PRIVATE MEDIA GROUP INC
Form 10-Q
August 09, 2013

U.S. 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 June 30, 2013

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)

Nevada	**87-0365673**
(State or other jurisdiction of	**(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 x 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated file, 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	x

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

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

Class	**Outstanding at August 08, 2013**
Common Stock, par value $.001	27,778,894

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2012 EUR	June 30, (Unaudited) 2013 EUR	2013 USD
		(in thousands)	
ASSETS			
Cash and cash equivalents	174	117	154
Trade accounts receivable net	1,965	1,676	2,212
Inventories (Note 2)	469	392	517
Deferred income tax asset	494	494	652
Prepaid expenses and other current assets	190	221	293
TOTAL CURRENT ASSETS	3,292	2,900	3,828
Library of photographs and videos	3,008	2,975	3,927
Property, plant and equipment	916	656	866
Other assets	343	307	405
TOTAL ASSETS	7,559	6,838	9,026
LIABILITIES AND SHAREHOLDERS EQUITY			
Short-term borrowings	200		
Current portion of long-term borrowings	322	292	385
Accounts payable trade	3,600	3,184	4,203
Dividends payable		120	158
Income taxes payable	842	842	1,111
Deferred income taxes	131	131	173
Accrued other liabilities	613	524	692
TOTAL CURRENT LIABILITIES	5,708	5,093	6,722
Long-term borrowings	1,544	2,602	3,435
TOTAL LIABILITIES	7,252	7,695	10,157
COMMITMENTS AND CONTINGENCIES			
PREFERRED STOCK			
EUR 10.00 Series B 6% Convertible Redeemable Preferred Stock 1,300,000 shares authorized, 800,000 issued and outstanding at December 31, 2012 and June 30, 2013	8,000	8,000	10,560
SHAREHOLDERS EQUITY			
Common Stock, $.001 par value, 100,000,000 shares authorized 27,259,869 and 27,778,894 issued and outstanding at December 31, 2012 and June 30, 2013, respectively	873	873	1,152
Additional paid-in capital	31,158	31,275	41,283
Retained earnings	(34,403)	(35,695)	(47,117)
Accumulated other comprehensive income	(5,321)	(5,310)	(7,009)
TOTAL SHAREHOLDERS EQUITY	(7,693)	(8,857)	(11,691)

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	7,559	6,838	9,026

See accompanying notes to consolidated statements

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)		
	2012 EUR	2013 EUR	2012 EUR	2013 EUR	2013 USD
			(in thousands)		
Net sales	1,755	1,408	3,457	2,904	3,833
Cost of sales	1,349	841	2,637	1,914	2,526
Gross profit	406	567	820	990	1,307
Selling, general and administrative expenses	276	1,188	1,541	1,947	2,570
Operating income (loss)	130	(621)	(721)	(957)	(1,263)
Interest expense	72	49	140	90	119
Interest income					
Income (loss) before income taxes	58	(670)	(861)	(1,047)	(1,382)
Income tax (benefit)			2	2	2
Net income (loss)	58	(670)	(863)	(1,049)	(1384)
Cumulative preferred dividends		(243)		(243)	(321)
Net income (loss) available to common shareholders		(913)	(863)	(1,292)	(1,705)
Other comprehensive income (loss):					
Foreign currency translation adjustments	(876)	206	(543)	11	15
Comprehensive income (loss)	(818)	(412)	(1406)	(1,281)	(1,691)
Net income (loss) per share:					
Basic	(0.00)	(0.03)	(0.04)	(0.05)	(0.06)
Diluted	(0.00)	(0.03)	(0.04)	(0.05)	(0.06)

See accompanying notes to consolidated statements

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30, (unaudited)		
	2012 EUR	2013 EUR	2013 USD
	(in thousands)		
Cash flows from operating activities:			
Net income (loss)	(863)	(1,049)	(1,384)
Adjustment to reconcile net income (loss) to net cash flows provided by operating activities:			
Provisions for doubtful debts	10	21	28
Loss on disposal of property, plant and equipment	28		
Amortization of other intangible assets	25	25	33
Amortization of web pages	233	266	351
Amortization of photographs and video	1,454	871	1,150
Depreciation	194	103	136
Changes in operating assets and liabilities:			
Trade accounts receivable	256	268	354
Inventories	128	77	101
Prepaid expenses and other current assets	(66)	(31)	(41)
Trade accounts payable	(195)	(416)	(549)
Accrued other liabilities	(230)	(95)	(126)
Net cash flow from operating activities	974	40	53
Cash flows from investing activities:			
Investment in library of photographs and videos	(295)	(837)	(1,105)
Other capital expenditure	(181)	(114)	(150)
Investment in other assets	(2)	15	19
Net cash flow from investing activities	(478)	(936)	(1,236)
Cash flows from financing activities:			
Short-term borrowings additions	327	260	343
Short-term borrowings repayments	(115)	(162)	(214)
Long-term borrowings additions	196	990	1,307
Long-term borrowings repayments	(182)	(260)	(343)
Net cash flow from financing activities	226	828	1,093
Foreign currency translation adjustments	(543)	11	14
Net increase (decrease) in cash and cash equivalents	179	(57)	(76)
Cash and cash equivalents at beginning of the period	179	174	230
Cash and cash equivalents at end of the period	358	117	154
Cash paid for interest	37	56	74
Cash paid for taxes	2	2	2

See accompanying notes to consolidated statements

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common Stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total shareholders equity
	Shares	Amounts EUR	EUR	EUR	EUR	EUR
Balance at January 1, 2012	21,805,825	869	30,468	(32,095)	(5,513)	(6,271)
Shares issued to settle claims	5,454,044	4	690			694
Translation adjustment					192	192
Net loss				(2,308)		(2,308)
Balance at December 31, 2012	27,259,869	873	31,158	(34,403)	(5,321)	(7,693)
Shares issued in lieu of dividends	519,025		117			117
Translation adjustment					11	11
Net loss				(1,049)		(1,049)
Preferred dividends				(243)		(243)
Balance at June 30. 2013	27,778,894	873	31,275	(35,695)	(5,310)	(8,857)

See accompanying notes to consolidated statements

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 branded adult media in digital and physical formats. Our principal distribution channels include the Internet, television distribution platforms, wireless providers and physical retail.

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, 2013 are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. 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, 2012.

Solely for the convenience of the reader, the accompanying consolidated financial statements as of June 30, 2013 and for the six months then ended have been translated from the euro (EUR) into United States dollars (USD) at the rate of EUR 0.76 per USD 1.00, the interbank exchange rate on June 30, 2013. 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, 2013, the Company had cash and cash equivalents of EUR 117,000 and a working capital deficit of EUR 2,193,000. 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 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 television distribution platforms including cable television, direct broadcast satellite and IPTV (Internet Protocol Television);
- 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)

2. Inventories

Inventories consist of the following:

	December 31, 2012 EUR	June 30, 2013 EUR
	(in thousands)	
Magazines for sale and resale	53	44
DVDs	416	348
	469	392

3. 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,	
	2012	2013	2012	2013
Net income (loss)	58	(670)	(863)	(1,049)
Cumulative preferred dividends		(243)		(243)
Numerator: (EUR in thousands)				
Net income available to common shareholders	58	(913)	(863)	(1,292)
Denominator:				
Denominator for basic earnings per share weighted average shares outstanding	22,511,404	27,613,490	22,511,404	27,613,490
Effect of dilutive securities:				
Common stock warrants, convertible notes, options and other dilutive securities				
Denominator for diluted earnings per share weighted average shares and assumed conversions				
Earnings (loss) per share, in EUR				
Basic	(0.00)	(0.03)	(0.04)	(0.05)
Diluted	(0.00)	(0.03)	(0.04)	(0.05)

4. Stock-based compensation

The compensation cost for stock based compensation charged against income for each of the six month periods ended June 30, 2012 and June 30, 2013 was nil.

The 2009 EIP

The Equity Incentive Plan (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 may 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, 2013, 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

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

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.

A summary of stock option activity for the six month period ended June 30, 2013 is as follows:

	Number of Shares	Weighted-Average Exercise Price in USD	Weighted-Average Remaining Life in Years	Aggregate Intrinsic Value[1] in Thousands of USD
Outstanding January 1, 2013	1,000	1.89		
Granted				
Exercised				
Forfeited				
Outstanding June 30, 2013	1,000	1.89	0.3	
Exercisable June 30, 2013	1,000	1.89	0.3	

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, 2012 and 2013 no grants were made.

As of June 30, 2013, there was no unrecognized compensation cost related to nonvested options granted under the 2009 EIP. The total fair value of all options vested and outstanding at June 30, 2012 and 2013 were negligible.

5. 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, 2013 of which nil was recognized as interest expense during the three month period then ended.

6. Dividends on 6% Series B Convertible Redeemable Preferred Stock

On December 28, 2012, the Company created a new series of preferred stock, designated as the 6% Series B Convertible Redeemable Preferred Stock (the Series B Preferred Stock). A total of 1,300,000 shares of Series B Preferred Stock have been authorized, of which 800,000 have been issued. Each share of Series B Preferred Stock has a stated issue price of EUR 10.00 per share.

Holders of the Series B Preferred Stock are entitled to receive dividends at an annual rate of 6% of the EUR 10.00 Series B Preferred Stock original issue price, which shall be cumulative, accrue daily and be payable quarterly in cash, in arrears. However, the holders of the Series B Preferred Stock may elect to receive shares of Common Stock in place of some or all of any quarterly dividend (the value of the shares is based on the 10-day trading price of the Common Stock).

On April 1, 2013 the Company declared a dividend for the period from December 28, 2012 up to an including March 31, 2013 on the Series B Preferred Stock in the aggregate amount of EUR 124,000. The holders of the Series B Preferred Stock elected to receive shares of Common Stock in place of the quarterly dividend based on the 10-day trading price of the Common Stock which was $0.29 per share. On April 29, 2013 the Company issued 519,025 Common Shares to the Holders of the Series B Preferred Stock in lieu of the cash dividend representing the amount of the dividend net of a 5% withholding tax.

On June 26, 2013 the Company declared a dividend for the quarter ended June 30, 2013 on the Series B Preferred Stock in the aggregate amount of EUR 120,000. The holders of the Series B Preferred Stock elected to receive shares of Common Stock in place of the quarterly dividend based on the 10-day trading price of the Common Stock which was $0.09 per share. The Company has agreed to issue 1,643,418 Common Shares to the Holders of the Series B Preferred Stock in lieu of the cash dividend representing the amount of the dividend net of a 5% withholding tax. However, these shares have not yet been formally issued.

[1] 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, 2013.

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, 2012. 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 2012 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.

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:

- subscriptions by end consumers to our internet websites, primarily private.com (e-commerce) and sales of our branded media to third party on-line content aggregators;
- sales of VOD content to television distribution platforms including cable television, direct broadcast satellite and IPTV (Internet Protocol Television) operators;
- sales of content and revenue participations in the two Private branded adult entertainment PPV networks;
- sales of DVDs and magazines;

- sales of Private branded media to wireless providers (wireless); and

- license fees and revenue share agreements for the use of our brand.

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 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.

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.

Subscriptions to the Company s websites are paid for almost exclusively by credit card. The Company recognizes revenue from the sale of subscriptions to the Company s websites 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. Revenues are deferred and recognized ratably over the subscription period. 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.

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.

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.

Results of Operations

Three months ended June 30, 2013 compared to the three months ended June 30, 2012

Net sales. Net sales for the three months ended June 30, 2013 (the fiscal 2013 quarter) decreased by EUR 347,000, or by 20%, compared to net sales for the three months ended June 30, 2012 (the fiscal 2012 quarter). This was 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 trends in the adult entertainment industry and the amount of new video and print content that we released during the fiscal 2013 quarter and prior periods. We believe that revenues in the segment of the adult entertainment industry that we compete in have been decreasing due to the proliferation of free adult content that is now available the Internet. This free, or low cost, alternate source of content has reduced the demand for our paid products, which has reduced our Internet sales, broadcast, DVD and magazine sales. We believe that the continuous release of new, high quality print and video products may retain our traditional customers and attract new customers. However, because of the change in management in 2012, the large amount of liabilities our new management inherited in 2012, and our lack of funding, we did not produce and release enough new video products during 2012 and the first quarter of 2013. We have recently completed a number of new products that we will be releasing in 2013, which new products are expected to generate additional revenues in the future. However, the longer term effects of the easy availability to our customers of free, or low cost, adult content over the Internet on our revenues and business are uncertain and cannot be predicted.

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 508,000 in the fiscal 2013 quarter due to the decrease in net sales and lower amortization costs of the library. Cost of sales as a percentage of net sales for the three months ended June 30, 2013 decreased (from 77% for the three months ended June 30, 2012 to 60% in the 2013 quarter), due to the decrease in amortization of our library and websites in the fiscal 2013 quarter. Amortization of our 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.

Gross Profit. In the three months ended June 30, 2013, our gross profit increased by EUR 161,000 compared to our gross profit for the three months ended June 30, 2012. Gross profits increased despite the decrease in net sales because of the decrease in the cost of sales.

Selling, general and administrative expenses. Our selling, general and administrative expenses for the three months ended June 30, 2013 increased by EUR 912,000 compared to the fiscal 2012 quarter. The increase was principally as a result of large foreign currency translation adjustments made during the June 30, 2012 fiscal quarter which lead to significantly lower selling, general and administrative expenses for the second quarter of 2012. 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 period end U.S. dollar to euro exchange rate fluctuated significantly and was 5% lower than for the three months ended June 30, 2013. This arises from large foreign currency denominated liabilities that are revalued on a period end basis. These foreign exchange fluctuations during the second quarter of 2012 were substantially resolved by year end. Net of these foreign exchange fluctuations, selling, general and administrative expenses were in line with the expenses for prior quarters. Excluding the effect of the foreign exchange gain in the fiscal 2012 quarter, as a percentage of net sales, selling general and administrative expenses remained unchanged at 84%.

Operating profit/loss. We reported an operating loss of EUR 621,000 for the three months ended June 30, 2013 compared to an operating profit of EUR 130,000 for the three months ended June 30, 2012. As mentioned above, there were significant foreign exchange transactions during the second quarter of 2012 which lead to the profit during the 2012 fiscal quarter.

Interest expense. Interest expense represented interest on the institutional line of credit and bank borrowings (including the Commerzbank promissory note held by Consipio Holding bv). Interest expense in the fiscal 2013 quarter decreased by EUR 23,000 compared to the fiscal 2012 quarter primarily because the Commerzbank promissory note was repaid on December 28, 2012. The decrease in interest was partially offset by interest on the new EUR 800,000 loan we obtained in February 2013.

Net Income/loss. We reported a small net profit of EUR 58,000 for the three months ended June 30, 2012, compared to a net loss of EUR 670,000 for the three months ended June 30, 2013. Lower sales and higher selling, general and administrative costs contributed to the net loss in the fiscal 2013 quarter.

Six months ended June 30, 2013 compared to the six months ended June 30, 2012

Net sales. Net sales for the six months ended June 30, 2013 (the fiscal 2013 period) decreased by EUR 553,000, or by 16%, compared to net sales for the six months ended June 30, 2012 (the fiscal 2012 period). This was 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, the decrease in net sales was attributable to both trends in the adult entertainment industry and the amount of new video and print content that we released during the fiscal 2013 period and prior periods.

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 723,000 in the fiscal 2013 period due to the decrease in net sales and lower amortization costs of the library. Cost of sales as a percentage of net sales for the six months ended June 30, 2013 decreased (from 76% for the six months ended June 30, 2012 to 66% in the 2013 period), due to the decrease in amortization of our library and websites in the fiscal 2013 period.

Gross Profit. In the six months ended June 30, 2013, our gross profit increased by EUR 170,000 compared to our gross profit for the six months ended June 30, 2012. Gross profits increased despite the decrease in net sales because of the decrease in the cost of sales.

Selling, general and administrative expenses. Our selling, general and administrative expenses for the six months ended June 30, 2013 increased by EUR 406,000 compared to the fiscal 2012 period. The increase was principally as a result of large foreign currency translation adjustments made during the June 30, 2012 fiscal quarter which lead to significantly lower selling, general and administrative expenses for the second quarter of 2012 and therefore the six month period then ended.

Net of these foreign exchange fluctuations, selling, general and administrative expenses were in line with the expenses for prior quarters. As a percentage of net sales, selling, general and administrative expenses decreased from 74% to 67%, after giving effect for the foreign exchange gain in the fiscal 2012 period.

Operating profit/loss. We reported an operating loss of EUR 761,000 for the six months ended June 30, 2012 compared to an operating loss of EUR 957,000 for the six months ended June 30, 2013. This resulted from lower sales and higher cost of sales and higher selling, general and administrative expenses.

Interest expense. Interest expense represented interest on the institutional line of credit and bank borrowings (including the Commerzbank promissory note held by Consipio Holding bv). Interest expense in the fiscal 2013 period decreased by EUR 50,000 compared to the fiscal 2012 period primarily because the Commerzbank promissory note was repaid on December 28, 2012. The decrease in interest was partially offset by interest on the new EUR 800,000 loan we obtained in February 2013.

Net Income/loss. We reported a net loss of EUR 863,000 for the six months ended June 30, 2012, compared to a net loss of EUR 1,049,000 for the six months ended June 30, 2013. Lower sales and higher selling, general and administrative costs contributed to the increase in the net loss in the fiscal 2013 period.

Liquidity and Capital Resources

We had a working capital deficit of EUR 2.2 million at June, 2013, compared to a working capital deficit of EUR 2.4 million as of December 31, 2012.

Operating Activities

For the six months ended June 30, 2013, the Company had cash flow of EUR 40,000 from its operating activities. Although the Company had a net loss of EUR 1,049,000 during this period, the net loss was partly attributable to non-cash expenses. The principal non-cash expenses consisted of amortization of photographs and videos (EUR 871,000), amortization of web pages (EUR 266,000), and depreciation (EUR 103,000). We also generated additional cash by our increased efforts to collect accounts receivable, which resulted in our trade accounts receivable decreasing by EUR 268,000. However, these benefits were more than offset by the use of cash to pay down trade accounts payable (EUR 416,000), which trade payables were largely related to the settlement and payment of professional fees incurred by former management.

Investing Activities

The Company used EUR 936,000 of net cash in investing activities during the six months ended June 30, 2013. The investing activities were principally capital expenditures of EUR 114,000 and investment in library of photographs and videos of EUR 837,000. The Company has increased its content production activities in order to provide new content to its customers. As a result of these increased video production activities, cash used in investment activities is expected to increase in future periods.

Financing Activities

Net cash generated by financing activities for the six months ended June 30, 2013 was EUR 828,000, reflecting the placement of new debt net of repayments on borrowings. 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. In June 2013 the Company borrowed an additional EUR 100,000 from one of the three unaffiliated foreign lenders under the same loan agreement.

Liquidity

In each of the past three years we have experienced losses from operations. At June 30, 2013, we had cash and cash equivalents of EUR 117,000 and a working capital deficit of EUR 2,193,000. 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 will depend on our ability to generate or obtain sufficient cash to meet our obligations on a timely basis and ultimately to attain profitable operations.

During the fiscal quarter ended March 31, 2012 we replaced most of our directors and replaced our prior senior executive officers. Since March 31, 2012, our 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 Holding bv, 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 Commerzbank 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 ordered 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.

As a result of the foregoing actions, and based on our internal forecasts of cash expected to be generated from our current operations, as of the date of this report, we currently expect that our available cash resources and cash generated from operations will be sufficient to meet our presently anticipated working capital and capital expenditure requirements for at least the next 12 months. Nevertheless, we may raise additional funds to support future growth, to repay more of the legacy liabilities accrued by prior management, or to respond to unanticipated capital requirements. No assurance can be given that we will be able to raise additional funding, or that such funding will be on terms favorable to our current shareholders.

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, 2013.

Changes in Internal Control Over Financial Reporting

There were no changes in the Company s internal control over financial reporting that occurred during the Company s fiscal quarter ended June 30, 2013, that have materially affected, or are 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

On June 26, 2013, Entertainment Without Limits, Inc. (the Plaintiff), a corporation incorporated under the laws of the Province of Ontario, Canada, filed a Statement of Claim in the Ontario Superior Court of Justice (Court File No. CU-13-483535) against Private Media Group Canada, Inc. and Private Media Group, Inc. (the Defendants). The Plaintiff alleged that the Defendants breached the implicit or explicit terms of a contract that was not reduced to writing or signed by any of the parties. The Plaintiff alleged that, based on the parties prior dealings, it had the exclusive right to distribute the Defendants products in Canada. Plaintiff further alleged that the Defendants breached this unwritten contract by granting a third party the right to distribute two of Defendants products per month in Canada. The Plaintiff seeks damages for breach of contract in the amount of CDN $2,500,000, punitive damages of CDN $500,000, interest, costs of the action and other remedies. The Defendants believe that the foregoing claims are wholly without merit and, accordingly, intend to vigorously defend these claims.

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, 2012 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 August 8, 2013

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

Chief Financial Officer