be unable to develop or enhance our products and services, take advantage of future opportunities, maintain the scope of our operations or respond to competitive pressures or unanticipated requirements, which could harm our business.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the specified time periods. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is accumulated and communicated to its management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. As of the end of the period covered by this report, the Company's management evaluated, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, the effectiveness of the Company's disclosure controls and procedures. Based on the evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 30, 2012.

*Changes in Internal Control Over Financial Reporting*

While the Company continued to implement the changes it made to its internal control over financial reporting during the quarter ended March 31, 2012, no additional changes were made to the Company's internal control over financial reporting during the quarter ended June 30, 2012 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

*Inherent Limitations in Internal Control Over Financial Reporting*

The Company does not expect that its disclosure controls and procedures will prevent all error and all fraud. A control procedure, no matter how well conceived and operated, can provide only reasonable not absolute, assurance that the objectives of the control procedure are met. Because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance 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. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any control procedure also is based in part upon 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; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control procedure, misstatements due to error or fraud may occur and not be detected.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Nothing to report.

**Item 1A. Risk Factors**

The discussion of our business and operations should be read together with the risk factors contained in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011 filed with the SEC, which describe various risks and uncertainties to which we are or may become subject. These risks and uncertainties have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner. There have been no material changes from the risk factors previously disclosed in the above-mentioned periodic report.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Nothing to report.

**Item 3. Defaults upon Senior Securities**

Nothing to report.

**Item 4. Mine Safety Disclosures**

Nothing to report.

**Item 5. Other Information**

Nothing to report.

**Item 6. Exhibits**

- 31.1 Certifications pursuant to pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certifications of CEO and CFO pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101.INS XBRL Instance Document.
- 101.SCH XBRL Taxonomy Extension Schema Document.
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document.
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document.
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

PRIVATE MEDIA GROUP, INC.  
(Registrant)

Date: June 26, 2013

/s/ Charles Prast  
Charles Prast, Chief Executive Officer and Interim Chief Financial  
Officer

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