CMG HOLDINGS GROUP, INC.
Form 10-Q
August 23, 2011

QUARTELY REPORT JUNE 30, 2011
UNITED STATES
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 quarter ended June 30, 2011

Commission file number 000-51770

CMG HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Nevada<br>(State or other jurisdiction of incorporation or organization) | 87-0733770<br>(I.R.S. Employer Identification No.) |
| 5601 Biscayne Boulevard<br>Miami, Florida, USA<br>(Address of principal executive offices) | 33137<br>(Zip Code) |

Registrant's telephone number including area code (305) 751-1667

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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 preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or small reporting company. See the definition of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12b-2 of the Exchange Act.

| | | | |
|---|---|---|---|
| Large accelerated filer | Accelerated filer | Non-accelerated filer | Smaller reporting company x |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No x
As of August 22, 2011, there were 66,163,847 common stock of the registrant issued and outstanding.

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CMG HOLDINGS, INC.
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PART I

ITEM 1: CONSOLIDATED FINANCIAL STATEMENTS

CMG HOLDINGS, INC.
UNAUDITED FINANCIAL STATEMENTS

FOR THE QUARTER ENDED JUNE 30, 2011 AND 2010

CONTENTS

CMG HOLDINGS, INC
CONSOLIDATED BALANCE SHEETS
(unaudited)

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| ASSETS | | |
| | | |
| CURRENT ASSETS: | | |
| Cash | $ 420,917 | $ 13,695 |
| Investments | 53,602 | 49,006 |
| Accounts receivable | 654,755 | 204,147 |
| Inventory | 3,240,502 | -- |
| Prepaid and other current assets | 58,881 | 71,497 |
| Total current assets | 4,428,657 | 338,345 |
| Property and equipment, net of accumulated depreciation of $95,723 and $56,357 | 112,595 | 151,520 |
| | | |
| Intangible assets, net accumulated amortization of $671,248 and $522,082, respectively | 245,590 | 394,756 |
| TOTAL ASSETS | $ 4,786,842 | $ 884,621 |
| | | |
| LIABILITIES AND STOCKHOLDERS' DEFICIT | | |
| | | |
| CURRENT LIABILITIES: | | |
| Client payable | $ 11,317 | $ 11,317 |
| Accounts payable | 1,443,217 | 1,713,300 |
| Accrued liabilities | 1.328,784 | 829,052 |
| Deferred income | 41,365 | 78,721 |
| Derivative liabilities | 770,475 | -- |
| Short term debt, net of unamortized discount of $119,121 and $67,063, respectively | 1,115,879 | 1,007,937 |
| Line of credit | 102,658 | 183,478 |
| Advances from related parties – net of unamortized discount of $676,668 and $0, respectively | 1,251,721 | 127,438 |
| TOTAL CURRENT LIABILITIES | 6,065,416 | 3,951,243 |
| | | |
| Advance from related parties – net of unamortized discount of $841,824 and $0, respectively | -- | 204,878 |
| | | |
| TOTAL LIABILITIES | 6,065,416 | 4,156,121 |
| | | |
| STOCKHOLDERS’ DEFICIT | | |
| Preferred stock: | | |
| Series A Convertible Preferred Stock; 5,000,000 shares authorized; par value $0.001 per share; none issued and outstanding | -- | -- |
| Series B Convertible Preferred Stock; 5,000,000 shares authorized; par value $0.001 per share; 50,000 and 0 shares issued and outstanding | 50 | -- |

| | | | | |
|---|---|---|---|---|
| Common stock: | | | | |
| 150,000,000 shares authorized, par value $0.001 per share; 66,163,847 and 58,165,988 shares issued, 66,126,673 and 58,128,814 outstanding | | 66,164 | | 58,166 |
| Additional paid in capital | | 8,220,161 | | 7,272,662 |
| Treasury stock, 37,174 and 37,174 shares held, respectively. | | 37 | | 37 |
| Accumulated deficit | | (9,564,986) | | (10,602,365) |
| | | | | |
| TOTAL STOCKHOLDERS' DEFICIT | | (1,278,574) | | (3,271,500) |
| | | | | |
| TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT | $ | 4,786,842 | $ | 884,621 |

See accompanying notes to unaudited consolidated financial statements

CMG HOLDINGS, INC.
CONSOLIDATED STATEMNTS OF OPERATIONS
(unaudited)

| | Three months ended June 30, 2011 | 2010 | Six months ended June 30, 2011 | 2010 |
|---|---|---|---|---|
| Revenues | $ 4,724,646 | $ 1,567,654 | $ 5,512,129 | $ 2,854,253 |
| Cost of revenues | 3,307,117 | 729,295 | 3,639,448 | 1,438,301 |
| Gross profit | 1,417,529 | 838,359 | 1,872,681 | 1,415,952 |
| | | | | |
| Operating expenses | 1,256,080 | 1,223,270 | 2,472,365 | 2,122,781 |
| | | | | |
| Operating income (loss) | 161,449 | (384,911) | (599,684) | (706,829) |
| | | | | |
| Other income (expense) | | | | |
| Gain on derivative liability | 1,495,723 | - | 2,402,933 | - |
| Loss on settlement of debt | (140,596) | - | (288,618) | - |
| Unrealized loss on marketable securities | (33,900) | (10,000) | (10,904) | (10,000) |
| Bargain purchase gain | -- | -- | -- | 405,759 |
| Interest expense | (246,917) | (64,800) | (466,348) | (80,200) |
| Interest income | -- | 49 | -- | 49 |
| Net income (loss) | $ 1,235,759 | $ (459,662) | $ 1,037,379 | $ (391,221) |
| | | | | |
| Basic and diluted income (loss) per common share | $ 0.02 | $ (0.01) | $ 0.02 | $ (0.01) |
| | | | | |
| Basic weighted average common shares outstanding | 64,223,763 | 40,509,406 | 62,077,496 | 39,490,565 |
| Diluted weighted average common shares outstanding | 64,223,763 | 40,509,406 | 62,195,289 | 39,490,565 |

See accompanying notes to unaudited consolidated financial statements

CMG HOLDINGS, INC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Six Months Ended June 30, 2011 | 2010 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income (loss) | $ 1,037,379 | $ (391,221) |
| Adjustments to reconcile net income (loss) | | |
| to net cash used in operating activities: | | |
| Bargain purchase gain | -- | (405,759) |
| Amortization of deferred financing costs | 68,292 | 21,631 |
| Shares issued for services | 41,437 | 34,812 |
| Amortization of intangible assets | 149,166 | 149,166 |
| Depreciation expense | 39,366 | 11,039 |
| Loss on settlement of debt | 288,618 | -- |
| Realized loss on trading securities | 10,904 | 10,000 |
| Gain on derivative liability | (2,402,933) | -- |
| Amortization of debt discount | 323,098 | 30,844 |
| Changes in: | | |
| Accounts receivable | (466,108) | (507,613) |
| Prepaid expense and other current assets | (55,676) | 2,954 |
| Deferred income | (37,356) | (19,600) |
| Accrued liabilities | 499,732 | 373,577 |
| Accounts payable | (93,68)) | 63,384 |
| | | |
| Net cash used in operating activities | (597,766) | (626,786) |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Acquisition of Audio Eye, Inc. net of cash received | - | (26,783) |
| Purchase of fixed assets | (441) | (11,287) |
| Net cash used in investing activities | (441) | (38,070) |
| | | |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Payments on related parties debt | (50,000) | -- |
| Payments of debt | -- | (125,000) |
| Payments of Financing fees | -- | (107,500) |
| Advances from related parties | 804,249 | 84,938 |
| Proceeds from issuance of debt | 75,000 | 1,075,000 |
| Stock issued for cash | 157,000 | -- |
| Net borrowings on line of credit | 19,180 | (9,645) |
| Cash provided by fiancing activities | 1,005,429 | 917,793 |
| | | |
| Net increase in cash | 407,222 | 252,937 |
| Cash: beginning of period | 13,695 | 32,968 |
| Cash: end of period | 420,917 | 285,905 |
| Supplemental cash flow information | | |
| Interest paid | 61,108 | 32,615 |
| Income taxes paid | -- | -- |

| | | |
|---|---|---|
| Non cash investing activity | -- | -- |
| Acquisition of AcuidoEye, Inc. | -- | 502,542 |
| Warrants issued recorded as debt discount | -- | 142,931 |
| Warrants issued recorded as deferred financing costs | -- | 43,127 |
| Preferred stock issued for inventory | 3,240,502 | -- |
| Discount on notes payable from derivative liabitlity | 160,000 | -- |
| Common stock issued for settlement of notes payables | 191,398 | -- |
| Reclassification of derivative liabitlies from additional paid in capital | 10,857,628 | -- |
| Reclassifcation of derivative liabilties to additional paid in capital | 7,894,220 | -- |
| Reclassification of long term related parties debt to short term | 204,878 | -- |

See accompanying notes to unaudited consolidated financial statements

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1 –BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements of CMG Holdings, Inc. (“we”, “our” or the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission, and should be read in conjunction with the audited financial statements and notes contained in its 2010 annual report on Form 10-K. In the opinion of management, these interim financial statements include all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Our future results of operations may change materially from the historical results of operations reflected in our historical financial statements. The unaudited consolidated financial statements should be read in conjunction with the historical audited consolidated financial statements and footnotes of the Company and management’s discussion and analysis of financial condition and results of operations included in the Company’s Annual Report for the year ended December 31, 2010 as filed with the Securities and Exchange Commission on Form 10-K. Notes to the financial statements that would substantially duplicate the disclosure contained in the audited financial statements for fiscal year 2010, as reported in the Form 10-K, have been omitted.

Principles of Consolidation

The consolidated financial statements include the accounts of CMG Holdings, Inc., CMG Acquisition, Inc., CMGO Capital, Inc., The Experiential Agency, Inc, Audio Eye, Inc., CMGO Logistics, Inc., Empire Technologies, LLC and Creative Management Group, Inc. after elimination of all significant inter-company accounts and transactions.

Earnings per share

Basic earnings per share (“EPS”) is calculated by dividing net income available to common stockholders by the weighted average number of shares of the Company’s common stock outstanding during the period. Diluted EPS reflect the potential dilution that could occur if the Company’s share-based awards were exercised into common stock. The dilutive effect of our share-based awards is computed using the treasury stock method, which assumes all share-based awards are exercised and the hypothetical proceeds from exercise are used to purchase common stock at the average market price during the period. The incremental shares (difference between shares assumed to be issued versus purchased), to the extent they would have been dilutive, are included in the denominator of the diluted EPS calculation. The following represents a reconciliation of the numerators and denominators of the basic and diluted EPS computations:

| | Three Months Ended June 30, 2011 | | | Three Months Ended June 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Net Income (Loss) Numerator | Shares Denominator | Per Shares Amount | Net Income (Loss) Numerator | Shares Denominator | Per Shares Amount |
| Basic EPS | 1,235,759 | 64,223,763 | 0.02 | (459,662) | 40,509,406 | (0.01) |
| Effect of dilutive securities | - | - | | - | - | |
| Warrants | - | - | | - | - | |
| Diluted EPS | 1,235,759 | 64,223,763 | 0.02 | (459,662) | 40,509,406 | (0.01) |

| | Six Months Ended June 30, 2011 | | | Six Months Ended June 30, 2010 | | |
|---|---|---|---|---|---|---|
| | Net Income (Loss) Numerator | Shares Denominator | Per Shares Amount | Net Income (Loss) Numerator | Shares Denominator | Per Shares Amount |
| Basic EPS | 1,037,379 | 62,077,496 | 0.02 | (391,221) | 39,490,565 | (0.01) |
| Effect of dilutive securities | - | - | | - | - | |
| Warrants | - | 117,793 | | - | - | |
| Diluted EPS | 1,037,379 | 62,195,289 | 0.02 | (391,221) | 39,490,565 | (0.01) |

CMG HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Fair Value Measurements

As defined in ASC 820 “Fair Value Measurements”, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observability of those inputs. ASC 820 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement).

The three levels of the fair value hierarchy defined by ASC 820 are as follows:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, marketable securities and listed equities.

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category generally include non-exchange-traded derivatives such as commodity swaps, interest rate swaps, options and collars.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value.

The following table sets forth by level within the fair value hierarchy the Company’s financial assets and liabilities that were accounted for at fair value as of March 31, 2011. As required by ASC 820, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

| | June 30, 2011 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| Derivative Liabilities | - | - | 770,475 | 770,475 |

Reclassification

Certain prior year amounts have been reclassified to conform to the current year presentation.

Recent Accounting Pronouncements

The Company has evaluated all the recent accounting pronouncements through the filing date and believes that none of them will have a material effect on the Company.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 2: EQUITY

Preferred Stock

Series B Preferred Stock and Inventory Purchase

On March 31, 2011 the Company acquired 20,000 cartoon animated cels (the “Cel Art”) from Continental Investments Group, Inc. (the “Agreement”). The Company issued 50,000 shares of its Series B Convertible Preferred Stock to Continental Investments Group, Inc. as consideration for the Cel Art, such shares of Series B Convertible Preferred Stock having a stated value per share of $100. The Cel Art consists of collectible, hand-painted cartoon animation cels. The shares of Series B Preferred Stock are convertible into common shares of the Company at the stated value of $100 per share divided by the volume weighted average trading price for the 30 days prior to conversion. The preferred shares are non-voting and do not receive dividends. The Company determined the fair value of the preferred stock to be $3,240,502 on the acquisition date based on the number of shares of common stock the preferred shares could be converted into and the market price of the common stock on the agreement date. This amount was recorded as inventory in the consolidated balance sheet as of June 30, 2011.

The cartoon animated cels are valued at the lower of cost or market. Management will writes down the inventories to market value if it is below cost. The Company also analyzed the embedded conversion option for derivative accounting consideration under ASC 815-15 “Derivatives and Hedging” and determined that the conversion option should be classified as equity.

Series A Preferred Stock Issuance and Rescission

On March 31, 2011 the Company approved the issuance of 51 shares of preferred stock designated as Series A Convertible Preferred Stock (the “Series A Preferred Stock”) to three officers of the Company in consideration for the officers forgiving $300,000 of accrued salaries. Each share of Series A Preferred Stock is convertible into 1% of the Company’s common stock. The number of votes for the Series A Preferred Stock shall be the same number as the amount of shares of Common Stock that would be issued upon conversion. The Series A Preferred Stock is not entitled to dividends or preference upon liquidation.

On May 16, 2011 the Company rescinded the above agreement with an effective date of March 31, 2011. There are no shares of Series A Preferred Stock issued or outstanding as June 30, 2011. There was no impact to the consolidated financial statements as a result of the above issuance and rescission.

Common Stock:

Garlette LLC

On January 6, 2011 the Company assigned $50,000 of debt owed to Morgan Stanley Smith Barney to Garlette, LLC. On the same date, the Company amended the assigned debt to add a conversion feature. The new note was convertible at 25% of the average of the five lowest closing prices for the Company's stock during the previous 30 trading days. The Company analyzed the conversion option for derivative accounting consideration under ASC 815-15 “Derivatives and Hedging” and determined that the embedded conversion feature should be classified as a liability due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The embedded conversion feature was measured at fair value at inception and on the date of conversion (see below) with the change in fair value recorded to earnings. The addition of the embedded conversion option resulted in a full discount to the note of $50,000 on January 6, 2011. See Note 4 for additional information on the derivative liability.

$25,000 of the note was converted on January 7, 2011 into 357,143 shares of common stock. The remaining $25,000 was converted on January 18, 2011 into 357,143 shares of common stock. As a result of the conversion, the entire discount of $50,000 was amortized to interest expense during the six months ended June 30, 2011.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

American Settlement LLC

On February 17, 2011 the Company assigned $25,000 of debt owed to Morgan Stanley Smith Barney to American Settlements, LLC. On the same date, the Company issued 548,246 shares of common stock with a fair value of $98,684 to settle the note. The difference between the fair value of the common stock and the debt was recorded as a loss on settlement of debt during the three months ended March 31, 2011. On March 21, 2011 the company assigned 25,000 of debt owed to Morgan Stanley Smith Barney to American Settlements, LLC. On the same date, the Company issued 735,835 shares of common stock with a fair value of $99,338 to settle the note. The difference between the fair value of the common stock and the debt was recorded as a loss on settlement of debt during the six months ended June 30, 2011.

Aware Capital Consultants, Inc.

On April 18, 2011, the Company assigned $41,398 of its accounts payable from a third party to Aware Capital Consultants, Inc. On May 6, 2011 the Company modified $20,000 of the payables into a convertible debenture. On the same date, the Company issued 655,737 shares of common stock with a fair value of $49,180 to settle the note. On May 24, 2011 the Company modified the remaining payables of $21,398 into a convertible debenture. On the same date, the Company issued 1,426,553 shares of common stock with a fair value of $85,592 to settle the note. The difference between the fair value of the common stock and the debt was recorded as a loss on settlement of debt during the six months ended June 30, 2011.

Connied, Inc.

On April 11, 2011 the Company assigned $135,000 of its account payable from a third party to Connied, Inc. On May 3, 2011, the Company amended the assigned account payable to add a conversion feature. The new note was convertible at 50% of the average of the five lowest closing prices for the Company's stock during the previous 30 trading days. On the same date, the Company issued 1,388,889 shares of common stock with a fair value of $97,222 to settle $50,000 of the note. The difference between the fair value of the common stock and the debt was recorded as a loss on settlement of debt during the six months ended June 30, 2011. The remaining balance of $85,000 was recorded as short term debt in the consolidated balance sheet as of June 30, 2011. The note bears interest at 20% and is due on May 2, 2013.

The Company analyzed the conversion option for derivative accounting consideration under ASC 815-15 "Derivatives and Hedging" and determined that the embedded conversion feature should be classified as a liability due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The embedded conversion feature was measured at fair value at inception and on the date of conversion (see below) with the change in fair value recorded to earnings. The addition of the embedded conversion option resulted in a full discount to the note of $85,000 on May 3, 2011. The discount will be amortized over the term of the note to interest expense. As of June 30, 2011, $11,712 of the discount had been amortized to interest expense. See Note 4 for additional information on the derivative liability.

Shares Issued for Services

During the six months ended June 30, 2011, a total of 658,333 shares were issued to six individuals for services provided by third parties over a period of one year and were valued at $41,137.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Shares and Warrants Issued for Cash

During the six months ended June 30, 2011, eight individuals purchased 1,870,000 shares of common stock, 374,000 A Warrants and 374,000 B Warrants for $157,000. The A Warrants are exercisable at a strike price of $0.25 for three years, and the B Warrants are exercisable at a strike price of $0.50 for three years. The Company can call each of the Warrants after twelve months if the price of the Common Shares of the Company in the Market is 150% of the Warrant strike price for 10 consecutive days.

A summary of warrant activity for the six months ended June 30, 2011 is as follows:

| | Outstanding and Exercisable | | Weighted average Exercise Price |
|---|---|---|---|
| December 31, 2010 | 250,000 | $ | 0.07 |
| Granted | 748,000 | | 0.38 |
| Exercised | - | | - |
| Forfeited | - | | - |
| June 30,2011 | 998,000 | $ | 0.30 |

The warrants have a weighted average remaining life of 3.0 years with $0 intrinsic value.

NOTE 3: Notes Payable

Asher Enterprises, Inc.

On March 15, 2011 the company issued a convertible promissory note for $75,000 to Asher Enterprises, Inc. The note bears interest at 8% and is due on December 17, 2011. The convertible promissory note calls 4,510,826 shares to be reserved for issuance upon conversion of the note and any amount not paid by December 17, 2011 will incur a 22% interest rate. The note is convertible at 58% of the average of the lowest three trading prices for the Company's common stock during the ten trading day period prior to the conversion date.

The Company analyzed the conversion option for derivative accounting consideration under ASC 815-15 "Derivatives and Hedging" and determined that the instrument should be classified as liabilities due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The instrument is measured at fair value at the end of each reporting period or termination of the instrument with the change in fair value recorded to earnings. The fair value of the embedded conversion option resulted in a full discount to the note on March 15, 2011 of $75,000. The discount will be amortized over the term of the note to interest expense. As of June 30, 2011, $29,167 of the discount had been amortized to interest expense. See Note 4 for additional information on the derivative liability.

CMGO Investors, LC

During year ended December 31, 2010, the Company borrowed $1,075,000 under five 13% convertible notes from third parties that will mature on July 1, 2011. The notes are convertible into common shares at any time after the maturity date at $0.10 per share. The Company has exercised the option to extend the maturity date of the notes for three months by paying an extension fee of 5% of the principal amount. During the six months ended June 30, 2011, the Company amortized $67,063 of the original discount recorded on these notes and $68,292 of the original deferred financing costs to interest expense.

The note agreements have various covenants. The agreements require the purchaser provide the Company with notice and a cure period of 10 days prior to an event qualifying as an event of default under the agreement. The agreements require a) the Company within 90 days after the close of each fiscal year of the Company, deliver to the note holders the balance sheet of the Company as of the end of such fiscal year and the related statements of income and retained earnings and statement of cash flows for such fiscal year certified by an independent registered accounting firm of recognized national standing, accompanied by an opinion of such accounting firm (which opinion shall be without any qualification or exception as to scope of audit) stating that in the course of its regular audit of the financial statements of the Company, which audit was conducted in accordance with GAAP, such accounting firm obtained no knowledge of any Default or an Event of Default relating to financial or accounting matters which has occurred and is continuing or, if in the opinion of such accounting firm such a Default or an Event of Default has occurred and is continuing, a statement as to the nature thereof, and management's discussion and analysis of the important operational and financial developments during such fiscal year. The timely public filing of the items described on EDGAR shall satisfy the delivery requirement under this provision but only with respect to the financial statements but not the opinion of the independent registered public accounting firm; and b) the Company deliver written Notice to the Purchaser within three Business Days after any Officer of the Company has knowledge of the occurrence of any event that, with the giving of notice or the lapse of time or both, would become an Event of Default under the agreement. As of August 22, 2011, the Company has not delivered to the purchaser the aforementioned information under a) or notice under b). As of August 22, 2011, the Company has not received notice of default from the purchaser.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 4: Derivative Liabilities

Garlette LLC

As discussed in Note 2, the Company determined that the instruments embedded in the convertible note should be classified as liabilities and recorded at fair value due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The fair value of the instruments was determined to be $246,314 using the Black-Scholes option pricing model. Because the number of shares to be issued upon settlement cannot be determined under this instrument, the Company cannot determine whether it will have sufficient authorized shares at a given date to settle any other of its share-settleable instruments. As a result of this, under ASC 815-15 “Derivatives and Hedging”, all other share-settleable instruments must be reclassified from equity to liabilities. The company had conversion options embedded in related parties notes payable agreements and accrued expenses and 398,000 warrants to purchase the Company’s common stock that were classified in equity as of the date that the Company entered in to the convertible note. The fair value of these instruments on January 7, 2011 was $7,969,599 of which $7,723,285 was reclassified to liabilities, $50,000 recorded as debt discount and $196,314 was recognized as loss on derivatives.

As a result of the note conversion in January 2011, under ASC 815-15 “Derivatives and Hedging”, the instrument is measured at fair value at the date of termination with the change in fair value recorded to earnings. The fair value of these instruments on January 18, 2011 was $7,923,055 and this value was reclassified out of liabilities to equity and $46,544 was recognized as a gain on derivatives during the six months ended June 30, 2011.

Asher Enterprises, Inc.

As discussed in Note 3, the Company determined that the instruments embedded in the convertible note should be classified as liabilities and recorded at fair value due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The fair value of the instruments was determined to be $85,106 using the Black-Scholes option pricing model. Because the number of shares to be issued upon settlement cannot be determined under this instrument, the Company cannot determine whether it will have sufficient authorized shares at a given date to settle any other of its share-settleable instruments. As a result of this, under ASC 815-15 “Derivatives and Hedging”, all other share-settleable instruments must be reclassified from equity to liabilities. The company had conversion options embedded in related parties notes payable agreements and accrued expenses and 948,000 warrants to purchase the Company common stock that were classified in equity as of the date that the Company entered in to the convertible note. The fair value of these instruments on March 15, 2011 was $3,245,833 of which $3,160,727 was reclassified to liabilities, $75,000 recorded as debt discount and $10,106 was recognized as loss on derivatives.

Under ASC 815-15 “Derivatives and Hedging” the liabilities were subsequently measured at fair value at the end of each reporting period with the change in fair value recorded to earnings. The fair value of these instruments on June 30, 2011 was $599,224 and $2,646,609 was recognized as gain on derivative.

Under ASC 815-15 “Derivatives and Hedging”, due to the convertible note – Asher Enterprises, Inc. remain outstanding as of June 30, 2011, all other share-settleable instruments that are issued subsequently should be classified as a liability due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The Company performed an analysis and determined all the following instruments should be classified as liabilities:

(1) Warrants

On May 20, 2011, 25,000 A Warrants and 25,000 B Warrants were issued to an individual in addition to shares purchase for cash as described in Note 2. The A Warrants are exercisable at a strike price of $0.25 for three years, and the B Warrants are exercisable at a strike price of $0.50 for three years. The fair value of the instruments was determined to be $2,451 using the Black-Scholes option pricing model.

Under ASC 815-15 “Derivatives and Hedging” the liabilities were subsequently measured at fair value at the end of each reporting period with the change in fair value recorded to earnings. The change in fair value of these instruments on June 30, 2011 was $1,364 and $1,087 was recognized as gain on derivative.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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(2) Connied, Inc.

As discussed in Note 2, the Company determined that the instruments embedded in the convertible note should be classified as liabilities and recorded at fair value due to their being no explicit limit to the number of shares to be delivered upon settlement of the above conversion options. The fair value of the instruments was determined to be $162,467 using the Black-Scholes option pricing model of which $85,000 recorded as debt discount and $77,467 was recognized as loss on derivatives.

Under ASC 815-15 "Derivatives and Hedging" the liabilities were subsequently measured at fair value at the end of each reporting period with the change in fair value recorded to earnings. The fair value of these instruments on June 30, 2011 was $169,887 and $7,420 was recognized as loss on derivative.

The following table summarizes the derivative liabilities included in the consolidated balance sheet:

| Derivative Liabilities | |
|---|---|
| Balance at December 31, 2010 | $ - |
| ASC 815-15 additions (Garlette, LLC) | 7,969,599 |
| Change in fair value (Garlette, LLC) | (46,544) |
| ASC 815-15 deletion (Garlette, LLC) | (7,923,055) |
| ASC 815-15 additions (Asher Enterprises, LLC) | 3,245,833 |
| Change in fair value (Asher Enterprises, LLC) | (2,646,609) |
| ASC 815-15 additions (Warrant) | 2,451 |
| Change in fair value (Warrant) | (1,087) |
| ASC 815-15 additions (Connied, Inc) | 162,467 |
| Change in fair value (Connied, Inc.) | 7,420 |
| Balance at June 30, 2011 | $ 770,475 |

The following table summarizes the derivative gain or loss recorded as a result of the derivative liabilities above:

| Gain/(Loss) on derivative liabilities | Six Months Ended June 30, 2011 |
|---|---|
| Change in fair value (Garlette, LLC) | $ 46,544 |
| Excess of fair value of liabilities over note payable (Garlette, LLC) | (196,314) |
| Change in fair value (Asher Enterprises, LLC) | 2,646,609 |
| Excess of fair value of liabilities over note payable (Asher Enterprises, LLC) | (10,106) |
| Change in fair value (Warrants) | 1,087 |
| Change in fair value (Connied, Inc.) | (7,420) |
| Excess of fair value of liabilities over note payable (Connied, Inc.) | (77,467) |
| Total | $ 2,402,933 |

The company values its warrant derivatives and all other share settleable instrument using the Black-Scholes option pricing model. Assumption used include (1) 0.10% to 1.96% risk-free interest rate, (2) life is the remaining contractual life of the instrument (3) expected volatility 204% to 488%, (4) zero expected dividends, (5) exercise price as set forth in the agreements, (6) common stock price of the underlying share on the valuation date, and (7) number of shares to be issued if the instrument is converted.

CMG HOLDINGS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 5: Legal Proceedings

We are subject to certain claims and litigation in the ordinary course of business. It is the opinion of management that the outcome of such matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

In February, 2011, the Company was served with a lawsuit filed by a former employee in the United States District Court for the Southern District of Florida. The complaint alleges breach of employee contract and entitlement to additional equity in the Company. The Company disagrees with the allegations contained in the Complaint and intends to vigorously defend the matter and otherwise enforce its rights with respect to the matter. The Company has retained counsel and is prepared to defend this lawsuit. A motion to dismiss the complaint has been filed and said motion is presently pending a ruling by the Court. The Company believes that all of the employee's claims are frivolous or are barred pursuant to the terms of the contract or various releases executed in favor of the Company by the employee. The Company intends to seek damages against the former employee regarding breach of his employment agreement, his non-compete agreements and other causes of action. The case is still ongoing and the matter remains unresolved.

On April 21, 2011, the Company was served with a lawsuit that was filed in Clark County, Nevada against the Company by A to Z Holdings, LLC and seven other individuals or entities. The complaint alleges, among other things, that the Company’s Board of Directors did not have the power to designate series A and B preferred stock without amending the articles of incorporation. The complaint also alleges any such amendment would require shareholder approval and filing of a proxy statement. The company has retained counsel in Nevada to represent it in this matter and intends to vigorously defend same. The Company believes that most, if not all, of the allegations contained in the lawsuit are moot and/or not actionable and further believes that the Plaintiffs lack standing to pursue their claim against the company. The Company, through counsel, is in the process of conducting discovery to ascertain the validity of the Plaintiffs’ claims and their standing to bring this lawsuit and, upon completion of discovery, will file appropriate pleadings with the Nevada court to attempt to have the complaint, as filed, dismissed.

On July 6, 2011, the Company was served with a lawsuit filed in the Circuit Court for the County of Multnomah, Oregon. The complaint alleges breach of contract and entitlement to consulting fees from the Company. The Company disagrees with the allegations contained in the Complaint and intends to vigorously defend the matter and otherwise enforce its rights with respect to the matter. The Company has retained counsel and is prepared to defend this lawsuit. The Company believes that the claims are frivolous pursuant to the terms of the contract. The case is still ongoing and the matter remains unresolved

Management believes the likelihood of a loss in any of the pending litigations is remote.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 6: COMMITMENTS AND CONTINGENCIES

On February 25, 2011, The Company's subsidiary XA Scenes and XA, The Experiential Agency, Inc. signed a separation agreement with Waterfront NY Realty Corporation regarding their office space located at 640 West 28th Street, New York NY. The separation agreement included the vacating of the premises on February 25, 2011, the payment of $50,000 on February 25, 2011, the full release from all of obligations under the Lease for &e. subject commercial premises located at 636-.642 West 28th Street, New York, NY 10001. The $50,000 payment was accrued as of June 30, 2011.

On February 25, 2011, The Company's subsidiary XA, The Experiential Agency, Inc. signed a lease agreement with Whitehall Property Management, Inc. regarding their office space located at 333 Hudson Street New York, NY. The lease agreement commences April 2011 and ends on March 2014 unless sooner terminated or extended.

On April 26, 2011, The Company's subsidiary XA, The Experiential Agency, Inc. signed a lease agreement with Golub JHC Realty, LLC regarding their office space located at 875 North Michigan Avenue, Chicago, IL. The lease agreement commences April 2011 and ends on March 2021 unless sooner terminated or extended.

Future minimum lease payments for the above lease schedule are as follow:

| | |
|---|---|
| 2011 | 71,927 |
| 2012 | 147,522 |
| 2013 | 152,137 |
| 2014 | 100,158 |
| 2015 | 84,248 |
| Thereafter | 481,286 |
| Total | 1,037,278 |

NOTE 7: RELATED PARTY TRANSACTIONS

From time to time the Company borrows money from its officers. These advances from the officers bear no interest and they are due on demand. During the six months ended June 30, 2011, $804,249 was advanced from and $50,000 was paid back to the officers. As of June 30, 2011, the Company owes $881,687 as related party debt to executive officers and management. There were a total of related party payables of $127,438 due to the officers at December 31, 2010.

On September 30, 2010 and December 31, 2010, the Company and its executive management entered into a deferred salary conversion agreements in order to assists with the working capital needs of the Company. The $1,046,702 unsecured notes carries an interest rate of 1% with a maturity date on March 31, 2012. The notes are convertible into the Company's common shares at $0.06 and $0.02 for the agreements entered on September 30, 2010 and December 31, 2010 respectively. The Company analyzed the conversion option under ASC 470-20 "Debt with Conversion and Other Options" and determined there was a beneficial conversion feature resulting in a discount to the note of $879,161. During the six months ended June 30, 2011 $165,156 of the discount was amortized to interest expense. As of June 30, 2011 and December 31, 2010, the principal balance for the related party's debt is $1,046,702, net of amortized discount of $676,668 and $841,824, respectively.

CMG HOLDINGS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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NOTE 8: SEGMENTS

We have three reportable segments: event marketing, commercial rights and consulting services, which are comprised within our specialist marketing service offerings. The profitability measure employed for allocating resources to operating divisions and assessing operating division performance are revenues and operating income, excluding the impact of restructuring and other reorganization-related charges (reversals) and long-lived asset impairment and other charges, if applicable. Summarized financial information concerning our reportable segments is shown in the following table.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Revenue: | | | | |
| Event marketing | $ 4,698,331 | $ 1,484,099 | $ 5,354,672 | $ 2,750,328 |
| Commercial rights | 2,197 | 16,089 | 45,697 | 36,459 |
| Consulting services | 24,118 | 67,466 | 111,760 | 67,466 |
| Total | $ 4,724,646 | $ 1,567,654 | $ 5,512,129 | $ 2,854,253 |
| | | | | |
| Operating income (loss) | | | | |
| Event marketing | $ 823,158 | $ 119,074 | $ 672,096 | $ 34,076 |
| Commercial rights | (291,022) | (267,079) | (568,757) | (503,999) |
| Consulting services | (370,687) | (236,906) | (703,023) | (236,906) |
| Total | $ 161,449 | $ (384,911) | $ (599,684) | $ (706,829) |

| Assets | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Event marketing | $ 1,237,556 | $ 583,476 |
| Commercial rights | 3,254,109 | 103,418 |
| Consulting services | 295,177 | 197,727 |
| Total | $ 4,786,842 | $ 884,621 |

CMG HOLDINGS, INC.
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NOTE 9: POTENTIAL SPIN OFF OF AUDIOEYE

On June 22, 2011, the Company signed a Master Agreement, with AudioEye Acquisition Corp., a Nevada Corporation, in which the shareholders of AudioEye Acquisition Corp. will exchange 100% of the stock in AudioEye Acquisition Corp. for 80% of capital stock of AudioEye, Inc. The Company will retain 15% stock in AudioEye Inc. and will distribute to its shareholders 5% of capital stock of AudioEye, in the form of a dividend on the closing date subject to transfer restrictions. The Master Agreement was approved by the Board of Directors and is subject to shareholder approval and subject to closing conditions. AudioEye, Inc. will pay to the Company, 10% of cash received from income earned, settlements or judgments directly resulting from its patent enforcement and licensing strategy whether received by AudioEye, Inc. or any of its affiliates, net of any direct costs or tax implications incurred in pursuit of such strategy pertaining to the patents and will enter into a consulting agreement where the Company will receive a commission of not less than 7.5% of all revenues received by AudioEye, Inc. and 10% of net revenues obtained from a third party described in the agreement. AudioEye, Inc. will arrange the release of obligations of the Company under outstanding 13% Senior Secured Convertible Extendable Notes due in 2011 with a current balance of $1,075,000 pursuant to a novation or other form of release of such obligation which shall include a termination of any security interest on any post Spin Off assets of the Company.

As of June 30, 2011, AudioEye is still presented as a consolidated subsidiary in the consolidated financial statements and will continue to be consolidated until the above agreement is approved by the Company’s shareholders.

NOTE 10: AUDIOEYE ACQUISITION

On March 31, 2010, the Company and AudioEye executed the final Stock Purchase Agreement where the Company acquired all outstanding shares of Audio Eye, Inc. in exchange for $30,000 cash, 1.5 million shares, warrants to purchase 250,000 shares at an exercise price of $0.07 per share and a term of 5 years plus other contingent considerations. Audio Eye develops patented internet content publication and distribution software enabling conversion of any media into accessible formats and allowing for real time distribution to end users on any internet connected device. The AudioEye, Inc. operations prior to the closing date of March 31, 2010 were insignificant in terms of revenues, operating expenses, assets and liabilities relative to the Company’s current operations. Therefore due to limited operations, the Company has not presented pro forma financial results for the six months ended June 30, 2010.

ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD LOOKING STATEMENTS

In addition to historical information, this Form 10-Q (this “Quarterly Report”) contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, which includes, but are not limited to, statements concerning expectations as to our revenues, expenses, and net income, our growth strategies and plans, the timely development and market acceptance of our products and technologies, the competitive nature of and anticipated growth in our markets, our ability to achieve cost reductions, the status of evolving technologies and their growth potential, the adoption of future industry standards, expectations as to our financing and liquidity requirements and arrangements, the need for additional capital, and other matters that are not historical facts. These forward-looking statements are based on our current expectations, estimates, and projections about our industry, management’s beliefs, and certain assumptions made by it. Words such as “anticipates”, “appears”, “believe,”, “expects”, “intends”, “plans”, “believes, “seeks”, “assume,” “estimates”, “may”, “will” these words or similar expressions are intended to identify forward-looking statements. All statements in this Quarterly Report regarding our future strategy, future operations, projected financial position, estimated future revenue, projected costs, future prospects, and results that might be obtained by pursuing management’s current plans and objectives are forward-looking statements. Therefore, actual results could differ materially and adversely from those results expressed in any forward-looking statements, as a result of various factors. Readers are cautioned not to place undue reliance on forward-looking statements, which are based only upon information available as of the date of this report. You should not place undue reliance on our forward-looking statements because the matters they describe are subject to known and unknown risks, uncertainties and other unpredictable factors, many of which are beyond our control. Our forward-looking statements are based on the information currently available to us and speak only as of the date on which this Quarterly Report was filed with the Securities and Exchange Commission (“SEC”). We expressly disclaim any obligation to revise or update publicly any forward-looking statements even if subsequent events cause our expectations to change regarding the matters discussed in those statements. Over time, our actual results, performance or achievements will likely differ from the anticipated results, performance or achievements that are expressed or implied by our forward-looking statements, and such difference might be significant and materially adverse to our stockholders. Unless the context indicates otherwise, the terms “Company”, “Corporate”, “CMGO”, “our”, and “we” refer to CMG Holdings, Inc. and its subsidiaries.

RESULTS OF OPERATIONS FOR THE PERIOD SIX MONHTHS ENDED JUNE 30, 2010

Gross revenues increased from $2,854,253 for the six months ended June 30, 2010 to $5,512,129 for the six months ended June 30, 2011. The increase in gross revenues was primarily due to additional client wins and organic business generated that was secured and serviced over the first quarter and second quarter of 2011 within our events marketing, public relations and consulting business of XA, The Experiential Agency, Inc. (XA), AudioEye Inc. and our talent management divisions.

Cost of revenue increased from $1,438,301 for the six months ended June 30, 2010 to $3,639,448 for the six months ended June 30, 2011. The increase in cost of goods sold was due to additional cost of sales associated with servicing additional clients and newly secured gross revenues serviced during the first and second quarter of 2011 within our events marketing, public relations and consulting business of XA, The Experiential Agency, Inc., AudioEye Inc. and our talent management divisions.

Operating expenses increased from $2,122,781 for the six months ended June 30, 2010 to $2,472,365 for the six months ended June 30, 2011. The increase in operating expenses is mainly due to the increase in operating expenses related to AudioEye, Inc. that was not included in 2010. Also included was the increased accounting and legal expenses related to corporate overhead during the six months ended June 30, 2011.

The net loss of $391,221 for the six months ended June 30, 2010 increased to net income of $1,037,380 for the six months ended June 30, 2011. The increase in net income was due to gain recognized for derivative liability of approximately $2.4 million and increased gross revenues and gross profits related to XA, The Experiential Agency, Inc. AudioEye Inc. as part of the company for a full six months during 2011 as the acquisition of AudioEye was finalized during the end of the first quarter for 2010, which is netted against additional operating expenses such as legal, technology and accounting expenses for AudioEye, Inc.. There are additional operating expenses associated with the events marketing, public relations and consulting business of XA, The Experiential Agency, Inc. to service new clients during six months of 2011. There were also additional overhead accounting and legal expenses associated with corporate overhead that was in six months 2011 that was not reflective in the six months of 2010.

RESULTS OF OPERATIONS FOR THE PERIOD THREE MONHTHS ENDED JUNE 30, 2010

Gross revenues increased from $1,567,654 for the three months ended June 30, 2010 to $4,724,646 for the three months ended June 30, 2011. The increase in gross revenues was primarily due to additional client wins and organic business generated that was secured and serviced over second quarter of 2011 within our events marketing, public relations and consulting business of XA, The Experiential Agency, Inc. (XA), AudioEye Inc. and our talent management divisions.

Cost of revenue increased from $729,295 for the three months ended June 30, 2010 to $3,307,117 for the three months ended June 30, 2011. The increase in cost of goods sold was due to additional cost of sales associated with servicing additional clients and newly secured gross revenues serviced during the second quarter of 2011 within our events marketing, public relations and consulting business of XA, The Experiential Agency, Inc., AudioEye Inc. and our talent management divisions.

Operating expenses increased from $1,223,270 for the three months ended June 30, 2010 to $1,256,080 for the three months ended June 30, 2011. The increase in operating expenses is mainly due to the increase in operating expenses related to AudioEye, Inc. such as legal, technology, accounting expenses. Also included was the increased accounting and legal expenses related to corporate overhead during the three months ended June 30, 2011.

The net loss of $459,662 for the three months ended June 30, 2010 increased to a net income of $1,235,759 for the three months ended June 30, 2011. The increase in net income was due to increased gross revenues and gross profits related to XA, The Experiential Agency, Inc. AudioEye Inc. which is netted against additional operating expenses such as legal, technology and accounting expenses regarding AudioEye, Inc. patents. There are additional operating expenses associated with the events marketing, public relations and consulting business of XA, The Experiential Agency, Inc. to service new clients during six months of 2011. There were also additional overhead accounting and legal expenses associated with corporate overhead that was in three months ended June 30, 2011 that was not reflective in the three months ended June 30, 2010. The Company also recognized approximately $1.5 million of gain on derivative liability during the three months ended June 30, 2011.

LIQUIDITY AND CAPITAL RESOURCES:

As of June 30, 2011, the Company's cash on hand was $420,917. Cash used by operations for the six months ended June 30, 2010 was $626,786, as compared to cash used by operations of $597,766 for the six months ended June 30, 2011. This change is primarily due to amortization of intangible assets, derivative expenses, stock expenses for services, deferred revenue and accrued expenses related to the increase in overhead and corporate expenses, events associated to event management, public relations, and consulting business of XA, The Experiential Agency, Inc. and additional operating expenses such as legal, technology and accounting expenses regarding AudioEye, Inc.

Cash used in investing activities for the six months ended June 30, 2010 was $38,070 as compared cash used in investing activities of $441 for the six months ended June 30, 2011. For the six months ended June 30, 2011, the cash invested of $441 resulted from acquisition of fixed assets.

Cash provided by financing activities for the for the six months ended June 30, 2010 was $917,793, as compared to $1,005,429 provided for the six months ended June 30, 2011. The increase during the six months ended June 30, 2011, was primarily due to the company's borrowings from related parties of $804,249, borrowings from third parties of $75,000 and increased cash from sale of restricted common stock to third parties by $157,000 which were only offset by $50,000 in repayments.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth as of August 22, 2011, information with respect to the beneficial ownership of the Company's Common Stock by (i) each person known by the Company to own beneficially 5% or more of such stock, (ii) each Director of the Company who owns any Common Stock, and (iii) all Directors and Officers as a group, together with their percentage of beneficial holdings of the outstanding shares. The information presented below regarding beneficial ownership of our voting securities has been presented in accordance with the rules of the Securities and Exchange Commission and is not necessarily indicative of ownership for any other purpose. Under these rules, a person is deemed to be a "beneficial owner" of a security if that person has or shares the power to vote or direct the voting of the security or the power to dispose or direct the disposition of the security. A person is deemed to own beneficially any security as to which such person has the right to acquire sole or shared voting or investment power within 60 days through the conversion or exercise of any convertible security, warrant, option or other right. More than one person may be deemed to be a beneficial owner of the same securities. The percentage of beneficial ownership by any person as of a particular date is calculated by dividing the number of shares beneficially owned by such person, which includes the number of shares as to which such person has the right to acquire voting or investment power within 60 days, by the sum of the number of shares outstanding as of such date plus the number of shares as to which such person has the right to acquire voting or investment power within 60 days. Consequently, the denominator used for calculating such percentage may be different for each beneficial owner. Except as otherwise indicated below and under applicable community property laws, we believe that the beneficial owners of our common stock listed below have sole voting and investment power with respect to the shares shown.

SECURITY OWNERSHIP OF MANAGEMENT:

| Title of Class | Name | Shares | Percent |
|---|---|---|---|
| Common Stock | Alan Morell | 10,107,000 | 13.2% |
| Common Stock | James J. Ennis | 3,500,000 | 4.6% |
| Common Stock | Michael Vandetty | 1,000,000 | 1.3% |
| All Directors and Executive Officers | | 14,607,000 | 19.1% |

These tables are based upon 66,201,021 shares outstanding as of August 22, 2011 and information derived from our stock records. Unless otherwise indicated in the footnotes to these tables and subject to community property laws where applicable, we believe unless otherwise noted that each of the shareholders named in this table has sole or shared voting and investment power with respect to the shares indicated as beneficially owned.

(1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and includes voting and investment power with respect to shares. Unless otherwise indicated, the persons named in the table have sole voting and sole investment control with respect to all shares beneficially owned, subject to community property laws where applicable. The number and percentage of shares beneficially owned are based on 76,284,347 shares of common stock outstanding. The address for those individuals for which an address is not otherwise indicated is: c/o CMG Holdings, Inc., 5601 Biscayne Boulevard, Miami, Florida 33137, USA.
(2) Mr. Morell owns 3,500,000 shares of The Company directly, and is the beneficial owner of additional 6,607,000 shares owned by Commercial Rights Intl Corp. for a total of 10,107,000 shares.

(3) Mr. Ennis owns 1,500,000 shares of The Company directly, and is the beneficial owner of an additional 2,000,000 shares owned by Hastings Creek Group, Inc. for a total of 3,500,000 shares.

## ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK FACTORS

### CURRENT ECONOMIC CONDITIONS AND THE GLOBAL FINANCIAL CRISIS MAY HAVE AN IMPACT ON OUR BUSINESS AND FINANCIAL CONDITION IN WAYS THAT WE CURRENTLY CANNOT PREDICT

The global economy has experienced a significant contraction, with an unprecedented lack of consumer credit within the credit markets and the shift away from discretionary spending within the marketing, communications. The decrease in the economic activity in the United States and in the commercial sectors in which we conduct business could adversely affect our financial condition and results of operations. Continued tightness within the credit markets, volatility, instability and economic weakness of our clients marketing budgets and decrease in discretionary consumer spending associated with our clients business spending may result in a reduction in our revenues.

### BUSINESS COULD BE ADVERSELY AFFECTED IF IT LOSES KEY CLIENTS AND KEY MANAGEMENT

The Company’s loss of one or more significant clients could materially affect results of the Company on a consolidated basis. Our Management is critically important to ongoing results of the Company because, as in any service business, success of the Company is mainly dependent upon the leadership of key executives and management. If key executives were to leave any of our operating divisions, the relationships that the Company has with its clients could be adversely affected.

### COMPETITION FOR CLIENTS IN HIGHLY COMPETITIVE INDUSTRIES

The Company operates in a very competitive industry characterized by numerous firms of varying sizes, with no group of firms having dominant positions in the marketplace. Competitive factors include creative expertise, executive management’s, personal relationships, quality and reliability of service and expertise in particular niche areas of the marketplace. In addition, our company’s principal asset is its people, barriers to entry are minimal, and relatively small firms may be on occasion able to take some portion of a client’s business from a larger competitor. While many of the Company’s client relationships are long-standing, clients may at times place their marketing services businesses up for competitive review from time to time, including at times when clients enter into strategic transactions. To the extent that the Company fails to maintain existing clients or attract new clients, the Company’s business, financial condition and operating results may be affected in a materially adverse manner.

### ABILITY TO GENERATE NEW BUSINESS FROM NEW AND EXISTING CLIENTS MAY BE LIMITED

To increase revenues, the Company needs to obtain additional clients, generate demand for additional services from existing clients and partner with external marketing firms to mutually service as single or multiple of clients. The company’s ability to generate demand for its services from new clients, additional demand from existing clients partner with external marketing firms to mutually service as single or multiple of clients is subject to clients’ requirements, pre-existing vendor relationships, financial condition, strategic plans and internal resources, as well as the quality of the Company’s employees, services and reputation and the breadth of its services. To the extent the Company cannot generate new business from new and existing clients due to these limitations; it will limit the Company’s ability to grow its business and to increase its revenues.

### REVENUES ARE SUSCEPTIBLE TO DECLINES AS A RESULT OF GENERAL ADVERSE ECONOMIC DEVELOPMENTS

The marketing communications services industry is cyclical and is subject to the negative effects of economic downturns. The Company’s marketing services operations are also exposed to the risk of clients changing their business plans and/or reducing their marketing budgets. As a result, if the U.S. markets and economies continue to weaken, our businesses, financial condition and gross revenues are likely to be negatively affected may be suspect to declines from quarter to quarter or from year to year.

BENEFITS EXPECTED FROM CURRENT ACQUISITION OR PRIOR ACQUISITIONS MADE IN THE FUTURE MAY NOT BE REALIZED

The Company's business strategy includes ongoing efforts to engage in material acquisitions of ownership interests in entities in the marketing communications services industry. The Company intends to finance these acquisitions by using any available cash from operations, through incurrence of debt or bridge financing or by issuing equity, which may have a dilutive impact on its existing shareholders. At any given time the Company may be engaged in a number of discussions that may result in one or more material acquisitions. These opportunities require confidentiality and may involve negotiations that require quick responses by the Company. Although there is uncertainty that any of these discussions will result in definitive agreements or the completion of any transactions, the announcement of any such transaction may lead to increased volatility in the trading price of its securities.

The success of acquisitions or strategic investments depends on the effective integration of newly acquired businesses into the Company's current operations. Such integration is subject to risks and uncertainties, including realization of anticipated synergies and cost savings, the ability to retain and attract personnel and clients, the diversion of management's attention from other business concerns, and undisclosed or potential legal liabilities of the acquired company. The Company may not realize the strategic and financial benefits that it expects from any of its past acquisitions, or any future acquisitions.

BUSINESS COULD BE ADVERSELY AFFECTED IF IT LOSES OR FAILS TO ATTRACT KEY EMPLOYEES

Our executive management and our employees, including creative, research, media, account and their skills and relationships with clients, are among the Company's most critically important assets. An important aspect of the Company's competitiveness is its ability to retain key employee and executive management. The compensation for these key employees is an essential factor in attracting and retaining them and the Company may not offer a level of compensation sufficient to attract and retain these key employees. If the Company fails to hire and retain a sufficient number of these key employees, it may not be able to compete effectively.

BUSINESS EXPOSED TO THE RISK OF CLIENT MEDIA ACCOUNT DEFAULTS

The Company often incurs expenses on behalf of its clients in order to secure a variety of opportunities in exchange for which it receives a fee. While the Company acts to prevent against default on payment for these services and have historically had a very low incidence of default, the Company is still exposed to the risk of significant uncollectible receivables from our clients.

SUBJECT TO REGULATIONS THAT COULD RESTRICT ITS ACTIVITIES OR NEGATIVELY IMPACT ITS REVENUES

Marketing communications businesses are subject to government regulation, both domestic and foreign. There has been an increasing tendency in the United States on the part of advertisers to resort to litigation and self-regulatory bodies to challenge comparative advertising on the grounds that the advertising is false and deceptive. Moreover, there has recently been an expansion of specific rules, prohibitions, media restrictions, labeling disclosures and warning requirements with respect to advertising for certain products. Representatives within government bodies, both domestic and foreign, continue to initiate proposals to ban the advertising of specific products and to impose taxes on or deny deductions for advertising which, if successful, may have an adverse effect on advertising expenditures and consequently the Company's revenues.

THE RESULTS OF OPERATIONS ARE SUBJECT TO CURRENCY FLUCTUATION RISKS

Although the Company’s financial results are reported in U.S. dollars, a portion of its revenues and operating costs may be denominated in currencies other than the US dollar. As a result, fluctuations in the exchange rate between the U.S. dollar and other currencies, may affect the Company’s financial results and competitive position.

COMPANY DIRECTORS AND EXECUTIVE OFFICERS BENEFICIALLY OWN A SUBSTANTIAL PERCENTAGE OF THE COMPANY’S OUTSTANDING COMMON STOCK, WHICH GIVES THEM CONTROL OVER CERTAIN MAJOR DECISIONS ON WHICH STOCKHOLDERS MAY VOTE, WHICH MAY DISCOURAGE AN ACQUISITION OF THE COMPANY

In the aggregate, the directors and executive officers as a group collectively own approximately 19% of the Company’s outstanding shares. The interests of the Company’s management may differ from the interests of other stockholders and as a result, the Company’s executive management may have the ability to control virtually all corporate actions requiring stockholder approval, irrespective of how the Company’s other stockholders may vote, including electing or defeating the election of directors; amending or preventing amendment of the Company’s certificate of incorporation or bylaws; effecting or preventing a merger, sale of assets or other corporate transaction; and controlling the outcome of any other matter submitted to the stockholders for vote. The Company’s management’s stock ownership may discourage a potential acquirer from seeking to acquire shares of the Company’s common stock or otherwise attempting to obtain control of the Company, which in turn could reduce the Company’s stock price or prevent the Company’s stockholders from realizing a premium over the Company’s stock price.

OUTSTANDING INDEBTEDNESS; SECURITY INTEREST AND UNREGISTERED SALES OF EQUITY SECURITIES

On April 1, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $725,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 3,625,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on July 1, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 942,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On April 23, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $125,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 625,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on July 28, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 162,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On June 1, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $150,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 750,000 shares of the Company's Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on September 1, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 195,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On June 18, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $50,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 250,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on September 18, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 65,000 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On June 30, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $20,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 125,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on September 30, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 32,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

SPINOUT OF SUBSIDIARIES

On June 22, 2011 the Company entered into a Master Agreement subject to shareholder approval as may be required under applicable law and subject to closing conditions with AudioEye Acquisition Corp., a Nevada corporation pursuant to which the shareholders of AudioEye Acquisition Corp. will exchange 100% of the stock in AudioEye Acquisition Corp. for 80% of the capital stock of AudioEye, Inc. The Company will retain 15% of AudioEye Inc. subject to transfer restrictions in accordance with the Master Agreement. The Company will distribute to its shareholders on the closing date, in the form of a dividend, 5% of the capital stock of AudioEye, Inc. in accordance with provisions of the Agreement. AudioEye, Inc. will pay to the Company 10% of cash received from income earned, settlements or judgments directly resulting from the AudioEye, Inc. patent enforcement and licensing strategy whether received by, AudioEye, Inc. or any of its affiliates, net of any direct costs or tax implications incurred in pursuit of such strategy pertaining to the patents as fully described in the Agreement. AudioEye Inc. will enter into a consulting agreement with the Company whereby the Company will receive a commission of not less than 7.5% of all revenues received by AudioEye, Inc. after the closing date from all business, clients or other sources of revenue procured by the Company or its employees, officers or subsidiaries and directed to AudioEye, Inc. and 10% of net revenues obtained from a third party described in the agreement. AudioEye, Inc. will arrange the release of the obligations of the Company under outstanding 13% Senior Secured Convertible Extendable Notes due in 2011 with a current aggregate balance of $1,075,000 pursuant to a novation or other form of release of such obligation which shall include a termination of any security interest on any post Spin Off assets of the Company. The Company believes that such a distribution, when combined with the other transactions contemplated in the Agreement, will allow AudioEye, Inc to raise capital and grow its business in such manner as it no longer can as a subsidiary of the Company, thus generating increased value for the Company’s stockholders.

PUBLIC COMPANY COMPLIANCE MAY MAKE IT MORE DIFFICULT TO ATTRACT AND RETAIN OFFICERS AND DIRECTORS

The Sarbanes-Oxley Act of 2002 and new rules subsequently implemented by the SEC have required changes in corporate governance practices of public companies. As a public entity, the Company expects these new rules and regulations to increase compliance costs in 2011 and beyond and to make certain activities more time consuming and costly. As a public entity, the Company also expects that these new rules and regulations may make it more difficult and expensive for the Company to obtain director and officer liability insurance in the future and it may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for the Company to attract and retain qualified persons to serve as directors or as executive officers.

THERE IS CURRENTLY NO LIQUID TRADING MARKET FOR THE COMPANY’S COMMON STOCK AND THE COMPANY CANNOT ENSURE THAT ONE WILL EVER DEVELOP OR BE SUSTAINED

The Company’s common stock is currently approved for quotation on the OTC Bulletin Board trading under the symbol CMGO.QB. However, there is limited trading activity and not currently a liquid trading market. There is no assurance as to when or whether a liquid trading market will develop, and if such a market does develop, there is no assurance that it will be maintained. Furthermore, for companies whose securities are quoted on the Over-The-Counter Bulletin Board maintained by the National Association of Securities Dealers, Inc. (the “OTCBB”), it is more difficult (1) to obtain accurate quotations, (2) to obtain coverage for significant news events because major wire services generally do not publish press releases about such companies, and (3) to obtain needed capital. As a result, purchasers of the Company’s common stock may have difficulty selling their shares in the public market, and the market price may be subject to significant volatility.

THE COMPANY’S STOCK PRICE MAY BE VOLATILE

The market price of the Company’s common stock is likely to be highly volatile and could fluctuate widely in price in response to various factors, many of which are beyond the Company’s control, including the following: technological innovations or new products and services by the Company or its competitors; additions or departures of key personnel; limited “public float” following the Reorganization , in the hands of a small number of persons whose sales or lack of sales could result in positive or negative pricing pressure on the market price for the common stock; the Company’s ability to execute its business plan; operating results that fall below expectations; loss of any strategic relationship; industry developments; economic and other external factors; and period-to-period fluctuations in the Company’s financial results. In addition, the securities markets have from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These market fluctuations may also materially and adversely affect the market price of the Company’s common stock.

OFFERS OR AVAILABILITY FOR SALE OF A SUBSTANTIAL NUMBER OF SHARES OF THE COMPANY’S COMMON STOCK MAY CAUSE THE PRICE OF THE COMPANY’S COMMON STOCK TO DECLINE OR COULD AFFECT THE COMPANY’S ABILITY TO RAISE ADDITIONAL WORKING CAPITAL

If the Company’s current stockholders seek to sell substantial amounts of common stock in the public market either upon expiration of any required holding period under Rule 144 or pursuant to an effective registration statement, it could create a circumstance commonly referred to as “overhang,” in anticipation of which the market price of the Company’s common stock could fall substantially. The existence of an overhang, whether or not sales have occurred or are occurring, also could make it more difficult for the Company to raise additional financing in the future through sale of securities at a time and price that the Company deems acceptable.

THE COMPANY’S COMMON STOCK IS CURRENTLY DEEMED TO BE “PENNY STOCK”, WHICH MAKES IT MORE DIFFICULT FOR INVESTORS TO SELL THEIR SHARES

The Company’s common stock is currently subject to the “penny stock” rules adopted under section 15(g) of the Exchange Act. The penny stock rules apply to companies whose common stock is not listed on the NASDAQ Stock Market or other national securities exchange and trades at less than $5.00 per share or that have tangible net worth of less than $5,000,000 ($2,000,000 if the company has been operating for three or more years). These rules require, among other things, that brokers who trade penny stock to persons other than “established customers” complete certain documentation, make suitability inquiries of investors and provide investors with certain information concerning trading in the security, including a risk disclosure document and quote information under certain circumstances. Many brokers have decided not to trade penny stocks because of the requirements of the penny stock rules and, as a result, the number of broker-dealers willing to act as market makers in such securities is limited. If the Company remains subject to the penny stock rules for any significant period, it could have an adverse effect on the market, if any, for the Company’s securities. If the Company’s securities are subject to the penny stock rules, investors will find it more difficult to dispose of the Company’s securities.

THE ELIMINATION OF MONETARY LIABILITY AGAINST THE COMPANY’S DIRECTORS, OFFICERS AND EMPLOYEES UNDER NEVADA LAW AND THE EXISTENCE OF INDEMNIFICATION RIGHTS TO THE COMPANY’S DIRECTORS, OFFICERS AND EMPLOYEES MAY RESULT IN SUBSTANTIAL EXPENDITURES BY THE COMPANY AND MAY DISCOURAGE LAWSUITS AGAINST THE COMPANY’S DIRECTORS, OFFICERS AND EMPLOYEES

The Company’s certificate of incorporation does not contain any specific provisions that eliminate the liability of directors for monetary damages to the Company and the Company’s stockholders; however, the Company is prepared to give such indemnification to its directors and officers to the extent provided by Nevada law. The Company may also have contractual indemnification obligations under its employment agreements with its executive officers. The foregoing indemnification obligations could result in the Company incurring substantial expenditures to cover the cost of settlement or damage awards against directors and officers, which the Company may be unable to recoup. These provisions and resultant costs may also discourage the Company from bringing a lawsuit against directors and officers for breaches of their fiduciary duties and may similarly discourage the filing of derivative litigation by the Company’s stockholders against the Company’s directors and officers even though such actions, if successful, might otherwise benefit the Company and its stockholders

ITEM 4: CONTROLS AND PROCEDURES

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

Management has evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) as of the end of the period covered by this report and concluded that our disclosure controls and procedures were not effective to ensure that all material information required to be disclosed in this Quarterly Report on Form 10-Q has been made known to them in a timely fashion. We are in the process of improving our internal control over financial reporting in an effort to remediate these deficiencies through improved supervision and training of our accounting staff. These deficiencies have been disclosed to our Board of Directors. We believe that this effort is sufficient to fully remedy these deficiencies and we are continuing our efforts to improve and strengthen our control processes and procedures. Our Chief Executive Officer, Chief Financial Officer and directors will continue to work with our auditors and other outside advisors to ensure that our controls and procedures are adequate and effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

No change in the Company’s internal control over financial reporting occurred during the three months ended June 30, 2011, that materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II

ITEM 1 – LEGAL PROCEEDINGS

We are subject to certain claims and litigation in the ordinary course of business. It is the opinion of management that the outcome of such matters will not have a material adverse effect on our consolidated financial position, results of operations or cash flows.

In February, 2011, the Company was served with a lawsuit filed by a former employee in the United States District Court for the Southern District of Florida. The complaint alleges breach of employee contract and entitlement to additional equity in the Company. The Company disagrees with the allegations contained in the Complaint and intends to vigorously defend the matter and otherwise enforce its rights with respect to the matter. The Company has retained counsel and is prepared to defend this lawsuit. A motion to dismiss the complaint has been filed and said motion is presently pending a ruling by the Court. The Company believes that all of the employee's claims are frivolous or are barred pursuant to the terms of the contract or various releases executed in favor of the Company by the employee. The Company intends to seek damages against the former employee regarding breach of his employment agreement, his non-compete agreements and other causes of action. The case is still ongoing and the matter remains unresolved.

On April 21, 2011, the company was served with a lawsuit that was filed in Clark County, Nevada against the company by A to Z Holdings, LLC and seven other individuals or entities. The complaint alleges, among other things, that the company's Board of Directors did not have the power to designate series A and B preferred stock without amending the articles of incorporation. The complaint also alleges any such amendment would require shareholder approval and filing of a proxy statement. The company has retained counsel in Nevada to represent it in this matter and intends to vigorously defend same. The company believes that most, if not all, of the allegations contained in the lawsuit are moot and/or not actionable and further believes that the Plaintiffs lack standing to pursue their claim against the company. The company, through counsel, is in the process of conducting discovery to ascertain the validity of the Plaintiffs' claims and their standing to bring this lawsuit and, upon completion of discovery, will file appropriate pleadings with the Nevada court to attempt to have the complaint, as filed, dismissed.

On July 6, 2011, the Company was served with a lawsuit filed in the Circuit Court for the County of Multnomah, Oregon. The complaint alleges breach of contract and entitlement to consulting fees from the Company. The Company disagrees with the allegations contained in the Complaint and intends to vigorously defend the matter and otherwise enforce its rights with respect to the matter. The Company has retained counsel and is prepared to defend this lawsuit. The Company believes that the claims are frivolous pursuant to the terms of the contract. The case is still ongoing and the matter remains unresolved.

ITEM 1A – RISK FACTORS

The Company is a smaller reporting company and is therefore not required to provide this information.

ITEM 2: UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

CAPITAL INVESTMENT CMGO INVESTORS, LLC.

On April 1, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $725,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 3,625,000 shares of the Company's Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on July 1, 2011; provided that, so long as there is no continuing

Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 942,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On April 23, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $125,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 625,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on July 28, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 162,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On June 1, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $150,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 750,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on September 1, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 195,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On June 18, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $50,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 250,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on September 18, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 65,000 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On June 30, 2010, the Company entered into a Note Purchase Agreement with CMGO Investors, LLC, a Delaware limited liability company, providing for the sale and issuance of (i) $20,000 of its 13% Senior Secured Convertible Extendible Notes due 2011 and (ii) warrants to purchase 125,000 shares of the Company’s Common Stock. The Note bears interest at a rate of 13% per annum payable quarterly. The entire amount of the Note, together with all accrued but unpaid interest thereon, is due and payable in full on September 30, 2011; provided that, so long as there is no continuing Event of Default, the Company may in its sole discretion extend the Maturity Date for a period of three months by paying an extension fee equal to 5% of the principal amount of the outstanding Notes. In the event of Default on the Note, the Note shall bear interest at the rate per annum equal to 18%. The Notes rank senior in right of payment with all indebtedness of the Company, whether currently existing or issued in the future. The Notes are secured by a security interest in all of the assets of the Company and the Company's subsidiaries pursuant to a Security Agreement and Subsidiary Guarantee. The Notes are convertible into shares of Common Stock of the Company at any time after the Maturity Date at an initial conversion price of $0.10 per share. The warrants are exercisable for seven years at an exercise price of $0.10 per share. The conversion price of the Notes and the exercise price of the warrants will be adjusted in connection with stock splits, dividends, mergers, reclassifications and similar transactions. In addition, if at any time the closing market price of the Common Stock is less than the conversion price or exercise price for a period of 90 consecutive trading days, then the conversion price or exercise price in effect shall be reduced to the closing market price of the Common Stock on such 90th trading day; provided that in no event shall the conversion price or exercise price be reduced to less than $0.07 per share pursuant to this provision. The investors also received certain registration rights pursuant to a Registration Rights Agreement. In connection with this transaction, the Company paid the placement agent 10% of the gross proceeds and warrants to purchase 32,500 shares of Common Stock. The sale of securities discussed above was made solely to accredited investors and was exempt from registration under Section 4(2) and/or Rule 506 of Regulation D of the Securities Act of 1933, as amended.

On February 1, 2011, an individual purchased 250,000 units at $0.10 each for a total sum of $25,000. Each Unit consists one Common Share and with a detachable A and B Warrant. The A Warrant is for 20% of the Shares represented herein at a strike price of $0.25 for three years, and the B Warrant is for 20% of the Shares represented herein at a strike price of $0.50 for three years. The Company can call each of the Warrants after twelve months if the price of the Common Shares of the Company in the Market is 150% of the Warrant strike price for 10 consecutive days.

On March 11, 2011, an individual purchased 333,333 units at $0.06 each for a total sum of $20,000. Each Unit consists one Common Share and with a detachable A and B Warrant. The A Warrant is for 20% of the Shares represented herein at a strike price of $0.25 for three years, and the B Warrant is for 20% of the Shares represented herein at a strike price of $0.50 for three years. The Company can call each of the Warrants after twelve months if the price of the Common Shares of the Company in the Market is 150% of the Warrant strike price for 10 consecutive days.

On March 11, 2011, an individual purchased 416,667 units at $0.06 each for a total sum of $25,000. Each Unit consists one Common Share and with a detachable A and B Warrant. The A Warrant is for 20% of the Shares represented herein at a strike price of $0.25 for three years, and the B Warrant is for 20% of the Shares represented herein at a strike price of $0.50 for three years. The Company can call each of the Warrants after twelve months if the price of the Common Shares of the Company in the Market is 150% of the Warrant strike price for 10 consecutive days.

On March 14, 2011 the company signed a convertible promissory note agreement with Asher Enterprises, Inc. for the sum of $75,000, together with any interest as set forth herein due on December 16, 2011 and to pay interest on the unpaid principal balance hereof at an interest rate of eight percent (8%) per annum from the date hereof until the same becomes due and payable, whether at maturity or upon acceleration or by prepayment or otherwise. The convertible promissory note calls 4,510,826 shares to be reserved for issuance upon conversion of this Note and any amount not paid by December 16, 2011 will incur a 22% interest rate. The conversion price will be 58% multiplied by market price which is the average of the lowest three trading prices for the Common Stock during the ten trading day period ending on the latest complete Trading Day prior to the Conversion Date.

ITEM 3 – DEFAULT UPON SENIOR SECURITIES

None

ITEM 4 – SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

ITEM 5 – OTHER INFORMATION

None

ITEM 6 – EXHIBITS
Exhibit No. Document Description

31.1 Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.

31.2 Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended.

32.1 Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350 as adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350 as adopted Pursuant to Section 906 of the Sarbanes Oxley Act of 2002.

Reports on Form 8-K:

The Company filed a Form 8-K on April 6, 2011 - Item 3.02. Unregistered Sales of Equity Securities
The Company filed a Form 8-K on April 12, 2011 - Item 2.01. Completion of Acquisition or Disposition of Assets
The Company filed a Form 8-K on May 16, 2011 - Item 1.02. Termination of a Material Definitive Agreement

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, there unto duly authorized.

CMG HOLDINGS, INC.
(Registrant)

Date: August 22, 2011

By: /s/ ALAN MORELL
Alan Morell
Chief Executive Officer
and Chairman of the Board

Chief Executive Officer and Chairman of the Board

Date: August 22, 2011

By: /s/ JAMES J. ENNIS
James J. Ennis
Chief Financial Officer
and Director

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| SIGNATURE | NAME | TITLE | DATE |
|---|---|---|---|
| /s/Alan Morell | Alan Morell | CEO & Chairman of the Board | August 22, 2011 |

| | | | |
|---|---|---|---|
| /s/James I. Ennis | James I. Ennis | CFO & Director | August 22, 2011 |

;background-color:#cceeff;padding-left:2px;padding-top:2px;padding-bottom:2px;padding-right:2px;">

$
232

$
1

Commitments to sell foreign currency
1,343

(46
)

1,430

12

Options to sell foreign currency
34

—

44

1

Balance sheet location:

Accounts receivable [1]

$
18

$
23

Other current liabilities [1]

(54
)

(9
)

[1] The fair values of derivative contracts are presented on a gross basis on the balance sheet and are subject to enforceable master netting arrangements, which contain various netting and setoff provisions.

The amount of gain (loss) recognized in income for the contracts to purchase and sell foreign currency is summarized below:

| | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| | (in millions) | |
| Foreign currency derivative contracts | | |
| General and administrative | $(44) | $ 33 |

The fair value of the foreign currency derivative contracts generally reflects the estimated amounts that the Company would receive (or pay), on a pre-tax basis, to terminate the contracts. The terms of the foreign currency derivative contracts are generally less than 18 months. The Company had no deferred gains or losses related to foreign exchange contracts in accumulated other comprehensive income as of March 31, 2016 and December 31, 2015, as these contracts were not accounted for under hedge accounting.

The Company’s derivative financial instruments are subject to both market and counterparty credit risk. Market risk is the risk of loss due to the potential change in an instrument’s value caused by fluctuations in interest rates and other variables related to currency exchange rates. The effect of a hypothetical 10% adverse change in foreign currency rates could result in a fair value loss of approximately $126 million on the Company’s foreign currency derivative contracts outstanding at March 31, 2016 related to the hedging program. Counterparty credit risk is the risk of loss due to failure of the counterparty to perform its obligations in accordance with contractual terms. To mitigate counterparty credit risk, the Company enters into derivative contracts with selected financial institutions based upon their credit ratings and other factors. Generally, the Company does not obtain collateral related to derivatives because of the high credit ratings of the counterparties.

Net investment hedge

The Company uses foreign currency denominated debt to hedge a portion of its net investment in foreign operations against adverse movements in exchange rates, with changes in the value of the debt recorded within currency translation adjustment in accumulated other comprehensive income (loss). During the fourth quarter of 2015, the Company designated its €1.65 billion euro-denominated debt as a net investment hedge for a portion of its net investment in European foreign operations. As of March 31, 2016, the Company had a net foreign currency transaction pre-tax loss of $104 million in accumulated other comprehensive income (loss) associated with hedging activity. There was no ineffectiveness in the current period.

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ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis supplements management's discussion and analysis of MasterCard Incorporated for the year ended December 31, 2015 as contained in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission on February 12, 2016. It also should be read in conjunction with the consolidated financial statements and notes of MasterCard Incorporated and its consolidated subsidiaries, including MasterCard International Incorporated (together, “MasterCard” or the “Company”), included elsewhere in this Report. Percentage changes provided throughout “Management’s Discussion and Analysis of Financial Condition and Results of Operations” were calculated on amounts rounded to the nearest thousand. Currency-neutral growth rates exclude the impacts from both translational and transactional foreign currency. Columns labeled “Foreign Currency” within the tables included within represent the impacts from both translational and transactional foreign currency.

Non-GAAP Financial Information

MasterCard presents growth rates on a currency-neutral basis, which is a non-GAAP financial measure. Currency-neutral growth rates are calculated by remeasuring the prior period’s results using the current period’s exchange rates for both the translational and transactional impacts on our operating results. The impact of foreign currency translation represents the effect of translating operating results where the functional currency is different than our U.S. dollar reporting currency. The impact of the transactional foreign currency represents the effect of converting revenue and expenses occurring in a currency other than the functional currency. MasterCard’s management believes the presentation of certain currency-neutral growth rates provides relevant information. MasterCard’s management uses non-GAAP financial measures to, among other things, evaluate its ongoing operations in relation to historical results, for internal planning and forecasting purposes and in the calculation of performance-based compensation. The presentation of non-GAAP financial measures should not be considered in isolation or as a substitute for the Company’s related financial results prepared in accordance with GAAP.

Overview

MasterCard is a technology company in the global payments industry that connects consumers, financial institutions, merchants, governments and businesses worldwide, enabling them to use electronic forms of payment instead of cash and checks. As the operator of what we believe is the world’s fastest payments network, we facilitate the processing of payment transactions, including authorization, clearing and settlement, and deliver related products and services. We make payments easier and more efficient by creating a wide range of payment solutions and services using our family of well-known brands, including MasterCard, Maestro and Cirrus. We also provide value-added offerings such as loyalty and reward programs, information services and consulting. Our network is designed to ensure safety and security for the global payments system.

A typical transaction on our network involves four participants in addition to us: cardholder (an individual who holds a card or uses another device enabled for payment), merchant, issuer (the cardholder’s financial institution) and acquirer (the merchant’s financial institution). We do not issue cards, extend credit, determine or receive revenue from interest rates or other fees charged to cardholders by issuers, or establish the rates charged by acquirers in connection with merchants’ acceptance of our branded cards. In most cases, cardholder relationships belong to, and are managed by, our financial institution customers.

We generate revenue by charging fees primarily to issuers and acquirers for providing transaction processing and other payment-related products and services, as well as by assessing these customers based primarily on the dollar volume of activity, or gross dollar volume (“GDV”), on the cards and other devices that carry our brands.

Our Strategy

Our ability to grow our business is influenced by personal consumption expenditure growth, driving cash and check transactions toward electronic forms of payment, increasing our share in electronic payments and providing value-added products and services. We drive growth by growing, diversifying and building our business.

Grow. We focus on growing our core businesses globally, including growing our credit, debit, prepaid and commercial products and solutions and increasing the number of payment transactions we process.

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Diversify. We look to diversify our business by focusing on:

- diversifying our customer base in new and existing markets by working with partners such as governments, merchants, large digital companies and other technology companies, mobile providers and other businesses;
- encouraging use of our products and solutions in areas that provide new opportunities for electronic payments, such as transit and person-to-person transfers;
- driving acceptance at small merchants and merchants who have not historically accepted MasterCard products; and
- broadening financial inclusion for the unbanked and underbanked.

Build. We build our business by:

- taking advantage of the opportunities presented by evolving ways consumers interact and transact as physical and digital payments converge; and
- using our safety and security products and solutions, data analytics and loyalty solutions to add value.

We grow, diversify and build our business through a combination of organic growth and strategic investments, including acquisitions.

Strategic Partners. We work with a variety of stakeholders. We provide financial institutions with solutions to help them increase revenue and increase preference for their MasterCard-branded products. We help merchants by delivering data-driven insights and other services to help them grow and create better and secure purchase experiences for consumers across physical and digital channels. We partner with large digital companies and other technology companies, mobile providers and telecommunication companies to support their digital payment solutions with our technology, expertise and security protocols. We help national and local governments drive increased financial inclusion and efficiency, reduce costs, increase transparency to reduce crime and corruption and advance social programs. For consumers, we provide better, safer and more convenient ways to pay.

Financial Results Overview

For the three months ended March 31, 2016, we recorded net income of $959 million, a decrease of 6%, or 2% on a currency-neutral basis, versus the comparable period in the prior year, and earnings per diluted share of $0.86, down 3%, or up 1% on a currency-neutral basis versus the comparable period in the prior year. Key highlights for the three months ended March 31, 2016 are as follows:

- Our net revenue increased 10%, or 14% on a currency-neutral basis versus the comparable period in 2015, primarily driven by increases across our revenue categories, partially offset by higher rebates and incentives. Our processed transactions increased 14%, MasterCard-Branded GDV increased 13% and cross border volumes increased 12%, on a local currency basis, versus the comparable period in 2015.
- Operating expenses increased 25%, or 29% on a currency-neutral basis versus the comparable period in 2015, primarily due to the difference between foreign currency gains related to currency hedging and balance sheet remeasurement which occurred in 2015 versus foreign exchange losses on currency hedging in the current year. Additionally, there were higher personnel costs in the current year due to our continued investment in the areas of digital, services and data analytics along with wage increases. The impact from foreign exchange derivative contracts and balance sheet remeasurement had a negative impact of 16 percentage points to operating expense growth versus the comparable period in 2015.
- The effective tax rate of 28.3% increased by 4.4 percentage points versus the comparable period in the prior year due to the lapping of a discrete tax benefit relating to foreign tax credits recorded in 2015.

Other financial highlights for three months ended March 31, 2016 were as follows:

- We generated net cash flows from operations of $1.0 billion compared to $911 million for the comparable period in 2015.
- We repurchased 15.4 million shares and paid dividends of $212 million.

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The following table provides a summary of our operating results for the three months ended March 31, 2016 and 2015:

| | Three Months Ended March 31, | | Percent Increase/(Decrease) |
| --- | --- | --- | --- |
| | 2016 | 2015 | |
| | (in millions, except per share data and percentages) | | |
| Net revenue | $2,446 | $2,230 | 10% |
| Operating expenses | $1,098 | $879 | 25% |
| Operating income | $1,348 | $1,351 | —% |
| Operating margin | 55.1 % | 60.6 % | |
| Income tax expense | $378 | $320 | 18% |
| Effective income tax rate | 28.3 % | 23.9 % | |
| Net Income | $959 | $1,020 | (6)% |
| Diluted earnings per share | $0.86 | $0.89 | (3)% |
| Diluted weighted-average shares outstanding | 1,112 | 1,152 | (3)% |

* Tables may not sum due to rounding.

Business Environment

We process transactions from more than 210 countries and territories and in more than 150 currencies. Net revenue generated in the United States was 39% and 38% for the three months ended March 31, 2016 and 2015, respectively. No individual country, other than the United States, generated more than 10% of total revenue in each period, but differences in market growth, economic health and foreign exchange fluctuations in certain countries can have an impact on the proportion of revenue generated outside the United States over time. While the global nature of our business helps protect our operating results from adverse economic conditions in a single or a few countries, the significant concentration of our revenue generated in the United States makes our business particularly susceptible to adverse economic conditions in the United States.

The competitive and evolving nature of the global payments industry provides both challenges to and opportunities for the continued growth of our business. Adverse economic trends (including distress in financial markets, turmoil in specific economies around the world and additional government intervention) have impacted the environment in which we operate. Certain of our customers, merchants that accept our brands and cardholders who use our brands, have been directly impacted by these adverse economic conditions.

MasterCard's financial results may be negatively impacted by actions taken by individual financial institutions or by governmental or regulatory bodies. In addition, further political instability or a decline in economic conditions in the countries in which the Company operates may accelerate the timing of or increase the impact of risks to our financial performance. As a result, our revenue may be negatively impacted, or the Company may be impacted in several ways. MasterCard continues to monitor political and economic conditions around the world to identify opportunities for the continued growth of our business and to evaluate the evolution of the global payments industry. The extent and pace of economic recovery in various regions remains uncertain and the overall business environment may present challenges for MasterCard to grow its business. For a full discussion see, "Risk Factors - Business Risks" in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

In addition, our business and our customers' businesses are subject to regulation in many countries. Regulatory bodies may seek to impose rules and price controls on certain aspects of our business and the payments industry. For further discussion, see Note 10 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part

I, Item 1 and our risk factors in “Risk Factors - Legal and Regulatory Risks” in Part I, Item 1A (Risk Factors) of the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. Further, information security risks for global payments and technology companies such as MasterCard have significantly increased in recent years. Although to date we have not experienced any material impacts relating to cyber-attacks or other information security breaches, there can be no assurance that we will be immune to these risks and not suffer such losses in the future. See our risk factor in “Risk Factors - Business Risks” in Part I, Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 related to a failure or breach of our security systems or infrastructure as a result of cyber-attacks.

Impact of Foreign Currency Rates

Our overall operating results can be impacted by foreign currency translation, which represents the effect of translating operating results where the functional currency is different than our U.S. dollar reporting currency. For the three months ended March 31, 2016, as compared to the same period in 2015, our operating results were impacted primarily by the weakening of the Brazilian real against the U.S. dollar, which devalued against the U.S. dollar by 27%, versus the comparable period in 2015.

Our operating results can also be impacted by transactional foreign currency. The impact of the transactional foreign currency represents the effect of converting revenue and expenses occurring in a currency other than the functional currency. Changes in foreign currency exchange rates directly impact the calculation of gross dollar volume (“GDV”) and gross euro volume (“GEV”), which are used in the calculation of our domestic assessments, cross-border volume fees and volume-related rebates and incentives. In most non-European regions, GDV is calculated based on local currency spending volume converted to U.S. dollars using average exchange rates for the period. In Europe, GEV is calculated based on local currency spending volume converted to euros using average exchange rates for the period. As a result, our domestic assessments, cross-border volume fees and volume-related rebates and incentives are impacted by the strengthening or weakening of the U.S. dollar versus non-European local currencies and the strengthening or weakening of the euro versus other European local currencies. For example, our billing in Australia is in the U.S. dollar, however, consumer spend in Australia is in the Australian dollar. The foreign currency transactional impact of converting Australian dollars to our U.S. dollar billing currency will have an impact on the revenue generated. The strengthening or weakening of the U.S. dollar is evident when GDV growth on a U.S. dollar-converted basis is compared to GDV growth on a local currency basis. For the three months ended March 31, 2016, as compared to the same period in 2015, GDV on a U.S. dollar-converted basis increased 7%, while GDV on a local currency basis grew 13%. Further, the impact from transactional foreign currency occurs in transaction processing revenue, other revenue and operating expenses when the local currency of these items are different than the functional currency.

The following table provides a summary of the foreign currency translational and transactional impact on growth for the following items in operating results for the three months ended March 31, 2016, versus the comparable period in 2015:

| | Positive (Negative) Impact from Foreign Currency |
|---|---|
| Net Revenue | (4)% |
| Operating Expenses | 4% |
| Net Income | (4)% |

In addition, the Company incurs foreign currency gains and losses from remeasuring monetary assets and liabilities that are in a currency other than the functional currency and from remeasuring foreign exchange derivative contracts (“Foreign Exchange Activity”). Foreign Exchange Activity is recorded in general and administrative expenses. The Company attempts to manage the impact of transactional foreign currency exposures through its foreign exchange risk management activities, which are discussed further in Note 12 (Foreign Exchange Risk Management) to the consolidated financial statements included in Part I, Item 1 of this Report. Since the Company does not designate foreign currency derivatives as hedging instruments pursuant to the accounting standards for derivative instruments and hedging activities, it records gains and losses on foreign exchange derivatives on a current basis, with the associated offset being recognized as the exposures materialize.

Financial Results

Revenue

Revenue Description

MasterCard’s business model involves four participants in addition to us: cardholders, merchants, issuers (the cardholders’ financial institutions) and acquirers (the merchants’ financial institutions). Our gross revenue is generated by assessing our customers based primarily on the dollar volume of activity on the cards and other devices that carry our brands and from the fees that we charge our customers for providing transaction processing and other payment-related products and services. Our revenue is based upon transactional information accumulated by our systems or reported by our customers. Our primary revenue billing currencies are the U.S. dollar, euro and Brazilian real.

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The price structure for our products and services is complex and is dependent on the nature of volumes, types of transactions and type of products and services we offer to our customers. Our net revenue can be significantly impacted by the following:

- domestic or cross-border transactions;
- signature-based or PIN-based transactions;
- geographic region or country in which the transaction occurs;
- volumes/transactions subject to tiered rates;
- processed or not processed across the MasterCard network;
- amount of usage of our other products or services; and
- amount of rebates and incentives provided to customers.

The Company classifies its net revenue into the following five categories:

1. Domestic assessments: Domestic assessments are fees charged to issuers and acquirers based primarily on the dollar volume of activity on cards and other devices that carry our brands where the merchant country and the issuer country are the same. Domestic assessments include items such as card assessments, which are fees charged on the number of cards issued or assessments for specific purposes, such as acceptance development or market development programs.
2. Cross-border volume fees: Cross-border volume fees are charged to issuers and acquirers based on the dollar volume of activity on cards and other devices that carry our brands where the merchant country and the issuer country are different. In general, a cross-border transaction generates higher revenue than a domestic transaction since cross-border fees are higher than domestic fees, and in most cases also include fees for currency conversion.
3. Transaction processing fees: Transaction processing fees are charged for both domestic and cross-border transactions and are primarily based on the number of transactions. Transaction processing fees include charges for the following:

- Switching fees for the following products and services:
  - Ø Authorization is the process by which a transaction is routed to the issuer for approval. In certain circumstances such as when the issuer's systems are unavailable or cannot be contacted, MasterCard or others, on behalf of the issuer approve in accordance with either the issuer's instructions or applicable rules (also known as "stand-in").
  - Ø Clearing is the exchange of financial transaction information between issuers and acquirers after a transaction has been successfully conducted at the point of interaction. MasterCard clears transactions among customers through our central and regional processing systems.
  - Ø Settlement is facilitating the exchange of funds between parties.
- Connectivity fees are charged to issuers and acquirers for network access, equipment and the transmission of authorization and settlement messages. These fees are based on the size of the data being transmitted through and the number of connections to the Company's network.
- Other Processing fees: We extend our processing capabilities in the payment value chain for issuer and acquirer solutions; payment gateways for e-commerce merchants; and mobile gateways for mobile initiated transactions.

4. Other revenues: Other revenues consist of other payment-related products and services and are primarily associated with the following:

- Consulting, data analytic and research fees are primarily generated by MasterCard Advisors, the Company's professional advisory services group.

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- Safety and security services fees are for products and services we offer to prevent, detect and respond to fraud and to ensure the safety of transactions made on MasterCard products. We work with issuers, merchants and governments to help deploy standards for safe and secure transactions for the global payments system.
- Loyalty and rewards solution fees are charged to issuers for benefits provided directly to consumers with MasterCard-branded cards, such as access to a global airline lounge network, global and local concierge services, individual insurance coverages, emergency card replacement, emergency cash advance services and a 24-hour cardholder service center. For merchants, we provide targeted offers and rewards campaigns and management services for publishing offers, as well as opportunities for holders of co-brand or loyalty cards and rewards program members to obtain rewards points faster.
- Program management services provided to prepaid card issuers consist of foreign exchange margin, commissions, load fees and ATM withdrawal fees paid by cardholders on the sale and encashment of prepaid cards.
- The Company also charges for a variety of other payment-related products and services, including account and transaction enhancement services, rules compliance and publications.

5. Rebates and incentives (contra-revenue): Rebates and incentives are provided to certain MasterCard customers and are recorded as contra-revenue.

Revenue Analysis

In the three months ended March 31, 2016, gross revenue increased 12%, or 16% on a currency-neutral basis, versus the comparable period in 2015. Gross revenue growth in the three months ended March 31, 2016 was driven by an increase in dollar volume of activity on cards carrying our brands, transactions, other payment-related products and services and the impact of acquisitions. Rebates and incentives, in the three months ended March 31, 2016, increased 18%, or 22% on a currency-neutral basis, versus the comparable period in 2015, primarily due to the impact from new and renewed agreements and increased volumes. Our net revenue increased 10%, or 14% on a currency-neutral basis, for the three months ended March 31, 2016, versus the comparable period in 2015.

The following table provides a summary of the trend in volume and transaction growth:

| | Three Months Ended March 31, | | | |
|---|---|---|---|---|
| | 2016 | | 2015 | |
| | Growth (USD) | Growth (Local) | Growth (USD) | Growth (Local) |
| MasterCard-Branded GDV [1] | 7 % | 13 % | 2 % | 12 % |
| Asia Pacific/Middle East/Africa | 6 % | 13 % | 9 % | 15 % |
| Canada | (2 )% | 9 % | 2 % | 15 % |
| Europe | 11 % | 18 % | (9)% | 15 % |
| Latin America | (9 )% | 14 % | (3)% | 15 % |
| United States | 10 % | 10 % | 7 % | 7 % |
| Cross-border Volume [1] | 6 % | 12 % | 3 % | 19 % |
| Processed Transactions | | 14 % | | 12 % |

[1] Excludes volume generated by Maestro and Cirrus cards.

A significant portion of our revenue is concentrated among our five largest customers. The loss of any of these customers or their significant card programs could adversely impact our revenue. In addition, as part of our business strategy, MasterCard, among other efforts, enters into business agreements with customers. These agreements can be terminated in a variety of circumstances. See our risk factor in “Risk Factor - Business Risks” in Part I, Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2015.

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The significant components of our net revenue for the three months ended March 31, 2016 and 2015 were as follows:

| | Three Months Ended March 31, 2016 | 2015 | Percent Increase (Decrease) |
|---|---|---|---|
| | (in millions, except percentages) | | |
| Domestic assessments | $1,027 | $963 | 7% |
| Cross-border volume fees | 796 | 724 | 10% |
| Transaction processing fees | 1,165 | 1,006 | 16% |
| Other revenues | 497 | 418 | 19% |
| Gross revenue | 3,485 | 3,111 | 12% |
| Rebates and incentives (contra-revenue) | (1,039 ) | (881 ) | 18% |
| Net revenue | $2,446 | $2,230 | 10% |

The following table provides a summary of the primary drivers of net revenue growth in the three months ended March 31, 2016, versus the comparable period in 2015:

| | Volume | Foreign Currency | Acquisitions | Other [1] | Total |
|---|---|---|---|---|---|
| Domestic assessments | 13 % | (6 )% | — % | — % [2] | 7 % |
| Cross-border volume fees | 10 % | (4 )% | — % | 4 % | 10 % |
| Transaction processing fees | 13 % | (2 )% | — % | 5 % | 16 % |
| Other revenues | ** | (3 )% | 5 % | 17 % [3] | 19 % |
| Rebates and incentives | 10 % | (4 )% | — % | 12 % [4] | 18 % |
| Net revenue | 11 % | (4 )% | 1 % | 2 % | 10 % |

** Not applicable

[1] Includes impact of pricing and other non-volume based fees.

[2] Includes impact of the allocation of revenue to service deliverables, which are recorded in other revenue when services are performed.

[3] Includes impacts from Advisors, safety and security fees, loyalty and reward solution fees and other payment-related products and services.

[4] Includes the impact from timing of new, renewed and expired agreements.

Operating Expenses

Our operating expenses are comprised of general and administrative, advertising and marketing and depreciation and amortization expenses. Operating expenses increased 25%, or 29% on a currency-neutral basis, for the three months ended March 31, 2016, versus the comparable period in 2015, primarily due to the difference between foreign currency gains related to currency hedging and balance sheet remeasurement which occurred in 2015 versus foreign exchange losses on currency hedging in the current year. Additionally, there were higher personnel costs in the current year due to our continued investment in the areas of digital, services and data analytics along with wage increases. For the three months ended March 31, 2016, foreign exchange activity had a negative impact of 16 percentage points to operating expense growth versus the comparable period in 2015. The components of operating expenses for the three months ended March 31, 2016 and 2015 were as follows:

| | Three Months Ended March 31, 2016 | 2015 | Percent Increase (Decrease) |
|---|---|---|---|
| | (in millions, except percentages) | | |
| General and administrative | $868 | $650 | 34% |

| | | | |
|---|---|---|---|
| Advertising and marketing | 135 | 142 | (5)% |
| Depreciation and amortization | 95 | 87 | 9% |
| Total operating expenses | $1,098 | $879 | 25% |

** Not meaningful

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The following table provides a summary of the primary drivers of operating expense growth in the three months ended March 31, 2016, versus the comparable period in 2015:

| | Acquisitions | Foreign Currency | Other | Total |
|---|---|---|---|---|
| General and administrative | 4 % | (4 )% | 34 % | 34 % |
| Advertising and marketing | — % | (3 )% | (2 )% | (5 )% |
| Depreciation and amortization | 10 % | (2 )% | 1 % | 9 % |
| Total operating expenses | 4 % | (4 )% | 25 % | 25 % |

General and Administrative

General and administrative expenses for the three months ended March 31, 2016 increased 34%, or 38% on a currency-neutral basis, versus the comparable period in 2015. The significant components of our general and administrative expenses for the three months ended March 31, 2016 and 2015 were as follows:

| | Three Months Ended March 31, | | Percent Increase (Decrease) |
|---|---|---|---|
| | 2016 | 2015 | |
| | (in millions, except percentages) | | |
| Personnel | $520 | $468 | 11% |
| Professional fees | 64 | 58 | 10% |
| Data processing and telecommunications | 97 | 78 | 24% |
| Foreign exchange activity | 40 | (88 ) | ** |
| Other | 147 | 134 | 11% |
| General and administrative expenses | $868 | $650 | 34% |

** Not meaningful

The primary drivers of changes in general and administrative expenses for three months ended March 31, 2016 versus the comparable period in 2015 were:

- Higher personnel expense was driven by an increase in the number of employees to support our continued investment in the areas of digital, services and data analytics along with wage increases.
- Professional fees consist primarily of third-party services, legal costs to defend our outstanding litigation and the evaluation of regulatory developments that impact our industry and brand.
- Data processing and telecommunication expense consists of expenses to support our global payments network infrastructure, expenses to operate and maintain our computer systems and other telecommunication systems. These expenses increased due to capacity growth of our business and higher third-party processing costs.
- Foreign exchange activity includes gains and losses on foreign exchange derivative contracts and the impact of remeasurement of monetary assets and liabilities denominated in foreign currencies. Foreign exchange activity negatively impacted general and administrative expense growth by $128 million, or 22 percentage points. During three months ended March 31, 2016, we incurred $40 million of losses primarily relating to our derivative contracts versus $33 million of gains on similar contracts in the comparable period in 2015. In addition, in the prior year, we recognized balance sheet remeasurement gains of $55 million driven primarily by the devaluation of the Venezuelan bolivar.
- Other expenses include costs to provide loyalty and rewards programs, travel and meeting expenses and rental expense for our facilities. Other expenses increased primarily due to increased cardholder benefit costs.

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Advertising and Marketing
Our brands, principally MasterCard, are valuable strategic assets that drive acceptance and usage of our products and facilitate our ability to successfully introduce new service offerings and access new markets globally. Our advertising and marketing strategy is to increase global MasterCard brand awareness, preference and usage through integrated advertising, sponsorship, promotions, interactive media and public relations programs on a global scale. We will continue to invest in marketing programs at the regional and local levels and sponsor diverse events aimed at multiple target audiences. Advertising and marketing expenses decreased 5%, or 2% on a currency-neutral basis, for the three months ended March 31, 2016, versus the comparable period in 2015, mainly due to the timing of sponsorship promotions.
Depreciation and Amortization
Depreciation and amortization expenses increased 9%, or 10% on a currency-neutral basis, for the three months ended March 31, 2016 versus the comparable period in 2015, primarily due to higher amortization of capitalized software costs associated with our acquisitions.
Other Income (Expense)
Other income (expense) is comprised primarily of investment income, interest expense, our share of income (losses) from equity method investments and other gains and losses. Total other expense for the three months ended March 31, 2016 remained flat versus the comparable period in 2015, primarily due to higher interest expense related to our debt issuance in December 2015, offset by various other items.
Income Taxes
The effective income tax rates were 28.3% and 23.9% for the three months ended March 31, 2016 and 2015, respectively. For the three months ended March 31, 2016, the effective tax rate was higher than the comparable period in 2015, due to the recognition of a discrete benefit in 2015 relating to certain foreign taxes becoming eligible to be claimed as credits in the United States.
See Note 9 (Income Taxes) to the consolidated financial statements included in Part I, Item 1 of this Report for further discussion of these items.
Liquidity and Capital Resources
We need liquidity and access to capital to fund our global operations, credit and settlement exposure, capital expenditures, investments in our business and current and potential obligations. The Company generates the cash required to meet these needs through operations. The following table summarizes the cash, cash equivalents, investments and credit available to the Company at March 31, 2016 and December 31, 2015:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| | (in billions) | |
| Cash, cash equivalents and investments [1] | $6.2 | $ 6.7 |
| Unused line of credit [2] | 3.8 | 3.8 |

[1] Investments include available-for-sale securities and held-to-maturity securities.  At March 31, 2016 and December 31, 2015 this amount excludes restricted cash related to the U.S. merchant class litigation settlement of $542 million and $541 million, respectively.
[2] The Company did not use any funds from the line of credit available during the periods presented.
Cash, cash equivalents and investments held by our foreign subsidiaries (i.e., any entities where earnings would be subject to U.S. tax upon repatriation) was $3.5 billion and $3.3 billion at March 31, 2016 and December 31, 2015, respectively, or 56% and 48% of our total as of such dates. It is our present intention to indefinitely reinvest historic undistributed accumulated earnings associated with our foreign subsidiaries as of December 31, 2015 outside of the United States (as disclosed in Note 17 (Income Tax) to the consolidated financial statements included in Part II, Item 8 of our Annual Report on Form 10-K for the year ended December 31, 2015), and our current plans do not require repatriation of these earnings. If these earnings are needed for U.S. operations or can no longer be indefinitely reinvested outside of the United States, the Company would be required to record a liability for such U.S. taxes for the historic undistributed accumulated earnings at that time. Such taxes would be due upon repatriation of such earnings to the United States.

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Our liquidity and access to capital could be negatively impacted by global credit market conditions. The Company guarantees the settlement of many MasterCard, Cirrus and Maestro-branded transactions between our issuers and acquirers. See Note 11 (Settlement and Other Risk Management) to the consolidated financial statements in Part I, Item 1 of this Report for a description of these guarantees. Historically, payments under these guarantees have not been significant; however, historical trends may not be an indication of the future. The risk of loss on these guarantees is specific to individual customers, but may also be driven significantly by regional or global economic conditions, including, but not limited to the health of the financial institutions in a country or region.

Our liquidity and access to capital could also be negatively impacted by the outcome of any of the legal or regulatory proceedings to which we are a party. For additional discussion of these and other risks facing our business, see Part I, Item 1A - Risk Factors of the Company's Annual Report on Form 10-K for the year ended December 31, 2015; Note 10 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1 of this Report; and "-Business Environment".

Cash Flow

The table below shows a summary of the cash flows from operating, investing and financing activities for the three months ended March 31, 2016 and 2015:

| | Three Months Ended March 31, 2016 | 2015 |
|---|---|---|
| | (in millions) | |
| Cash Flow Data: | | |
| Net cash provided by operating activities | $1,008 | $911 |
| Net cash used in investing activities | (385 ) | (519 ) |
| Net cash used in financing activities | (1,545 ) | (1,100) |

Net cash provided by operating activities increased $97 million for the three months ended March 31, 2016, versus the comparable period in 2015, primarily due to higher customer incentive accruals and lower litigation payments in the current year, partially offset by lower net income and timing of payables.

Net cash used in investing activities decreased by $134 million for the three months ended March 31, 2016, versus the comparable period in 2015, due to lower net purchases of investment securities as compared to prior year.

Net cash used in financing activities increased by $445 million for the three months ended March 31, 2016, versus the comparable period in 2015, due to higher repurchases of the Company's Class A common stock in the current year and higher dividends.

The table below shows a summary of the balance sheet data at March 31, 2016 and December 31, 2015:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| | (in millions) | |
| Balance Sheet Data: | | |
| Current assets | $10,606 | $ 10,984 |
| Current liabilities | 6,440 | 6,269 |
| Long-term liabilities | 3,954 | 3,919 |
| Equity | 5,511 | 6,062 |

The Company believes that its existing cash, cash equivalents and investment securities balances, its cash flow generating capabilities, its borrowing capacity and its access to capital resources are sufficient to satisfy its future operating cash needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations and potential obligations.

Debt and Credit Availability

In December 2015, the Company issued €1.65 billion aggregate principal amount of notes. This offering consisted of €700 million aggregate principal amount of notes due 2022, €800 million aggregate principal amount of notes due 2027 and €150 million aggregate principal amount of notes due 2030 (collectively the “Euro Notes”). In March 2014, the Company issued $500 million aggregate principal amount of notes due 2019 and $1 billion aggregate principal amount of notes due 2024 (collectively the “USD Notes”). The Company is not subject to any financial covenants under the Euro Notes and the USD Notes (collectively the “Notes”). Interest on the Euro Notes is payable annually on December 1. Interest on the USD Notes is payable semi-annually on April 1 and October 1. The Notes may be redeemed in whole, or in part, at the Company’s option at any time for a specified make-whole amount. The Notes are senior unsecured obligations and would rank equally with any future unsecured and unsubordinated indebtedness.

In November 2015, the Company established a commercial paper program (the “Commercial Paper Program”). Under the Commercial Paper Program, the Company is authorized to issue up to $3.75 billion in outstanding notes, denominated in U.S. Dollars, with maturities up to 397 days from the date of issuance. In conjunction with the Commercial Paper Program, the Company entered into a committed unsecured $3.75 billion revolving credit facility (the “Credit Facility”) in October 2015, which expires in 2020. The Credit Facility amended and restated the Company’s prior credit facility. Borrowings under the Credit Facility are available in U.S. dollars and/or euros. The facility fee and borrowing cost under the Credit Facility are dependent upon the Company’s credit rating. Currently, the applicable facility fee is 8 basis points on the average daily commitment (whether or not utilized). In addition to the facility fee, interest on borrowings under the Credit Facility would be charged at the London Interbank Offered Rate (LIBOR) plus an applicable margin of 79.5 basis points, or an alternative base rate.

The Credit Facility contains customary representations, warranties, events of default and affirmative and negative covenants, including a financial covenant limiting the maximum level of consolidated debt to earnings before interest, taxes, depreciation and amortization (EBITDA), which are substantially similar to the prior credit facility. MasterCard was in compliance in all material respects with the covenants of the Credit Facility as of March 31, 2016 and December 31, 2015. The majority of Credit Facility lenders are customers or affiliates of customers of MasterCard.

Borrowings under the Credit Facility and the Commercial Paper Program are used for general corporate purposes. MasterCard had no borrowings outstanding under the Credit Facility or the Commercial Paper Program at March 31, 2016 and December 31, 2015.

Dividends and Share Repurchases

MasterCard has historically paid quarterly dividends on its outstanding Class A common stock and Class B common stock. Subject to legally available funds, we intend to continue to pay a quarterly cash dividend. However, the declaration and payment of future dividends is at the sole discretion of our Board of Directors after taking into account various factors, including our financial condition, operating results, available cash and current and anticipated cash needs.

On December 8, 2015, our Board of Directors declared a quarterly cash dividend of $0.19 per share paid on February 9, 2016 to holders of record on January 8, 2016 of our Class A common stock and Class B common stock. The aggregate amount of this dividend was $212 million.

On February 2, 2016, our Board of Directors declared a quarterly cash dividend of $0.19 per share payable on May 9, 2016 to holders of record on April 8, 2016 of our Class A common stock and Class B common stock. The aggregate amount of this dividend will be $209 million.

Aggregate payments for quarterly dividends totaled $212 million and $184 million for the three months ended March 31, 2016 and 2015, respectively.

Shares in the Company's common stock that are repurchased are considered treasury stock. The timing and actual number of additional shares repurchased will depend on a variety of factors, including the operating needs of the business, legal requirements, price and economic and market conditions. In December 2015, our Board of Directors approved a new share repurchase program authorizing the Company to repurchase up to $4 billion of our Class A common stock. This program became effective in February 2016. We typically complete a share repurchase program before a new program becomes effective.

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The following table summarizes the Company's share repurchase authorizations of its Class A common stock through March 31, 2016, as well as historical purchases:

| | Authorization Dates | | |
|---|---|---|---|
| | December 2015 | December 2014 | Total |
| | (in millions, except average price data) | | |
| Board authorization | $4,000 | $ 3,750 | $7,750 |
| Remaining authorization at December 31, 2015 | $4,000 | $ 507 | $4,507 |
| Dollar value of shares repurchased during the three months ended March 31, 2016 | $850 | $ 507 | $1,357 |
| Remaining authorization at March 31, 2016 | $3,150 | $ — | $3,150 |
| Shares repurchased during the three months ended March 31, 2016 | 9.7 | 5.7 | 15.4 |
| Average price paid per share during the three months ended March 31, 2016 | $87.38 | $ 89.76 | $88.26 |

See Note 6 (Stockholders' Equity) to the consolidated financial statements included in Part I, Item 1 of this Report for further discussion.

Off-Balance Sheet Arrangements

MasterCard has no off-balance sheet debt other than lease arrangements and other commitments as presented in the future obligations table in Item 7 (Liquidity and Capital Resources) in Part II of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

Refer to Note 1 (Summary of Significant Accounting Policies) to the consolidated financial statements included in Part I, Item 1.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the potential for economic losses to be incurred on market risk sensitive instruments arising from adverse changes in market factors such as interest rates, foreign currency exchange rates and equity price risk. Our exposure to market risk from changes in interest rates, foreign exchange rates and equity price risk is limited. Management establishes and oversees the implementation of policies governing our funding, investments and use of derivative financial instruments. We monitor risk exposures on an ongoing basis. The effect of a hypothetical 10% adverse change in foreign currency rates could result in a fair value loss of approximately $126 million on our foreign currency derivative contracts outstanding at March 31, 2016 related to the hedging program. A 100 basis point adverse change in interest rates would not have a material impact on the Company’s investments at March 31, 2016 or December 31, 2015. Our euro-denominated debt is vulnerable to changes in the euro to U.S. dollar exchange rates. We use the euro-denominated debt to hedge a portion of our net investment in foreign operations against adverse movements in exchange rates, with changes in the translated value of the debt recorded within currency translation adjustment in accumulated other comprehensive income (loss). In addition to euro-denominated debt, we have U.S. dollar-denominated debt, both of which carry a fixed interest rate and thus the fair value of our debt is subject to interest rate risk.  There was no material equity price risk at March 31, 2016 or December 31, 2015.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are designed to ensure that information that is required to be disclosed in the reports under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and to ensure that information required to be disclosed is accumulated and communicated to management, including our President and Chief Executive Officer and our Chief Financial Officer, to allow timely decisions regarding disclosure. The President and Chief Executive Officer and the Chief Financial Officer, with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of the end of the period covered by this Report and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Changes in Internal Control over Financial Reporting

There was no change in MasterCard’s internal control over financial reporting that occurred during the three months ended March 31, 2016 that has materially affected, or is reasonably likely to materially affect, MasterCard's internal control over financial reporting.

Other Financial Information

With respect to the unaudited consolidated financial information of MasterCard Incorporated and its subsidiaries as of March 31, 2016 and for the three months ended March 31, 2016 and 2015, PricewaterhouseCoopers LLP reported that they have applied limited procedures in accordance with professional standards for a review of such information. However, their report dated April 28, 2016 appearing below, states that they did not audit and they do not express an opinion on that unaudited financial information. Accordingly, the degree of reliance on their report on such information should be restricted in light of the limited nature of the review procedures applied. PricewaterhouseCoopers LLP is not subject to the liability provisions of Section 11 of the Securities Act of 1933 (the “Act”) for their report on the unaudited consolidated financial information because that report is not a “report” or a “part” of a registration statement prepared or certified by PricewaterhouseCoopers LLP within the meaning of Sections 7 and 11 of the Act.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders
of MasterCard Incorporated:

We have reviewed the consolidated balance sheet of MasterCard Incorporated and its subsidiaries (the “Company”) as of March 31, 2016, and the related consolidated statements of operations and comprehensive income for the three-month periods ended March 31, 2016 and 2015, and the consolidated statement of changes in equity for the three-month period ended March 31, 2016, and the consolidated statement of cash flows for the three-month periods ended March 31, 2016 and 2015 included within Part I, Item 1 of this Form 10-Q. These interim financial statements are the responsibility of the Company’s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet as of December 31, 2015, and the related consolidated statements of operations, of comprehensive income, of changes in equity, and of cash flows for the year then ended (not presented herein), and in our report dated February 12, 2016, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2015, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

/s/ PricewaterhouseCoopers LLP
New York, New York
April 28, 2016

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## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS
Refer to Note 10 (Legal and Regulatory Proceedings) to the consolidated financial statements included in Part I, Item 1.
### ITEM 1A. RISK FACTORS
For a discussion of the Company's risk factors, see Item 1A (Risk Factors) in Part I of our Annual Report on Form 10-K for the year ended December 31, 2015.
### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS
ISSUER PURCHASES OF EQUITY SECURITIES
During the first quarter of 2016, MasterCard repurchased a total of approximately 15.4 million shares for $1.4 billion at an average price of $88.26 per share of Class A common stock. See Note 6 (Stockholders' Equity) to the consolidated financial statements included in Part I, Item 1 of this Report for further discussion with respect to the Company's share repurchase programs. The Company's repurchase activity during the first quarter of 2016 is summarized in the following table:

| Period | Total Number of Shares Purchased | Average Price Paid per Share (including commission cost) | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Dollar Value of Shares that may yet be Purchased under the Plans or Programs [1] |
|---|---|---|---|---|
| January 1 - 31 | 4,405,982 | $ 90.75 | 4,405,982 | $ 4,106,703,645 |
| February 1 - 29 | 5,621,009 | $ 85.22 | 5,621,009 | $ 3,627,673,500 |
| March 1 - 31 | 5,340,163 | $ 89.40 | 5,340,163 | $ 3,150,286,592 |
| Total | 15,367,154 | $ 88.26 | 15,367,154 | |

[1] Dollar value of shares that may yet be purchased under the repurchase programs is as of the end of the period.
### ITEM 5. OTHER INFORMATION
Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012, we hereby incorporate by reference herein the disclosure contained in Exhibit 99.1 of this Report.
### ITEM 6. EXHIBITS
Refer to the Exhibit Index included herein.

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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.

MASTERCARD INCORPORATED
(Registrant)

| | | | |
|---|---|---|---|
| Date: | April 28, 2016 | By: | /S/ AJAY BANGA<br>Ajay Banga<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| Date: | April 28, 2016 | By: | /S/ MARTINA HUND-MEJEAN<br>Martina Hund-Mejean<br>Chief Financial Officer<br>(Principal Financial Officer) |
| Date: | April 28, 2016 | By: | /S/ ANDREA FORSTER<br>Andrea Forster<br>Corporate Controller<br>(Principal Accounting Officer) |

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EXHIBIT INDEX

| Exhibit Number | Exhibit Description |
|---|---|
| 10.1+* | Form of Restricted Stock Unit Agreement for awards under MasterCard Incorporated 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2016). |
| 10.2+* | Form of Stock Option Agreement for awards under MasterCard Incorporated 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2016). |
| 10.3+* | Form of Performance Unit Agreement for awards under MasterCard Incorporated 2006 Long Term Incentive Plan (effective for awards granted on and subsequent to March 1, 2016). |
| 12.1* | Computation of Ratio of Earnings to Fixed Charges. |
| 15* | Awareness Letter from the Company's Independent Registered Public Accounting Firm. |
| 31.1* | Certification of Ajay Banga, President and Chief Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2* | Certification of Martina Hund-Mejean, Chief Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1* | Certification of Ajay Banga, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification of Martina Hund-Mejean, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 99.1* | Disclosure pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012. |
| 101.INS* | XBRL Instance Document |
| 101.SCH* | XBRL Taxonomy Extension Schema Document |
| 101.CAL* | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF* | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB* | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE* | XBRL Taxonomy Extension Presentation Linkbase Document |

+Management contracts or compensatory plans or arrangements.
*Filed or furnished herewith.
The agreements and other documents filed as exhibits to this report are not intended to provide factual information or other disclosure other than with respect to the terms of the agreements or other documents themselves, and should not be relied upon for that purpose. In particular, any representations and warranties made by the Company in these

agreements or other documents were made solely within the specific context of the relevant agreement or document and may not describe the actual state of affairs as of the date they were made or at any other time.

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