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PLAYBOY ENTERPRISES INC  
Form 10-Q  
November 08, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2004

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-14790

Playboy Enterprises, Inc.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

36-4249478  
(I.R.S. Employer  
Identification Number)

680 North Lake Shore Drive, Chicago, IL  
(Address of principal executive offices)

60611  
(Zip Code)

(312) 751-8000  
(Registrant's telephone number, including area code)

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  No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes  No

At October 31, 2004, there were 4,864,102 shares of Class A common stock, par value \$0.01 per share, and 28,513,005 shares of Class B common stock, par value \$0.01 per share, outstanding.

PLAYBOY ENTERPRISES, INC.  
FORM 10-Q  
TABLE OF CONTENTS

PART I  
FINANCIAL INFORMATION

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	Page
	----
Item 1. Financial Statements	
Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) for the Quarters Ended September 30, 2004 and 2003 (Unaudited)	3
Condensed Consolidated Statements of Operations and Comprehensive Loss for the Nine Months Ended September 30, 2004 and 2003 (Unaudited)	4
Condensed Consolidated Balance Sheets at September 30, 2004 (Unaudited) and December 31, 2003	5
Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2004 and 2003 (Unaudited)	6
Notes to Condensed Consolidated Financial Statements (Unaudited)	7
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3. Quantitative and Qualitative Disclosures About Market Risk	23
Item 4. Controls and Procedures	23
PART II OTHER INFORMATION	
Item 1. Legal Proceedings	23
Item 6. Exhibits and Reports on Form 8-K	25

2

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE INCOME (LOSS)  
for the Quarters Ended September 30 (Unaudited)  
(In thousands, except per share amounts)

	2004	2003
Net revenues	\$ 80,258	\$ 74,448
Costs and expenses		
Cost of sales	(59,314)	(54,304)
Selling and administrative expenses	(14,239)	(14,483)
Total costs and expenses	(73,553)	(68,787)
Operating income	6,705	5,661
Nonoperating income (expense)		
Investment income	114	95

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Interest expense	(2,928)	(4,254)
Amortization of deferred financing fees	(275)	(375)
Minority interest	(364)	(345)
Other, net	(96)	(242)
-----		
Total nonoperating expense	(3,549)	(5,121)
-----		
Income before income taxes	3,156	540
Income tax expense	(1,229)	(1,150)
-----		
Net income (loss)	1,927	(610)
-----		
Other comprehensive income (loss)		
Unrealized gain on marketable securities	--	153
Unrealized gain (loss) on derivatives	(3)	20
Foreign currency translation adjustments	99	82
-----		
Total other comprehensive income	96	255
-----		
Comprehensive income (loss)	\$ 2,023	\$ (355)
=====		
Net income (loss)	\$ 1,927	\$ (610)
Dividend requirements of preferred stock	--	(334)
-----		
Net income (loss) applicable to common shareholders	\$ 1,927	\$ (944)
=====		
Weighted average number of common shares outstanding		
Basic	33,371	27,437
=====		
Diluted	33,384	27,437
=====		
Basic and diluted earnings per common share	\$ 0.06	\$ (0.03)
=====		

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
AND COMPREHENSIVE LOSS  
for the Nine Months Ended September 30 (Unaudited)  
(In thousands, except per share amounts)

	2004	2003
-----		
Net revenues	\$ 239,845	\$ 224,700
-----		
Costs and expenses		
Cost of sales	(179,742)	(162,834)
Selling and administrative expenses	(42,785)	(41,237)
-----		
Total costs and expenses	(222,527)	(204,071)
-----		
Gain on disposal	2	--

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Operating income	17,320	20,629
-----		
Nonoperating income (expense)		
Investment income	337	264
Interest expense	(10,737)	(12,032)
Amortization of deferred financing fees	(1,007)	(1,022)
Minority interest	(1,066)	(1,309)
Debt extinguishment expenses	(5,908)	(3,264)
Other, net	(793)	(664)
-----		
Total nonoperating expense	(19,174)	(18,027)
-----		
Income (loss) before income taxes	(1,854)	2,602
Income tax expense	(2,622)	(3,485)
-----		
Net loss	(4,476)	(883)
-----		
Other comprehensive income (loss)		
Unrealized gain on marketable securities	107	415
Unrealized gain on derivatives	34	619
Foreign currency translation adjustments	(209)	(156)
-----		
Total other comprehensive income (loss)	(68)	878
-----		
Comprehensive loss	\$ (4,544)	\$ (5)
=====		
Net loss	\$ (4,476)	\$ (883)
Dividend requirements of preferred stock	(428)	(557)
-----		
Net loss applicable to common shareholders	\$ (4,904)	\$ (1,440)
=====		
Basic and diluted weighted average number of common shares outstanding	30,978	26,881
=====		
Basic and diluted earnings per common share	\$ (0.16)	\$ (0.05)
=====		

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

4

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)

	(Unaudited) Sept. 30, 2004	Dec. 31, 2003
-----		
Assets		
Cash and cash equivalents	\$ 32,037	\$ 31,332

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Marketable securities	3,672	3,546
Receivables, net of allowance for doubtful accounts of \$4,640 and \$4,364, respectively	39,855	52,230
Receivables from related parties	1,489	1,226
Inventories, net	14,041	12,017
Deferred subscription acquisition costs	12,359	11,759
Other current assets	8,353	10,208
<b>Total current assets</b>	<b>111,806</b>	<b>122,318</b>
Property and equipment, net	11,672	12,020
Long-term receivables	2,755	--
Programming costs, net	58,209	57,426
Goodwill	111,893	111,893
Trademarks	55,263	58,159
Distribution agreements, net of accumulated amortization of \$1,573 and \$970, respectively	31,566	32,170
Other noncurrent assets	19,310	24,074
<b>Total assets</b>	<b>\$ 402,474</b>	<b>\$ 418,060</b>
<b>Liabilities</b>		
Acquisition liabilities	\$ 10,065	\$ 15,392
Accounts payable	20,251	22,899
Accrued salaries, wages and employee benefits	7,425	11,472
Deferred revenues	50,406	53,963
Accrued litigation settlement	1,000	6,500
Other liabilities and accrued expenses	16,990	19,088
<b>Total current liabilities</b>	<b>106,137</b>	<b>129,314</b>
Financing obligations	80,000	115,000
Acquisition liabilities, less current portion	21,849	26,982
Net deferred tax liabilities	14,497	13,877
Accrued litigation settlement, less current portion	1,000	2,000
Other noncurrent liabilities	13,081	13,170
<b>Total liabilities</b>	<b>236,564</b>	<b>300,343</b>
Minority interest	12,147	11,081
<b>Shareholders' equity</b>		
Preferred stock, \$10,000 par value - 10,000,000 shares authorized; 0 and 1,674 issued, respectively	--	16,959
Common stock, \$0.01 par value		
Class A voting - 7,500,000 shares authorized; 4,864,102 issued	49	49
Class B nonvoting - 75,000,000 and 30,000,000 shares authorized, respectively; 28,509,664 and 22,579,363 issued, respectively	285	226
Capital in excess of par value	222,330	152,969
Accumulated deficit	(67,414)	(62,510)
Unearned compensation - restricted stock	(362)	--
Accumulated other comprehensive loss	(1,125)	(1,057)
<b>Total shareholders' equity</b>	<b>153,763</b>	<b>106,636</b>
<b>Total liabilities and shareholders' equity</b>	<b>\$ 402,474</b>	<b>\$ 418,060</b>

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

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5

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 for the Nine Months Ended September 30 (Unaudited)  
 (In thousands)

	2004	2003
-----		
Cash flows from operating activities		
Net loss	\$ (4,476)	\$ (883)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Depreciation of property and equipment	2,390	2,962
Amortization of intangible assets	1,711	4,240
Amortization of investments in entertainment programming	31,984	29,216
Amortization of deferred financing fees	1,007	1,022
Debt extinguishment expenses	5,908	3,264
Deferred income taxes	534	222
Net change in operating assets and liabilities	(435)	(6,143)
Investments in entertainment programming	(34,211)	(34,461)
Litigation settlement	(6,500)	--
Other, net	710	1,074
-----		
Net cash provided by (used for) operating activities	(1,378)	513
-----		
Cash flows from investing activities		
Proceeds from disposals	150	116
Additions to property and equipment	(2,308)	(4,280)
Other, net	201	105
-----		
Net cash used for investing activities	(1,957)	(4,059)
-----		
Cash flows from financing activities		
Proceeds from financing obligations	--	115,000
Proceeds from public equity offering	51,844	--
Repayment of financing obligations	(35,000)	(65,767)
Payment of debt extinguishment expenses	(3,850)	(356)
Payment of acquisition liabilities	(8,691)	(14,892)
Payment of deferred financing fees	--	(9,023)
Payment of preferred stock dividends	(651)	--
Proceeds from stock plans	407	253
Other	(19)	--
-----		
Net cash provided by financing activities	4,040	25,215
-----		
Net increase in cash and cash equivalents	705	21,669
Cash and cash equivalents at beginning of period	31,332	4,118
-----		
Cash and cash equivalents at end of period	\$ 32,037	\$ 25,787
=====		

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

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6

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited)

(A) BASIS OF PREPARATION

Playboy Enterprises, Inc., together with its subsidiaries and predecessors, will be referred to in this Quarterly Report on Form 10-Q by terms such as "we," "us," "our," "Playboy" and the "Company" unless the context otherwise requires. The financial information included in these financial statements is unaudited but, in the opinion of management, reflects all normal recurring and other adjustments necessary for a fair presentation of the results for the interim periods. The interim results of operations and cash flows are not necessarily indicative of those results and cash flows for the entire year. These financial statements should be read in conjunction with the financial statements and notes to the financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2003. Certain amounts reported for prior periods have been reclassified to conform to the current year's presentation.

(B) RESTRUCTURING EXPENSES

Through September 30, 2004, we have made cash payments of \$1.2 million on our 2002 and 2001 restructuring plans. Approximately \$8.3 million of the total restructuring charges of \$10.3 million for those plans, net of non-cash adjustments, has been paid as of September 30, 2004 with most of the remainder to be paid by the end of 2004, although some payments will continue through 2007.

Our 2002 restructuring initiative to reduce our ongoing operating expenses resulted in a \$5.7 million charge, of which \$2.9 million related to workforce reductions and \$2.8 million related to consolidation of our office space. Our 2001 restructuring plan resulted in a \$4.6 million charge, of which \$2.6 million related to workforce reductions and \$2.0 million related to excess office space. In 2003, we recorded adjustments of \$0.3 million related to these charges. In the second quarter of 2004, we recorded additional charges of \$0.2 million to the 2001 plan and reversed \$0.2 million related to the 2002 plan as a result of changes in assumptions related to the consolidation of facilities and operations.

The following table displays the activity and balances of the restructuring reserve for the year ended December 31, 2003 and the nine months ended September 30, 2004 (in thousands):

	Workforce Reduction	Consolidation of Facilities and Operations	Total
Balance at December 31, 2002	\$ 2,772	\$ 3,805	\$ 6,577
Adjustment to previous estimate	(168)	518	350
Cash payments	(1,974)	(1,760)	(3,734)
Balance at December 31, 2003	630	2,563	3,193
Cash payments	(453)	(793)	(1,246)
Balance at September 30, 2004	\$ 177	\$ 1,770	\$ 1,947

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7

(C) EARNINGS PER COMMON SHARE

The following table sets forth the computation of basic and diluted earnings per share, or EPS (in thousands, except per share amounts):

	(Unaudited) Quarters Ended September	
	2004	
-----		
Numerator:		
For basic and diluted EPS - net income (loss) applicable to common shareholders	\$ 1,927	\$
=====		
Denominator:		
For basic EPS - weighted-average shares		33,371
Effect of dilutive potential common shares:		
Employee stock options and other		13
-----		
Dilutive potential common shares		13
-----		
For diluted EPS - weighted-average shares		33,384
=====		

The following table represents the approximate number of shares related to options to purchase our Class B common stock, or Class B stock, that were outstanding but were not included in the computation of diluted EPS, as the inclusion of these shares would have been antidilutive (in thousands):

	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
-----				
Stock options	3,262	2,875	2,636	3,155
Preferred stock	--	1,535	--	1,535
-----				
Total	3,262	4,410	2,636	4,690
=====				

On May 1, 2003, \$10.0 million of PEI Holdings, Inc., or Holdings, Series A Preferred Stock held by Hugh M. Hefner, our Editor-in-Chief, along with accumulated dividends of \$0.1 million, were exchanged for 1,122,209 shares of Playboy Class B stock.

On April 26, 2004, we completed a public offering of 6,021,340 shares of our Class B stock. Included in this offering were 1,485,948 shares sold by Mr. Hefner. The shares sold by Mr. Hefner consisted of all of the shares of Class B common stock he received upon conversion of all of the outstanding shares of Playboy Series A convertible preferred stock, which we refer to as the Playboy Preferred Stock, at the time of the offering. See Note (J) Public Equity Offering for additional information.



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### (D) INVENTORIES, NET

Inventories, net, which are stated at the lower of cost (specific cost and average cost) or fair value, consisted of the following (in thousands):

	Sept. 30, 2004	Dec. 31, 2003
-----		
Paper	\$ 2,594	\$ 2,613
Editorial and other prepublication costs	8,322	6,082
Merchandise finished goods	3,125	3,322
-----		
Total inventories, net	\$ 14,041	\$ 12,017
=====		

### (E) FINANCING OBLIGATIONS

On March 11, 2003, we completed the offering of \$115.0 million in aggregate principal amount of senior secured notes of Holdings. On September 17, 2003, the senior secured notes were exchanged for new registered senior secured notes. The form and terms of the new senior secured notes are identical in all material respects (including principal amount, interest rate, maturity, ranking and covenant restrictions) to the form and terms of the old notes. The senior secured notes mature on March 15, 2010 and bear interest at the rate of 11.00% per annum, with interest payable on March 15th and September 15th of each year, beginning September 15, 2003.

8

Under the terms of the indenture governing the notes, at any time prior to March 15, 2006, we have the right to redeem up to 35.0% of the original \$115.0 million in aggregate principal amount of the notes, or \$40.25 million, at a redemption price of 111.0% of the principal amount of the notes redeemed, plus accrued and unpaid interest, with the net cash proceeds from a qualifying equity offering. On June 11, 2004, we used the proceeds of our equity offering, more fully described in Note (J) Public Equity Offering, to redeem \$35.0 million in aggregate principal amount of the outstanding notes, which reduced our financing obligations to \$80.0 million as of June 30, 2004. We paid a redemption premium of \$3.9 million as well as accrued and unpaid interest of \$0.9 million related to the redeemed principal amount. We also recorded a charge of \$2.0 million to write off the related deferred financing costs.

### (F) INCOME TAXES

Our income tax provision consists primarily of foreign income tax related to our international networks and withholding tax on licensing income for which we do not receive a current U.S. income tax benefit. The tax provision also includes deferred federal and state income tax related to the amortization of goodwill and other indefinite-lived intangibles, which cannot be offset against deferred tax assets due to the indefinite reversal period of the deferred tax liabilities. The tax provision for the nine months ended September 30, 2004 reflects a benefit of approximately \$1.0 million from the reversal of deferred income taxes provided in prior periods relating to the tax amortization of the Sarah Coventry trademarks and service marks, which we sold in the first quarter.

### (G) CONTINGENCIES

In 2002, a \$4.4 million verdict was entered against us by a state trial court in Texas in a lawsuit with a former publishing licensee. We terminated the license in 1998 due to the licensee's failure to pay royalties and other amounts

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due to us under the license agreement. We have posted a bond in the amount of \$7.7 million, which represents the amount of the judgment, costs and estimated pre- and post-judgment interest. We, on advice of legal counsel, believe that it is not probable that a material judgment against us will be sustained and have not recorded a liability for this case in accordance with Statement of Financial Accounting Standards, or Statement, 5, Accounting for Contingencies. We are currently pursuing an appeal.

In the fourth quarter of 2003, we recorded \$8.5 million related to the settlement of the Logix litigation, which related to events prior to our 1999 acquisition of Spice. We made a payment of \$6.5 million in February 2004 and will make payments of \$1.0 million each in 2005 and 2006.

9

### (H) STOCK-BASED COMPENSATION

We account for stock options using the intrinsic value method as prescribed by Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and disclose pro forma information as provided by Statement 123, Accounting for Stock Based Compensation as amended by Statement 148, Accounting for Stock Based Compensation - Transition and Disclosure.

Pro forma net income (loss) and net income (loss) per common share, presented below (in thousands, except per share amounts), were determined as if we had accounted for our stock options under the fair value method of Statement 123. The fair value of these options was estimated at the date of grant using an option pricing model. Such models require the input of highly subjective assumptions including the expected volatility of the stock price. For pro forma disclosures, the options' estimated fair value was amortized over their vesting period. No stock-based employee compensation expense is recognized because all options granted under those plans had an exercise price equal to or in excess of the market value of the underlying common stock at the grant date. If we accounted for our employee stock options under Statement 123, compensation expense would have increased \$0.7 million and \$2.1 million for the quarter and the nine-month period ended September 30, 2004, respectively.

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net income (loss)				
As reported	\$ 1,927	\$ (610)	\$ (4,476)	\$ (883)
Pro forma (1)	1,238	(1,321)	(6,567)	(2,311)
Basic and diluted EPS				
As reported	\$ 0.06	\$ (0.03)	\$ (0.16)	\$ (0.05)
Pro forma (1)	0.04	(0.06)	(0.23)	(0.11)

(1) Amounts for the prior year nine-month period reflect the cancellation of a significant number of stock options.

### (I) SEGMENT INFORMATION

The following table represents financial information by reportable segment (in thousands):

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	Quarters Ended		Nine Months Ended	
	September 30,		September 30,	
	2004	2003	2004	2003
Net revenues				
Entertainment	\$ 36,380	\$ 33,598	\$105,682	\$100,559
Publishing	29,521	28,444	88,291	83,882
Online	9,773	8,981	30,335	26,532
Licensing	4,584	3,425	15,537	13,727
Total	\$ 80,258	\$ 74,448	\$239,845	\$224,700
Income (loss) before income taxes				
Entertainment	\$ 6,719	\$ 6,773	\$ 15,459	\$ 21,251
Publishing	1,275	980	5,239	2,889
Online	1,083	474	2,997	898
Licensing	2,614	1,775	7,564	6,689
Corporate Administration and Promotion	(4,986)	(4,341)	(13,941)	(11,098)
Gain on disposal	--	--	2	--
Investment income	114	95	337	264
Interest expense	(2,928)	(4,254)	(10,737)	(12,032)
Amortization of deferred financing fees	(275)	(375)	(1,007)	(1,022)
Minority interest	(364)	(345)	(1,066)	(1,309)
Debt extinguishment expenses	--	--	(5,908)	(3,264)
Other, net	(96)	(242)	(793)	(664)
Total	\$ 3,156	\$ 540	\$ (1,854)	\$ 2,602

10

	Sept. 30,	Dec. 31,
	2004	2003
Identifiable assets		
Entertainment	\$261,761	\$265,056
Publishing	41,982	48,462
Online	6,407	5,493
Licensing	6,173	8,199
Corporate Administration and Promotion	86,151	90,850
Total	\$402,474	\$418,060

On October 15, 2004, we announced a change in our segment reporting. See Note (K) Subsequent Event for additional information.

(J) PUBLIC EQUITY OFFERING

On April 26, 2004, we completed a public offering of 6,021,340 Class B shares at \$12.69 per share, before underwriting discounts. Included in this offering were 4,385,392 shares sold by Playboy, 1,485,948 shares sold by Mr. Hefner, and 150,000 shares sold by Christie Hefner, our Chairman and Chief Executive Officer. Playboy's shares included 3,600,000 initial shares, plus an additional 785,392 shares due to the underwriters' exercise of their over-allotment option. The shares sold by Mr. Hefner consisted of all of the

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shares of Class B stock he received upon conversion, at the time of the offering, of all of the outstanding shares of Playboy Preferred Stock.

Net proceeds to us from the sale of our shares were approximately \$51.8 million. On June 11, 2004, we used \$39.8 million of the net proceeds of this sale to redeem \$35.0 million in aggregate principal amount of the outstanding 11.00% senior secured notes due 2010, which included a \$3.9 million bond redemption premium and accrued and unpaid interest of \$0.9 million. We used approximately \$0.7 million of the net proceeds to pay accrued and unpaid dividends on the Playboy Preferred Stock up to the time of conversion. The balance of the net proceeds will be used for general corporate purposes.

### (K) SUBSEQUENT EVENT

On October 15, 2004, we announced the realignment of our existing Online and Entertainment businesses into a combined Playboy Entertainment Group. The new operating structure is designed to streamline operations, maximize return on content creation and increase responsiveness to customers, but it is not expected to yield significant cost savings. We expect to take a restructuring charge of approximately \$0.5 million in the fourth quarter as a result of the consolidation. The new structure will result in a change in segment reporting effective October 1, 2004 and had no impact on the current quarter financial reporting.

### (L) SUPPLEMENTAL CONDENSED CONSOLIDATING FINANCIAL STATEMENTS

The payment obligations under the 11% senior secured notes due 2010 are fully and unconditionally guaranteed, jointly and severally, on a senior secured basis, by us and by substantially all of our domestic subsidiaries, referred to as the guarantors, excluding Playboy.com and its subsidiaries. All of our remaining subsidiaries, referred to as the nonguarantors, are wholly-owned by the guarantors except for Playboy.com and its subsidiaries, which are majority-owned subsidiaries. The following supplemental Condensed Consolidating Statements of Operations for the quarters and nine months ended September 30, 2004 and 2003, the Condensed Consolidating Balance Sheets at September 30, 2004 and December 31, 2003 and the Condensed Consolidating Statements of Cash Flows for the nine months ended September 30, 2004 and 2003, present financial information for (a) us (carrying our investment in Holdings under the equity method), (b) Holdings, the issuer of the 11% senior secured notes due 2010 (carrying its investment in the guarantors under the equity method), (c) on a combined basis, the guarantors (carrying any investment in nonguarantors under the equity method) and (d) on a combined basis, the nonguarantors. Separate financial statements of the guarantors are not presented because the guarantors are jointly, severally, and unconditionally liable under the guarantees, and we believe that separate financial statements and other disclosures regarding the guarantors are not material to investors. In general, Holdings has entered into third-party borrowings and financed its subsidiaries via intercompany accounts. All intercompany activity has been included as "Net receipts from (payments to) subsidiaries" in the Condensed Consolidating Statements of Cash Flows. In certain cases, taxes have been calculated on the basis of a group position that includes both guarantors and nonguarantors. In such cases, the taxes have been allocated to individual legal entities based upon each legal entity's actual contribution to the tax provision.

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	Quarter Ended September 30, 2002			
	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Guara Subsidia
Net revenues	\$ --	\$ --	\$ 64,185	\$ 20
Costs and expenses				
Cost of sales	--	--	(47,977)	(15
Selling and administrative expenses	--	--	(11,479)	(2
Total costs and expenses	--	--	(59,456)	(18
Operating income	--	--	4,729	1
Nonoperating income (expense)				
Investment income	--	--	114	
Interest expense	--	(2,216)	(711)	
Amortization of deferred financing fees	--	(275)	--	
Minority interest	--	--	(364)	
Equity income from subsidiaries	1,927	4,501	1,698	
Other, net	--	(83)	9	
Total nonoperating income (expense)	1,927	1,927	746	
Income before income taxes	1,927	1,927	5,475	1
Income tax expense	--	--	(974)	
Net income	\$ 1,927	\$ 1,927	\$ 4,501	\$ 1

	Quarter Ended September 30, 2003			
	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Guara Subsidia
Net revenues	\$ --	\$ --	\$ 61,190	\$ 17
Costs and expenses				
Cost of sales	--	--	(45,211)	(13
Selling and administrative expenses	--	--	(11,721)	(2
Total costs and expenses	--	--	(56,932)	(16
Operating income	--	--	4,258	1
Nonoperating income (expense)				
Investment income	--	--	120	
Interest expense	--	(3,174)	(1,080)	
Amortization of deferred financing fees	--	(375)	--	
Minority interest	--	--	(345)	
Equity income (loss) from subsidiaries	(610)	3,055	1,003	

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Other, net	--	(116)	(86)	
Total nonoperating expense	(610)	(610)	(388)	
Income (loss) before income taxes	(610)	(610)	3,870	1
Income tax expense	--	--	(815)	
Net income (loss)	\$ (610)	\$ (610)	\$ 3,055	\$ 1

12

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATING STATEMENTS OF OPERATIONS  
(In thousands)

	Nine Months Ended September 30, 2012			
	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Guarantor Subsidiaries
Net revenues	\$ --	\$ --	\$ 190,839	\$ 61,115
Costs and expenses				
Cost of sales	--	--	(145,732)	(46,115)
Selling and administrative expenses	--	--	(34,429)	(8,311)
Restructuring expenses	--	--	31	
Total costs and expenses	--	--	(180,130)	(54,426)
Gain on disposal	--	--	2	
Operating income	--	--	10,711	6,689
Nonoperating income (expense)				
Investment income	--	--	352	
Interest expense	--	(8,350)	(2,387)	
Amortization of deferred financing fees	--	(1,007)	--	
Minority interest	--	--	(1,066)	
Debt extinguishment expenses	--	(5,908)	--	
Equity income (loss) from subsidiaries	(4,476)	11,115	5,880	
Other, net	--	(326)	(351)	
Total nonoperating income (expense)	(4,476)	(4,476)	2,428	
Income (loss) before income taxes	(4,476)	(4,476)	13,139	6,689
Income tax expense	--	--	(2,024)	
Net income (loss)	\$ (4,476)	\$ (4,476)	\$ 11,115	\$ 6,689

Nine Months Ended September 30, 2012

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	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Guara Subsidia
Net revenues	\$ --	\$ --	\$ 184,424	\$ 52
Costs and expenses				
Cost of sales	--	--	(134,563)	(40
Selling and administrative expenses	--	--	(33,112)	(8
Total costs and expenses	--	--	(167,675)	(48
Operating income	--	--	16,749	3
Nonoperating income (expense)				
Investment income	--	--	318	
Interest expense	--	(8,119)	(3,476)	
Amortization of deferred financing fees	--	(998)	--	
Minority interest	(297)	--	(1,012)	
Debt extinguishment expenses	--	(3,061)	--	
Equity income (loss) from subsidiaries	(586)	11,843	1,783	
Other, net	--	(251)	(294)	
Total nonoperating expense	(883)	(586)	(2,681)	
Income (loss) before income taxes	(883)	(586)	14,068	3
Income tax expense	--	--	(2,225)	(1
Net income (loss)	\$ (883)	\$ (586)	\$ 11,843	\$ 1

13

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATING BALANCE SHEET  
September 30, 2004 (Unaudited)  
(In thousands)

	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Guara Subsidia
Assets				
Cash and cash equivalents	\$ --	\$ --	\$ 26,312	\$ 5
Marketable securities	--	--	3,672	
Receivables, net of allowance for doubtful accounts	--	--	33,243	6
Receivables from related parties	--	--	1,480	
Inventories, net	--	--	11,600	2
Deferred subscription acquisition costs	--	--	12,359	
Other current assets	--	--	5,808	2

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Total current assets	--	--	94,474	17
Receivables from affiliates	--	75,446	33,782	
Property and equipment, net	--	--	10,146	1
Long-term receivables	--	--	2,755	
Programming costs, net	--	--	56,565	1
Goodwill	--	--	111,370	
Trademarks	--	--	55,263	
Distribution agreements, net of accumulated amortization	--	--	31,566	
Investment in subsidiaries	153,763	153,763	(24,224)	
Other noncurrent assets	--	5,043	14,210	
<b>Total assets</b>	<b>\$ 153,763</b>	<b>\$ 234,252</b>	<b>\$ 385,907</b>	<b>\$ 21</b>
<b>Liabilities</b>				
Acquisition liabilities	\$ --	\$ --	\$ 9,600	\$ --
Accounts payable	--	98	14,230	5
Accrued salaries, wages and employee benefits	--	--	7,284	
Deferred revenues	--	--	44,334	6
Accrued litigation settlement	--	--	1,000	
Other liabilities and accrued expenses	--	391	16,152	
<b>Total current liabilities</b>	<b>--</b>	<b>489</b>	<b>92,600</b>	<b>13</b>
Financing obligations	--	80,000	--	
Financing obligations to affiliates	--	--	84,093	25
Acquisition liabilities, less current portion	--	--	15,888	5
Net deferred tax liabilities	--	--	14,497	
Accrued litigation settlement, less current portion	--	--	1,000	
Other noncurrent liabilities	--	--	11,919	1
<b>Total liabilities</b>	<b>--</b>	<b>80,489</b>	<b>219,997</b>	<b>45</b>
Minority interest	--	--	12,147	
Shareholders' equity	153,763	153,763	153,763	(24)
<b>Total liabilities and shareholders' equity</b>	<b>\$ 153,763</b>	<b>\$ 234,252</b>	<b>\$ 385,907</b>	<b>\$ 21</b>

14

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATING BALANCE SHEET  
December 31, 2003  
(In thousands)

Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Guara Subsida
--	----------------------	---------------------------	------------------



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Assets						
Cash and cash equivalents	\$	--	\$	--	\$ 24,445	\$ 6
Marketable securities		--		--	3,546	
Receivables, net of allowance for doubtful accounts		--		--	43,948	8
Receivables from related parties		--		--	(7,277)	8
Inventories, net		--		--	9,624	2
Deferred subscription acquisition costs		--		--	11,759	
Other current assets		--		--	8,420	1
-----						
Total current assets		--		--	94,465	27
-----						
Receivables from affiliates		--	110,843		49,315	
Property and equipment, net		--	--		10,621	1
Programming costs, net		--	--		56,442	
Goodwill		--	--		111,370	
Trademarks		--	--		58,159	
Distribution agreements, net of accumulated amortization		--	--		32,170	
Investment in subsidiaries	106,636		106,636		(41,990)	
Other noncurrent assets		--	8,013		16,023	
-----						
Total assets	\$	106,636	\$	225,492	\$ 386,575	\$ 30
=====						
Liabilities						
Acquisition liabilities	\$	--	\$	--	\$ 13,244	\$ 2
Accounts payable		--	131		17,205	5
Accrued salaries, wages and employee benefits		--	--		11,200	
Deferred revenues		--	--		47,098	6
Accrued litigation settlement		--	--		6,500	
Other liabilities and accrued expenses		--	3,725		13,896	1
-----						
Total current liabilities		--	3,856		109,143	16
-----						
Financing obligations		--	115,000		--	
Financing obligations to related parties		--	--		110,843	49
Acquisition liabilities, less current portion		--	--		21,107	5
Net deferred tax liabilities		--	--		13,877	
Accrued litigation settlement, less current portion		--	--		2,000	
Other noncurrent liabilities		--	--		11,888	1
-----						
Total liabilities		--	118,856		268,858	72
-----						
Minority interest		--	--		11,081	
-----						
Shareholders' equity	106,636		106,636		106,636	(41)
-----						
Total liabilities and shareholders' equity	\$	106,636	\$	225,492	\$ 386,575	\$ 30
=====						

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(In thousands)

	Nine Months Ended September 30, 200			
	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Non Guarantor Subsidiarie
-----				
Cash flows from operating activities				
Net cash provided by (used for)				
operating activities	\$ --	\$ (12,043)	\$ (4,570)	\$ 15,23
-----				
Cash flows from investing activities				
Proceeds from disposals	--	--	150	--
Additions to property and equipment	--	--	(1,417)	(89
Other, net	--	--	201	--
-----				
Net cash used for investing activities	--	--	(1,066)	(89
-----				
Cash flows from financing activities				
Proceeds from public equity offering	51,844	--	--	--
Repayment of financing obligations	--	(35,000)	--	--
Payment of debt extinguishment expenses	--	(3,850)	--	--
Payment of acquisition liabilities	--	--	(6,965)	(1,72
Payment of preferred stock dividends	(651)	--	--	--
Proceeds from stock plans	407	--	--	--
Other, net	(19)	--	--	--
-----				
Net cash provided by (used for)				
financing activities	51,581	(38,850)	(6,965)	(1,72
-----				
Net receipts from (payments to)				
subsidiaries	(51,581)	50,893	14,468	(13,78
-----				
Net increase (decrease) in cash and				
cash equivalents	--	--	1,867	(1,16
Cash and cash equivalents				
at beginning of period	--	--	24,445	6,88
-----				
Cash and cash equivalents				
at end of period	\$ --	\$ --	\$ 26,312	\$ 5,72
=====				

	Nine Months Ended September 30, 200			
	Playboy Enterprises, Inc. (Parent)	Holdings (Issuer)	Guarantor Subsidiaries	Non Guarantor Subsidiarie
-----				
Cash flows from operating activities				
Net cash provided by (used for)				
operating activities	\$ (186)	\$ (8,398)	\$ 5,352	\$ 3,74
-----				
Cash flows from investing activities				
Proceeds from disposals	--	--	116	--
Additions to property and equipment	--	--	(3,537)	(74
Other, net	--	--	102	--

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Net cash used for investing activities	--	--	(3,319)	(74)
Cash flows from financing activities				
Proceeds from financing obligations	--	115,000	--	--
Repayment of financing obligations	--	(65,267)	--	(50)
Payment of debt extinguishment expenses	--	(356)	--	--
Payment of acquisition liabilities	--	--	(13,145)	(1,74)
Payment of deferred financing fees	--	(9,023)	--	--
Other, net	253	--	--	--
Net cash provided by (used for) financing activities	253	40,354	(13,145)	(2,24)
Net receipts from (payments to) subsidiaries	(67)	(31,956)	35,527	(3,50)
Net increase (decrease) in cash and cash equivalents	--	--	24,415	(2,74)
Cash and cash equivalents at beginning of period	--	--	(1,908)	6,02
Cash and cash equivalents at end of period	\$ --	\$ --	\$ 22,507	\$ 3,28

16

MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

The following table represents our results of operations (in millions, except per share amounts):

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Net revenues				
Entertainment				
Domestic TV networks	\$ 24.5	\$ 23.9	\$ 71.4	\$ 71.2
International TV	10.5	8.2	30.3	25.1
Worldwide DVD/home video	1.3	1.4	3.6	3.9
Other	0.1	0.1	0.4	0.4
Total Entertainment	36.4	33.6	105.7	100.6
Publishing				
Playboy magazine				
Subscription	12.5	12.7	38.6	37.6
Newsstand	2.7	3.4	9.6	10.1
Advertising	9.4	6.9	26.6	22.4

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Other domestic publishing	3.4	4.0	8.9	9.7
International publishing	1.5	1.5	4.6	4.1
<hr/>				
Total Publishing	29.5	28.5	88.3	83.9
<hr/>				
Online				
Subscriptions	5.3	4.7	15.4	13.0
E-commerce	3.4	3.5	12.0	10.7
Other	1.0	0.7	2.9	2.8
<hr/>				
Total Online	9.7	8.9	30.3	26.5
<hr/>				
Licensing				
International licensing	3.1	2.3	8.9	5.7
Domestic licensing	0.8	0.7	2.4	2.3
Entertainment licensing	0.5	0.4	1.5	1.0
Artwork sales	--	--	--	1.9
Marketing events	0.2	--	2.7	2.8
<hr/>				
Total Licensing	4.6	3.4	15.5	13.7
<hr/>				
Total net revenues	\$ 80.2	\$ 74.4	\$ 239.8	\$ 224.7
<hr/>				
Net income (loss)				
Entertainment				
Before programming expense	\$ 17.3	\$ 16.4	\$ 47.4	\$ 50.4
Programming expense	(10.5)	(9.7)	(32.0)	(29.2)
<hr/>				
Total Entertainment	6.8	6.7	15.4	21.2
<hr/>				
Publishing	1.2	1.0	5.2	2.9
<hr/>				
Online	1.1	0.5	3.0	0.9
<hr/>				
Licensing	2.6	1.8	7.6	6.7
<hr/>				
Corporate Administration and Promotion	(5.0)	(4.4)	(13.9)	(11.1)
<hr/>				
Operating income	6.7	5.6	17.3	20.6
<hr/>				
Nonoperating income (expense)				
Investment income	0.1	0.1	0.3	0.3
Interest expense	(2.9)	(4.2)	(10.7)	(12.0)
Amortization of deferred financing fees	(0.3)	(0.3)	(1.0)	(1.0)
Minority interest	(0.4)	(0.3)	(1.1)	(1.3)
Debt extinguishment expenses	--	--	(5.9)	(3.3)
Other, net	(0.1)	(0.3)	(0.8)	(0.7)
<hr/>				
Total nonoperating expense	(3.6)	(5.0)	(19.2)	(18.0)
<hr/>				
Income (loss) before income taxes	3.1	0.6	(1.9)	2.6
Income tax expense	(1.2)	(1.2)	(2.6)	(3.5)
<hr/>				
Net income (loss)	\$ 1.9	\$ (0.6)	\$ (4.5)	\$ (0.9)
<hr/>				
Basic and diluted EPS	\$ 0.06	\$ (0.03)	\$ (0.16)	\$ (0.05)
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### MANAGEMENT'S DISCUSSION AND ANALYSIS

Our revenues increased approximately 8% for the quarter and 7% for the nine-month period due to higher revenues from all of our groups.

Operating income increased \$1.1 million for the quarter due to improved operating results from each of our groups, except Entertainment, which was flat. Operating income was \$3.3 million lower for the nine-month period due to lower income from our Entertainment Group as a result of a one-time retroactive revenue rate adjustment in the second quarter and higher programming amortization, as well as a planned increase in Corporate Administration and Promotion expenses. The impact of these factors was partially offset by improved operating income performance from Publishing, Online and Licensing.

Net income for the quarter was a result of higher operating income compared to the prior year period as well as lower interest expense, due to the redemption of \$35.0 million aggregate principal amount of our 11.0% senior secured notes due 2010, as previously discussed. The net loss for the nine-month period includes \$5.9 million of debt extinguishment expenses related to the redemption, comprised of \$3.9 million for the bond redemption premium and approximately \$2.0 million for the non-cash write-off of the related deferred financing costs. The 2003 nine-month period included \$3.3 million of debt extinguishment expenses in connection with prior financing obligations, which were paid upon completion of our debt offering in the first quarter of 2003.

Several of our businesses can experience variations in quarterly performance. As a result, our performance in any quarter is not necessarily reflective of full-year or longer-term trends. Playboy magazine newsstand revenues vary from issue to issue, with revenues generally higher for holiday issues and any issues including editorial or pictorial features that generate additional public interest. Advertising revenues also vary from quarter to quarter depending on economic conditions, holiday issues and changes in advertising buying patterns. Online subscription revenues and operating results are impacted by decreased Internet traffic during the summer months, and e-commerce revenues and operating results are typically impacted by the holiday buying season and the timing of catalog mailings.

### ENTERTAINMENT GROUP

Revenues from our domestic TV networks business increased \$0.6 million, or 2%, for the quarter. For the nine-month period, domestic TV networks returned to growth with an increase of \$0.2 million, or 3%, over the prior year period. The revenue increases for both the quarter and the nine-month period resulted largely from an increase in direct-to-home, or DTH, subscribers and an increase in video on demand, or VOD, revenues, which were due to the roll out of VOD service in additional cable systems. Additionally, renting our studio facility and providing various related services to third parties also contributed favorably to revenues in both periods. These revenue increases for the quarter and the nine-month period were partially offset by a decrease in pay-per-view buys. Revenues were also negatively impacted in both periods as a result of some affiliates of Time Warner Cable Inc., one of our major multiple systems operators, or MSOs, replacing our movie networks with other adult programming. In July 2004, we signed a new carriage agreement with Time Warner, which is expected to enable us to regain market share via VOD. A one-time \$1.5 million unfavorable adjustment to movie network revenues from the unanticipated retroactive rate reduction related to the 2002 acquisition of one large MSO by another was also included in the nine-month period.

Revenues from our international TV business increased \$2.3 million, or 29%, for the quarter. For the nine-month period, international TV revenues were up \$5.2 million, or 21%. The increase in both periods is attributed to higher

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DTH and cable revenues in the U.K. resulting from the launch of three new cable channels.

The group's administrative expenses were flat for the quarter. For the nine-month period, administrative expenses increased 13% due in part to a contractually obligated severance charge, as well as higher legal and technology costs.

As a result of the above, the group's segment income before programming expense increased \$0.9 million for the quarter. Segment income before programming expense was \$3.0 million lower for the nine-month period.

Programming amortization increased \$0.8 million, or 8%, and \$2.8 million, or 9%, for the quarter and the nine-month period, respectively, due to the mix of programming. We are on track for our programming amortization to be approximately \$41.0 million for the year and our programming cash expenditures to be approximately \$44.0 million for the year, or flat compared to 2003 amounts.

18

### PUBLISHING GROUP

Playboy magazine revenues increased \$1.6 million, or 7%, and \$4.7 million, or 7%, for the quarter and the nine-month period, respectively. Newsstand revenues decreased \$0.7 million for the quarter due to strong-selling issues in the prior year periods. For the nine-month period, newsstand revenues were down \$0.5 million. Advertising pages and revenues increased 42% and \$2.5 million, respectively, for the quarter. For the nine-month period, advertising pages and revenues increased 21% and \$4.2 million, respectively. Subscription revenues decreased \$0.2 million for the quarter and increased \$1.0 million for the nine-month period. The increase for the nine months was primarily due to a favorable adjustment for paid subscriptions that will not be served, combined with higher list rental revenues in the current year. Ad sales for the 2004 fourth quarter magazine issues are closed, and we expect to report 30% lower ad revenues and 25% fewer ad pages compared to the 2003 fourth quarter. This anticipated decline is due to the Playboy 50th Anniversary issue in the prior year that had approximately 60 more ad pages compared to the current year comparative issue. We expect to close the year with approximately 20 more ad pages and flat revenues in 2004 compared to 2003.

Revenues from our other domestic publishing businesses decreased \$0.6 million, or 15%, and \$0.8 million, or 8%, for the quarter and the nine-month period, respectively, primarily due to two fewer calendars published in the current year periods. Also contributing to the decline in the nine-month period were fewer copies sold and higher display costs for special editions, mostly offset by royalties from Hef's Little Black Book and Playboy: 50 Years: The Photographs.

International publishing revenues were flat for the quarter and increased \$0.5 million, or 12%, for the nine-month period primarily due to higher revenues from the Brazilian edition.

The group's segment income increased \$0.2 million and \$2.3 million for the quarter and the nine-month period, respectively, attributable to the higher revenues partially offset by higher editorial costs for both periods.

### ONLINE GROUP

Online Group revenues increased \$0.8 million, or 9%, and \$3.8 million, or

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14%, for the quarter and the nine-month period, respectively. Subscription revenues increased \$0.6 million, or 13%, for the quarter and \$2.4 million, or 18%, for the nine-month period primarily due to increases in our revenues per subscriber of 5% for the quarter and 13% for the nine-month period, as customers are choosing additional higher priced offerings as well as an overall increase in total subscribers. E-commerce revenues were flat for the quarter, due to the timing of catalog circulation, and increased by \$1.3 million, or 12%, for the nine-month period as a result of increased email campaigns and special offers combined with increased catalog circulation. The group's segment income increased \$0.6 million, or 128%, and \$2.1 million, or 230%, for the quarter and the nine-month period, respectively, attributable to the higher revenues, partially offset by increases in related costs and higher marketing expenses.

### LICENSING GROUP

Licensing Group revenues increased \$1.2 million, or 34%, and \$1.8 million, or 13%, for the quarter and the nine-month period, respectively. International revenues increased \$0.8 million for the quarter and \$3.2 million for the nine-month period, due to higher royalties from existing licensees in Japan, Western Europe and Southeast Asia, as well as several new licensing arrangements. For the nine-month period, the increase in international revenues was partially offset by the sale in the prior year period of an original painting by Salvador Dali for \$1.9 million. Segment income increased \$0.8 million and \$0.9 million for the quarter and the nine-month period, respectively, due to increased royalties in both periods which were partially offset by higher related expenses and, for the nine-month period, the prior year's sale of the Dali painting.

In the first quarter of 2004, we sold our Sarah Coventry trademarks and service marks for their approximate book value, pursuant to an agreement under which we will receive payments over a period not to exceed ten years.

### CORPORATE ADMINISTRATION AND PROMOTION

Corporate Administration and Promotion expenses increased \$0.6 million, or 15%, for the quarter. They were \$2.8 million, or 25%, higher for the nine-month period. The quarter was impacted by higher legal expenses partially offset by lower benefit-related expenses. The increase in expenses for the nine-month period was related to the new Senior Executive Vice President position, together with higher marketing, consulting and legal expenses.

19

### INCOME TAX EXPENSE

Our income tax provision consists primarily of foreign income tax related to our international networks and withholding tax on licensing income for which we do not receive a current U.S. income tax benefit. The tax provision also includes deferred federal and state income tax related to the amortization of goodwill and other indefinite-lived intangibles, which cannot be offset against deferred tax assets due to the indefinite reversal period of the deferred tax liabilities. The tax provision for the nine-month period reflects a benefit of approximately \$1.0 million from the reversal of deferred income taxes provided in prior periods relating to the tax amortization of the Sarah Coventry trademarks and service marks, which we sold in the first quarter.

### LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2004, we had \$32.0 million in cash and cash equivalents compared to \$31.3 million in cash and cash equivalents at December 31, 2003.

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Total financing obligations were \$80.0 million at September 30, 2004, compared to \$115.0 million at December 31, 2003.

Our cash position at September 30, 2004 included cash provided from our March 2003 \$115.0 million offering of 11.00% senior secured notes due 2010, the net proceeds from our April 2004 public offering of Class B shares and cash from operations. We also have a \$30.0 million revolving credit facility, which was increased from \$20.0 million in September 2004. In addition, we amended the facility to extend the term to September 1, 2007 and to decrease the applicable margin by 1.0% on all borrowings and letters of credit. At September 30, 2004, there were no borrowings and \$10.0 million in letters of credit outstanding under this facility. We believe that cash on hand and operating cash flows, together with funds available under our credit facility and potential access to credit and capital markets will be sufficient to meet our operating expenses, capital expenditures, debt service requirements and other contractual obligations as they become due.

On April 26, 2004, we completed a public offering of 6,021,340 Class B shares at \$12.69 per share, before underwriting discounts. Included in this offering were 4,385,392 shares sold by Playboy, 1,485,948 shares sold by Mr. Hefner and 150,000 shares sold by Christie Hefner. Playboy's shares included 3,600,000 initial shares, plus an additional 785,392 shares due to the underwriters' exercise of their over-allotment option. The shares sold by Mr. Hefner consisted of all of the shares of Class B common stock he received upon conversion, at the time of the offering, of all of the outstanding shares of Playboy Preferred Stock.

Net proceeds to us from the sale of our shares were approximately \$51.8 million. On June 11, 2004, we used \$39.8 million of the net proceeds of this sale to redeem \$35.0 million in aggregate principal amount of the outstanding 11.00% senior secured notes due 2010, which included a \$3.9 million bond redemption premium and accrued and unpaid interest of \$0.9 million. The balance of the net proceeds will be used for general corporate purposes. As a result of the redemption of the senior secured notes, we incurred second quarter charges of \$3.9 million for the bond redemption premium and \$2.0 million for the non-cash write-off of the related deferred financing costs.

### DEBT FINANCINGS

On March 11, 2003, we completed the offering of \$115.0 million in aggregate principal amount of senior secured notes. On September 17, 2003, the senior secured notes were exchanged for new registered senior secured notes. The form and terms of the new senior secured notes are identical in all material respects (including principal amount, interest rate, maturity, ranking and covenant restrictions) to the form and terms of the old notes. The senior secured notes mature on March 15, 2010 and bear interest at the rate of 11.00% per annum, with interest payable on March 15th and September 15th of each year, beginning September 15, 2003.

Under the terms of the indenture governing the notes, we have the right at any time prior to March 15, 2006, to redeem up to 35% of the original \$115.0 million in aggregate principal amount of the notes, or \$40.25 million, at a redemption price of 111.0% of the principal amount of the notes redeemed, plus accrued and unpaid interest, with the net cash proceeds from a qualifying equity offering. On June 11, 2004, we used a portion of the net proceeds of the stock offering to redeem \$35.0 million in aggregate principal amount of the outstanding notes, which reduced our financing obligations to \$80.0 million.



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### FINANCING FROM RELATED PARTY

At December 31, 2002, Playboy.com had an aggregate of \$32.0 million of outstanding indebtedness to Mr. Hefner in the form of three promissory notes. Upon the closing of the senior secured notes offering on March 11, 2003, Playboy.com's debt to Mr. Hefner was restructured. One promissory note, in the amount of \$10.0 million, was extinguished in exchange for shares of Holdings Series A Preferred Stock with an aggregate stated value of \$10.0 million. The two other promissory notes, in a combined principal amount of \$17.2 million, were extinguished in exchange for \$0.5 million in cash and shares of Holdings Series B Preferred Stock with an aggregate stated value of \$16.7 million. Pursuant to the terms of an exchange agreement between us, Holdings, Playboy.com and Mr. Hefner and certificates of designation governing the Holdings Series A and Series B Preferred Stock, we were required to exchange the Holdings Series A Preferred Stock for shares of Playboy Class B stock and to exchange the Holdings Series B Preferred Stock for shares of Playboy Preferred Stock.

On May 1, 2003, we exchanged the Holdings Series A Preferred Stock plus accumulated dividends for 1,122,209 shares of Playboy Class B stock and exchanged the Holdings Series B Preferred Stock for 1,674 shares of Playboy Preferred Stock with an aggregate stated value of \$16.7 million. The Playboy Preferred Stock accrued dividends at a rate of 8.00% per annum, which were paid semi-annually.

The Playboy Preferred Stock was convertible at the option of Mr. Hefner, the holder, into shares of our Class B stock at a conversion price of \$11.2625, which is equal to 125% of the weighted average closing price of our Class B stock over the 90-day period prior to the exchange of Holdings Series B Preferred Stock for Playboy Preferred Stock.

On April 26, 2004, Mr. Hefner converted his \$16.7 million of Playboy Preferred Stock into 1,485,948 shares of our Class B stock and sold these shares as part of our public equity offering on that date. Mr. Hefner chose not to sell the 1,122,209 shares that he had previously received in exchange for his Holdings Series A Preferred Stock, as had been contemplated in our February 11, 2004 registration statement.

### CALIFA ACQUISITION

The Califa acquisition agreement gives us the option of paying up to \$71 million of the purchase price in cash or Class B stock through 2007. We have notified the sellers that the base consideration of \$7.0 million and the performance-based payment of \$7.0 million that are due in 2004 will be paid in cash. Under the terms of the agreement, the performance-based payment was paid in full on March 1, 2004 and the base consideration is paid in two equal installments of \$3.5 million, one of which was paid on May 3, 2004 and the other of which was paid on November 1, 2004.

### CASH FLOWS USED FOR OPERATING ACTIVITIES

Net cash used for operating activities was \$1.4 million for the nine-month period, which represents use of an additional \$1.9 million compared to the prior year, which includes the payment of \$6.5 million of the Logix settlement in the first quarter of 2004.

### CASH FLOWS PROVIDED BY FINANCING ACTIVITIES

Net cash provided by financing activities was \$4.0 million for the nine-month period principally due to the \$51.8 million of net proceeds from the April 2004 public equity offering partially offset by the \$35.0 million repayment of senior secured notes, the payment of \$8.7 million of acquisition liabilities and the payment of \$3.9 million of debt extinguishment expenses

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related to the bond redemption premium.

21

### FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains "forward-looking statements," including statements in "Management's Discussion and Analysis of Financial Condition and Results of Operations" as to expectations, beliefs, plans, objectives and future financial performance, and assumptions underlying or concerning the foregoing. We use words such as "may," "will," "would," "could," "should," "believes," "estimates," "projects," "potential," "expects," "plans," "anticipates," "intends," "continues" and other similar terminology. These forward-looking statements involve known and unknown risks, uncertainties and other factors, which could cause our actual results, performance or outcomes to differ materially from those expressed or implied in the forward-looking statements. The following are some of the important factors that could cause our actual results, performance or outcomes to differ materially from those discussed in the forward-looking statements:

- (1) Foreign, national, state and local government regulation, actions or initiatives, including:
  - (a) attempts to limit or otherwise regulate the sale, distribution or transmission of adult-oriented materials, including print, television, including video, and online materials,
  - (b) limitations on the advertisement of tobacco, alcohol and other products which are important sources of advertising revenue for us, or
  - (c) substantive changes in postal regulations or rates which could increase our postage and distribution costs;
- (2) Risks associated with our foreign operations, including market acceptance and demand for our products and the products of our licensees;
- (3) Our ability to manage the risk associated with our exposure to foreign currency exchange rate fluctuations;
- (4) Changes in general economic conditions, consumer spending habits, viewing patterns, fashion trends or the retail sales environment which, in each case, could reduce demand for our programming and products and impact our advertising revenues;
- (5) Our ability to protect our trademarks, copyrights and other intellectual property;
- (6) Risks as a distributor of media content, including our becoming subject to claims for defamation, invasion of privacy, negligence, copyright, patent or trademark infringement, and other claims based on the nature and content of the materials we distribute;
- (7) The risk our outstanding litigation could result in settlements or judgments which are material to us;
- (8) Dilution from any potential issuance of additional common or convertible preferred stock in connection with financings or acquisition activities;
- (9) Competition for advertisers from other publications, media or online

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providers or any decrease in spending by advertisers, either generally or with respect to the adult male market;

- (10) Competition in the television, men's magazine, Internet and product licensing markets;
- (11) Attempts by consumers or private advocacy groups to exclude our programming or other products from distribution;
- (12) Our television and Internet businesses' reliance on third parties for technology and distribution, and any changes in that technology and/or unforeseen delays in its implementation which might affect our plans and assumptions;
- (13) Risks associated with losing access to transponders and competition for transponders and channel space;
- (14) The impact of industry consolidation, any decline in our access to, and acceptance by, DTH and/or cable systems and the possible resulting deterioration in the terms, cancellation of fee arrangements or pressure on margin splits with operators of these systems;
- (15) Risks that we may not realize the expected increased sales and profits and other benefits from acquisitions and the restructuring of our international TV joint ventures;
- (16) Any charges or costs we incur in connection with restructuring measures we may take in the future;
- (17) Risks associated with the financial condition of Claxson Interactive Group Inc., our Playboy TV-Latin America, LLC joint venture partner;
- (18) Increases in paper or printing costs;
- (19) Effects of the national consolidation of the single-copy magazine distribution system; and
- (20) Uncertainty of the viability of our primarily subscription- and e-commerce-based Internet model.

22

### QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Effective with the refinancing of our financing obligations, which occurred on March 11, 2003, we no longer have any floating interest rate exposure. All of our current debt is represented by the senior secured notes, which are fixed rate obligations. On June 11, 2004, we redeemed \$35.0 million of the \$115.0 million outstanding balance. The fair value of the \$80.0 million senior secured notes will be influenced by changes in market rates and our credit quality. At September 30, 2004, the notes were trading above par for an implied fair value of \$92.1 million.

### CONTROLS AND PROCEDURES

#### (a) Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and

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15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of the end of the period covered by this quarterly report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective in recording, processing, summarizing and reporting, on a timely basis, information required to be disclosed by us in the reports that we file or submit under the Exchange Act.

### (b) Internal Control Over Financial Reporting

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### LEGAL PROCEEDINGS

On February 17, 1998, Eduardo Gongora, or Gongora, filed suit in state court in Hidalgo County, Texas against Editorial Caballero SA de CV, or EC, Grupo Siete International, Inc., or GSI, collectively the Editorial Defendants, and us. In the complaint, Gongora alleged that he was injured as a result of the termination of a publishing license agreement, or the License Agreement, between us and EC for the publication of a Mexican edition of Playboy magazine, or the Mexican Edition. We terminated the License Agreement on or about January 29, 1998 due to EC's failure to pay royalties and other amounts due us under the License Agreement. On February 18, 1998, the Editorial Defendants filed a cross-claim against us. Gongora alleged that in December 1996 he entered into an oral agreement with the Editorial Defendants to solicit advertising for the Mexican Edition to be distributed in the United States. The basis of GSI's cross-claim was that it was the assignee of EC's right to distribute the Mexican Edition in the United States and other Spanish-speaking Latin American countries outside of Mexico. On May 31, 2002, a jury returned a verdict against us in the amount of approximately \$4.4 million. Under the verdict, Gongora was awarded no damages. GSI and EC were awarded \$4.1 million in out-of-pocket expenses and approximately \$0.3 million for lost profits, respectively, even though the jury found that EC had failed to comply with the terms of the License Agreement. On October 24, 2002, the trial court signed a judgment against us for \$4.4 million plus pre- and post-judgment interest and costs. On November 22, 2002, we filed post-judgment motions challenging the judgment in the trial court. The trial court overruled those motions and we are vigorously pursuing an appeal with the State Appellate Court sitting in Corpus Christi challenging the verdict. We have posted a bond in the amount of approximately \$7.7 million (which represents the amount of the judgment, costs and estimated pre- and post-judgment interest) in connection with the appeal. We, on advice of legal counsel, believe that it is not probable that a material judgment against us will be sustained. In accordance with Statement 5, Accounting for Contingencies, no liability has been accrued.

23

On May 17, 2001, Logix Development Corporation, or Logix, D. Keith Howington and Anne Howington filed suit in state court in Los Angeles County Superior Court in California against Spice Entertainment Companies, Inc., or Spice, Emerald Media, Inc., or EMI, Directrix, Inc., or Directrix, Colorado Satellite Broadcasting, Inc., New Frontier Media, Inc., J. Roger Faherty, or Faherty, Donald McDonald, Jr., and Judy Savar. On February 8, 2002, plaintiffs amended the complaint and added as a defendant, Playboy, which acquired Spice in 1999. The complaint alleged 11 contract and tort causes of action arising principally out of a January 18, 1997 agreement between EMI and Logix in which

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EMI agreed to purchase certain explicit television channels broadcast over C-band satellite. The complaint further sought damages from Spice based on Spice's alleged failure to provide transponder and uplink services to Logix. Playboy and Spice filed a motion to dismiss plaintiffs' complaint. After pre-trial motions, Playboy was dismissed from the case and a number of causes of action were dismissed against Spice. A trial date for the remaining breach of contract claims against Spice was set for December 10, 2003, and then continued, first to February 11, 2004 and then to March 17, 2004. Spice and the plaintiffs filed cross-motions for summary judgment or, in the alternative, for summary adjudication, on September 5, 2003. Those motions were heard on November 19, 2003 and were denied. In February 2004, prior to the trial, Spice and the plaintiffs agreed to a settlement in the amount of \$8.5 million, which we recorded as a charge in the fourth quarter of 2003, \$6.5 million of which was paid in February 2004. The remaining \$2.0 million will be paid in \$1.0 million installments in 2005 and 2006.

On April 12, 2004, Faherty filed suit in the United States District Court for the Southern District of New York against Spice, Playboy, Playboy Enterprises International Inc., or PEII, D. Keith Howington, Anne Howington and Logix. The complaint alleges that Faherty is entitled to statutory and contractual indemnification from Playboy, PEII and Spice with respect to defense costs and liabilities incurred by Faherty in the litigation described in the preceding paragraph, or the Logix litigation. The complaint further alleges that Playboy, PEII, Spice, D. Keith Howington, Anne Howington and Logix conspired to deprive Faherty of his alleged right to indemnification by excluding him from the settlement of the Logix litigation. On June 18, 2004, a jury entered a special verdict finding Faherty personally liable for \$22,541,846 in damages to the plaintiffs in the Logix litigation. A judgment was entered on the verdict on or around August 2, 2004. Faherty filed post-trial motions for a judgment notwithstanding the verdict and a new trial, but these motions were both denied on or about September 21, 2004. On October 20, 2004, Faherty filed a notice of appeal from the verdict. In consideration of this appeal Faherty and Playboy have agreed to seek a temporary stay of the indemnification action filed in the United States District Court for the Southern District of New York. In the event Faherty's indemnification and conspiracy claims go forward against us, we believe they are without merit and that we have good defenses against them. As such, based on the information known to us to date, we do not believe that it is probable that a material judgment against us will result. In accordance with Statement 5, Accounting for Contingencies, no liability has been accrued.

On September 26, 2002, Directrix filed suit in the U.S. Bankruptcy Court in the Southern District of New York against Playboy Entertainment Group, Inc. In the complaint, Directrix alleged that it was injured as a result of the termination of a Master Services Agreement under which Directrix was to perform services relating to the distribution, production and post production of our cable networks and a sublease agreement under which Directrix would have subleased office, technical and studio space at our Los Angeles, California production facility. Directrix also alleged that we breached an agreement under which Directrix had the right to transmit and broadcast certain versions of films through C-band satellite, commonly known as the TVRO market, and Internet distribution. On November 15, 2002, we filed an answer denying Directrix's allegations, along with counterclaims against Directrix relating to the Master Services Agreement and seeking damages. On May 15, 2003, we filed an amended answer and counterclaims. On July 30, 2003, Directrix moved to dismiss one of the amended counterclaims, and on October 20, 2003, the Court denied Directrix's motion. The parties are engaged in discovery. We believe that we have good defenses against Directrix's claims. We believe it is not probable that a material judgment against us will result. In accordance with Statement 5, Accounting for Contingencies, no liability has been accrued.

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## EXHIBITS AND REPORTS ON FORM 8-K

### (a) Exhibits

Exhibit Number	Description
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*10.1	Affiliation Agreement dated July 8, 2004 between Playboy Entertainment Group, Inc., Spice Entertainment, Inc., Spice Hot Entertainment, Inc., and Time Warner Cable Inc.
10.2	Second Amendment to April 23, 2002 Lease dated September 23, 2004 between Los Angeles Media Tech Center, LLC and Playboy Enterprises, Inc.
10.3	Second Amendment, dated September 15, 2004, to the Credit Agreement, dated March 11, 2003, among PEI Holdings, Inc., each lender from time to time party thereto and Bank of America, N.A., as Agent.
10.4	First Amendment, dated September 15, 2004, to Deed of Trust With Assignment of Rents, Security Agreement and Fixture Filing, dated as of March 11, 2003, made and executed between Playboy Enterprises International, Inc. and Bank of America, N.A., as Agent.
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*	Portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment pursuant to Rule 24b-2 of the Securities and Exchange Act of 1934.

### (b) Reports on Form 8-K

On August 5, 2004, we furnished a Current Report on Form 8-K, dated August 5, 2004, under Item 12., attaching our press release announcing our financial results for the second quarter of 2004.

On September 17, 2004, we furnished a Current Report on Form 8-K, dated September 17, 2004, under Items 1.01 and 9.01, attaching an amendment, dated September 15, 2004, to our Credit Agreement, dated March 11, 2003, and an amendment to the related Deed of Trust, dated September 15, 2004.

25

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

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PLAYBOY ENTERPRISES, INC.  
(Registrant)

Date: November 8, 2004

By /s/ Linda Havard

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Linda G. Havard  
Executive Vice President,  
Finance and Operations,  
and Chief Financial Officer  
(Authorized Officer and  
Principal Financial and  
Accounting Officer)