

Edgar Filing: PRIVATE MEDIA GROUP INC - Form 10-Q

PRIVATE MEDIA GROUP INC  
Form 10-Q  
May 20, 2002

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, 2002  
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 Issuer as Specified in its Charter)

Nevada 87-0365673  
(State or other jurisdiction of (I.R.S. Employer Identification Number)  
incorporation or organization)

Carrettera de Rubi 22-26, 08190 Sant Cugat del Valles, Barcelona, Spain  
(Address of principal executive offices)

34-93-590-7070  
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Issuer's telephone number

Check whether the issuer (1) filed all reports required to be filed by  
Section 13 or 15(d) of the Exchange Act 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 \_\_\_\_\_  
-----

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

Class -----	Outstanding at May 17, 2002 -----
Common Stock, par value \$.001	28,436,152

PART I.

Item 1. Financial Statements

PRIVATE MEDIA GROUP, INC.  
CONSOLIDATED BALANCE SHEETS

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	December 31,	
	-----	-----
	2001	2000
	-----	-----
	EUR	EUR
	(in thousands)	
<b>ASSETS</b>		
Cash and cash equivalents .....	6,408	2
Short-term investment .....	2,850	2
Trade accounts receivable .....	15,930	16
Related party receivable .....	1,563	5
Inventories - net (Note 3) .....	8,252	8
Deferred tax asset .....	159	
Prepaid expenses and other current assets .....	1,785	2
	-----	-----
TOTAL CURRENT ASSETS .....	36,946	37
Library of photographs and videos - net .....	14,241	15
Property, plant and equipment - net .....	2,786	3
Goodwill and other intangible assets (Note 5) .....	2,892	2
Other assets .....	220	
	-----	-----
TOTAL ASSETS .....	57,086	59
	=====	=====
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Short-term borrowings .....	4,530	4
Accounts payable trade .....	6,874	7
Income taxes payable .....	2,431	2
Deferred tax liability .....	22	
Accrued other liabilities .....	728	2
	-----	-----
TOTAL CURRENT LIABILITIES .....	14,586	16
Long-term borrowings .....	220	
<b>SHAREHOLDERS' EQUITY</b>		
\$4.00 Series A Convertible Preferred Stock .....	-	
10,000,000 shares authorized, 7,000,000 shares issued and outstanding		
Common Stock, \$.001 par value, 100,000,000 shares authorized 28,370,857 and 28,426,152 issued and outstanding at December 31, 2001 and March 31, 2002, respectively	863	
Additional paid-in capital .....	14,351	14
Stock dividends to be distributed .....	381	
Retained earnings .....	29,782	28
Accumulated other comprehensive income .....	(3,097)	(1
	-----	-----
TOTAL SHAREHOLDERS' EQUITY .....	42,280	42
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY .....	57,086	59
	=====	=====

See accompanying notes to consolidated statements.

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PRIVATE MEDIA GROUP, INC.  
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three-months ended March 31, (unaudited)		
	2001	2002	2002
	Restated EUR	EUR (in thousands)	USD
Net sales .....	11,004	9,262	8,054
Cost of sales .....	4,111	3,517	3,058
Gross profit .....	6,893	5,745	4,996
Selling, general and administrative expenses .....	3,671	5,770	5,017
Offering expenses .....	-	1,401	1,219
Operating profit (loss) .....	3,221	(1,426)	(1,240)
Interest expense .....	62	279	242
Interest income .....	19	162	141
Income (loss) before income tax .....	3,178	(1,542)	(1,341)
Income tax expense (benefit) .....	455	(324)	(282)
Net income (loss) .....	2,724	(1,218)	(1,059)
Other comprehensive income:			
Unrealized loss on short-term investment .....	-	124	108
Foreign currency translation adjustments .....	(976)	1,724	1,499
Comprehensive income .....	1,748	382	332
Income applicable to common shares .....	2,327	(1,619)	(1,408)
Net income per share:			
Basic .....	0.08	(0.06)	(0.05)
Diluted .....	0.05	(0.06)	(0.05)

See accompanying notes to consolidated statements.

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PRIVATE MEDIA GROUP, INC.

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## CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three-months ended March 31, (unaudited)		
	2001	2002	2002
	Restated EUR	EUR (in thousands)	USD
Cash flows from operating activities:			
Net income .....	2,724	(1,218)	(1,059)
Adjustment to reconcile net income to net cash flows from operating activities:			
Depreciation .....	222	139	121
Bad debt provision .....	-	686	597
Provision for offering expenses .....	-	1,000	870
Amortization of goodwill .....	76	-	-
Amortization of photographs and videos .....	1,017	614	534
Effects of changes in operating assets and liabilities:			
Trade accounts receivable .....	(3,265)	(757)	(658)
Related party receivable .....	216	(3,821)	(3,323)
Inventories .....	(139)	(557)	(485)
Prepaid expenses and other current assets .....	(120)	(471)	(410)
Accounts payable trade .....	212	807	701
Income taxes payable .....	500	(222)	(193)
Accrued other liabilities .....	639	400	348
Net cash provided by operating activities .....	2,083	(3,401)	(2,958)
Cash flows from investing activities:			
Short-term investments .....	-	(5)	(5)
Investment in library of photographs and videos .....	1,339	1,895	1,648
Capital expenditures .....	138	607	528
Investments in asset held for sale .....	(42)	-	-
Investments in (sale of) other assets .....	688	(4)	(4)
Net cash used in investing activities .....	2,124	2,493	2,168
Cash flow from financing activities:			
Conversion of warrants .....	114	232	202
Long-term loan (repayments on loan) .....	(55)	6	5
Short-term borrowings (repayments) .....	47	50	43
Net cash (used in) provided by financing activities .....	106	288	251
Foreign currency translation adjustment .....	(976)	1,600	1,391
Net (decrease) increase in cash and cash equivalents .....	(910)	(4,006)	(3,483)
Cash and cash equivalents at beginning of the period .....	1,624	6,408	5,572
Cash and cash equivalents at end of the period .....	713	2,402	2,089
Cash paid for interest .....	44	195	170
Cash paid for taxes .....	96	(102)	(89)

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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, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. 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, 2001.

Effective January 1, 2002, the Company changed its reporting currency from the Swedish Kronor (SEK) to the euro ("EUR"). On that date, the euro became the principal currency in which Private Media Group generates its cash flows. The assets and operations of the Company's US based operations are currently not significant. The accompanying financial statements have been recast for all periods presented using methodology consistent with SFAS # 52.

Solely for the convenience of the reader, the accompanying consolidated financial statements as of March 31, 2001 and for the three months then ended have been translated into United States dollars ("USD") at the rate of EUR 1.15 per USD 1.00 the interbank exchange rate on March 31, 2002. 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. Restatement

As previously reported in the Company's Annual Report on Form 10-K for the year ended December 31, 2001, in connection with the preparation of the Company's 2001 annual financial statements, management of the Company determined, as a result of circumstances related to the acquisition of certain assets from Anton Enterprises, Inc., it to be more appropriate accounting to reverse certain revenues and sales return provisions recorded in the first - fourth quarters of 2001. The impact of these adjustments reduced previously recorded first quarter revenues by EUR 641 thousand, net income by EUR 614 thousand and basic and diluted earnings per share by EUR 0.04 and EUR 0.02.

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PRIVATE GROUP, INC.  
NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
(UNAUDITED)

3. Inventories

Inventories consist of the following:

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	December 31,
	2001
	EUR
	(in thousands)
Magazines for sale and resale .....	2,551
Video cassettes .....	2,929
DVDs .....	2,464
Other .....	308
	-----
	8,252
	=====

4. Earnings per share

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

	Three-months ended March 31,	
	2001	2002
	Restated	
Numerator: (EUR in thousands)		
Net income (loss) (numerator diluted EPS)	2,724	(1,218)
	=====	=====
Less: Dividends on preferred stock	397	401
	-----	-----
Income applicable to common shares (numerator basic EPS)	2,327	(1,619)
	=====	=====
Denominator: (EUR in thousands)		
Denominator for basic earnings per share - Weighted average shares .....	28,012,362	28,462,709
Effect of dilutive securities:		
Preferred stock .....	21,000,000	n/a
Common stock warrants, options and other dilutive securities .....	539,301	n/a
	-----	-----
Denominator for diluted earnings per share - weighted average shares and assumed conversions .....	49,551,663	n/a
	=====	=====
Earnings (loss) per share (EUR)		
Basic .....	0.08	(0.06)

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Diluted .....	0.05	(0.06)
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PRIVATE GROUP, INC.  
 NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
 (UNAUDITED)

For 2002 diluted impact of potentially dilutive securities is anti-dilutive therefore diluted and basic loss per share are EUR 0.06.

5. New accounting standards

Effective January 1, 2002, the Company adopted the provisions of Statement No. 142, "Goodwill and Other Intangible Assets," applicable to business combinations completed after June 30, 2001. Effective January 1, 2002, the Company adopted the additional provisions of Statement No. 142 relating to business combinations completed prior to June 30, 2001. Statement No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment at least annually. Intangible assets with definite useful lives will continue to be amortized over their estimated useful lives. The Company is currently in the process of completing the initial impairment review, but does not believe any significant impairments will be recognized. As a result of adoption, the Company realized a benefit of approximately EUR 73 thousand of annual amortization reductions in the first quarter of 2002 relative to the first quarter of 2001.

The Company's pro forma comparative earnings and earnings per share would not have been materially different from reported results had the non-amortization provisions of Statement No. 142 been adopted for all periods presented.

The following table provides the gross carrying amount of all intangible assets and the related accumulated depreciation for intangible assets subject to amortization at March 31, 2002 and December 31, 2001, respectively.

	March 31, 2001	
	Gross carrying amount	Accu amor
	EUR (in thousands)	
Amortized intangible assets:		
Other intangible assets .....	506	
	506	
Unamortized intangible assets:		
Goodwill .....	2,900	
	2,900	

=====

Total amortization expense for the three months ended March 31, 2002 was EUR 13 thousand as compared to EUR 73 thousand for the three months ended March 31, 2001.

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PRIVATE GROUP, INC.  
 NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS  
 (UNAUDITED)

The following table provides estimated depreciation expense for other intangible assets for each of the five succeeding fiscal years.

Fiscal year	Estimated amortization expense
-----	-----
	EUR (in thousands)
2002 .....	51
2003 .....	51
2004 .....	51
2005 .....	51
2006 .....	51

There has been no change in the carrying amount of goodwill for the three months ended March 31, 2002.

6. Contingent Liability

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 plus fines amounting to SEK 16,800,000 plus interest. The Company believes the assessment is without merit and is in the process of appealing the assessment to the Administrative court in Stockholm. The final outcome of the appeal is expected to take several years and the Company has asked for a postponement of payment of the taxes and fees until the case is settled. No final decision has been given.

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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



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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.

As previously reported in our Annual Report on Form 10-K for the year ended December 31, 2001, in connection with the preparation of our 2001 annual financial statements, our management determined that the previously issued 2001 interim consolidated financial statements, including the consolidated financial statements contained in our Form 10-Qs for the quarters ended March 31, June 30 and September 30, 2001, required restatement. Accordingly, the previously issued interim financial statements for the three months ended March 31, 2001, have been restated in this Report as described in Note 2 to the accompanying Consolidated Financial Statements to reflect (i) decrease in previously reported income tax expense, and (ii) decreased revenues. All amounts and percentages in the following discussions reflect the effects of such restatements.

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

### Depreciation expense

Depreciation expense decreased to EUR 13 thousand in the first quarter of 2002 from EUR 73 thousand in the first quarter of 2001. The decrease in expense for the first quarter of 2002 is primarily a result of the Company's adoption on January 1, 2002 of Financial Accounting Standards Board (FASB) Statement No. 142, "Goodwill and Other Intangible Assets". The Company is currently in the process of completing the initial impairment review, but does not believe any significant impairments will be recognized. As a result of adoption of Statement No. 142, the Company realized a pre-tax benefit of approximately EUR 73 thousand of annual depreciation reductions in the first quarter of 2002.

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### Results of Operations

Three months ended March 31, 2002 compared to the three months ended March 31, 2001

Net sales. For the three months ended March 31, 2002, we had net sales of EUR 9,262 thousand compared to net sales of EUR 11,004 thousand for the three months ended March 31, 2001, a decrease of 15.8%. We attribute this change mainly to a decrease in Video and Magazine sales of 41% as a result of Easter taking place in the first quarter this year as opposed to the second quarter last year. Internet sales decreased by 28% to EUR 1,552 thousand as a result of a non-recurring drop in Internet license sales. The decrease in Video, Magazine and Internet sales was offset by an increase in DVD and Broadcasting sales. DVD sales increased 39% to EUR 3,630 thousand and Broadcasting sales increased 22% to EUR 784 thousand for the three months ended March 31, 2002. We attribute the growth in sales of DVDs to the increasing number of DVD players being sold in all of our markets. We believe that the growth in DVD and Broadcasting sales will continue through the remainder of 2002.

Cost of Sales. Our cost of sales was EUR 3,517 thousand for the three months ended March 31, 2002 compared to EUR 4,111 thousand for the three months ended March 31, 2001, a decrease of EUR 595 thousand, or 14.5%. The decrease was primarily the result of a decrease in sales volume. Cost of sales as a

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percentage of sales was 38.0% for the three months ended March 31, 2002, compared to 37.4% for the three months ended March 31, 2001.

Gross Profit. In the three months ended March 31, 2002, we realized a gross profit of EUR 5,745 thousand, or 62.0% of net sales compared to EUR 6,893 thousand, or 62.6% of net sales for the three months ended March 31, 2001.

Selling, general and administrative expenses. Our selling, general and administrative expenses were EUR 5,770 thousand for the three months ended March 31, 2002 compared to EUR 3,671 thousand for the three months ended March 31, 2001, an increase of EUR 2,098 thousand, or 57.1%. We attribute this change to increased provisions for bad debts of EUR 686 thousand, increased selling, general and administrative expenses of EUR 576 thousand related to our expansion in the United States through our new subsidiary Private North America which began operating April 1 last year and our continued investment in Internet, Broadband, DVD and broadcasting related activities which we expect to continue through 2002.

Offering expense. We reported offering expenses of EUR 1,401 thousand for the three months ended March 31, 2002 for the activities related to the listing and secondary offering on the Frankfurt Stock Exchange, Neuer Markt in Germany. The offering was postponed in January, 2002 due to poor market conditions.

Operating profit/ loss. We reported an operating loss of EUR 1,426 thousand for the three months ended March 31, 2002 compared to an operating profit of EUR 3,221 thousand for the three months ended March 31, 2001, a decrease of EUR 4,647 thousand, or 144.3%. We attribute this change primarily to decreased sales, offering expense and provisions for bad debts.

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Interest expense. We reported interest expense of EUR 279 thousand for the three months ended March 31, 2002, compared to EUR 62 thousand for the three months ended March 31, 2001, an increase of EUR 216 thousand. We attribute this increase to higher short-term borrowings outstanding during the three months ended March 31, 2002, compared to the three months ended March 31, 2001.

Income tax expense/benefit. We reported income tax benefit of EUR 324 thousand for the three months ended March 31, 2002, compared to EUR 455 thousand for the three months ended March 31, 2001. We attribute this change to decreased operating profit.

Net income/loss. We reported a net loss of EUR 1,218 thousand for the three months ended March 31, 2002, compared to net income of EUR 2,724 thousand for the three months ended March 31, 2001. We attribute this change in net income in 2002 of EUR 3,942 thousand, or 144.7%, to decreased operating profit.

### Liquidity and Capital Resources

We reported a working capital surplus of EUR 21,236 thousand at March 31, 2002, a decrease of EUR 1,124 thousand compared to the year ended December 31, 2001. The decrease is principally attributable to increased accrued other liabilities and accounts receivable offset by increased inventories and prepaid expenses and other current assets.

### Operating Activities

Net cash used in operating activities was EUR 3,401 thousand for the three months ended March 31, 2002, and was primarily the result of changes in operating assets and liabilities. The net loss of EUR 1,218 thousand offset by

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adjustments to reconcile net income to net cash flows from operating activities, representing depreciation of EUR 139 thousand, bad debt provision of EUR 686 thousand, provision for offering expense of EUR 1,000 thousand and amortization of photographs and videos of EUR 614 thousand provided a total of EUR 1,221 thousand. The total of EUR 1,221 thousand was then primarily reduced by the increases in trade accounts receivable, related party receivable, inventories, prepaid expenses and other current assets and income taxes payable totaling EUR 5,829 thousand, offset by EUR 1,206 thousand from accounts payable trade, and accrued other liabilities. Net cash used by operating activities was EUR 3,401 thousand for the three months ended March 31, 2001. The decrease in cash provided by operating activities for the three months ended March 31, 2002 compared to the same period last year is both the result of net income and adjustments to reconcile net income to net cash flows from operating activities and changes in operating assets and liabilities.

### Investing Activities

Net cash used in investing activities for the three months ended March 31, 2002 was EUR 2,493 thousand. The investing activities were principally investment in library of photographs and videos of EUR 1,895 thousand, which are carried out in order to maintain the 2002 release schedules for both magazines, video and DVD. In addition to investment in library of photographs and videos,

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EUR 606 thousand was invested in capital expenditures. The increase over the comparable three-month 2001 period is principally due to increased investments in library of photographs and videos and capital expenditures related to the opening up of a new warehouse and shipping facilities.

### Financing Activities

Net cash provided by financing activities for the three months ended March 31, 2002 was EUR 288 thousand, represented primarily by conversion of warrants. The increase over the comparable three-month 2001 period is primarily due to conversion of warrants.

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 12 months. However, we may need to raise additional funds to support more rapid expansion or respond to unanticipated requirements. 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 transact our business in various foreign currencies and, accordingly, we are subject to exposure from adverse movements in foreign currency exchange rates. The principal currencies in which our revenues and expenses are incurred are Euro, U.S. dollar and Swedish Kronor. To date, the effect of changes in foreign currency exchange rates on revenues and operating expenses has not been material.

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We do not use financial instruments or derivatives to hedge our operations in foreign currencies or for speculative trading purposes.

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### PART II. OTHER INFORMATION

#### Item 4. Submission of Matters to a Vote by Securityholders

Our 2001 Annual Meeting of Shareholders was held on February 11, 2002. At the Annual Meeting each of the Company's nominees was elected to serve as a director until the next Annual Meeting of Shareholders. The election results are as follows:

Name	For	Against	Abstain
----	---	-----	-----
Berth H. Milton	23,085,199	76,621	23,629
Ferran Mirapeix	23,161,795	25	23,629
Bo Rodebrant	23,161,820	0	23,629
Robert L. Tremont	23,085,199	76,621	23,629

#### Item 6. Exhibits and Reports on Form 8-K

- a. Exhibits  
None
- b. Reports on Form 8-K:  
None.

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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 20, 2002

/s/ Johan Gillborg

-----  
Johan Gillborg  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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