PRIVATE MEDIA GROUP INC
Form 10-Q
May 10, 2007

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 March 31, 2007

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)

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

(Registered office)

Carretera de Rubí 22, 08173 Sant Cugat del Vallès, Barcelona, Spain

(European headquarters and address of principal executive offices)

34-93-590-7070

Registrant s telephone number

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 file, or a non-accelerated filer (as defined in Rule 12b-2 of the Act).

Large Accelerated Filer ____ Accelerated Filer __√__ Non-accelerated filer ___

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, 2007
Common Stock, par value $.001	53,148,166

PART I.

Item 1. Financial Statements

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED BALANCE SHEETS

	December 31, 2006 EUR	March 31, (Unaudited) 2007 EUR	2007 USD
	(in thousands)		
ASSETS			
Cash and cash equivalents	2,329	2,333	3,110
Trade accounts receivable	8,685	7,531	10,041
Related party receivable	6,423	6,578	8,771
Inventories - net (Note 2)	8,274	7,904	10,538
Deferred income tax asset	3,727	3,727	4,969
Prepaid expenses and other current assets	2,026	2,250	3,000
TOTAL CURRENT ASSETS	31,464	30,322	40,430
Library of photographs and videos net	16,909	17,369	23,159
Property, plant and equipment net	2,499	2,602	3,470
Other intangible assets	3,219	3,188	4,251
Goodwill	2,425	2,425	3,234
Other assets	350	352	469
TOTAL ASSETS	56,866	56,258	75,011
LIABILITIES AND SHAREHOLDERS EQUITY			
Short-term borrowings	3,402	3,329	4,439
Current portion of long-term borrowings	408	408	544
Accounts payable trade	4,748	5,072	6,763
Income taxes payable	733	570	760
Deferred income taxes	55	55	73
Accrued other liabilities	1,054	924	1,232
TOTAL CURRENT LIABILITIES	10,401	10,359	13,811
Long-term borrowings	132	26	35
TOTAL LIABILITIES	10,533	10,385	13,846
SHAREHOLDERS EQUITY			
$4.00 Series A Convertible Preferred Stock 10,000,000 shares authorized, none issued and outstanding at December 31, 2006 and March 31, 2007, respectively			
Common Stock, $.001 par value, 100,000,000 shares authorized, 53,148,166 and 53,148,166 issued and outstanding at December 31, 2006 and March 31, 2007, respectively	885	885	1,180
Additional paid-in capital	20,675	20,688	27,584
Retained earnings	27,667	27,110	36,146
Accumulated other comprehensive income	(2,894)	(2,810)	(3,746)
TOTAL SHAREHOLDERS EQUITY	46,333	45,873	61,164
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	56,866	56,258	75,010

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)		
	2006 EUR	2007 EUR	2007 USD
	(in thousands)		
Net sales	6,394	5,420	7,227
Cost of sales	3,582	3,172	4,229
Gross profit	2,811	2,248	2,998
Selling, general and administrative expenses	3,230	3,087	4,116
Operating income (loss)	(508)	(838)	(1,118)
Interest expense	157	88	117
Interest income	47	75	100
Income (loss) from continuing operations before income taxes	(618)	(851)	(1,135)
Income tax (benefit) from continuing operations	(182)	(294)	(392)
Income (loss) from continuing operations	(436)	(557)	(743)
Discontinued operations:			
Loss from discontinued operations	(102)		
Income tax (benefit)	(36)		
Loss on discontinued operations	(66)		
Net income (loss)	(502)	(557)	(743)
Other comprehensive income:			
Foreign currency translation adjustments	32	84	112
Comprehensive income	(471)	(474)	(632)
Income (loss) per share from continuing operations:			
Basic	(0.01)	(0.01)	(0.01)
Diluted	(0.01)	(0.01)	(0.01)
Loss per share from discontinued operations:			
Basic	0.00		
Diluted	0.00		
Net income (loss) per share:			
Basic	(0.01)	(0.01)	(0.01)

Diluted	(0.01)	(0.01)	(0.01)

See accompanying notes to consolidated statements.

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three-months ended March 31, (unaudited)		
	2006 EUR	**2007 EUR**	**2007 USD**
	(in thousands)		
Cash flows from operating activities:			
Net income (loss)	(502)	(557)	(743)
Adjustment to reconcile net income to net cash flows from operating activities:			
Depreciation	220	202	269
Stock based compensation	21	13	17
Bond adjustment	23		
Bad debt provision	8	36	48
Amortization of other intangible assets	31	31	41
Amortization of photographs and videos	1,517	1,717	2,289
Effects of changes in operating assets and liabilities:			
Trade accounts receivable	226	1,118	1,491
Related party receivable	(38)	(155)	(206)
Inventories	140	371	494
Prepaid expenses and other current assets	75	(224)	(299)
Accounts payable trade	(276)	324	432
Income taxes payable	(196)	(163)	(217)
Accrued other liabilities	(493)	(130)	(173)
Net cash provided by operating activities	756	2,582	3,442
Cash flows used in investing activities:			
Investment in library of photographs and videos	(1,618)	(2,177)	(2,902)
Capital expenditures	(360)	(305)	(407)
Cash received from sale of building	225		
Investments in (sale of) other assets	(16)	(1)	(2)
Note receivable	205		
Net cash (used in) investing activities	(1,565)	(2,483)	(3,311)
Cash flows from financing activities:			
Short-term borrowings repayments	(70)	(73)	(97)
Long-term borrowings repayments	(220)	(106)	(141)
Net cash (used in) provided by financing activities	(290)	(179)	(238)
Foreign currency translation adjustment	31	84	112
Net (decrease) increase in cash and cash equivalents	(1,068)	4	5
Cash and cash equivalents at beginning of the period	3,112	2,329	3,106
Cash and cash equivalents at end of the period	2,044	2,333	3,110
Cash paid for interest	122	66	88
Cash paid for taxes			
Conversion of bond principal into common stock	164		

See accompanying notes to consolidated statements.

PRIVATE MEDIA GROUP, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

	Common stock		Additional paid-in capital	Retained earnings	Accumulated other comprehensive income	Total shareholders equity
	Shares	Amounts				
		EUR	EUR	EUR	EUR	EUR
Balance at January 1, 2006	52,478,723	885	19,585	27,188	(2,769)	44,889
Repurchase of common stock	(42,935)		(152)			(152)
Conversion of bond principal into common stock	662,500		1,057			1,057
Conversion of bond interest into common stock	16,128		39			39
Conversion of options	33,750		79			79
Stock based compensation			67			67
Translation adjustment					(124)	(124)
Net income (loss)				479		479
Balance at December 31, 2006	53,148,166	885	20,675	27,667	(2,893)	46,334
Stock based compensation			13			13
Translation adjustment					84	84
Net income (loss)				(557)		(557)
Balance at March 31, 2007	53,148,166	885	20,688	27,110	(2,810)	45,873

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 three months period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007. 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, 2006.

Solely for the convenience of the reader, the accompanying consolidated financial statements as of March 31, 2007 and for the three months then ended have been translated into United States dollars (USD) at the rate of EUR 0.75 per USD 1.00 the interbank exchange rate on March 31, 2007. The translations should not be construed as a representation that the amounts shown could have been, our could be, converted into US dollars at that or any other rate.

2. Inventories

Inventories consist of the following:

	December 31, 2006 EUR	March 31, 2007 EUR
	(in thousands)	
Magazines for sale and resale	3,341	3,208
DVDs	4,362	4,294
Other	571	402
	8,274	7,904

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:

	Three-months ended March 31, 2006	Three-months ended March 31, 2007
Numerator: (EUR in thousands)		
Income (loss) from continuing operations	(436)	(557)
Loss on discontinued operations	(66)	
Net income (loss)	(502)	(557)
Denominator:		
Denominator for basic earnings per share weighted average shares outstanding	52,488,883	53,148,166
Effect of dilutive securities:		
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
Earnings (loss) per share from continuing operations (in EUR)		
Basic	(0.01)	(0.01)
Diluted	(0.01)	(0.01)
Earnings (loss) per share on discontinued operations (in EUR)		
Basic	0.00	
Diluted	0.00	
Earnings (loss) per share (in EUR)		
Basic	(0.01)	(0.01)
Diluted	(0.01)	(0.01)

For the three months ended March 31, 2006 and 2007 diluted impact of potentially dilutive securities is anti-dilutive therefore diluted and basic loss per share is EUR 0.01. The equivalent of 863,993 and 199,171 common shares derived from dilutive securities such as options, warrants and convertible notes are excluded from the diluted earnings per share as they are anti-dilutive.

4. Stock-based compensation

The Company has an Employee Stock Option Plan as described below. On adoption, 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 period ended March 31, 2007 was EUR 13 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.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

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 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, 2006 and 2007 no grants were made.

A summary of stock option activity for the three month period ended March 31, 2007 is a follows:

	Number of Shares	Weighted-Average Exercise Price in USD	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value[1] in Thousands of USD
Outstanding January 1, 2007	2,711,936	5.22		
Granted				
Exercised				
Forfeited	272,500	5.59		
Outstanding March 31, 2007	2,439,436	5.18	2.03	59
Exercisable March 31, 2007	2,338,436	5.20	2.00	75

1 The aggregate intrinsic value is calculated as the difference between the exercise price of the underlying awards and the quoted price of our common stock for the options that were in-the-money at March 31, 2007.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

During the three month periods ended March 31, 2006 and 2007, no options under our stock option plan were exercised.

As of March 31, 2007, there was USD 21 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 0.3 years. The total fair value of all shares vested and outstanding at March 31, 2006 and 2007, was USD 6.7 million and USD 6.3 million, respectively.

5. Income Taxes

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109 (FIN 48). FIN 48 provides guidance on the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 requires that companies recognize in their financial statements the impact of a tax position if that position more likely than not will be sustained on an audit, based on the technical merits of the position. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition provisions. The Company adopted FIN 48 on January 1, 2007. As a result of the implementation of FIN 48, no adjustment to retained earnings was made.

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 U.S. Federal and State income tax matters for years up to and including 2002 and 2001 respectively, and all foreign income tax matters for years up to 2001.

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 256 thousand were accrued as of March 31, 2007, of which EUR 12 thousand was recognized as interest expense during the quarter 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.

PRIVATE MEDIA GROUP, INC.

NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

(UNAUDITED)

6. Recent Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (FAS 157). FAS 157 provides enhanced guidance for using fair value to measure assets and liabilities. We are required to adopt FAS 157 effective at the beginning of 2008. We are currently evaluating the impact of adopting FAS 157 on our financial statements but it is not expected to have a material impact.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities (FAS 159). FAS 159 permits entities to choose to measure certain financial instruments and other eligible items at fair value when the items are not otherwise currently required to be measured at fair value. We are required to adopt FAS 159 effective at the beginning of 2008. We are currently evaluating the impact of adopting FAS 159 on our financial statements but it is not expected to have a material impact.

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 DVDs;
- sales of adult feature magazines;
- Internet subscriptions and licensing;
- broadcasting movies through 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, the Internet, wireless and broadcasting. We expect net sales from the Internet, wireless and broadcasting to grow during the coming years.

We released 110 titles on DVD during 2006, 113 titles on DVD during 2005 and 104 titles during 2004 , including both new and archival material. We plan to release approximately 110 proprietary titles on DVDs in 2007.

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 $2.00 per unit. Our DVDs are duplicated on an all region format, playable on both NTSC and PAL with multiple languages and sub-titles.

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, wireless and broadcasting. Internet, wireless and broadcasting sales has historically not carried any material direct 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

Revenues from the sale of magazines, DVD s and other related products where distributors are not granted rights-of-return are recognized upon transfer of title, which generally occurs upon delivery.

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 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 15.00) per copy and are printed on glossy high-quality paper at a cost of EUR 1.25 (USD 1.60). 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 19.50). 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 recently started 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 DVDs 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) persuasive evidence of a sale or licensing arrangement with a customer exists, (ii) the film is complete and has been delivered or is available for immediate and unconditional delivery (in accordance with the terms of the arrangement), (iii) the license period has begun and the customer can begin its exploitation, exhibition, or sale, (iv) the fee is fixed or determinable and (v) collection of the fee is reasonably assured. Revenues from satellite & cable broadcasting are recognized based on sales reported each month by its cable and satellite affiliates. The affiliates do not report actual monthly sales for each of their systems until approximately 90 120 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.

Revenues from wireless are recognized based on sales reported each month by aggregators. The aggregators do not report actual monthly sales for each of their systems until approximately 90 120 days after the month of service ends. This practice requires management to make monthly revenue estimates based on historical experience for each aggregator. Revenue is subsequently adjusted to reflect the actual amount earned upon receipt.

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).

During 2002, the Company performed an initial impairment test of goodwill and indefinite lived intangible assets as of January 1, 2002. This generally required us 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 was no effect of on the earnings and financial position of the Company as a result of the impairment testing.

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 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, 2007 compared to the three months ended March 31, 2006

Net sales. For the three months ended March 31, 2007, we had net sales of EUR 5.4 million compared to net sales of EUR 6.4 million for the three months ended March 31, 2006, a decrease of EUR 1.0 million or 15%.

DVD & Magazine sales decreased EUR 1.4 million, or 34%, to EUR 2.7 million. The decrease in DVD & Magazine sales was primarily attributable to the reorganization of our DVD & Magazine distribution, see discussion under *Outlook* below. Internet sales was EUR 1.1 million, which represents an increase of EUR 0.1 million compared to the same period last year. Broadcasting sales increased EUR 0.2 million to EUR 1.0 million as a result of an increase in video on demand sales offset by a decrease in channel sales in the US. Wireless sales increased EUR 0.2 million to EUR 0.6 million as a result our content being available with more operators.

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

Cost of Sales. Our cost of sales was EUR 3.2 million for the three months ended March 31, 2007 compared to EUR 3.6 million for the three months ended March 31, 2006, a decrease of EUR 0.4 million, or 11%.

Included in cost of sales is printing, processing and duplication, amortization of library and broadcasting costs. Printing, processing and duplication cost was EUR 1.4 million for the three months ended March 31, 2007 compared to EUR 2.0 million for the three months ended March 31, 2006, a decrease of EUR 0.6 million, or 31%. Printing, processing and duplication cost as a percentage of DVD & Magazine sales was 50% for the three months ended March 31, 2007, which represents an increase of 3%. The increase was the result of a decrease in average price on products sold. Amortization of library was EUR 1.7 million for the three months ended March 31, 2007 compared to EUR 1.5 million for the three months ended March 31, 2006, which represents an increase of EUR 0.2 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. Broadcasting cost was EUR 0.1 million for the three months ended March 31, 2007 compared to EUR 0.1 million for the three months ended March 31, 2006. Broadcasting cost represents programming cost.

Gross Profit. In the three months ended March 31, 2007, we realized a gross profit of EUR 2.2 million, or 41% of net sales compared to EUR 2.8 million, or 44% of net sales for the three months ended March 31, 2006. The decrease in gross profit as a percentage of sales was the result of amortization of library, which does not vary with sales, and decreased margins on DVD & Magazine sales.

Selling, general and administrative expenses. Our selling, general and administrative expenses were EUR 3.1 million for the three months ended March 31, 2007 compared to EUR 3.3 million for the three months ended March 31, 2006, a decrease of EUR 0.2 million, or 2%.

Operating loss. We reported an operating loss of EUR 0.8 million for the three months ended March 31, 2007 compared to an operating loss of EUR 0.5 million for the three months ended March 31, 2006. The decrease in operating profit of EUR 0.3 million was primarily the result of the decrease in gross profit offset by reduced selling, general and administrative expenses.

Interest expense. We reported interest expense of EUR 0.1 million for the three months ended March 31, 2007, compared to EUR 0.2 million for the three months ended March 31, 2006. The decrease in interest expense was primarily the result of less borrowings outstanding during the period.

Income tax benefit from continuing operations. We reported income tax benefit of EUR 0.3 million for the three months ended March 31, 2007, compared to EUR 0.2 million for the three months ended March 31, 2006. The increase in income tax benefit is a result of higher losses being recorded in jurisdictions with higher corporate tax rates.

Loss from continuing operations. We reported a loss from continuing operations of EUR 0.6 million for the three months ended March 31, 2007, compared to EUR 0.4 million for the three months ended March 31, 2006. We attribute the increase in loss from continuing operations in 2007 to an increase in operating loss offset by reduced interest expense and increased tax benefit.

Loss from discontinued operations. Our loss from discontinued operations for the three months ended March 31, 2006 was EUR 0.1 million.

Net loss. We reported a loss of EUR 0.6 million for the three months ended March 31, 2007, compared to EUR 0.5 million for the three months ended March 31, 2006. We attribute the increase in loss in the period to increased loss from continuing operations offset by the absence of loss from discontinued operations we reported in the three month period ended March 31, 2006.

Liquidity and Capital Resources

We reported a working capital surplus of EUR 20.0 million at March 31, 2007, a decrease of EUR 1.1 million compared to the year ended December 31, 2006. The decrease is principally attributable to a decrease in current assets.

Operating Activities

Net cash provided by operating activities was EUR 2.6 million for the three months ended March 31, 2007, 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 0.6 million was adjusted to reconcile net income to net cash flows from operating activities with depreciation of EUR 0.2 million and amortization of photographs and videos of EUR 1.7 million making a total of EUR 2.0 million, providing a net balance of EUR 1.4 million. The total of EUR 1.4 million was added to by changes in trade accounts receivable, inventories and accounts payable trade totaling EUR 1.8 million offset by EUR 0.7 million from related party receivable, prepaid expenses and other current assets, income taxes payable and accrued other liabilities. Net cash provided by operating activities was EUR 0.8 million for the three months ended March 31, 2006. The increase in net cash provided by operating activities of EUR 1.8 million for the three months ended March 31, 2007 compared to the same period last year was primarily the result effects of changes in operating assets and liabilities.

Investing Activities

Net cash used in investing activities for the three months ended March 31, 2007 was EUR 2.5 million. The investing activities were principally investment in library of photographs and videos of EUR 2.2 million, which was carried out in order to maintain the 2007 release schedules for both magazines and DVDs and capital expenditure of EUR 0.3 million. Net cash used in investing activities increased EUR 0.9 million over the same period last year. The increase is principally due increased investment in library of photographs and videos offset by the absence of cash received from sale of building and note receivable.

Financing Activities

Net cash used in financing activities for the three-month period ended March 31, 2007 was EUR 0.2 million, represented by repayments on short- and long-term borrowings. Compared to the three-month 2006 period there was no material change.

Non-Cash Transaction

In March 2006, a holder of a convertible note converted $0.2 million of principal into common stock.

Contractual obligations

During the three-month period ended March 31, 2007, 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, 2006.

Outlook

We expect significant growth going forward, particularly on our new media platforms, Internet, broadcasting and wireless, which during 2006 became responsible for close to fifty percent of our revenues. Below follows a discussion highlighting some of the important factors which we expect to contribute to growth in all areas:

Broadcasting

During the past twelve months we have seen evidence of a new source of significant future profits in the IPTV based True Video on Demand (TVOD[2]) market in Europe. Revenues from our initial distributors on this type of platform have increased steadily in line with subscriber growth.

In response to the development and rollout of IPTV and cable based TVOD, the Company is aggressively targeting all major TVOD platforms and we are currently in the process of contracting with several platforms. As of December 2006, we had contracted with 9 platforms and during the first six months of 2007 we expect to add a total of nine new TVOD platforms, including three in Germany, two in France and one each in the Netherlands, Belgium and Spain.

Since January 1, 2007, we have reached multi-year agreements with five platform operators, including the leading telecoms in the Netherlands, Germany, Belgium and France which all offer Triple-Play featuring IPTV based TVOD. As of December 31, 2006, the French platform ranked as the world s second largest platform of this kind. Our content is progressively becoming available to subscribers to these platforms.

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2 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.

By the end of 2007, the Company expects to reach a subscription base of at least 16 million TVOD enabled subscribers on a minimum of 28 new platforms represented by: Western Europe (17), North America (7), the Far East (3) and Australia (1). We have reason to believe that our revenue from TVOD platforms will grow in line with the addition of platforms and their subscriber growth and consequently we expect a significant contribution to operating profit going forward.

In order to increase growth and profitability in 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, The Portland Television Group and Playboy TV International. During the first quarter of 2007, all three partners have expanded their reach for the Private branded TV channels significantly and we expect revenues and operating profit to grow going forward.

Wireless Adult Mobile Content

As of April 2007, Private content was available to approximately 657 million handsets in 33 countries via 72 operators, of which 7 operators went live during the first quarter of 2007. The Company is scheduled to go live with 11 additional operators in the second quarter of 2007 and is expecting to grow steadily with at least 10 additional operators each remaining quarter of 2007. Asia and the Americas are currently underexploited and therefore represent a significant growth potential to the Company. More distribution channels, advanced technology development, and the implementation of age verification systems offers us further significant growth potential in 2007 and beyond[3].

Internet

Traffic to our sites has been growing steadily during 2006 and the number of unique visits has grown by 24% to 10.8 million compared to 2005. Driving the growth in traffic is the development of our affiliate program Private Cash. In February 2007, we launched the new private.com website. The key objective of the design of the new website is to increase conversion rates by more effectively marketing our products to site visitors.

DVDs & Magazines

During the first quarter of 2007 we started a reorganization of our distribution of DVDs and Magazines in order to modify our business model which now is changing towards new media. The reorganization has initially reduced DVD & magazine sales, however, going forward we expect sales to improve, and in particular to increase operating profit in this area.

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.

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3 Juniper Research estimates in its white paper *Adult to Mobile: Personal Services Third Edition (September 2006)* that the global mobile adult content market will more than double over the next five years, to nearly US$3.3 billion by 2011.

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, 2007.

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, 2007, 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, 2007:

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares That May Yet Be Purchased Under the Plans or Programs (1)
January, 2007				
February, 2007				
March, 2007				
Total (1)				

(1) We have an arrangement with a non-affiliated shareholder whereby we sell our products in exchange for shares of common stock valued at market price at the time of repurchase. We may repurchase up to an additional 2,999 shares of common stock under this arrangement.

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.

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)

/s/ Johan Gillborg
Johan Gillborg, Chief Financial Officer

Date: May 10, 2007