

December 20, 2010

PLAYBOY ENTERPRISES, INC. (NYSE:PLA)

CURRENT PRICE: \$5.11

RATING: NEUTRAL

PRICE TARGET: N/A

CURRENT YIELD: N/A

3Q10 Earnings Report: PLA contemplates Hefner offer

HIGHLIGHTS

- 3Q10 results of (\$0.81)/share vs (\$0.03)/share during 3Q09
- Segment income fell to \$0.7 million from \$2.7 million
- \$25.8 million restructuring charge taken during 3Q10
- PLA's choice: take Hefner offer or remain public
- Maintain Neutral rating

EPS Estimates - Non-GAAP

	DEC 09	DEC 10E
1Q	(\$0.41)	(\$0.03)
2Q	(\$0.26)	(\$0.16)
3Q	(\$0.03)	(\$0.81)
4Q	(\$0.83)	(\$0.01)e
	(\$1.53)	(\$1.01)

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 rate PLA NEUTRAL awaiting evidence of positive results from the company's turnaround strategy.

Trading Data

52-WEEK PRICE RANGE:	\$6.10-3.04
SHARES OUTSTANDING:	33.7(M)
MARKET CAP:	\$172.2(M)
AVG. DAILY TRADING VOLUME:	120(K)
S&P 500:	1,247

Valuation Data

BOOK VALUE:	n/a
PRICE TO BOOK:	n/a
DIVIDEND:	n/a

COMPANY SUMMARY

Playboy Enterprises Inc (PLA-\$5.11), 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.



EQUITY RESEARCH

RECENT DEVELOPMENTS

Founder, and majority shareholder, Hugh Hefner announced a proposal to take the company private. Mr. Hefner is offering to purchase all shares he does not own for \$5.50/share in cash. According to his proposal letter Mr. Hefner has arranged financing from Rizvi Traverse Management LLC, in order to arrange finance the deal. During June PLA announced plans to downsize its organizational structure and incurred a restructuring charge in 2Q10. Kai-Shing Tao was elected to PLA's board of directors and Kendice K. Briggs was named senior vice president of human resources.

RECENT EARNINGS

PLA reported 3Q10 earnings of (\$0.81)/share vs. (\$0.03)/share during 3Q09. 3Q10's and 3Q09's results included impairment/restructuring charges of \$25.8 million and \$0.5 million, respectively. Net of these charges the company reported an operating loss of (\$0.05)/share vs. (\$0.02)/share on a quarter-to-quarter comparison. Revenues declined 7% to \$52.1 million from \$56.0 million and total segment income fell to \$0.7 million from \$2.7 million. The declines were from lower profits in the Entertainment Group and higher Corporate expenses more than offsetting improvements in PLA's Print/Digital and Licensing Group units. EBITDA was (\$18.6 million) vs. \$11.2 million and adjusted EBITDA was \$0.1 million vs. \$6.8 million.

SEGMENT PERFORMANCE

Entertainment: Segment income for the Entertainment Group came in at \$0.8 million compared to \$2.3 million on a quarter-to-quarter comparison. Domestic TV revenues fell 21% to \$9.8 million from \$12.5 million as results suffered from DirecTV, Inc.'s decision to withhold \$3.0 million of estimated TV payments. This and a decline in movie network/video-on-demand revenues created the negative comparisons. During the quarter this unit took a \$1.2 million charge for bad debt expense for receivables involving DirecTV. International TV's revenues fell \$1.7 million to \$9.0 million due to unfavorable exchange rates and increased competition. The decline was partially offset by lower expenses during the quarter. Programming amortization expense was \$3.9 million compared to a \$7.2 million reflecting an impairment charge taken during the quarter. This units overall revenues fell 20% to \$19.5 million from \$24.4 million.

Print/Digital: Segment income increased to \$1.3 million from \$0.4 million due mainly to "Playboy Magazine" as magazine revenues rose 6% to \$10 million and a decline in operating costs. Revenues were higher as the magazine was published three times during the quarter compared to twice during 3Q09, producing a 21% increase in circulation revenues. While advertising pages were 31% higher, advertising revenues fell 25% resulting in a



planned 42% reduction of the magazine's rate base. Digital's revenues fell \$1.1 million to \$8.5 million because of lower pay-sites and ad revenues. Overall revenues for this unit fell 5% to \$21.7 milli

Licensing: This unit's segment income improved 11% to \$6.2 million from \$5.5 million as revenues grew 24% to \$10.9 million from \$8.7 million. The outsourcing agreements with IMG are bearing fruit as consumer product sales increased 36% due to higher royalties from Southeast Asia and Latin America. Expenses for Licensing rose to \$3.6 million due to higher bad debt expense and agency fees.

Other: Corporate expenses rose to \$7.6 million from \$5.5 million because of higher trademark defense costs and fees related to the proposed takeover by Mr. Hefner. The proposal is to take PLA private and is currently being examined by a special committee appointed by the company.

OUR THOUGHTS

There are a couple of different themes surrounding PLA currently 1) Hugh Hefner's offer to take the company private for \$5.50/share and 2) management's moves towards engineering a potential operating turnaround of the company.

Hugh Hefner's offer to take PLA private for \$5.50/share is currently being considered by a special committee. Once the special committee either gives the offer a "thumbs-up" or "thumbs-down" recommendation to the Board, the Board of Directors will vote to either accept/reject the offer. A consideration the Board may take into its decision making matrix is the potential of an operating turnaround of PLA in 2011.

PLA has cut operating costs from its operating structure during the past two years and outsourced part of its business. The results of these efforts hint at the emergence of improved future operating results. Specifically, the outsourcing agreements with IMG are bearing some fruit as royalties/revenues from the Asian markets are painting a picture of increased revenues/profitability in the Licensing unit. Moreover, PLA plans to open clubs in Macau, Cancun, and London potentially increasing brand awareness of PLA's products and generating higher revenues down the road. The Entertainment unit continues to be a work in progress as PLA seeks to turnaround operating losses in this area. Recent moves in Publishing has recently lead to improved results with hopes that by cutting costs, an improving advertising market could eventually lead to breakeven or positive in this unit.

The question becomes will the promise of a potential operating turnaround cause the Board of Directors to reject Hefner's offer and keep the company public, in hopes of a higher share price assuming a turnaround does materialize, thus causing increased investor demand for PLA's stock. Additionally, Hefner owns 75% of the voting stock, adding an interesting twist to this takeover story.



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)

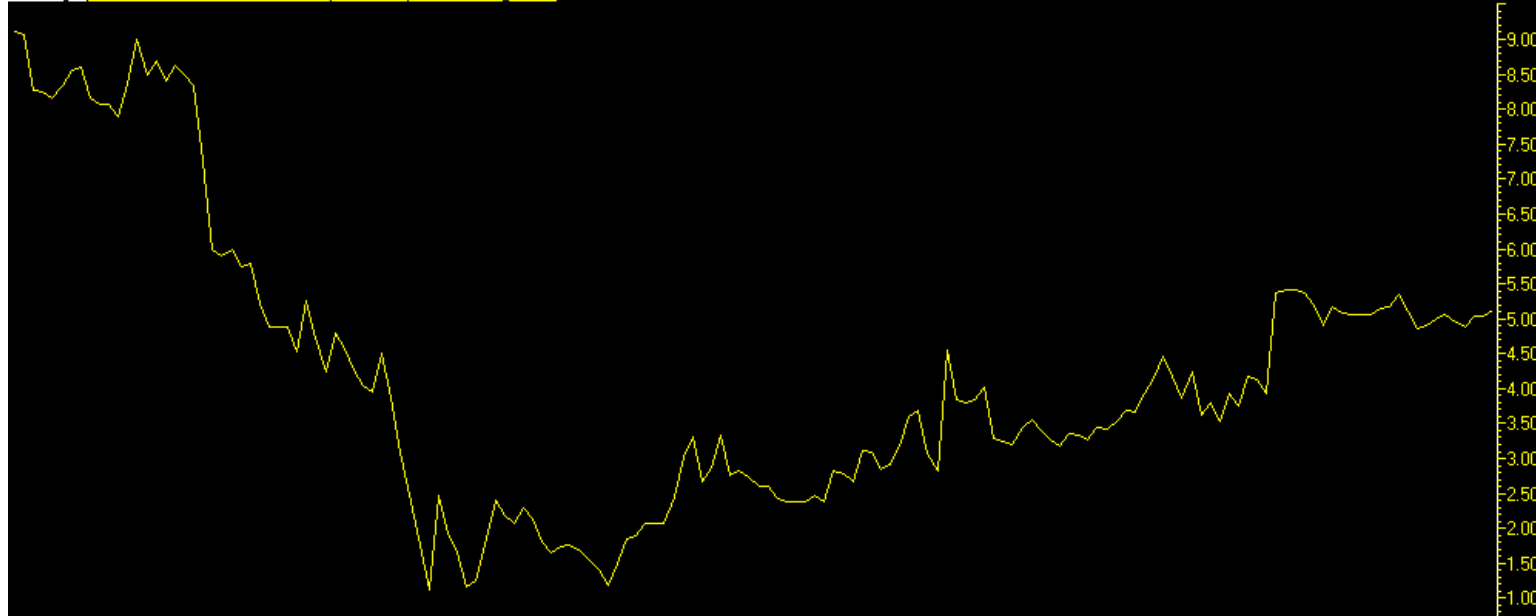
	1Q09	2Q09	3Q09	4Q09	2009	1Q10	2Q10	3Q10	4Q10e	2010e
Revenues	\$61.6	\$62.2	\$56.0	\$60.6	\$240.4	\$53.1	\$56.0	\$52.1	\$56.3	\$216.5
Expenses	62.9	58.6	53.3	58.5	\$233.3	48.9	55.6	51.4	52.5	208.4
Segment Income	-1.3	3.6	2.7	2.1	7.1	3.2	0.4	0.7	3.8	8.1
Restructuring expense	-3.2	-9.1	-0.5	-6.4	-19.2	-0.7	-1.6	-0.4	-0.2	-2.9
Provisions for reserves / impairment charge	-5.5			-22.2	-27.7	-0.4		-25.4	-0.3	-26.1
Operating Income	-10	-5.5	2.2	-26.5	-39.8	2.1	-1.2	-25.1	3.3	-20.9
Investment Income		0.7		0.1	0.8				0.2	0.2
Interest expense	-2.1	-2.2	-2.2	-2.2	-8.7	-2.2	-2.2	-2.1	-2.2	-8.7
Amortization of deferred financing fees	-0.3	-0.1	-0.1	-0.2	-0.7	-0.2	-0.1	-0.2	-0.2	-0.7
Other, net	-0.1	-0.4	0.2	0.1	-0.2		-1	1.1	-0.3	-0.2
Income before income taxes	-12.5	-7.5	0.1	-28.7	-48.6	-0.3	-4.5	-26.3	0.8	-30.3
Income tax expense	-1.2	-1.2	-1.2	0.9	-2.7	-0.7	-0.9	-1.1	-1	-3.7
Net gain/loss	-13.7	-8.7	-1.1	-27.8	-51.3	-1	-5.4	-27.4	-0.2	-34
Diluted outstanding shares	33	33.44	33.47	33.49	33.49	33.54	33.62	33.7	33.7	33.7
Diluted profit/loss per common stock	(\$0.41)	(\$0.26)	(\$0.03)	(\$0.83)	(\$1.53)	(\$0.03)	(\$0.16)	(\$0.81)	(\$0.01)	(\$1.01)



EQUITY RESEARCH

Important Disclosures

Weekly > PLA PLAYBOY ENTRPS INC (HLDG CO) C: 5.13 Chg 0.09



> PLA PLAYBOY ENTRPS INC (HLDG CO) V: 166.810K



1/26/10 Initiate NEUTRAL

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