

PRIVATE MEDIA GROUP INC  
Form 10-Q  
May 12, 2008

**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 March 31, 2008

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**  
(State or other jurisdiction of  
incorporation or organization)

**87-0365673**  
(I.R.S. Employer Identification Number)

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3230 Flamingo Road, Suite 156, Las Vegas, Nevada 89121

(Registered office)

Calle de la Marina 14-16, Floor 18, Suite D, 08005 Barcelona, Spain

(European headquarters and address of 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 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	Outstanding at May 9, 2008
Common Stock, par value \$.001	53,580,494

## PART I.

## Item 1. Financial Statements

## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED BALANCE SHEETS

	December 31, 2007 EUR	March 31, (Unaudited) 2008 EUR      USD	
	(in thousands)		
<b>ASSETS</b>			
Cash and cash equivalents	1,599	914	1,451
Trade accounts receivable	8,591	7,821	12,415
Related party receivable	6,740	6,787	10,773
Inventories - net (Note 2)	7,150	6,965	11,055
Deferred income tax asset	4,332	4,332	6,876
Prepaid expenses and other current assets	2,523	1,619	2,569
<b>TOTAL CURRENT ASSETS</b>	<b>30,935</b>	<b>28,438</b>	<b>45,139</b>
Library of photographs and videos net	17,178	17,143	27,211
Property, plant and equipment net	3,043	3,121	4,955
Other intangible assets	3,095	3,064	4,863
Goodwill	2,425	2,425	3,850
Other investments	1,022	1,022	1,622
Other assets	357	339	538
<b>TOTAL ASSETS</b>	<b>58,056</b>	<b>55,552</b>	<b>88,177</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>			
Short-term borrowings	4,202	3,996	6,343
Current portion of long-term borrowings	111		
Accounts payable trade	4,912	5,109	8,109
Income taxes payable	990	380	603
Deferred income taxes	24	24	38
Accrued other liabilities	1,069	892	1,417
<b>TOTAL CURRENT LIABILITIES</b>	<b>11,308</b>	<b>10,401</b>	<b>16,509</b>
<b>SHAREHOLDERS EQUITY</b>			
\$4.00 Series A Convertible Preferred Stock 10,000,000 shares authorized, none issued and outstanding at December 31, 2007 and March 31, 2008, respectively			
Common Stock, \$.001 par value, 100,000,000 shares authorized, 53,580,494 and 53,580,494 issued and outstanding at December 31, 2007 and March 31, 2008, respectively	885	885	1,405
Additional paid-in capital	21,718	21,722	34,479
Retained earnings	27,262	26,422	41,940
Accumulated other comprehensive income	(3,118)	(3,878)	(6,155)
<b>TOTAL SHAREHOLDERS EQUITY</b>	<b>46,747</b>	<b>45,151</b>	<b>71,669</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>	<b>58,055</b>	<b>55,552</b>	<b>88,178</b>

See accompanying notes to consolidated statements.



## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED STATEMENTS OF INCOME (LOSS)

## AND COMPREHENSIVE INCOME (LOSS)

	Three-months ended		
	March 31,		
	(unaudited)		
	2007	2008	2008
	EUR	EUR	USD
	(in thousands)		
Net sales	5,420	5,251	8,336
Cost of sales	3,172	3,396	5,391
Gross profit	2,248	1,855	2,945
Selling, general and administrative expenses	3,087	3,256	5,168
Operating income (loss)	(838)	(1,401)	(2,223)
Interest expense	88	79	125
Interest income	75	76	121
Income (loss) before income taxes	(851)	(1,403)	(2,228)
Income tax (benefit)	(294)	(563)	(894)
Net income (loss)	(557)	(840)	(1,333)
Other comprehensive income:			
Foreign currency translation adjustments	84	(760)	(1,206)
Comprehensive income	(474)	(1,600)	(2,540)
Net income (loss) per share:			
Basic	(0.01)	(0.02)	(0.02)
Diluted	(0.01)	(0.02)	(0.02)

See accompanying notes to consolidated statements.

## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three-months ended		
	March 31,		
	(unaudited)		
	2007	2008	2008
	EUR	EUR	USD
	(in thousands)		
<b>Cash flows from operating activities:</b>			
Net income (loss)	(557)	(840)	(1,333)
<b>Adjustment to reconcile net income to net cash</b>			
flows from operating activities:			
Depreciation	202	290	460
Stock based compensation	13	4	6
Bad debt provision	36	22	35
Amortization of other intangible assets	31	31	49
Amortization of photographs and videos	1,717	1,612	2,559
<b>Effects of changes in operating assets and liabilities:</b>			
Trade accounts receivable	1,118	748	1,187
Related party receivable	(155)	(46)	(74)
Inventories	371	185	294
Prepaid expenses and other current assets	(224)	904	1,435
Accounts payable trade	324	197	313
Income taxes payable	(163)	(610)	(968)
Accrued other liabilities	(130)	(177)	(281)
<b>Net cash provided by operating activities</b>	<b>2,582</b>	<b>2,320</b>	<b>3,683</b>
<b>Cash flows used in investing activities:</b>			
Investment in library of photographs and videos	(2,177)	(1,577)	(2,503)
Capital expenditures	(305)	(369)	(585)
Investments in (sale of) other assets	(1)	19	30
<b>Net cash (used in) investing activities</b>	<b>(2,483)</b>	<b>(1,927)</b>	<b>(3,059)</b>
<b>Cash flows from financing activities:</b>			
Short-term borrowings repayments	(73)	(207)	(329)
Long-term borrowings repayments	(106)	(111)	(176)
<b>Net cash (used in) provided by financing activities</b>	<b>(179)</b>	<b>(318)</b>	<b>(505)</b>
Foreign currency translation adjustment	84	(760)	(1,206)
<b>Net (decrease) increase in cash and cash equivalents</b>	<b>4</b>	<b>(685)</b>	<b>(1,087)</b>
<b>Cash and cash equivalents at beginning of the period</b>	<b>2,329</b>	<b>1,599</b>	<b>2,538</b>
<b>Cash and cash equivalents at end of the period</b>	<b>2,333</b>	<b>914</b>	<b>1,451</b>
Cash paid for interest	66	58	91
Cash paid for taxes			

See accompanying notes to consolidated statements.



## PRIVATE MEDIA GROUP, INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common stock		Additional paid-in capital EUR	Retained earnings EUR	Accumulated other comprehensive income EUR	Total shareholders equity EUR
	Shares	Amounts EUR				
Balance at January 1, 2007	53,148,166	885	20,675	27,667	(2,893)	46,334
Repurchase of common stock	(2,999)		(8)			(8)
Shares issued for investment	435,327		1,022			1,022
Stock based compensation			28			28
Translation adjustment					(224)	(224)
Net income (loss)				(405)		(405)
Balance at December 31, 2007	53,580,494	885	21,718	27,262	(3,118)	46,748
Stock based compensation			4			4
Translation adjustment					(760)	(760)
Net income (loss)				(840)		(840)
Balance at March 31, 2008	53,580,494	885	21,722	26,422	(3,878)	45,152

See accompanying notes to consolidated statements.



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**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 three months period ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. 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, 2007.

Solely for the convenience of the reader, the accompanying consolidated financial statements as of March 31, 2008 and for the three months then ended have been translated into United States dollars ( USD ) at the rate of EUR 0.63 per USD 1.00 the interbank exchange rate on March 31, 2008. 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:

	<b>December 31, 2007 EUR</b>	<b>March 31, 2008 EUR</b>
	(in thousands)	
Magazines for sale and resale	3,133	2,975
DVDs	3,737	3,683
Other	280	306
	7,150	6,965

## PRIVATE MEDIA GROUP, INC.

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

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

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

	<b>Three-months ended March 31,</b>	
	<b>2007</b>	<b>2008</b>
<b>Numerator: (EUR in thousands)</b>		
Net income (loss)	(557)	(840)
<b>Denominator:</b>		
Denominator for basic earnings per share weighted average shares outstanding	53,148,166	53,590,147
<b>Effect of dilutive securities:</b>		
Common stock warrants, convertible notes, options and other dilutive securities	n/a	n/a
Denominator for diluted earnings per share weighted average shares and assumed conversions	n/a	n/a
<b>Earnings (loss) per share (in EUR)</b>		
Basic	(0.01)	(0.02)
Diluted	(0.01)	(0.02)

For the three months ended March 31, 2007 and 2008 diluted impact of potentially dilutive securities is anti-dilutive therefore diluted and basic loss per share are EUR 0.01 and EUR 0.02, respectively. The equivalent of 199,171 and 9,652 common shares derived from dilutive securities such as options, warrants and convertible notes are excluded from the diluted earnings per share at March 31, 2007 and 2008 as they are anti-dilutive.

**4. Stock-based compensation**

The Company has an Employee Stock Option Plan as described below. The Company reviewed the Employee Stock Option Plan for potential forfeitures and estimated that out of the nonvested options outstanding at March 31, 2007 there would be none. The compensation cost charged against income for the three-month periods ended March 31, 2007 and 2008 was EUR 13 thousand and EUR 4 thousand, respectively, 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.

*Employee Stock Option Plan*

The 1999 Employee Stock Option Plan ( the Plan ), which is shareholder approved, allows 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 Plan

## PRIVATE MEDIA GROUP, INC.

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

## (UNAUDITED)

authorizes the Company to grant stock options exercisable for up to an aggregate of 7,200,000 shares of common stock. No stock options may be granted under the Plan, after the Plan expires, on March 1, 2009. 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. The stock option is exercisable for a period of ten years from the date of grant or such shorter period as is determined by the Company. Each stock option may provide that it is exercisable in full or in cumulative or non-cumulative installments, and each stock option is exercisable from the date of grant or any later date specified in the option. Unless otherwise provided by the Company, an optionee may not exercise a stock option unless from the date of grant to the date of exercise the optionee remains continuously in the Company's employ.

The Company calculates the fair value of each option award 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 three month periods ended March 31, 2007 and 2008 no grants were made.

A summary of stock option activity for the three month period ended March 31, 2008 is as follows:

	Number of Shares	Weighted- Average Exercise Price in USD	Weighted- Average Remaining Contractual Term in Years	Aggregate Intrinsic Value <sup>1</sup> in Thousands of USD
Outstanding January 1, 2008	2,111,920	5.04		
Granted				
Exercised				
Forfeited				
Outstanding March 31, 2008	2,111,920	5.04	1.07	8
Exercisable March 31, 2008	2,090,920	5.06	1.05	8

During the three month periods ended March 31, 2007 and 2008, no options under our stock option plan were exercised.

As of March 31, 2008, there was USD 10 thousand of total unrecognized compensation cost related to nonvested option granted under the Plan. That cost is expected to be recognized over a weighted-average period of 0.4 years. The total fair value of all shares vested and outstanding at March 31, 2007 and 2008, was USD 6.3 million and USD 4.6 million, respectively.

<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 March 31, 2008.

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**PRIVATE MEDIA GROUP, INC.**

**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**(UNAUDITED)**

**5. Income Taxes**

On January 1, 2007 the Company adopted FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 ( FIN 48 ).

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. The statute of limitations varies by the various jurisdictions in which we operate. Because of the number of jurisdictions in which we file tax returns, in any given year the statute of limitations in certain jurisdictions may lapse without examination within the 12-month period from the balance sheet date. Other than the recurring effect of changes in unrecognized tax benefits due to the lapse of the statute of limitations, none of which are expected to be individually significant, management believe there are no other reasonably possible changes 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 US Federal and State income tax matters for years up to and including 2003 and 2001 respectively, and all foreign income tax matters for years up to 2002.

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 358 thousand were accrued as of March 31, 2008, of which EUR 21 thousand was recognized as interest expense during the period then ended.

In December 1999 the Company received final notification from the Swedish Tax Authority assessing its subsidiary in Cyprus for the tax years 1995-1998 for a total amount of SEK 42,000,000 (approx. EUR 4.5 million) plus fines amounting to SEK 16,800,000 (approx. EUR 1.8 million) plus interest. The Swedish Tax Authority has taken the position that the subsidiary carried on business in Sweden from a permanent establishment during the period in question and should therefore be taxed on the income attributable to the permanent establishment. The case is under litigation and the Company believes the circumstances supporting the Tax Authority's claim are without merit. However, the Administrative Court of Appeal has decided that a permanent establishment is at hand. The Court has only made a principle statement and the question of how to calculate any eventual profit that can be allocated to the permanent establishment is not decided by the Court at this stage. The final outcome of this litigation will not be known for several years. Due to the early stages of this matter and the uncertainty regarding the ultimate decision, no amounts have been provided in the Company's financial statements for this dispute.

**6. Recent Accounting Pronouncements**

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations ( FAS 141(R) ), to further enhance the accounting and financial reporting related to business combinations. FAS 141 (R) establishes principles and requirements for how the acquirer in a business combination (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree, (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature

**PRIVATE MEDIA GROUP, INC.**

**NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**(UNAUDITED)**

and financial effects of the business combination. FAS 141 (R) applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Therefore, the effects of the adoption of FAS 141 (R) will depend upon the extent and magnitude of acquisitions after December 31, 2008.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, ( FAS 157 ). This Statement defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 applies to other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. The Statement does not require any new fair value measurements and was originally effective beginning January 1, 2008. In February 2008, the FASB issued FASB Staff Position ( FSP ) FAS 157-2. FSP FAS 157-2 defers the effective date of FAS 157 until January 1, 2009 for non-financial assets and non-financial liabilities except those items recognized or disclosed at fair value on an annual or more frequently recurring basis.

We adopted SFAS No. 157 effective January 1, 2008 for financial assets and liabilities measured on a recurring basis. There was no impact for the partial adoption of SFAS No. 157 on our consolidated financial statements. We do not expect the application of SFAS No. 157 to our non-financial assets and liabilities to have any material effect on our consolidated financial statements.

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

You should read this section together with the consolidated financial statements and the notes and the other financial data in this Report. 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. 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.

The following discussion should be read in conjunction with the consolidated financial statements and related notes included elsewhere in this Report.

References in this report to we, us, the Company and Private refer to Private Media Group, Inc., a Nevada corporation, including its consolidated subsidiaries.

### Overview

We are an international provider of adult media content. We acquire still photography and motion pictures from independent directors and process these images into products suitable for popular media formats such as print publications, DVDs and digital media content for Broadcasting, Mobile and Internet distribution. In addition to media content, 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, service-oriented market and are subject to changes in business, economic and competitive conditions. Nearly all of our products compete with other products and services that utilize adult leisure time and disposable income.

We generate revenues primarily through:

- sales of movies on DVD;
- sales of adult feature magazines;
- Internet subscriptions and licensing;
- broadcasting movies through IPTV (Internet Protocol Television), cable, satellite and hotel television programming;
- sales of adult mobile content (wireless); and
- content, brand name and trademark licensing.

Over time, we expect net sales from DVDs & magazines to continue to decline as a percentage of net sales in relation to total net sales from Internet, broadcasting and wireless. We expect net sales from Internet, wireless and broadcasting to grow during the coming years.

We recognize net sales on delivery (for further information, see Critical Accounting Estimates).

Even though we recognize net sales upon delivery, we generally provide extended payment terms to our 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. In addition, we view our extended payment terms as an investment in our distribution channels which are important to the growth of our business.

Our primary expenses include:

acquisition of content for our library of photographs and videos;  
printing, processing and duplication costs; and  
selling, general and administrative expenses.

Our magazines and DVD covers are printed by independent third-party printers in Spain. We introduced DVDs as a motion picture medium in 1999. The production of each DVD master disc, prior to duplication, costs approximately \$10,000. DVDs have a relatively low cost of duplication, inclusive of box and packaging, of approximately \$1.00 per unit. Our DVDs are duplicated on an all region format, playable on both NTSC and PAL with multiple languages and sub-titles.

We released 101 titles on DVD during 2007, including both new and archival material. We plan to release approximately 100 proprietary titles on DVDs in 2008.

Over the years, our cost of sales has been fluctuating relative to net sales due to our use of new mediums for our products, such as the Internet, DVD broadcasting and wireless. Internet, wireless and broadcasting sales has historically not carried any significant cost of sales and variations in these areas affect the overall cost of sales percentage in relation to sales. These new media provide us with additional sales of our existing content

We also incur significant intangible expenses in connection with the amortization of our library of photographs and movies and capitalized development costs, which include the Internet. We amortize these tangible and intangible 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 bad debt, 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 sells magazines to wholesalers on firm sale basis and via national newsstand distributors with the right to return. Our magazines are multi-lingual and the principal magazine market is in Europe.

Revenues from the sale of magazines 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 magazines. Distributors with the right to return are primarily national newsstand distributors. Most of our magazines are bi-monthly (six issues per year) and remain on sale at a newsstand for a period of two 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. A majority of our national newsstand distributors are members of Distripress, the international organization for publishers and distributors, and carry out the distribution of the largest national and international newspapers and periodicals, including: Financial Times, Herald Tribune, Time, Newsweek, Vogue, etc.

The Company uses specific return percentages per title and distributor based on estimates and historical data. The percentages vary from 50-80%. Higher percentages generally reflect newer markets and/or products. Percentages are reviewed on an on-going basis.

The magazines have an approximate retail price of EUR 11.50 (USD 16.90) per copy and are printed on glossy high-quality paper at a cost of EUR 1.25 (USD 1.84). They are often shrink-wrapped in order to comply with local regulation or guidance for the sale of adult publications. 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 has always collected the returns from newsstands in order to make them available for sale again.

The Company has scheduled re-distribution of the returned magazines, via national newsstand distributors, as Megapacks or Superpacks (three different copies per pack) where the retail price is EUR 14.95 (USD 21.99). As the national newsstand distributors have the right to return, the packs come back to us and are then broken up in individual copies in order to be sent out in DVD packs, see below, or sold on firm sale basis to wholesalers as back numbers at a lower price than new issues.

The Company also 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 and the magazines are broken out in order to be sold on firm sale basis to wholesalers as back numbers at a lower price than



new issues. The Company has historically sold all copies printed at an average price higher than, or equal, to cost.

Revenues from the sale of DVD products under consignment agreements with distributors are recognized based upon reported sales by the Company's distributors. Revenues from the sale of subscriptions to the Company's internet website are deferred and recognized ratably over the subscription period. Revenues from licensing of broadcasting rights to the Company's video and film library 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.

Revenues from IPTV (Internet Protocol Television), satellite & cable broadcasting are recognized based on sales reported each month by its IPTV, cable and satellite affiliates. The affiliates do not report actual monthly sales for each of their systems to the Company until approximately 60-90 days 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.

Revenues from mobile content sales (wireless) 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 until approximately 60-90 days 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 collectibility of our trade receivables and notes receivable. A considerable amount of judgment is required in assessing the ultimate realization 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 collectibility of specific accounts as well as a reserve for a portion of other accounts which have been outstanding for more than 180 days. 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*

On January 1, 2002 the Company adopted Financial Accounting Standards Board Statement (SFAS) No. 142, "Goodwill and Other Intangible Assets". Under SFAS 142, goodwill and indefinite lived intangible assets will no longer be amortized but will be reviewed annually for impairment (or more frequently if indicators of impairment arise).

The Company performs impairment tests of goodwill and indefinite lived intangible assets annually. The Company is required to assess these assets for recoverability when events or circumstances indicate a potential impairment by estimating the undiscounted cash flows to be generated from the use of these assets. There has historically been no effect on the earnings and financial position of the Company as a result of the impairment testing.

Other Intangible Assets represents the value attributable to certain acquisitions. Amortization expense is calculated on a straight-line basis over 10 years.

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

The Company periodically evaluates the carrying value of long-lived assets including its library of photographs and videos for potential impairment. Upon indication of impairment, the Company will record a loss on its long-lived assets if the undiscounted cash flows that are estimated to be generated by those assets are less than the related carrying value of the assets. An impairment loss is then measured as the amount by which the carrying value of the asset exceeds the estimated discounted future cash flows. Management's estimated future revenues are based upon assumptions about future demand and market conditions and additional write downs may be required if actual conditions are less favorable than those assumed.

#### *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, videocassettes 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 projected by management, additional write-downs may be required.

### **Results of Operations**

#### ***Three months ended March 31, 2008 compared to the three months ended March 31, 2007***

*Net sales.* For the three months ended March 31, 2008, we had net sales of EUR 5.3 million compared to net sales of EUR 5.4 million for the three months ended March 31, 2007, a decrease of EUR 0.1 million. The decrease was the result of reduced DVD & Magazine sales offset by increased Broadcasting and Internet sales. Net sales in general were affected by Easter taking place in the first quarter of 2008 as opposed to the second quarter in 2007.

DVD & Magazine sales decreased EUR 0.5 million, or 18%, to EUR 2.7 million. The reduction in DVD & Magazine sales was primarily attributable to an industry wide decrease in DVD sales (see discussion under *Outlook* below). Despite the weakening dollar<sup>2</sup>, Internet sales increased EUR 0.1 million to EUR 1.1 million, which represents an increase of 7% compared to the same period last year. Broadcasting sales increased EUR 0.2 million, or 21%, to EUR 1.3 million primarily as a result of an increase in video on demand sales via IPTV. Wireless sales generated EUR 0.6 million in the period.

<sup>2</sup> Our Internet sites collect a significant part of its sales from US customers.

Going forward, we expect Internet, wireless and Broadcasting sales, in particular, to increase (see discussion under *Outlook* below).

Net sales in general were affected by changes in exchange rates. The three-month average dollar exchange rate for the period was 12% lower compared to the same period in 2007. This reduced all our sales in dollar by the same percentage. Fluctuations in exchange rates between the euro and the dollar can affect the comparability of our results from year to year. We translate our consolidated subsidiaries whose functional currency is not the euro into the euro for reporting purposes. Income statement amounts are translated into euros using the average exchange rate for the fiscal year. The balance sheet is translated at the year-end exchange rate.

*Cost of Sales.* Our cost of sales was EUR 3.4 million for the three months ended March 31, 2008 compared to EUR 3.2 million for the three months ended March 31, 2007, an increase of EUR 0.2 million, or 7%.

Included in cost of sales is printing, processing and duplication, amortization of library and Internet, broadcasting and wireless costs. Printing, processing and duplication cost was EUR 1.3 million for the three months ended March 31, 2008 compared to EUR 1.1 million for the three months ended March 31, 2007, an increase of EUR 0.2 million. Printing, processing and duplication cost as a percentage of DVD & Magazine sales was 56% for the three months ended March 31, 2008 compared to 41% in the same period last year. The increase was the result of an increase in sales volume sold at a lower average price as part of a program to reduce stock levels. Amortization of library was EUR 1.6 million for the three months ended March 31, 2008 compared to EUR 1.7 million for the three months ended March 31, 2007, which represents a decrease of EUR 0.1 million. 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. Internet, broadcasting and wireless cost was EUR 0.5 million for the three months ended March 31, 2008 compared to EUR 0.3 million for the three months ended March 31, 2007. Internet, broadcasting and wireless cost as a percentage of related sales in the period was 17% compared to 12% in the same period last year. The increase was primarily the result of increased internet and wireless cost.

*Gross Profit.* In the three months ended March 31, 2008, we realized a gross profit of EUR 1.9 million, or 35% of net sales compared to EUR 2.2 million, or 41% of net sales for the three months ended March 31, 2007. The decrease in gross profit as a percentage of sales was primarily the result of reduced margins on DVD & Magazine sales.

*Selling, general and administrative expenses.* Our selling, general and administrative expenses were EUR 3.3 million for the three months ended March 31, 2008 compared to EUR 3.1 million for the three months ended March 31, 2007, an increase of EUR 0.2 million, or 5%. The increase was the result of moving part of our European headquarters office and increased depreciation of property, plant and equipment.

*Operating loss.* We reported an operating loss of EUR 1.4 million for the three months ended March 31, 2008 compared to an operating loss of EUR 0.8 million for the three months ended March 31, 2007. The decrease in operating profit of EUR 0.6 million was the result of the decrease in gross profit combined with the increase in selling, general and administrative expenses.

*Interest expense.* We reported interest expense of EUR 0.1 million for the three months ended March 31, 2008, compared to EUR 0.1 million for the three months ended March 31, 2007.

*Income tax benefit.* We reported income tax benefit of EUR 0.6 million for the three months ended March 31, 2008, compared to EUR 0.3 million for the three months ended March 31, 2007. The increase in income tax benefit is a result of higher losses being recorded in jurisdictions with higher corporate tax rates.

*Net loss.* We reported a loss of EUR 0.8 million for the three months ended March 31, 2008, compared to EUR 0.6 million for the three months ended March 31, 2007. We attribute the increase in loss in the period to increased operating loss offset by increased income tax benefit.

### **Liquidity and Capital Resources**

We reported a working capital surplus of EUR 18.0 million at March 31, 2008, a decrease of EUR 1.6 million compared to the year ended December 31, 2007. The decrease is principally attributable to a decrease in current assets.

#### *Operating Activities*

Net cash provided by operating activities was EUR 2.3 million for the three months ended March 31, 2008, and was primarily the result of net income, as adjusted for non-cash transactions, and cash related to changes in operating assets and liabilities. The net loss of EUR 0.8 million was adjusted to reconcile net income to net cash flows from operating activities with depreciation of EUR 0.3 million and amortization of photographs and videos of EUR 1.6 million making a total of EUR 1.9 million, providing a net balance of EUR 1.1 million. The total of EUR 1.1 million was added to by changes in trade accounts receivable, inventories, accounts payable trade and prepaid expenses and other current assets totaling EUR 2.0 million offset by EUR 0.8 million from related party receivable, income taxes payable and accrued other liabilities. Net cash provided by operating activities was EUR 2.6 million for the three months ended March 31, 2007. The decrease in net cash provided by operating activities of EUR 0.3 million for the three months ended March 31, 2008 compared to the same period last year was primarily the result of net income, as adjusted for non-cash transactions.

#### *Investing Activities*

Net cash used in investing activities for the three months ended March 31, 2008 was EUR 1.9 million. The investing activities were principally capital expenditure of EUR 0.3 million and investment in library of photographs and videos of EUR 1.6 million, which was carried out in order to maintain the 2008 release schedules. Net cash used in investing activities decreased EUR 0.6 million over the same period last year. The decrease is principally due to above average investment activity in library of photographs and videos in the three month period ended March 31, 2007.

#### *Financing Activities*

Net cash used in financing activities for the three-month period ended March 31, 2008 was EUR 0.3 million, represented by repayments on short- and long-term borrowings. Compared to the three-month 2007 period there was no material change.

**Contractual obligations**

During the three-month period ended March 31, 2008, we have not experienced any material changes in our contractual obligations compared to what was reported in our Form 10-K for the year ended December 31, 2007.

*Disputed contractual obligation*

In 2001 Private borrowed \$4.0 million from Commerzbank AG pursuant to a Note which bore interest at an annual rate of 7%, payable quarterly. In April 2003 the Note was acquired by Consipio Holding b.v. from Commerzbank AG, and Consipio and Private reached an agreement-in-principle with Consipio to extend the maturity of the Note until April 2008. However, Consipio and Private were unable to reach final agreement on other terms and conditions relating to the restructured Note. The Company continued to make regular payments on the Note, including principal and accrued interest.

In April 2008 Consipio requested Private to pay the remaining balance of the Note, without indicating the amount due. Private in turn requested that Consipio provide a statement of the amount due and the basis for its calculation. In response, Consipio demanded payment of \$3,194,000 as settlement in full of the Note, to be received by May 9, 2008. This calculation was made using an interest rate of 9.9%, as opposed to the 7% rate provided under the original terms of the Note. Consipio also advised that if payment was not received on such date it would institute litigation, in which event Consipio would claim that the amount due under the Note should be denominated in Euro, rather than U.S. dollars.

Private believes that the amount due under the Note at May 9, 2008, including accrued interest, is no more than \$2.4 million, utilizing an interest rate of 7%. Private also believes it has valid claims and defenses against Consipio and its affiliates which may ultimately reduce all or a portion of its obligations relating to the Note. However, there are no assurances that either Private will be able to reach agreement with Consipio or that Private will ultimately prevail on its claims and defenses. In any event, the Company does not believe that the Note obligations will have a material adverse effect on the liquidity of the Company, as the Note is fully collateralized by 4,950,000 shares of Private Media Group, Inc. Common Stock pursuant to the guaranty agreement from Slingsby Enterprises Limited to the holder of the Note.

## Outlook

Going forward, we expect significant growth on our new media platforms, Internet, broadcasting and wireless. Currently, our new media platforms are responsible for fifty-seven percent of our revenues. Below follows a discussion highlighting some of the important factors of our business going forward:

### *Broadcasting*

While European broadband users are signing up for IPTV services in the hundreds of thousands each month, making Europe the biggest and fastest growing IPTV region in the world<sup>2</sup>, we have successfully implemented part of our new media strategy and contracted for supplying content for TVOD<sup>3</sup> services to a total of 24 major platform operators in 11 countries in the region. During 2007 the European IPTV market grew by 60% to 6.4 million IPTV subscribers and by the end of the year we had gained 70% coverage with 4.5 million subscribers. In March 2008, we launched our content on the Neuf-Cegetel platform in France and made it available to their 750,000 subscribers.

It is important to note that part of our content has only been launched recently on some of these new IPTV platforms and subsequently we have not seen any impact on our bottom line from this high-margin business yet. However, during 2008 we are launching and building up shelf-space on all platforms and by the end of the second quarter 2008 we will have full exposure of our content on these fast growing IPTV platforms. By the end of 2008 and 2009, we expect to have our content available to 7.9 million and 12.0 million European IPTV subscribers, respectively.

Furthermore, in order to increase growth and profitability in our other types of broadcasting, we have restructured our trademark and content licensing business with respect to the operation and distribution of Private branded TV channels carrying our content in Europe and Latin America. The restructuring included finding new partners in these markets and subsequently we entered into agreements with Playboy TV Latin America and Playboy TV International. For 2008, we have reason to believe both partners will continue to expand their reach for the Private branded TV channels and consequently we expect sales to increase. In addition, we partnered with New Frontier Media in 2007 for the exclusive distribution of Private branded content to the U.S. broadcast market including video-on-demand, pay-per-view, IPTV and television. New Frontier Media's services reach over 139 million network homes and recently our content became available on the first video-on-demand platform in the US to more than six million subscribers via one of the biggest operators. Going forward, we expect additional video-on-demand platforms in the US to follow.

<sup>2</sup> According to Global IPTV Forecasts made by MRG (Multimedia Research Group, Inc.), the number of global IPTV subscribers is estimated to grow from 13.5 million in 2007 to 92.8 million in 2012, a compound annual growth rate of 47 percent. Europe continues to be the biggest market for IPTV, with France significantly leading the growth projections through its principal telcos. The number of IPTV subscribers in Europe is forecasted to grow from approximately 6.4 million in 2007 to 36.4 million in 2012, a compound annual growth rate of 42 percent.

<sup>3</sup> True Video On Demand (TVOD) TVOD is the ideal VOD service where individual users get immediate responses when interacting with the VOD system. With TVOD, the user can not only get instant access to the program online and watch it on TV, but also be able to do any VCR or DVD-like commands on the VOD system with the same quick response time as it is when working a VCR or DVD.

#### *Wireless Adult Mobile Content*

With respect to mobile content, we believe this market is still in its infancy. During 2007 the distribution of Private content increased by 67% and by the end of the year it was available to 906 million handsets in 36 countries via 86 operators. The markets of Asia and the Americas are still underexploited by us and therefore represent a significant growth potential. In addition, Mobile TV, increased penetration of 3G handsets and the implementation of age verification systems offer additional significant growth potential with both current and future operators in 2008 and beyond<sup>4</sup>.

Furthermore, during 2007 we entered into an exclusive global partnership with Mobile Streams to distribute our premium adult content through their platform for off-portal mobile services. Mobile Streams is a premier global mobile music and media provider and through this partnership we are entering a new dimension of mobile content delivery. During the first quarter, the mobile site private.mobi was launched in a few selected European markets as part of the initial stage in the development of this strategic global partnership. We believe the user behavior for mobile content will migrate from on-portal to off-portal and that this new business will be the principal revenue generator going forward.

#### *Internet*

Traffic to our sites increased by 85% to 20 million unique visits in 2007 compared to 2006. This was primarily the result of the re-launch of the affiliate program PrivateCash. The affiliate program is now our biggest source of traffic. In the second quarter of 2008, the Company is launching a large number of niche sites focusing on specific genres and top stars with the key objective to offer customers content matching their specific desires. In addition to catering to a wider clientele and creating more shelf-space on the web, this will grow the affiliate program as webmasters will have more tools at their disposal to drive traffic. Finally, it will enable the Company to take advantage of additional up-selling and cross-selling opportunities.

#### *DVDs & Magazines*

As we are moving further into a world of global digital content delivery, DVD pricing and volume is being affected considerably and as a result the industry in general is experiencing a severe downturn in DVD sales. In view of the aforementioned, during 2007 we started a reorganization of our distribution of DVDs and Magazines. Through this reorganization, we expect to maximize existing sales and over time reduce the revenue impact of this on our overall business.

#### *Liquidity*

We 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 twelve months. However, we may need to raise additional funds to support more rapid expansion or respond to unanticipated requirements.

<sup>4</sup> Juniper Research estimates in its white paper *Adult Content in the Palm of Your Hand (November 2007)* that the global mobile adult content market will increase from US\$1.7 billion in 2007 to just over US\$4.6 billion by 2012.

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 our current shareholders. 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 or respond to competitive pressures or unanticipated requirements, which could harm our business.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk.**

We do not use derivative financial instruments for trading purposes and were never a party to any derivative, swap or option contracts. We do not hedge our interest rate or foreign currency exchange rate exposures.

As our cash and cash equivalents and short-term investments consist principally of money market securities and investments in short-term debt or equity securities and our borrowings are primarily at fixed rates of interest our market risk related to fluctuations in interest rates is limited. Accordingly, a one percentage change in market interest rates would not have a material impact on our results of operations.

We transact our business in various currencies, principally the Euro and the U.S dollar and certain other European Union currencies. We generally attempt to limit exposure to currency rate fluctuations by matching transaction currencies (revenues/expenses) to the functional currency of its operating subsidiaries. Our exposure to market risk for fluctuations in foreign currency exchange rates relates primarily to fluctuations in the Euro versus the U.S dollar. We translate our consolidated subsidiaries whose functional currency is not the euro into the euro for reporting purposes. Income statement amounts are translated into euros using the average exchange rate for the fiscal year. The balance sheet is translated at the year-end exchange rate. Due to the significance of the results reported in dollars the impact of the euro/dollar exchange rate on our major categories of revenue and expense can be material.

**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, as amended, is recorded, processed, summarized and reported within the specified time periods. 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 March 31, 2008.



*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 March 31, 2008, 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 2. Unregistered Sales of Securities and Use of Proceeds**

*Purchases of Equity Securities*

The following table sets forth information with respect to shares of common stock of the Company purchased by the Company during the three months ended March 31, 2008:

<b>Period</b>	<b>(a) Total Number of Shares Purchased</b>	<b>(b) Average Price Paid Per Share</b>	<b>(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs</b>
January, 2008				
February, 2008				
March, 2008				

**Total**

**Item 6. Exhibits**

- 31.1 Certifications pursuant to Rule 13a-14 under the Securities Exchange Act of 1934.
- 31.2 Certifications pursuant to Rule 13a-14 under the Securities Exchange Act of 1934.
- 32.1 Certification of CEO and CFO Pursuant to 18 U.S.C. § 1350, as Adopted Pursuant to § 906 of the Sarbanes-Oxley Act of 2002.

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**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: May 12, 2008

/s/ Johan Gillborg  
Johan Gillborg, Chief Financial Officer