PLAYBOY ENTERPRISES INC
Form 10-Q
August 05, 2005

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2005
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	36-4249478
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
680 North Lake Shore Drive, Chicago, IL	60611
(Address of principal executive offices)	(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 |X| 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 |X| No |_|

At July 31, 2005, there were 4,864,102 shares of Class A common stock, par value $0.01 per share, and 28,229,950 shares of Class B common stock, par value $0.01 per share, outstanding.

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	2005	2004
Net revenues	$ 82,871	$ 78,717
Costs and expenses		
Cost of sales	(62,055)	(61,444)
Selling and administrative expenses	(13,521)	(14,112)
Total costs and expenses	(75,576)	(75,556)
Gain on disposal	14	2

Operating income	7,309	3,163
Nonoperating income (expense)		
Investment income	595	133
Interest expense	(1,412)	(3,651)
Amortization of deferred financing fees	(133)	(357)
Minority interest	(370)	(351)
Debt extinguishment expenses	--	(5,908)
Other, net	(324)	(238)
Total nonoperating expense	(1,644)	(10,372)
Income (loss) before income taxes	5,665	(7,209)
Income tax expense	(1,025)	(1,082)
Net income (loss)	4,640	(8,291)
Other comprehensive (loss) income		
Unrealized loss on marketable securities	(46)	(25)
Unrealized gain on derivatives	46	65
Foreign currency translation adjustments	(84)	112
Total other comprehensive (loss) income	(84)	152
Comprehensive income (loss)	$ 4,556	$ (8,139)
Net income (loss)	$ 4,640	$ (8,291)
Dividend requirements of preferred stock	--	(93)
Net income (loss) applicable to common shareholders	$ 4,640	$ (8,384)
Weighted average number of common shares outstanding		
Basic	33,080	32,098
Diluted	33,265	32,098
Basic and diluted earnings (loss) per common share	$ 0.14	$ (0.26)

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 Six Months Ended June 30 (Unaudited)
(In thousands, except per share amounts)

	2005	2004

Net revenues	$ 166,322	$ 159,587
Costs and expenses		
Cost of sales	(121,331)	(120,428)
Selling and administrative expenses	(26,788)	(28,546)
Total costs and expenses	(148,119)	(148,974)
Gain on disposal	14	2
Operating income	18,217	10,615
Nonoperating income (expense)		
Investment income	782	223
Interest expense	(4,060)	(7,809)
Amortization of deferred financing fees	(366)	(732)
Minority interest	(740)	(702)
Debt extinguishment expenses	(19,280)	(5,908)
Other, net	(800)	(697)
Total nonoperating expense	(24,464)	(15,625)
Loss before income taxes	(6,247)	(5,010)
Income tax expense	(2,232)	(1,393)
Net loss	(8,479)	(6,403)
Other comprehensive income (loss)		
Unrealized (loss) gain on marketable securities	(71)	107
Unrealized gain on derivatives	257	37
Foreign currency translation adjustments	192	(308)
Total other comprehensive income (loss)	378	(164)
Comprehensive loss	$ (8,101)	$ (6,567)
Net loss	$ (8,479)	$ (6,403)
Dividend requirements of preferred stock	--	(428)
Net loss applicable to common shareholders	$ (8,479)	$ (6,831)
Basic and diluted weighted average number of common shares outstanding	33,216	29,788
Basic and diluted loss per common share	$ (0.26)	$ (0.23)

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

PLAYBOY ENTERPRISES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	(Unaudited) June 30, 2005	Dec. 2
Assets		
Cash and cash equivalents	$ 31,461	$ 26,
Marketable securities and short-term investments	39,388	24,
Receivables, net of allowance for doubtful accounts of $3,595 and $3,897, respectively	39,064	45,
Receivables from related parties	1,857	1,
Inventories, net	13,118	12,
Deferred subscription acquisition costs	11,527	13,
Other current assets	9,773	8,
Total current assets	146,188	131,
Property and equipment, net	12,010	11,
Long-term receivables	2,495	2,
Programming costs, net	53,390	55,
Goodwill	111,893	111,
Trademarks	57,706	57,
Distribution agreements, net of accumulated amortization of $2,398 and $1,935, respectively	30,743	31,
Other noncurrent assets	18,600	18,
Total assets	$ 433,025	$ 420,
Liabilities		
Acquisition liabilities	$ 11,156	$ 10,
Accounts payable	21,900	21,
Accrued salaries, wages and employee benefits	8,159	8,
Deferred revenues	49,048	51,
Accrued litigation settlement	1,000	1,
Other liabilities and accrued expenses	15,056	18,
Total current liabilities	106,319	110,
Financing obligations	115,000	80,
Acquisition liabilities	13,084	19,
Net deferred tax liabilities	16,253	15,
Accrued litigation settlement	--	1,
Other noncurrent liabilities	12,873	13,
Total liabilities	263,529	239,
Minority interest	13,257	12,
Shareholders' equity		
Common stock, $0.01 par value		
Class A voting - 7,500,000 shares authorized; 4,864,102 issued	49	
Class B nonvoting - 75,000,000 shares authorized; 28,609,057 and 28,521,493 issued, respectively	286	
Capital in excess of par value	223,174	222,
Accumulated deficit	(61,428)	(52,
Treasury stock, at cost, 381,971 and 0 shares, respectively	(5,000)	
Accumulated other comprehensive loss	(842)	(1,

Total shareholders' equity	156,239	168,
Total liabilities and shareholders' equity	$ 433,025	$ 420,

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

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

	2005	2004
Cash flows from operating activities		
Net loss	$ (8,479)	$ (6,403)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Depreciation of property and equipment	1,542	1,624
Amortization of intangible assets	868	1,264
Amortization of investments in entertainment programming	18,968	21,504
Amortization of deferred financing fees	366	732
Debt extinguishment expenses	19,280	5,908
Deferred income taxes	498	40
Net change in operating assets and liabilities	(207)	(412)
Investments in entertainment programming	(15,984)	(23,121)
Litigation settlement	(1,875)	(6,500)
Other, net	437	923
Net cash provided by (used for) operating activities	15,414	(4,441)
Cash flows from investing activities		
Purchases of investments	(34,107)	--
Proceeds from sale of investments	18,700	--
Additions to property and equipment	(2,164)	(1,450)
Proceeds from disposals	--	150
Other, net	--	201
Net cash used for investing activities	(17,571)	(1,099)
Cash flows from financing activities		
Proceeds from financing obligations	115,000	--
Repayment of financing obligations	(80,000)	(35,000)
Proceeds from public equity offering	--	51,858
Payment of debt extinguishment expenses	(15,197)	(3,850)
Payment of acquisition liabilities	(4,558)	(7,801)
Purchase of treasury stock	(5,000)	--
Payment of deferred financing fees	(4,040)	--
Payment of preferred stock dividends	--	(651)
Proceeds from stock plans	784	385
Other	(39)	--

Net cash provided by financing activities	6,950	4,941
Net increase (decrease) in cash and cash equivalents	4,793	(599)
Cash and cash equivalents at beginning of period	26,668	31,332
Cash and cash equivalents at end of period	$ 31,461	$ 30,733

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

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

(A) BASIS OF PREPARATION

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/A for the fiscal year ended December 31, 2004. Certain amounts reported for prior periods have been reclassified to conform to the current year's presentation.

(B) RESTRUCTURING EXPENSES

During the six-month period ended June 30, 2005, we made cash payments of $0.6 million related to our various restructuring plans. Approximately $9.6 million of the total restructuring charges was paid by June 30, 2005, with most of the remainder related to the consolidation of our facilities to be paid in the current year and some payments continuing through 2007.

In 2004, we recorded a restructuring charge of $0.5 million relating to the realignment of our entertainment and online businesses. In addition, primarily due to excess office space, we recorded additional charges of $0.4 million related to the 2002 restructuring plan and reversed $0.2 million related to the 2001 restructuring plan as a result of changes in plan assumptions.

Our 2002 restructuring initiative to reduce ongoing operating expenses resulted in a $5.7 million charge, of which $2.9 million related to the termination of employees and $2.8 million related to consolidation of our office space in Los Angeles and Chicago. Our 2001 restructuring plan resulted in a $4.6 million charge, of which $2.6 million related to the termination of employees and $2.0 million related to excess space in our Chicago and New York offices.

The following table displays the activity and balances of the restructuring reserve for the year ended December 31, 2004 and the six months ended June 30, 2005 (in thousands):

	Workforce Reduction	Consolidation of Facilities and Operations	Total

Balance at December 31, 2003	$ 630	$ 2,563	$ 3,193
Additional reserve recorded	466	--	466
Adjustment to previous estimate	-	278	278
Cash payments	(917)	(1,014)	(1,931)
Balance at December 31, 2004	179	1,827	2,006
Cash payments	(179)	(380)	(559)
Balance at June 30, 2005	$ --	$ 1,447	$ 1,447

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(C) EARNINGS (LOSS) PER COMMON SHARE

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

	(Unaudited) Quarters Ended June 30,	
	2005	2004
Numerator:		
For basic EPS - net income (loss)	$ 4,640	$ (8,384)
Preferred stock dividends	--	93
For diluted EPS - net income (loss)	$ 4,640	$ (8,291)
Denominator:		
For basic EPS - weighted-average shares	33,080	32,098
Effect of dilutive potential common shares:		
Employee stock options and other	185	--
Dilutive potential common shares	185	--
For diluted EPS - weighted-average shares	33,265	32,098
Basic and diluted earnings (loss) per common share	$ 0.14	$ (0.26)

The reconciliations of basic and diluted EPS for the six-month periods ending June 30, 2005 and 2004 were excluded as both periods were in a net loss position, and therefore, potential common shares would have been antidilutive.

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 which were not included in the computation of diluted EPS as the inclusion of these shares would have been antidilutive (in thousands):

	Quarters Ended	Six Months Ended

	June 30,		June 30,	
	2005	2004	2005	2004
Stock options	1,982	3,324	2,864	2,323
Total	1,982	3,324	2,864	2,323

In addition, in accordance with Emerging Issues Task Force Issue 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share", the shares used in the calculation of diluted EPS also exclude the potential shares of Class B stock contingently issuable under our 3.00% convertible senior secured notes because they are antidilutive. See Footnote (I), Debt Refinancing, for additional information.

On April 26, 2004, we completed a public offering of 6,021,340 shares of our Class B stock at $12.69 per share, before underwriting discounts. Included in this offering were 4,385,392 shares sold by Playboy Enterprises, Inc., or Playboy, 1,485,948 shares sold by Hugh M. Hefner, our Founder and Editor-in-Chief, and 150,000 shares sold by Christie Hefner, our Chairman and Chief Executive Officer. Playboy's shares included 3,600,000 initial shares, and an additional 785,392 shares due to the underwriters' exercise of their over-allotment option. The shares sold by Mr. Hefner consisted of all the 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. Mr. Hefner and Ms. Hefner paid for expenses related to this transaction proportionate to the number of shares each sold to the total number of shares sold in the offering.

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(D) INVENTORIES, NET

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

	(Unaudited) June 30, 2005	Dec. 31, 2004
Paper	$ 3,849	$ 2,573
Editorial and other prepublication costs	6,835	7,814
Merchandise finished goods	2,434	2,050
Total inventories, net	$ 13,118	$ 12,437

(E) INCOME TAXES

Our income tax provision consists 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.

(F) CONTINGENCIES

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 Entertainment Companies, Inc., or Spice. We made a payment of $6.5 million in February 2004 and a payment of $1.0 million in January 2005 and will make the remaining payment of $1.0 million in 2006.

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 due to us under the license agreement. We have posted a bond in the amount of $8.5 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 5, Accounting for Contingencies. We are currently pursuing an appeal.

(G) STOCK-BASED COMPENSATION

We account for stock options as prescribed by Accounting Principles Board Opinion, or APB, No. 25, Accounting for Stock Issued to Employees, and disclose pro forma information as provided by Statement 123, as amended by Statement 148, Accounting for Stock Based Compensation. In December 2004, the Financial Accounting Standards Board (the "FASB") issued Statement 123 (revised 2004), Share-Based Payment ("Statement 123(R)"), which supersedes APB No. 25, and amends Statement No. 95, Statement of Cash Flows. The implementation of Statement 123(R) has since been delayed and will be effective for the first fiscal year beginning after December 15, 2005. We are required to adopt Statement 123(R) on January 1, 2006 and will utilize the modified prospective method. We are currently conducting an analysis of the impact on our financial statements.

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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 related to stock options would have been $0.7 million and $1.4 million for each of the quarters and six months ended June 30, 2005 and 2004, respectively.

	(Unaudited) Quarters Ended June 30,		(Unaudited) Six Months Ende June 30,	
	2005	2004	2005	
Net income (loss)				
As reported	$ 4,640	$ (8,291)	$ (8,479)	$ (

Pro forma	3,922	(8,944)	(9,901)	(
Basic EPS				
As reported	$ 0.14	$ (0.26)	$ (0.26)	$
Pro forma	0.12	(0.28)	(0.30)	
Diluted EPS				
As reported	$ 0.14	$ (0.26)	$ (0.26)	$
Pro forma	0.12	(0.28)	(0.30)	

Our restricted stock unit expense was $0.4 million and $0.1 million for the quarters ended June 30, 2005 and June 30, 2004, respectively, and $0.7 million and $0.3 million of compensation expense for the six months ended June 30, 2005 and 2004, respectively, as it was probable that the performance criteria would be met.

(H) SEGMENT INFORMATION

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

	(Unaudited) Quarters Ended June 30,		(Unaudited) Six Months Ende June 30,	
	2005	2004	2005	
Net revenues				
Entertainment	$ 48,882	$ 43,420	$ 99,358	$ 8
Publishing	25,530	29,093	52,534	5
Licensing	8,459	6,204	14,430	1
Total	$ 82,871	$ 78,717	$ 166,322	$ 15
Income (loss) before income taxes				
Entertainment	$ 9,914	$ 3,101	$ 21,810	$ 1
Publishing	(2,356)	2,065	(2,740)	
Licensing	3,881	2,379	7,483	
Corporate Administration and Promotion	(4,144)	(4,384)	(8,350)	(
Gain on disposal	14	2	14	
Investment income	595	133	782	
Interest expense	(1,412)	(3,651)	(4,060)	(
Amortization of deferred financing fees	(133)	(357)	(366)	
Minority interest	(370)	(351)	(740)	
Debt extinguishment expenses	--	(5,908)	(19,280)	(
Other, net	(324)	(238)	(800)	
Total	$ 5,665	$ (7,209)	$ (6,247)	$ (

Prior period segment information has been restated as a result of the realignment of our Entertainment and Online businesses, into a combined Entertainment segment, as announced during the fourth quarter of 2004.

	(Unaudited) June 30, 2005	Dec. 31, 2004
Identifiable assets		
Entertainment	$ 262,119	$ 266,736
Publishing	38,549	45,724
Licensing	8,042	5,344
Corporate Administration and Promotion (1)	124,315	102,777
Total (1)	$ 433,025	$ 420,581

(1) The increase in identifiable assets since December 31, 2004 was primarily due to our debt refinancing in March 2005. See Footnote (I), Debt Refinancing.

(I) DEBT REFINANCING

On March 15, 2005, we issued and sold in a private placement $100.0 million aggregate principal amount of our 3.00% convertible senior subordinated notes due 2025, or the convertible notes. On March 28, 2005, we issued and sold in a private placement an additional $15.0 million aggregate principal amount of the convertible notes due to the initial purchasers' exercise of the over-allotment option. The net proceeds of approximately $110.3 million from the issuance and sale of the convertible notes, after deducting the initial purchasers' discount and estimated offering expenses payable by us, were used, together with available cash, (i) to complete a tender offer and consent solicitation for, and to purchase and retire, all $80.0 million outstanding principal amount of the 11.00% senior secured notes of our subsidiary PEI Holdings, Inc., or Holdings, for a total of approximately $95.2 million, including the bond tender premium and consent fee of $14.9 million and other expenses of $0.3 million, (ii) to purchase 381,971 shares of our Class B stock for an aggregate purchase price of $5.0 million concurrently with the sale of the convertible notes and (iii) for working capital and general corporate purposes.

The convertible notes bear interest at a rate of 3.00% per annum on the principal amount of the notes, payable semi-annually in arrears on March 15 and September 15 of each year, beginning on September 15, 2005. In addition, under certain circumstances beginning in 2012, if the trading price of the convertible notes exceeds a specified threshold during a prescribed measurement period prior to any semi-annual interest period, contingent interest will become payable on the convertible notes for that semi-annual interest period at an annual rate of 0.25%.

The convertible notes are convertible into cash and, if applicable, shares of our Class B stock based on an initial conversion rate, subject to adjustment, of 58.7648 shares per $1,000 principal amount of the convertible notes (which represents an initial conversion price of approximately $17.02 per share), only under the following circumstances: (1) during any fiscal quarter after the fiscal quarter ending March 31, 2005, if the closing sale price of our Class B stock for each of 20 or more consecutive trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter exceeds 130% of the conversion price in effect on that trading day; (2) during the five business day period after any five consecutive trading day period in which the average trading price per $1,000 principal amount of convertible notes over that five consecutive trading day period was equal to or less than 95% of the average conversion value of the convertible notes during that period; (3) upon the occurrence of specified corporate transactions, as set forth in the indenture governing the convertible notes; or

(4) if we have called the convertible notes for redemption. Upon conversion of a convertible note, a holder will receive cash in an amount equal to the lesser of the aggregate conversion value of the note being converted and the aggregate principal amount of the note being converted. If the aggregate conversion value of the convertible note being converted is greater than the cash amount received by the holder, the holder will also receive an amount in whole shares of Class B stock equal to the aggregate conversion value less the cash amount received by the holder. A holder will receive cash in lieu of any fractional shares of Class B stock.

The convertible notes mature on March 15, 2025. On or after March 15, 2010, if the closing price of our Class B stock exceeds a specified threshold, we may redeem any of the convertible notes at a redemption price in cash equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest up to, but excluding, the redemption date. On or after March 15, 2012, we may at any time redeem any of the convertible notes at the same redemption price. On each of March 15, 2012, March 15, 2015 and March 15, 2020, or upon the occurrence of a fundamental change, as specified in the indenture governing the convertible notes, holders may require us to purchase all or a portion of their convertible notes at a purchase price in cash equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest up to, but excluding, the purchase date.

The convertible notes are unsecured senior subordinated obligations of the issuer, Playboy, and rank junior to all of the issuer's senior debt, including its guarantee of Holdings' borrowings under our credit facility; equally with all of the issuer's future senior subordinated debt; and senior to all of the issuer's future subordinated debt. In addition, the assets of the issuer's subsidiaries are subject to the prior claims of all creditors, including trade creditors, of those subsidiaries.

On July 5, 2005, the Securities and Exchange Commission declared effective our registration statement on Form S-3 relating to the resales of the convertible notes and the underlying shares of our class B common stock issuable upon conversion of the convertible notes.

(J) EQUITY OFFERING

On April 26, 2004, we completed a public offering of 6,021,340 shares of our Class B stock 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 Ms. Hefner. Playboy's shares included 3,600,000 initial shares, plus an additional 785,392 shares due to the underwriters' exercise of the over-allotment option. The shares sold by Mr. Hefner consisted of all of the shares of Class B stock he received upon conversion of all of the outstanding shares of Playboy's Series A convertible preferred stock, which we refer to as the Playboy Preferred Stock, at the time of the offering.

Net proceeds to us from the sale of our shares were approximately $51.9 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 our 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 net proceeds to pay accrued and unpaid dividends on the Playboy Preferred Stock up to the time of conversion.

ITEM 2. 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 June 30,	
	2005	2004(1)
Net revenues		
Entertainment		
Domestic TV networks	$ 24.9	$ 22.5
International	11.9	10.4
Online subscriptions	5.7	4.9
E-commerce	5.1	3.8
Other	1.3	1.8
Total Entertainment	48.9	43.4
Publishing		
Playboy magazine	22.1	24.8
Other domestic publishing	1.9	2.8
International publishing	1.5	1.5
Total Publishing	25.5	29.1
Licensing		
International licensing	4.7	2.6
Domestic licensing	0.8	0.7
Entertainment licensing	0.4	0.5
Marketing events	2.4	2.3
Other	0.1	0.1
Total Licensing	8.4	6.2
Total net revenues	$ 82.8	$ 78.7
Net income (loss)		
Entertainment		
Before programming amortization and online content expenses	$ 20.1	$ 14.9
Programming amortization and online content expenses	(10.2)	(11.9)
Total Entertainment	9.9	3.0
Publishing	(2.3)	2.1
Licensing	3.9	2.4
Corporate Administration and Promotion	(4.2)	(4.4)
Operating income	7.3	3.1

Nonoperating income (expense)		
Investment income	0.6	0.1
Interest expense	(1.5)	(3.6)
Amortization of deferred financing fees	(0.2)	(0.3)
Minority interest	(0.3)	(0.3)
Debt extinguishment expenses	--	(5.9)
Other, net	(0.2)	(0.3)
Total nonoperating expense	(1.6)	(10.3)
Income (loss) before income taxes	5.7	(7.2)
Income tax expense	(1.1)	(1.1)
Net income (loss)	$ 4.6	$ (8.3)
Basic and Diluted EPS	$ 0.14	$ (0.26)

(1) Prior period segment information has been restated as a result of the realignment of our Entertainment and Online businesses, into a combined Entertainment segment, as announced during the fourth quarter of 2004.

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Our revenues increased $4.1 million, or 5%, and $6.7 million, or 4%, for the quarter and six-month period, respectively, and our operating income increased $4.2 million, or 131%, and $7.6 million, or 72%, for the quarter and six-month period, respectively, primarily due to strong results from our Entertainment and Licensing Groups, partially offset by expected lower results from our Publishing Group.

Net income of $4.6 million for the quarter represented a $12.9 million increase over the prior year quarter due to the above-mentioned improvement in operating results combined with a decrease in interest expense related to our debt refinancing completed during the first quarter of 2005 and debt extinguishment expenses recorded in the prior year quarter. Net loss for the current six-month period of $8.5 million includes $19.3 million of debt extinguishment expenses compared to $5.9 million in the prior year period.

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 strongest in the fourth quarter due to the holiday buying season.

ENTERTAINMENT GROUP

The following discussion focuses on the profit contribution of each of our Entertainment Group businesses before programming amortization and online content expenses.

Revenues from our domestic TV networks business increased $2.4 million, or 11%, and $3.2 million, or 7%, for the quarter and six-month period,

respectively. Direct-to-home, or DTH, revenues increased $1.1 million and $1.9 million for the quarter and six-month period, respectively, due to subscriber growth and an increase in average pay-per-view, or PPV, buys. Video-on-demand, or VOD, revenues increased $0.9 million, or 113%, and $1.6 million, or 95%, for the quarter and six-month period, respectively, due to the continued roll out of VOD service in additional cable systems as well as a growing number of consumer buys in existing cable systems. The discontinuation of a service agreement with a distributor of our high-definition service, which resulted in the accelerated recognition of the remaining $1.4 million of deferred revenue associated with the agreement, also favorably impacted the quarter and six-month period. These revenue increases were partially offset by a $0.6 million and $1.8 million decrease in cable revenues for the quarter and six-month period, respectively, primarily due to a decrease in cable PPV buys for both periods as certain cable companies migrate consumers from linear channels to VOD. Profit contribution from domestic TV networks increased $3.1 million, or 22%, and $4.6 million, or 15%, for the quarter and six-month period, respectively, primarily due to the revenue activity described above combined with a decrease in cable marketing and overhead expenses.

International revenues increased $1.5 million, or 14%, and $4.4 million, or 21%, for the quarter and six-month period, respectively. DTH revenues from our networks in the U.K., several of which launched in the prior year quarter, contributed favorably to revenues in both periods. Additionally, increased revenues from new networks launched in Australia and Germany during the second half of 2004 and increased royalties from wireless agreements, principally in Europe, contributed favorably to revenues in both periods. Profit contribution from our international businesses increased $1.0 million, or 30%, and $2.6 million, or 34%, for the quarter and six-month period, respectively, due to the higher international revenues mentioned above, partially offset by higher costs related to the new channels in the U.K.

Online subscription revenues increased $0.8 million, or 15%, and $1.4 million, or 14%, for the quarter and six-month period, respectively, due to growth in the number of subscribers for our online clubs. Profit contribution for the online subscription business increased $0.4 million, or 13%, for the quarter and $1.1 million, or 16%, for the six-month period, due to the revenue increase described above, partially offset by higher technology costs.

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E-commerce revenues increased $1.3 million, or 35%, and $1.7 million, or 20%, for the quarter and six-month period, respectively. A $1.2 million payment due to the termination of a marketing alliance is reflected in the current quarter's revenues. Excluding this termination fee, e-commerce revenues were flat for the quarter and increased $0.5 million for the six-month period as the prior year periods experienced higher traffic to the online catalog in response to our 50th Anniversary. Profit contribution from e-commerce increased $0.2 million for the quarter and decreased $0.3 million for the six-month period as the favorable termination fee was offset by higher anticipated paper costs combined with increased circulation costs and marketing expenses associated with the production of a test catalog.

Profit contribution from other businesses was flat for the quarter and decreased $0.3 million for the six-month period primarily due to the expected decline in worldwide DVD sales.

The group's administrative expenses decreased for both the quarter and six-month period due in part to lower legal costs and a contractually obligated severance charge recorded in the prior year quarter.

Segment income for the group increased $6.9 million, or 220%, and $11.2 million, or 105%, for the quarter and six-month period, respectively, primarily due to the previously mentioned higher revenues and lower administrative expenses. Segment income was also favorably impacted by lower programming amortization and online content expenses of $1.7 million, or 14%, for the quarter and $2.8 million, or 12%, for the six-month period. This is due to both the mix of programming and the number of program premieres. We continue to expect that our cash programming investments will be approximately $38.0 million for the year, down nearly 10% from last year, and cash investments in online content will be approximately $2.0 million. We expect programming amortization to decline to about $38.0 million for the year, down from $41.7 million in 2004, and online content amortization to be approximately $2.0 million, down from $2.3 million in 2004.

PUBLISHING GROUP

Playboy magazine revenues decreased $2.7 million, or 11%, and $5.2 million, or 10%, for the quarter and six-month period, respectively. Newsstand revenues declined $0.6 million for the quarter and $1.5 million for the six-month period primarily due to fewer copies sold. Additionally, the current year six-month period included an unfavorable adjustment of $0.3 million related to prior year issues compared to a $0.3 million favorable adjustment in the prior year period. Subscription revenues decreased $0.2 million and $1.1 million for the quarter and six-month period, respectively, primarily due to lower average net revenue per copy in the current year periods, higher favorable adjustments recorded in the prior year periods to recognize revenues for paid subscriptions that will not be served and lower list rental revenues in the current year periods, partially offset by an increase in the number of subscription copies in the current year periods. Advertising revenues decreased $1.9 million and $2.6 million for the quarter and six-month period, respectively, due to fewer advertising pages, as a result of a shift in advertising media, and lower average net revenue per page, due to the mix in advertisements. Advertising sales for the 2005 third quarter magazine issues are closed, and we expect to report approximately 20% lower advertising revenues and 29% fewer advertising pages compared to the 2004 third quarter.

Revenues from our other domestic publishing businesses decreased $0.9 million, or 32%, and $1.3 million, or 23%, for the quarter and six-month period, respectively, primarily due to fewer special editions copies sold on the newsstand in the current year periods combined with higher unfavorable adjustments to prior period issues in the current periods. An expected decrease in royalties from books published in prior periods also contributed to the revenue decrease.

International publishing revenues were flat for the quarter and increased $0.2 million, or 8%, for the six-month period primarily due to higher royalties from the German edition.

The group's segment income decreased $4.4 million and $6.7 million for the quarter and six-month period, respectively, as a result of the lower revenues discussed above combined with higher subscription acquisition expense of $0.5 million for the quarter and $1.0 million for the six-month period and higher paper costs of $0.4 million for the quarter and $0.8 million for the six-month period, partially offset by a $0.9 million decrease in editorial expenses for the six-month period.

LICENSING GROUP

Licensing Group revenues increased $2.2 million, or 36%, and $3.5 million, or 32%, for the quarter and the six-month period, respectively, primarily due to higher royalties from existing licensees and new licensee agreements in Europe and Asia. The group's segment income increased $1.5 million, or 63%, and $2.5 million, or 51%, for the quarter and six-month period, respectively, due to the revenue increase, partially offset by higher revenue-related expenses, including agency fees.

CORPORATE ADMINISTRATION AND PROMOTION

Corporate Administration and Promotion expenses decreased $0.2 million, or 5%, for the quarter and $0.6 million, or 7%, for the six-month period related to lower variable compensation expense, the reclassification of a senior position from Corporate to a division and lower marketing expenses, partially offset by an increase in internal audit expenses.

NONOPERATING INCOME (EXPENSES)

The six-month period included debt extinguishment expenses of $19.3 million related to our redemption of all $80.0 million of the 11.00% senior secured notes due 2010, or the senior secured notes, issued by our subsidiary, PEI Holdings, Inc., or Holdings. These expenses were comprised of $14.9 million of bond redemption premium combined with $0.3 million of related expenses and $4.1 million for the non-cash write-off of the related deferred financing costs. The senior secured notes were repurchased using the proceeds of the issuance of $115.0 million of 3.00% convertible senior subordinated notes due 2025, or the convertible notes. The prior quarter and six-month period included $5.9 million of debt extinguishment expenses related to our redemption of $35.0 million aggregate principal amount of the senior secured notes. A reduction of interest expenses of $2.1 million and $3.7 million for the quarter and six-month period, respectively, related to the lower interest rate on the new 3.00% convertible notes, partially offset the redemption expenses.

INCOME TAX EXPENSE

Our effective income tax rate differs from U.S. statutory rates. The income tax provision consists 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.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2005, we had $31.5 million in cash and cash equivalents compared to $26.7 million in cash and cash equivalents at December 31, 2004. At June 30, 2005, we had $34.8 million of auction rate securities, or ARS, included in short-term investments compared to $20.0 million at December 31, 2004. ARS generally have long-term maturities; however, these investments have characteristics similar to short-term investments because at predetermined intervals, typically every 28 days, there is a new auction process. Total financing obligations were $115.0 million and $80.0 million at June 30, 2005 and December 31, 2004, respectively.

At June 30, 2005, our liquidity requirements were being provided by cash generated from our operating activities, our existing cash and cash equivalents and short-term investments. At June 30, 2005, we had a $50.0 million credit facility, which can be used for revolving borrowings, issuing letters of credit or a combination of both. At June 30, 2005, there were no borrowings and $10.8 million in letters of credit outstanding under this facility, permitting $39.2 million of available borrowings under this facility. See "Credit Facility" for

additional information.

DEBT FINANCINGS

On March 15, 2005, we issued and sold in a private placement $100.0 million aggregate principal amount of our 3.00% convertible senior subordinated notes due 2025. On March 28, 2005, we issued and sold in a private placement an additional $15.0 million aggregate principal amount of the convertible notes due to the initial purchasers' exercise of the over-allotment option. The net proceeds of approximately $110.3 million from the issuance and sale of the convertible notes, after deducting the initial purchasers' discount and estimated offering expenses payable by us, were used, together with available cash, (i) to complete a tender offer and consent solicitation for, and to purchase and retire, all $80.0 million outstanding principal amount of the 11.00% senior secured notes, for a total of approximately $95.2 million, including the bond tender premium and consent fee of $14.9 million and other expenses of $0.3 million, (ii) to purchase 381,971 shares of our Class B common stock, or Class B stock, for an aggregate purchase price of $5.0 million concurrently with the sale of the convertible notes and (iii) for working capital and general corporate purposes. Also, on March 15, 2005, concurrently with the convertible note offering, Hugh M. Hefner, our Founder and Editor-In-Chief, purchased 381,971 shares of our Class B stock for an aggregate purchase price of $5.0 million.

The convertible notes bear interest at a rate of 3.00% per annum on the principal amount of the notes, payable semi-annually in arrears on March 15 and September 15 of each year, beginning on September 15, 2005. In addition, beginning in March 2012, if the trading price of the convertible notes exceeds a specified threshold during a prescribed measurement period prior to any semi-annual interest period, contingent interest will become payable on the convertible notes for that semi-annual interest period at an annual rate of 0.25%. The notes are convertible under specified circumstances into cash and, if applicable, shares of our Class B stock based on an initial conversion rate of 58.7648 shares per $1,000 principal amount of the convertible notes (which represents an initial conversion price of approximately $17.02 per share). In general, upon conversion of a convertible note, the holder of the note will receive cash in an amount equal to the principal amount of the note and Class B stock for the note's conversion value in excess of the principal amount. See Footnote (I), Debt Refinancing, for additional information.

The convertible notes mature on March 15, 2025. On or after March 15, 2010, if the closing price of our Class B stock exceeds a specified threshold, we may redeem any of the convertible notes at a redemption price in cash equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest to, but excluding, the redemption date. On or after March 15, 2012, we may at any time redeem any of the convertible notes at the same redemption price. On each of March 15, 2012, March 15, 2015 and March 15, 2020, or upon the occurrence of a fundamental change, as specified in the indenture governing the convertible notes, holders may require us to purchase all or a portion of their convertible notes at a purchase price in cash equal to 100% of the principal amount of the notes, plus any accrued and unpaid interest up to, but excluding, the purchase date.

The convertible notes are unsecured senior subordinated obligations of the issuer, Playboy Enterprises, Inc., or Playboy, and rank junior to all of the issuer's senior debt, including its guarantee of Holdings' borrowings under our credit facility; equally with all of the issuer's future senior subordinated debt; and senior to all of the issuer's future subordinated debt. In addition,

the assets of the issuer's subsidiaries are subject to the prior claims of all creditors, including trade creditors, of those subsidiaries.

On July 5, 2005, the Securities and Exchange Commission declared effective our registration statement on Form S-3 relating to resales of the convertible notes and the underlying shares of our class B common stock issuable upon conversion of the convertible notes.

CREDIT FACILITY

Effective April 1, 2005, Holdings and its lenders amended and restated the credit agreement governing our credit facility, primarily to increase the size of our credit facility from $30.0 million to $50.0 million. The credit facility provides for revolving borrowings by Holdings of up to $50.0 million and the issuance of up to $30.0 million in letters of credit, subject to a maximum of $50.0 million in combined borrowings and letters of credit outstanding at any time. Borrowings under the credit facility bear interest at a variable rate, equal to a specified Eurodollar, LIBOR or base rate plus a specified borrowing margin based on our Transactions Adjusted EBITDA, as defined in the credit agreement. We pay fees on the outstanding amount of letters of credit under the credit facility based on the borrowing margin that applies to borrowings that bear interest at a rate based on LIBOR. All amounts outstanding under the credit facility will mature on April 1, 2008. Holdings' obligations as borrower under the credit facility are guaranteed by Playboy and each of our other U.S. subsidiaries, except for Playboy.com and its subsidiaries. The obligations of the borrower and each of the guarantors under the credit facility are secured by a first-priority lien on substantially all of the borrower's and the guarantors' assets.

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CALIFA ACQUISITION

The Califa acquisition agreement gives us the option of paying $17.5 million of the remaining $23.8 million purchase price consideration obligation, as of June 30, 2005, in cash or in shares of Class B stock. We have notified the sellers that the $7.0 million of base consideration due in 2005 will be paid in cash. Under the terms of the agreement, the base consideration is due in two installments of $3.5 million, one of which was paid on May 2, 2005 and the other of which will be paid on November 1, 2005.

CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by operating activities was $15.4 million for the six-month period, which represents an increase of $19.9 million from the prior year period. This increase is primarily due to better overall operating results combined with a decrease in investments in entertainment programming of $7.1 million and a decrease in legal settlement payments of approximately $4.6 million compared to the prior period.

CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used for investing activities increased $16.5 million due to investments made in auction rate securities during the six-month period. There was no such investment activity in the prior year period.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash provided by financing activities was $7.0 million for the six-month period primarily due to the proceeds from our sale of $115.0 million

aggregate principal amount of convertible notes partially offset by the payment of $94.9 million in connection with the purchase and retirement of all $80.0 million outstanding principal amount of Holdings' 11.00% senior secured notes and the payment of $0.3 million in associated debt extinguishment expenses and $4.0 million of related financing fees. Proceeds from the convertible note offering were also used to purchase 381,971 shares of our Class B stock for an aggregate purchase price of $5.0 million. See Footnote (I), Debt Refinancing, for additional information.

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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, 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 common or convertible preferred stock or convertible debt in connection with financings or acquisition activities;

(9) Competition for advertisers from other publications, media or online 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 splits with operators of these systems;

(15) Risks that we may not realize the expected increased sales and profits and other benefits from acquisitions, joint ventures and/or licensing arrangements;

(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, postage or printing costs;

(19) Effects of the national consolidation of the single-copy magazine distribution system; and

(20) Risks associated with the viability of our primarily subscription- and e-commerce-based Internet model.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At June 30, 2005, we did not have any floating interest rate exposure. All of our outstanding debt as of that date consisted of the convertible notes, which are fixed-rate obligations. The fair value of the $115.0 million aggregate principal amount of the convertible notes will be influenced by changes in market interest rates, the share price of our Class B stock and our credit quality. As of June 30, 2005, the convertible senior subordinated notes had an implied fair value of $112.6 million.

ITEM 4. CONTROLS AND PROCEDURES

Disclosure 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 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.

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.

PART II
OTHER INFORMATION

ITEM 1. 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 $8.5 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 of Financial Accounting Standards, or Statement, 5, Accounting for Contingencies, no liability has been accrued.

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 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 the 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 2004 and $1.0 million in 2005. The remaining $1.0 million will be paid in 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 (together, the "Howington defendants") 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 $22.5 million 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. On January 14, 2005, Logix and the Howington defendants filed a motion to dismiss the Faherty action for, among other things, lack of personal jurisdiction. On February 15, 2005, Faherty filed a cross-motion to stay the action pending the outcome of his appeal. The motion and cross-motions are pending. 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.

In the fourth quarter of 2004, we received a $5.6 million insurance recovery partially related to the prior year litigation settlement with Logix.

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

Our annual meeting of shareholders was held on May 11, 2005. At the meeting, the following director nominees were elected by the holders of our Class A common stock, who were the only holders entitled to vote on the matter:

Nominee	Votes For	Votes Withheld
Dennis S. Bookshester	4,690,283	8,766
David I. Chemerow	4,667,433	31,616
Donald G. Drapkin	4,690,183	8,866
Christie A. Hefner	4,364,194	334,855
Jerome H. Kern	4,690,183	8,866
Russell I. Pillar	4,690,158	8,891
Sol Rosenthal	4,364,159	334,890
Richard S. Rosenzweig	4,364,166	334,883

Also at the meeting, the holders of our Class A common stock approved the ratification of Ernst & Young LLP as independent auditors, with voting as set forth below:

Class A Common Stock			
Votes For	Votes Against	Votes Withheld	Non-Vote
4,691,315	5,993	1,741	N/A

ITEM 6. EXHIBITS

Exhibit Number	Description
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

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PLAYBOY ENTERPRISES, INC.
(Registrant)

Date: August 5, 2005

By /s/ Linda Havard

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