PRIVATE MEDIA GROUP INC
Form 10-Q
November 18, 2011

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 September 30, 2011

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 incorporation or organization)	**(I.R.S. Employer 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 November 7, 2011
Common Stock, par value $.001	21,805,824

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2010 EUR	September 30, (Unaudited) 2011 EUR	2011 USD
		(in thousands)	
ASSETS			
Cash and cash equivalents	370	318	430
Trade accounts receivable	4,199	3,205	4,330
Inventories - net (Note 2)	1,790	1,413	1,909
Deferred income tax asset	5,014	5,014	6,776
Prepaid expenses and other current assets	618	481	650
TOTAL CURRENT ASSETS	11,990	10,430	14,095
Library of photographs and videos	8,345	5,936	8,022
Property, plant and equipment	4,397	3,245	4,385
Other intangible assets	4,847	4,772	6,449
Goodwill	9,204	9,204	12,438
Other assets	500	444	600
TOTAL ASSETS	39,283	34,031	45,988
LIABILITIES AND SHAREHOLDERS EQUITY			
Short-term borrowings	2,689	2,397	3,239
Current portion of long-term borrowings	402	297	401
Accounts payable trade	6,146	4,659	6,296
Income taxes payable	1,059	957	1,293
Deferred income taxes	277	277	374
Accrued other liabilities	2,519	2,682	3,624
TOTAL CURRENT LIABILITIES	13,093	11,268	15,228
Contingent consideration payable	514	514	695
Long-term borrowings	1,905	1,844	2,491
Related party payable	30		
TOTAL LIABILITIES	15,542	13,627	18,414
SHAREHOLDERS EQUITY			
$4.00 Series A Convertible Preferred Stock 10,000,000 shares authorized, none issued and outstanding at December 31, 2010 and September 30, 2011, respectively			
Common Stock, $.001 par value, 100,000,000 shares authorized 20,815,824 and 21,805,824 issued and outstanding at December 31, 2010 and September 30, 2011, respectively	869	870	1,176
Additional paid-in capital	30,468	30,468	41,173
Retained earnings	(2,771)	(6,161)	(8,325)
Accumulated other comprehensive income	(4,824)	(4,773)	(6,450)
TOTAL SHAREHOLDERS EQUITY	23,742	20,404	27,573

TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	39,283	34,031	45,987

See accompanying notes to consolidated statements.

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME (LOSS)

AND COMPREHENSIVE INCOME (LOSS)

	Three-months ended September 30, (unaudited)		Nine-months ended September 30, (unaudited)		
	2010 EUR	2011 EUR	2010 EUR	2011 EUR	2011 USD
			(in thousands)		
Net sales	5,878	4,754	18,277	14,829	20,039
Cost of sales	3,811	3,269	12,124	9,707	13,118
Gross profit	2,066	1,485	6,153	5,121	6,921
Selling, general and administrative expenses	4,565	2,665	11,055	8,222	11,111
Change in fair value of contingent consideration payable			2,352		
Operating income (loss)	(2,499)	(1,181)	(2,551)	(3,101)	(4,191)
Interest expense	97	76	295	265	358
Interest income	1		1	2	2
Income (loss) before income taxes	(2,595)	(1,256)	(2,844)	(3,364)	(4,546)
Income tax (benefit)	3	12	20	25	34
Net income (loss)	(2,598)	(1,268)	(2,864)	(3,390)	(4,581)
Other comprehensive income:					
Foreign currency translation adjustments	574	(484)	(811)	51	69
Comprehensive income	(2,024)	(1,752)	(3,676)	(3,339)	(4,512)
Net income (loss) per share:					
Basic	(0.12)	(0.06)	(0.13)	(0.15)	(0.21)
Diluted	(0.12)	(0.06)	(0.13)	(0.15)	(0.21)

See accompanying notes to consolidated statements.

PRIVATE MEDIA GROUP, INC

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine-months ended September 30, (unaudited)		
	2010 EUR	2011 EUR	2011 USD
	(in thousands)		
Cash flows from operating activities:			
Net income (loss)	(2,864)	(3,390)	(4,581)
Adjustment to reconcile net income to net cash flows from operating activities:			
Depreciation	559	422	570
Change in fair value of contingent consideration payable	(2,352)		
Stock based compensation	2		
Bad debt provision	377	396	536
Amortization of other intangible assets	93	76	103
Amortization of web pages	2,161	1,391	1,879
Amortization of photographs and videos	3,732	3,215	4,345
Effects of changes in operating assets and liabilities:			
Trade accounts receivable	93	598	808
Inventories	666	377	510
Prepaid expenses and other current assets	(156)	137	185
Accounts payable trade	12	(1,487)	(2,009)
Income taxes payable		(102)	(138)
Accrued other liabilities	818	162	219
Net cash provided by operating activities	3,140	1,796	2,427
Cash flows used in investing activities:			
Investment in library of photographs and videos	(1,456)	(807)	(1,090)
Capital expenditures	(1,182)	(660)	(892)
Investments in (sale of) other assets	186	56	76
Net cash (used in) investing activities	(2,452)	(1,411)	(1,907)
Cash flows from financing activities:			
Short-term borrowings repayments	(433)	(401)	(542)
Short-term borrowings additions	233	109	147
Long-term borrowings repayments	(239)	(656)	(886)
Long-term borrowings additions	270	460	622
Net cash (used in) provided by financing activities	(169)	(488)	(660)
Foreign currency translation adjustment	(811)	51	69
Net (decrease) increase in cash and cash equivalents	(293)	(52)	(70)
Cash and cash equivalents at beginning of the period	613	370	500
Cash and cash equivalents at end of the period	321	318	430
Cash paid for interest	223	156	211
Cash paid for taxes	20	102	138

See accompanying notes to consolidated statements.

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common stock Shares	Amounts EUR	Additional paid-in capital EUR	Retained earnings EUR	Accumulated other comprehensive income EUR	Total shareholders equity EUR
Balance at January 1, 2010	20,704,934	869	30,466	1,564	(3,565)	29,334
Shares issued in reverse split	890					
Conversion of exchangeable shares	110,000					
Stock based compensation			2			2
Translation adjustment					(1,259)	(1,259)
Net loss				(4,335)		(4,335)
Balance at December 31, 2010	20,815,824	869	30,468	(2,771)	(4,824)	23,742
Conversion of exchangeable shares	990,000	1				1
Translation adjustment					51	51
Net loss				(3,390)		(3,390)
Balance at September 30, 2011	21,805,824	870	30,468	(6,161)	(4,773)	20,404

See accompanying notes to consolidated statements.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

1. Basis of Presentation

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 nine months period ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. 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, 2010.

Solely for the convenience of the reader, the accompanying consolidated financial statements as of September 30, 2011 and for the nine months then ended have been translated into United States dollars (USD) at the rate of EUR 0.74 per USD 1.00 the interbank exchange rate on September 30, 2011. 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.

2. Inventories

Inventories consist of the following:

	December 31, 2010 EUR	**September 30, 2011 EUR**
	(in thousands)	
Magazines for sale and resale	564	295
DVDs	1,152	1,068
Other	73	50
	1,790	1,413

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.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

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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 Recurring Basis

As of September 30, 2011, the Company held certain liabilities that are required to be measured at fair value on a recurring basis. The fair value hierarchy requires the use of observable market data when available. In instances in which the inputs used to measure fair value fall into different levels of the fair value hierarchy, the fair value measurement classification below has been determined based on the lowest level input that is significant to the fair value measurement in its entirety. Management s assessment of the significance of a particular item to the fair value measurement in its entirety requires judgment, including the consideration of inputs specific to the asset or liability.

The fair values of liabilities measured on a recurring basis were determined using the following inputs:

	For the year ended December 31, 2010				
	Level 1 EUR	Level 2 EUR	Level 3 EUR	Net Fair Value EUR	Total Gains (Losses) EUR
			(in thousands)		
Contingent consideration payable (a)			514	514	4,189
Total			**514**	**514**	**4,189**

	For the nine months ended September 30, 2011				
	Level 1 EUR	Level 2 EUR	Level 3 EUR	Net Fair Value EUR	Total Gains (Losses) EUR
			(in thousands)		
Contingent consideration payable (a)			514	514	
Total			**514**	**514**	

(a) Under certain acquisition agreements, the Company has agreed to pay the sellers earnouts based on the performance of the businesses acquired. These earnout payments will be made in common stock of the Company. Contingent consideration payable is measured at its acquisition date fair value. Contingent consideration payable in the tables above represents the estimated fair value of additional future earn-outs payable for such acquisitions and is based on management s estimates and entity-specific assumptions, which are Level 3 inputs.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

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, 2010	4,703
Change in fair value recorded in earnings	(4,189)
Balance at December 31, 2010	514
Balance at September 30, 2011	514

4. Earnings (loss) per share

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

	Three-months ended September 30,		Nine-months ended September 30,	
	2010	2011	2010	2011
Numerator: (EUR in thousands)				
Net income (loss)	(2,598)	(1,268)	(2,864)	(3,390)
Denominator:				
Denominator for basic earnings per share weighted average shares outstanding	22,005,824	22,005,824	22,005,508	22,005,824
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	(0.12)	(0.06)	(0.13)	(0.15)
Diluted	(0.12)	(0.16)	(0.13)	(0.15)

For the three and nine months ended September 30, 2010, basic earnings per share include exchangeable shares equivalent to 1,300,000 shares of common stock outstanding in the period. For the three and nine months ended September 30, 2011, basic earnings per share include exchangeable shares equivalent to 200,000 shares of common stock outstanding in the period.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

5. Stock-based compensation

The Company has an expired Employee Stock Option Plan (the 1999 Plan) and a new Equity Incentive Plan (the 2009 EIP) available as described below. The compensation cost charged against income for the nine-month period ended September 30, 2010 was EUR 2 thousand, which is included in selling, general and administrative expense. The charge of compensation cost had no impact on tax since none of the option beneficiaries are taxable in the U.S. and tax rules are different in the beneficiaries respective tax jurisdictions.

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 Private Media Group. 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 stock options may be granted under the 1999 Plan, following its expiration, on March 1, 2009.

Under the expired plan, the purchase price (exercise price) of option shares had to be at least equal to the fair market value of such shares on the date the stock option was granted. The stock option was exercisable for a period of ten years from the date of grant or such shorter period as was determined by the Company. Each stock option under the plan provided that it was exercisable in full or in cumulative or non-cumulative installments, and each stock option was exercisable from the date of grant or any later date specified in the option. Unless otherwise provided by the Company, an optionee could not exercise a stock option unless from the date of grant to the date of exercise the optionee remained continuously in the Company s employ. At September 30, 2011, options for 8,668 shares were still outstanding under the 1999 Plan.

The 2009 EIP

The 2009 EIP is shareholder approved and came into effect 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.

The Company may grant Awards under the 2009 EIP to employees, directors and consultants of Private Media Group. 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 cumulative or non-cumulative 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