January 26, 2010

CURRENT PRICE:	**$3.47**
RATING:	**NEUTRAL**
PRICE TARGET:	**N/A**
CURRENT YIELD:	**N/A**

EPS Estimates - Non-GAAP

	DEC 09E	DEC 10E
1Q	($0.41) A	($0.08) e
2Q	($0.26) A	($0.08) e
3Q	($0.03) A	($0.07) e
4Q	($0.06) e	($0.04) e
	($0.76)	**($0.27)**

Trading Data

52-WEEK PRICE RANGE:	**$5.22-$1.10**
SHARES OUTSTANDING:	**33.47(M)**
MARKET CAP:	**$116.1(M)**
AVG. DAILY TRADING VOLUME:	**260(K)**
S&P 500:	**1,092**

Valuation Data

BOOK VALUE:	**$0.89**
PRICE TO BOOK:	**3.91x**
DIVIDEND:	**n/a**

PLAYBOY ENTERPRISES, INC. (NYSE:PLA)

Initiating Coverage with a Neutral Rating

HIGHLIGHTS

- Named Scott Flanders as new CEO
- Unveiled turnaround strategy
- Focus on revenue growth & cost containment
- Improvement in EBITDA could lead to positive EPS in 2011
- Initiating coverage with 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 are initiating coverage of PLA with a NEUTRAL rating awaiting evidence of positive results from the company's turnaround strategy.

COMPANY SUMMARY

Playboy Enterprises Inc (PLA-$3.47), 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 2008 revenues totaled $292.1 million and generated an operating loss of ($4.69)/share. During 2008 the Entertainment unit produced $167.2 million in revenues, while Publishing generated $84.5 million, and Licensing was $40.5 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.

BUSINESS STRATEGY

PLA is currently implementing a strategy geared to turnaround its business results hurt by both the current recession and the changing face of various media platforms. The company's is well known for its flagship publication, "Playboy Magazine". However, operating fundamentals in the media business has changed drastically due to competition for consumers, advertising dollars, and increased competition on cable/satellite TV platforms. We met with PLA's new CEO, Scott Flanders, and he outlined his strategy for potentially moving PLA back towards operating profitability.

Flanders noted the world wide recognition of the iconic Playboy "Bunny" logo can be utilized to increase product offerings in order to grow revenues. Additionally, he discussed the value of strategic partnerships being an important element of future growth due to PLA being a small cap equity. The value of using strategic partners has been realized given PLA's favorable results in its exisiting Las Vegas casino venture. The Vegas casino venture gives PLA a blueprint for expansion in the hotel/casino/nightclub business, potentially generating revenue/profit growth. Based on logo recognition, strategic partnerships, cross marketing, cost cutting efforts, and increased casino/hotel ventures, he feels the company can set the course towards an operating turnaround.

PLA believes the recognition of the "Bunny" logo helped create worldwide consumer demand for the Licensing Unit's products. Prior to the current economic slowdown, Licensing's sales were growing 20% annually. While sales were hurt by the current recession, management believes a pick-up in the world economy could boost revenues, since 80% of this units' sales come from overseas. Additionally, the company's has had success with the launch of its line of men's fragrances marketed through an agreement with "Coty", the world's largest fragrance company. Retail sales of this item have thus far totaled $2 million with anticipation of additional revenue growth from this product. The success of "Coty" has encouraged PLA to offer other new products such as its Playboy Energy Drink. The energy drink has been launched in Europe and Africa, with plans for an expanded US distribution in 2010. Recently, PLA's mobile phone application was added to the menu of app choices for Apple's(AAPL-$205.94) I-Phone. Management anticipates the launching of other "Bunny"-logoed products in the future. Going forward, rising revenues, generated from an improving world economy, geographic expansion, and additional product launches, along with recent cost cutting efforts, could produce profit growth in the Licensing Unit.

One area of recent success which PLA plans to increase its exposure is partnering in more clubs/casinos bearing the Bunny logo or "Playboy" name. The company views the recent success of the Playboy Club, at the Palms Casino Resort in Las Vegas, as a blue print for potential future ventures in other cities, both domestically and internationally. PLA anticipates adding new licensed ventures with their partners owning and financing the projects in order to lessen its financial liability in these projects. In 2010 a casino project will open in Cancun Mexico and a hotel will begin operations in South Beach, near Miami FL. PLA is looking to develop casino/hotel/nightclub ventures in Europe, Asia, and North/South America based on financing and market conditions.

In the Entertainment Unit, management sees this as a longer term project with changes needed in order to make it a viable business. Specifically, Network TV has lost shelf space due to increased competition on the "On-Demand" platform and from internet content providers causing a 50% decline in operating revenues.

PLA believes the potential exists to attract more viewers to these its Network TV by shifting its programming focus from male-oriented towards couples. An area of management's focus is Playboy TV's approximately $10 million year in annual programming costs and its effect on the bottom line. Given management's assertion of its intent to utilize partners to help grow PLA's businesses, a lack of turnaround in this area may lead the company to let another entity run this unit in the future.

PLA began reducing costs in the Publishing Unit before the current recession due to shifting fundamentals in the media print business. Various staff positions were eliminated and the magazine's size/frequency/rate base was reduced. Approximately $10 million in costs were eliminated in 2007-2008 from domestic magazine operations. In further cost-cutting efforts, PLA recently announced it was outsourcing the publication of "Playboy Magazine" to American Media Inc (AMI). PLA believes this could reduce the operating loss at the magazine unit from about $8 million to $3 million in 2010, before potentially generating a profit in 2011. 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.

RECENT EARNINGS

PLA reported 3Q09 earnings of ($0.03)/share compared to ($0.19)/share during 3Q08. 3Q09 included a $500,0000 restructing charge and 3Q08 had $6.3 million in restructuring charges/provisions for reserves. Revenues, on a quarter-to-quarter comparison, declined to $56.0 million from $70.4 million. Segment income fell by $900,000 to $2.7 million as improved results in PLA's media operations were offset by lower profits from the Licensing Unit and increased corporate expenses.

The Licensing Unit's income declined 16% to $5.5 million from $6.7 million and revenues fell to $8.7 million from $10.4 million. Declines in revenues and income came primarily from the global economic slowdown and lower royalty payments.

The Print/Digital segment income was $400,000 vs ($200,000) during 3Q08 and revenues declined to $22.9 million from $32.7million, partially reflecting the combination of the July/August US editions of Playboy Magazine into one editorial package. Additionally, results were aided by improved e-commerce results. Because there were only two published issues during 3Q09, lower circulation/advertising generated a $7.5 million decline in domestic revenues to $9.4 million. The fall in revenues were offset by large reductions in printing, paper, and other operating expenses. International magazine revenues fell 21% to $1.5 million due to the worldwide recession and lower royalty payments. This unit was also negatively impacted by lower pay-site sales as digital revenues fell to $9.6 million from $10.9 million.

The Entertainment Unit's income grew 37% to $2.3 million due primarily to cost-cutting efforts. Cost reduction measures were achieved through staff cuts, lower program spending, and smaller DVD/other expenses. Total revenues declined to $24.4 million from $27.3 million. Domestic TV revenues fell $2.1 million to $12.5 million due to lower linear network sales as consumers migrated to competitors VOD offerings. International TV revenues declined $1.1 million to $10.7 million resulting from expired contracts, more competition, and lower consumer spending created by the recession.

OUR THOUGHTS

Given the recent rollout of the new turnaround strategy, and the ongoing economic recession, we are initiating coverage of PLA with a NEUTRAL rating awaiting signs of improved operating profitability. The potential exists for PLA to successfully execute its turnaround plan which would be evidenced by EBITDA improvement during 2H10 or 1H11. Several factors need to fall into place for this scenario to occur during the next 12-24 months.

First, a worldwide economic rebound could increase consumer spending on for the company's products. This would be reflected in rising revenues for PLA's operating units. Additionally, the Publishing Unit could also benefit as an improving economy could raise advertising rates during the next 1-2 years for "Playboy Magazine". Rising revenues with cost cutting efforts, could produce profitability in the Publishing Unit during 2H11.

Second, management needs to reverse the revenue declines in the TV network business and broaden its product appeal to consumers with its' PPV offerings. While PLA has pointed out the importance of justifying $10 million in annual programming costs, and may consider letting a potential future partner run this segment, we believe the larger issue for this unit is producing revenue growth.

Should the positives mentioned above materialize, operating results may show sequential quarterly EBITDA improvement during the 2H10 or 1H11, potentially leading to positive earnings by year end 2011. PLA's debt load should not be an issue as long as cash flow remains at current levels. This stock offers significant upside, potential should the company engineer a successful turnaround and remerge from its "Bunny" hole with a new profitable hop. We are initiating coverage of PLA with a NEUTRAL rating.

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.

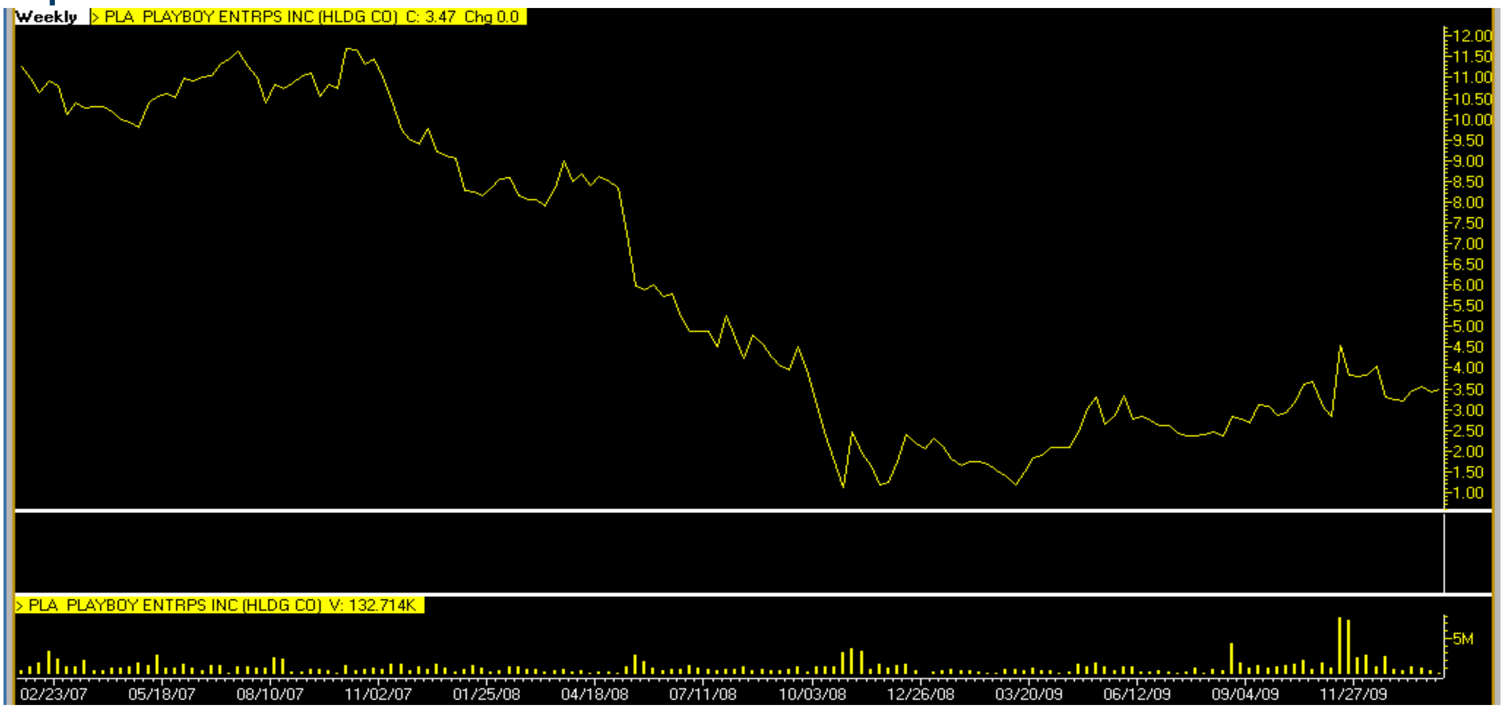
Steve Marascia
Director of Research
Capitol Securities Management
804-612-9715
smarascia@capitolsecurities.com

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

	1Q09	2Q09	3Q09	4Q09e	2009e	1Q10e	2Q10e	3Q10e	4Q10e	2010e
Revenues	$61.60	$62.20	$56.00	$54.10	$233.90	$53.40	$53.20	$53.90	$56.30	$216.80
Expenses	62.9	58.6	53.3	52.7	$227.50	52.1	52	52.3	52.5	208.9
Segment Income	-1.3	3.6	2.7	1.4	6.4	1.3	1.2	1.6	3.8	7.9
Restructuring expense	-3.2	-9.1	-0.5	-0.2	-13	-0.5	-0.4	-0.4	-0.2	-1.5
Provisions for reserves / impairment charge	-5.5				-5.5				-0.3	-0.3
Operating Income	-10	-5.5	2.2	1.2	-12.1	0.8	0.8	1.2	3.3	6.1
Investment Income		0.7			0.7	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	-0.1	-0.6	-0.1	-0.2	-0.1	-0.2	-0.6
Other, net	-0.1	-0.4	0.2	0.2	-0.1	-0.2	0.2	-0.1	-0.3	-0.4
Income before income taxes	-12.5	-7.5	0.1	-0.9	-20.8	-1.6	-1.4	-1.1	0.8	-4.9
Income tax expense	-1.2	-1.2	-1.2	-1.2	-4.8	-1.2	-1.2	-1.2	-1.2	-4.8
Net gain/loss	-13.7	-8.7	-1.1	-2.1	-25.6	-2.8	-2.6	-2.3	-1.4	-9.1
Diluted outstanding shares	33	33.44	33.47	33.47	33.47	33.47	33.47	33.47	33.47	33.47
Diluted profit/loss per common stock	($0.41)	($0.26)	($0.03)	($0.06)	($0.76)	($0.08)	($0.08)	($0.07)	($0.04)	($0.27)

CAPITOL SECURITIES MANAGEMENT, INC. EQUITY RESEARCH

Important Disclosures



1/26/10 Initiate NEUTRAL

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:

(1) Outperform – The stock's total return including dividends is expected to exceed the industry or market average by at least 10% over the next twelve months.
(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.

The distribution of investment ratings for all companies in our coverage universe are as follows: (1) 75%, (2) 25%, (3) 0%

Capitol Securities does not have investment banking operations.

For regulatory purposes, our ratings of Outperform, Neutral and Underperform most closely correspond to Buy, Hold and Sell, respectively.

Other Disclosures

For more information on this report, please contact us at 888-612-1484 or write to Capitol Securities, 100 Concourse Boulevard, Suite 101, Glen Allen, Virginia 23059