

March 11, 2010

**CURRENT PRICE:** \$3.58

**RATING:** NEUTRAL

**PRICE TARGET:** N/A

**CURRENT YIELD:** N/A

**EPS Estimates - Non-GAAP**

	DEC 09	DEC 10E
1Q	(\$0.41)	(\$0.08) e
2Q	(\$0.26)	(\$0.07) e
3Q	(\$0.03)	(\$0.07) e
4Q	(\$0.83)	(\$0.01) e
	<b>(\$1.53)</b>	<b>(\$0.23)</b>

**Trading Data**

52-WEEK PRICE RANGE: \$5.22-\$1.10

SHARES OUTSTANDING: 33.49(M)

MARKET CAP: \$119.9(M)

AVG. DAILY TRADING VOLUME: 130(K)

S&P 500: 1,150

**Valuation Data**

BOOK VALUE: \$1.06

PRICE TO BOOK: 3.36x

DIVIDEND: n/a

**PLAYBOY ENTERPRISES, INC. (NYSE:PLA)**

*4Q09 Earnings Report: Maintain Neutral Rating*

**HIGHLIGHTS**

- 4Q09 results of (\$0.83)/share vs (\$4.40)/share during 4Q08
- Segment income rose to \$2.1 million from \$1.1 million
- Licensing & Digital/Print drove improvement
- EBITDA growth could lead to positive EPS in 2011
- Maintain Neutral rating

**INVESTMENT THESIS**

Following a string of quarterly operating losses, and management changes, PLA recently unveiled its' turnaround strategy. The decline in consumer spending, due to the global recession, negatively impacted PLA. New CEO Scott Flanders has the company focused on revenue growth & cost controls. An improving world economy in 2010, and successful turnaround strategy could return PLA towards positive EPS by 2011. We have given PLA a NEUTRAL rating awaiting evidence of positive results from the company's turnaround strategy.

**COMPANY SUMMARY**

Playboy Enterprises Inc (PLA-\$3.58), headquartered in Chicago IL, is a media and lifestyle company providing content/products for adults through a variety of platforms to US and international audiences. The company's iconic publication is "Playboy Magazine" and PLA creates/distributes content through television networks, radio, websites, and mobile platforms. PLA also uses licensing agreements to market the Playboy brand, and products in over 150 countries. Additionally, marketing is done through entertainment venues and retail stores. The company consists of three primary business units: Entertainment, Digital/Print, and Licensing. PLA's 2009 revenues totaled \$240.4 million and generated an operating loss of (\$1.53)/share. During 2009 the Entertainment unit produced \$98.1 million in revenues, while Digital/Print generated \$105.5 million, and Licensing was \$36.8 million.

*For Important Disclosure information regarding the Firm's rating system, valuation methods and potential conflicts of interest, please refer to the last page of this report.*



PLA has debt of \$110 million and pays an average interest rate of 3%. The company has approximately 573 employees.

## RECENT DEVELOPMENTS

Since PLA distributes content over five different media platforms, and has over 100 licensing agreements globally, management unveiled its strategy to reduce its operating oversight and license/partner most of its non-core competences such as creation of content. PLA recently entered into a licensing agreement with IMG making this company the licensing agent for PLA products in the Asian markets. Additionally, this past fall American Media Inc. (AMI) was given the non-editorial operations of “Playboy” Magazine. AMI will handle the production, circulation, advertising sales, marketing, and support functions for “Playboy Magazine” and PLA’s other domestic publications. Management believes AMI’s large presence in the newsstand business could increase magazine sales and eventually lead to increased advertising revenues. PLA is projecting approximately 20% segment income growth in 2010 and potential profitability in 2011.

## RECENT EARNINGS

PLA reported 4Q09 earnings of (\$0.83)/share vs (\$4.40)/share during 4Q08. 4Q09 included impairment charges of \$28.6 million and 4Q08 had charges of \$157.2 million. Segment income was \$2.1 million compared to \$1.1 million during last year’s quarter due to improved results in Licensing and Print/Digital. Declining revenues in the media unit caused overall 4Q09 revenues to decline to \$69.8 million from \$60.6 million. During FY09 PLA reported earnings of (\$1.53)/share vs (\$4.81)/share while revenues declined to \$240.4 million from \$292.1 million.

### 4Q09 SEGMENT PERFORMANCE

**Entertainment:** Operating income declined to \$2.6 million from \$4.2 million as revenues fell by \$5.5 million to \$23.7 million. The decline in income and revenues was partially due to 4Q08 high margin revenues related to 3<sup>rd</sup> party productions licensing fees. Another key factor to the decline in 4Q09’s profitability was the 29% decline in revenues, to \$12.0 million, from the domestic TV business. Video-on-Demand and movie networks were lower due to competition and lower consumer spending on premium TV services. Revenues from monthly Playboy TV subscriptions showed a slight increase when compared to last year’s quarter. On the positive side for this unit, PLA experienced increased revenues and profits from its International TV business produced by higher licensing fees from its European partners and reduced overhead.

**Print/Digital:** Operating income rose to \$2.5 million from (\$400,000), despite a 14% decline in revenues to \$28.2 million. “PLAYBOY” magazine produced a profit for the quarter, vs 4Q08’s operating loss, after the company decided to combine the January/February 2010 issue into one editorial package. This combined with the newsstand success of the November 2009 issue, featuring “Marge Simpson”, produced 4Q09 circulation revenues and lead to a profit contribution to overall segment results. Despite improved revenues, the magazine saw a decline in its advertising revenues. The domestic magazine results were favorably impacted by cost reduction efforts. Results at International publishing business experienced revenue/profit declines from the worldwide economic recession and unfavorable operating fundamentals in the advertising/publishing industries. Digital revenues declined from lower pay site and advertising contributions. These were offset by overhead



# EQUITY RESEARCH

reductions and lower content expense along with higher revenues/profits from the international and mobile businesses leading to improved 4Q09 digital results.

**Licensing:** Operating income rose to \$5.1 million from \$4.3 million as revenues grew 10% to \$8.7 million. New recently introduced domestic and international product categories and increased consumer spending, and revenues from location based entertainment venues (casinos & clubs) generated improved results at this business unit. Consumer product revenues increased to \$7.1 million from \$6.5 million and location based entertainment rose to \$1.1 million from \$900,000.

**Other:** Corporate expense rose to \$8.1 million from \$7.0 million during 4Q09 due to higher severance/other employee-benefit-related expense items. 4Q08 corporate expenses were lower because of a decline in the company's deferred compensation plan liability. PLA had a \$6.4 million restructuring charge and a \$22.2 million non-cash impairment charge in relation to a past television acquisition. PLA did have a \$900,000 tax benefit during 4Q09 from a tax effect of the impairment charge and a foreign withholding tax adjustment.

## OUR THOUGHTS

PLA reported 4Q09 earnings of (\$0.83)/share vs (\$4.40)/share during 4Q08. The improved results were produced by lower restructuring costs and improved operating segment income. Both quarters included restructuring expense/impairment charges of \$28.6 million and \$157.2 million, respectively. Operating segment income increased to \$2.1 million from \$1.1 million due to higher Licensing and Print/Digital results, offsetting a profit decline in the Entertainment unit. The Print/Digital unit's operating profit improved to \$2.5 million from (\$400,000), while Licensing's profits rose to \$5.1 million from \$4.3 million. Operating income at the Entertainment unit declined to \$2.6 million from \$4.2 million. Corporate expenses on a quarter-to-quarter basis grew to \$8.1 million from \$7.0 million resulting from higher severance and other employee benefit related expenses. EBITDA, on a quarter-to-quarter comparison, was (\$17.7 million) vs (\$147.9 million). Full year 2009 earnings per share improved to (\$1.53)/share from (\$4.81)/share during 2008. EBITDA during 2009 was (\$3.1 million) vs. (\$121.6 million) in 2008.

Overall, 4Q09's results were positive as the company enters the first stages of its turnaround strategy. Management has stated it will continue to manage operating costs and emphasis revenue growth. On managing costs, investors should not be surprised if PLA farms out more of its operations to third-party sources. On the revenue side, some of its new business partners could help grow the overseas business in the Licensing area while results in the Publishing unit could improve this year. Additionally, increased consumer spending, based on an improving world economy, may go a long way towards improving profitability at PLA. Declining revenues in the Entertainment business need to be reversed to usher in a full turnaround at PLA. Evidence of a turnaround could materialize during 2010 if segment income, and EBITDA, show sequential quarterly improvement going forward. Our 2010 earnings estimate is (\$0.23)/share. However, due to several moving parts to the PLA operating strategy, our estimate is subject to change as the company moves further into the upcoming year.



## **RISKS**

There are no guarantees PLA's turnaround strategy will return the company to profitability. A prolonged downturn in consumer spending and continued competition could hinder a recovery at PLA. New media formats/technology platforms is another risk. Being a small cap stock, PLA's shares are subject to wide price fluctuations from increased trading activity. Profitability could be impacted by rising interest rates, or higher operational expenses. PLA's stock could be adversely impacted by negative equity markets, failure to comply with Sarbanes Oxley guidelines, or terrorist attacks.

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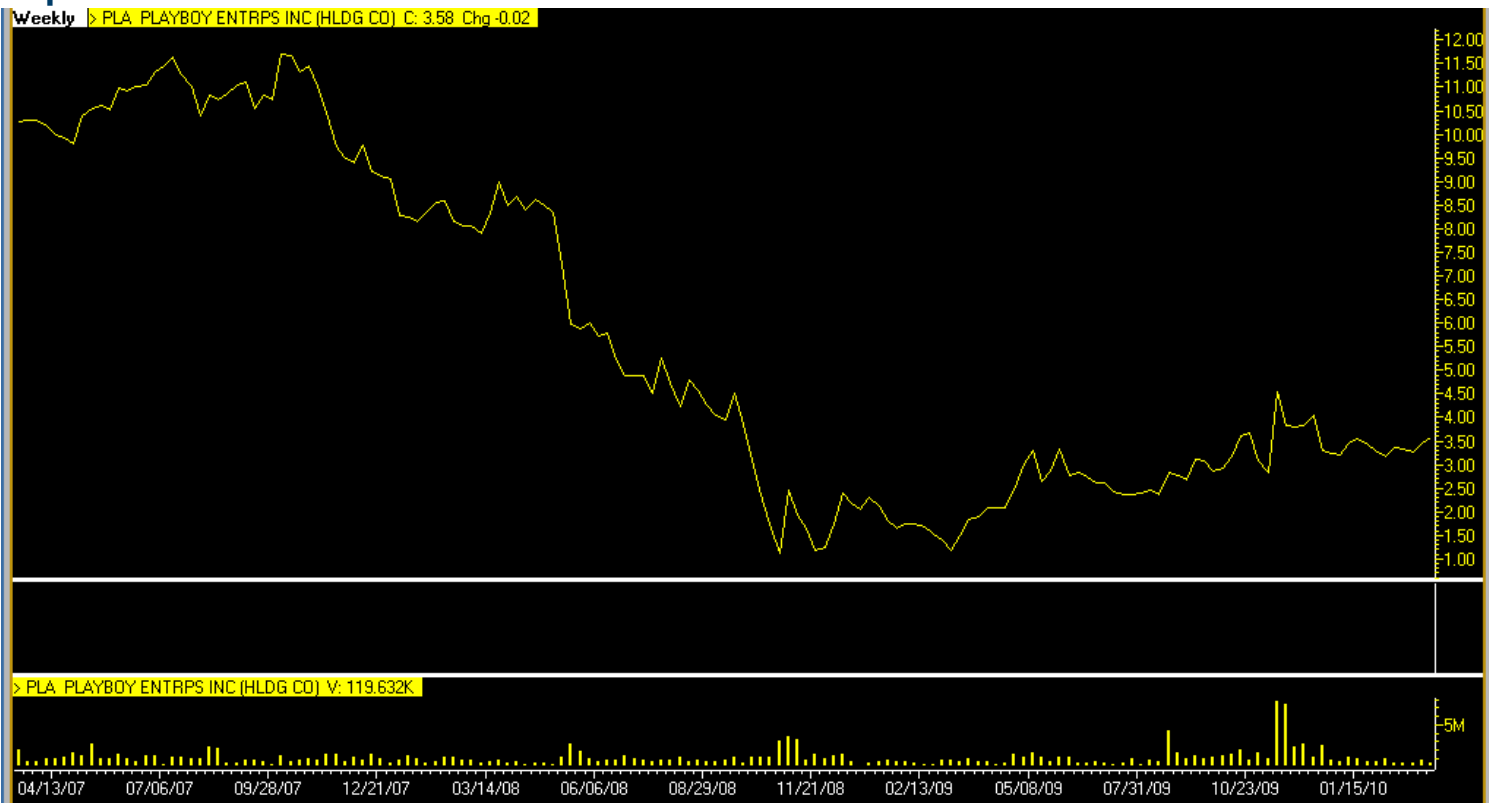


# EQUITY RESEARCH

Playboy Enterprises, Inc.  
(in millions, except per share)

	1Q09	2Q09	3Q09	4Q09	2009	1Q10e	2Q10e	3Q10e	4Q10e	2010e
Revenues	\$61.6	\$62.2	\$56.0	\$60.6	\$240.4	\$53.4	\$53.9	\$54.1	\$56.5	\$217.9
Expenses	62.9	58.6	53.3	58.5	\$233.3	52.1	52.4	52.4	52.5	209.4
Segment Income	-1.3	3.6	2.7	2.1	7.1	1.3	1.5	1.7	4.0	8.5
Restructuring expense	-3.2	-9.1	-0.5	-6.4	-19.2	-0.5	-0.4	-0.4	-0.2	-1.5
Provisions for reserves / impairment charge	-5.5			-22.2	-27.7				-0.3	-0.3
Operating Income	-10	-5.5	2.2	-26.5	-39.8	0.8	1.1	1.3	3.5	6.7
Investment Income		0.7		0.1	0.8	0.1		0.1	0.2	0.4
Interest expense	-2.1	-2.2	-2.2	-2.2	-8.7	-2.2	-2.2	-2.2	-2.2	-8.8
Amortization of deferred financing fees	-0.3	-0.1	-0.1	-0.2	-0.7	-0.1	-0.2	-0.1	-0.2	-0.6
Other, net	-0.1	-0.4	0.2	0.1	-0.2	-0.2	0.2	-0.1	-0.3	-0.4
Income before income taxes	-12.5	-7.5	0.1	-28.7	-48.6	-1.6	-1.1	-1	1	-2.7
Income tax expense	-1.2	-1.2	-1.2	0.9	-2.7	-1.2	-1.2	-1.2	-1.2	-4.8
Net gain/loss	-13.7	-8.7	-1.1	-27.8	-51.3	-2.8	-2.3	-2.2	-0.2	-7.5
Diluted outstanding shares	33	33.44	33.47	33.49	33.49	33.49	33.49	33.49	33.49	33.49
Diluted profit/loss per common stock	(\$0.41)	(\$0.26)	(\$0.03)	(\$0.83)	(\$1.53)	(\$0.08)	(\$0.07)	(\$0.07)	(\$0.01)	(\$0.23)

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Steven Marascia certifies, with respect to the companies or securities that he analyzes, that (1) the views expressed in this report accurately reflect his personal views about all of the subject companies and securities and (2) no part of his compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this report.

Capitol Securities and employees of Capitol Securities may own shares of Playboy Enterprises, Inc.

Stock ratings used in this report are defined as follows:

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- (2) Neutral – The stock's total return including dividends is expected to be in line with the industry or market average of +/- 10% over the next twelve months.
- (3) Underperform – The Stock's total return including dividends is expected to be below the industry or market average by 10% or more over the next twelve months.

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