PLAYBOY ENTERPRISES INC
Form 10-Q
November 08, 2006

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 September 30, 2006

OR

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

Commission file number 001-14790

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

Delaware	36-4249478
(State of incorporation)	(I.R.S. Employer Identification Number)

680 North Lake Shore Drive Chicago, IL	60611
(Address of principal executive offices)	(Zip Code)

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

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 a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer |_| Accelerated filer |X| Non-accelerated filer |_|

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes |_| No |X|

At October 31, 2006, there were 4,864,102 shares of Class A common stock and 28,341,240 shares of Class B common stock outstanding.

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 regulations, 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 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 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, Internet and wireless 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) Failure to maintain our agreements with multiple system operators and direct-to-home operators on favorable terms, as well as any decline in our access to, and acceptance by, direct-to-home 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;

(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, printing or postage costs;

(19) Risks associated with certain minimum revenue amounts under our cable distribution agreements;

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

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

For a detailed discussion of these and other factors that may affect our performance, see Item 1A in our Annual Report on Form 10-K for the year ended December 31, 2005.

PLAYBOY ENTERPRISES, INC.
FORM 10-Q

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	2006	2005
Net revenues	$ 82,297	$ 80,884
Costs and expenses		
Cost of sales	(63,097)	(62,180)
Selling and administrative expenses	(15,366)	(13,355)
Restructuring expenses	(118)	--
Total costs and expenses	(78,581)	(75,535)
Operating income	3,716	5,349
Nonoperating income (expense)		
Investment income	527	661
Interest expense	(1,471)	(1,425)
Amortization of deferred financing fees	(134)	(135)
Minority interest	--	(384)

Other, net	(165)	(294)
Total nonoperating expense	(1,243)	(1,577)
Income before income taxes	2,473	3,772
Income tax expense	(1,336)	(594)
Net income	1,137	3,178
Other comprehensive income (loss)		
Unrealized gain on marketable securities	107	107
Unrealized gain (loss) on derivatives	74	(55)
Foreign currency translation loss	(131)	(91)
Total other comprehensive income (loss)	50	(39)
Comprehensive income	$ 1,187	$ 3,139
Weighted average number of common shares outstanding		
Basic	33,169	33,102
Diluted	33,173	33,366
Basic and diluted earnings per common share	$ 0.03	$ 0.10

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

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

	2006	2005
Net revenues	$ 244,894	$ 247,206
Costs and expenses		
Cost of sales	(191,916)	(183,511)
Selling and administrative expenses	(44,960)	(40,143)
Restructuring expenses	(2,024)	--
Total costs and expenses	(238,900)	(223,654)
Gains on disposal	29	14
Operating income	6,023	23,566
Nonoperating income (expense)		

Investment income	1,736	1,443
Interest expense	(4,180)	(5,485)
Amortization of deferred financing fees	(402)	(501)
Minority interest	--	(1,124)
Debt extinguishment expenses	--	(19,280)
Other, net	(311)	(1,094)
Total nonoperating expense	(3,157)	(26,041)
Income (loss) before income taxes	2,866	(2,475)
Income tax expense	(4,247)	(2,826)
Net loss	(1,381)	(5,301)
Other comprehensive income		
Unrealized gain on marketable securities	116	36
Unrealized gain on derivatives	13	202
Foreign currency translation gain	286	101
Total other comprehensive income	415	339
Comprehensive loss	$ (966)	$ (4,962)
Weighted average number of common shares outstanding		
Basic and diluted	33,156	33,178
Basic and diluted loss per common share	$ (0.04)	$ (0.16)

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

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

	(Unaudited) September 30, 2006	December 31, 2005
Assets		
Cash and cash equivalents	$ 21,704	$ 26,089
Marketable securities and short-term investments	15,637	25,963
Receivables, net of allowance for doubtful accounts of $4,021 and $3,883, respectively	45,005	46,296
Receivables from related parties	1,885	1,928
Inventories, net	13,220	12,846
Deferred subscription acquisition costs	10,287	10,452
Other current assets	9,245	8,761
Total current assets	116,983	132,335

Property and equipment, net	15,637	13,771
Long-term receivables	4,669	2,628
Programming costs, net	55,413	52,683
Goodwill	133,087	122,448
Trademarks	62,959	61,139
Distribution agreements, net of accumulated amortization of $3,028 and $2,779, respectively	30,113	30,362
Other noncurrent assets	15,417	13,603
Total assets	$ 434,278	$ 428,969
Liabilities		
Acquisition liabilities	$ 10,509	$ 11,782
Accounts payable	25,897	25,429
Accrued salaries, wages and employee benefits	6,135	10,068
Deferred revenues	45,251	45,987
Accrued litigation settlement	--	1,000
Other liabilities and accrued expenses	16,054	16,396
Total current liabilities	103,846	110,662
Financing obligations	115,000	115,000
Acquisition liabilities	13,167	11,792
Net deferred tax liabilities	20,440	17,555
Other noncurrent liabilities	20,624	16,713
Total liabilities	273,077	271,722
Shareholders' equity		
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 shares authorized; 28,719,483 and 28,643,443 issued, respectively	287	286
Capital in excess of par value	228,456	223,537
Accumulated deficit	(61,357)	(59,976)
Treasury stock, at cost, 381,971 shares	(5,000)	(5,000)
Accumulated other comprehensive loss	(1,234)	(1,649)
Total shareholders' equity	161,201	157,247
Total liabilities and shareholders' equity	$ 434,278	$ 428,969

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

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

	2006	2005

Cash flows from operating activities		
Net loss	$ (1,381)	$ (5,301)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation of property and equipment	2,816	2,340
Amortization of intangible assets	1,294	1,260
Amortization of investments in entertainment programming	26,768	28,131
Amortization of deferred financing fees	402	501
Debt extinguishment expenses	--	19,280
Deferred income taxes	2,885	1,203
Net change in operating assets and liabilities	(2,446)	(341)
Investments in entertainment programming	(28,264)	(24,276)
Litigation settlement	(1,000)	(1,875)
Stock-based compensation	3,235	112
Other, net	987	366
Net cash provided by operating activities	5,296	21,400
Cash flows from investing activities		
Payments for acquisitions	(7,761)	(8,283)
Purchases of investments	(485)	(41,494)
Proceeds from sales of investments	11,000	28,700
Additions to property and equipment	(4,633)	(4,010)
Other, net	(141)	--
Net cash used for investing activities	(2,020)	(25,087)
Cash flows from financing activities		
Proceeds from financing obligations	--	115,000
Repayment of financing obligations	--	(80,000)
Payment of debt extinguishment expenses	--	(15,197)
Payment of acquisition liabilities	(8,296)	(5,871)
Purchase of treasury stock	--	(5,000)
Payment of deferred financing fees	--	(5,057)
Proceeds from stock-based compensation	265	959
Other, net	--	(38)
Net cash provided by (used for) financing activities	(8,031)	4,796
Effect of exchange rate changes on cash and cash equivalents	370	(273)
Net increase (decrease) in cash and cash equivalents	(4,385)	836
Cash and cash equivalents at beginning of period	26,089	26,668
Cash and cash equivalents at end of period	$ 21,704	$ 27,504

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

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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 for the fiscal year ended December 31, 2005. Certain amounts reported for the prior periods have been reclassified to conform to the current year's presentation.

(B) RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board, or the FASB, issued Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R), or Statement 158. Statement 158 requires an entity to (a) recognize in its statement of financial position an asset or an obligation for a defined benefit postretirement plan's funded status, (b) measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year and (c) recognize changes in the funded status of a defined benefit postretirement plan in comprehensive income in the year in which the changes occur. We are required to adopt the recognition and related disclosure provisions of Statement 158 effective at the end of 2006. The measurement date provision of Statement 158 is effective at the end of 2008. We are currently evaluating the impact of adopting Statement 158 on our future results of operations and financial condition.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or Statement 157. Statement 157 provides enhanced guidance for using fair value to measure assets and liabilities. We are required to adopt Statement 157 effective at the beginning of 2008. We do not expect the adoption of Statement 157 to have a significant impact on our future results of operations or financial condition.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. We are required to adopt FIN 48 effective at the beginning of 2007. We are currently evaluating the impact of adopting FIN 48 on our future results of operations and financial condition.

(C) RESTRUCTURING EXPENSES

During the nine-month period ended September 30, 2006, we made cash payments of $1.4 million, $0.2 million and $26 thousand related to our 2006, 2002 and 2001 restructuring plans, respectively. Of the total costs related to our restructuring plans, approximately $11.7 million was paid by September 30, 2006, with the remaining $1.0 million to be paid through 2007.

In the second quarter of 2006, we implemented a cost reduction plan that will result in lower annual programming and editorial investments as well as other discretionary expenses. As a result of the 2006 restructuring plan, we reported a charge of $2.1 million related to costs associated with a workforce reduction of 15 employees. During the nine-month period ended September 30, 2006, we also reduced our 2002 and 2001 restructuring plans by $0.7 million as a result of changes related to leased space.

In the fourth quarter of 2005, we recorded an additional charge of $0.1 million related to our 2002 restructuring plan as a result of changes in assumptions related to leased space.

The following table sets forth the activity and balances of our restructuring reserves for the year ended December 31, 2005 and for the nine-month period ended September 30, 2006 (in thousands):

	Workforce Reduction	Consolidation of Facilities and Operations	Total
Balance at December 31, 2004	$ 179	$ 1,827	$ 2,006
Adjustments to previous estimates	17	132	149
Cash payments	(196)	(749)	(945)
Balance at December 31, 2005	--	1,210	1,210
Reserve recorded	2,129	--	2,129
Adjustments to previous estimates	--	(105)	(105)
Other	--	(574)	(574)
Cash payments	(1,442)	(220)	(1,662)
Balance at September 30, 2006	$ 687	$ 311	$ 998

(D) EARNINGS PER COMMON SHARE

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

	Quarters Ended September 30, 2006	Quarters Ended September 30, 2005
Numerator:		
For basic and diluted EPS - net income	$ 1,137	$ 3,178
Denominator:		
For basic EPS - weighted average shares	33,169	33,102
Effect of dilutive potential common shares:		
Employee stock options and other	4	264
Dilutive potential common shares	4	264
For diluted EPS - weighted average shares	33,173	33,366
Basic and diluted EPS	$ 0.03	$ 0.10

The computations of basic and diluted EPS for the nine-month periods ended September 30, 2006 and 2005, were excluded as both periods resulted in a net loss, and, therefore, potential common shares would have been antidilutive.

The following table sets forth the number of shares related to outstanding options to purchase our Class B common stock, or Class B stock, and the potential shares of Class B stock contingently issuable under our 3.00% convertible senior subordinated notes due 2025, or convertible notes. These shares were not included in the computations of diluted EPS for the quarters and nine-month periods ended September 30, 2006 and 2005, as their inclusion would have been antidilutive (in thousands):

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Stock options	3,892	1,866	3,425	2,576
Convertible notes	6,758	6,758	6,758	6,758
Total	10,650	8,624	10,183	9,334

(E) INVENTORIES, NET

The following table sets forth inventories, net, which are stated at the lower of cost (specific cost and average cost) or fair value (in thousands):

	September 30, 2006	December 31, 2005
Paper	$ 3,523	$ 3,939
Editorial and other prepublication costs	6,910	6,529
Merchandise finished goods	2,787	2,378
Total inventories, net	$13,220	$12,846

(F) INCOME TAXES

Our income tax provision consists of foreign income tax, which relates to our international networks and withholding tax on licensing income for which we do not receive a current U.S. income tax benefit due to our net operating loss position. Our income tax provision also includes deferred federal and state income taxes 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.

(G) CONTINGENCIES

In the current year, we acquired Club Jenna, Inc., a multi-media adult entertainment business, to complement our existing television, online and DVD businesses. As the pro forma results would not be materially different from actual results, they are not presented. We paid $7.7 million at closing with additional payments of $1.6 million, $1.7 million, $2.3 million and $4.3 million required in 2007, 2008, 2009 and 2010, respectively. Pursuant to the acquisition agreement, we are also obligated to make future contingent earnout payments based primarily on sales of existing content of the acquired business over a ten-year period and on content produced by the acquired business during the five-year period after the closing of the acquisition. If the required performance benchmarks are achieved, any contingent earnout payments will be recorded as additional purchase price. During the nine-month period ended

September 30, 2006, no earnout payments were made.

In 2005, we acquired an affiliate network of websites to complement our existing online business. We paid $8.0 million at closing, $2.0 million in the current quarter, and an additional payment of $2.0 million is required in 2007. Pursuant to the asset purchase agreement, we are also obligated to make future contingent earnout payments over a five-year period based primarily on the financial performance of the acquired business. If the required performance benchmarks are achieved, any contingent earnout payments will be recorded as additional purchase price and/or compensation expense. During the nine-month period ended September 30, 2006, an earnout payment of approximately $0.1 million was made and recorded as additional purchase price.

In 2003, we recorded $8.5 million for the settlement of the Logix litigation, which related to events prior to our 1999 acquisition of Spice. We made payments of $1.0 million, $1.0 million and $6.5 million in 2006, 2005 and 2004, respectively, and have no further obligations under the settlement.

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 us under the license agreement. We vigorously pursued an appeal with the State Appellate Court sitting in Corpus Christi challenging the verdict. We have posted a bond in the amount of approximately $9.4 million, which represents the amount of the judgment, costs and estimated pre- and post-judgment interest, in connection with the appeal. On May 25, 2006, the State Appellate Court reversed the judgment by the trial court, rendered judgment for us on the majority of the plaintiffs' claims and remanded the remaining claims for a new trial. On July 14, 2006, the plaintiffs filed a motion for rehearing and en banc reconsideration, which we opposed. On October 12, 2006, the State Appellate Court denied plaintiff's motion. We, on advice of legal counsel, believe that it is not probable that a material judgment against us will be obtained. In accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, no liability has been accrued.

(H) STOCK-BASED COMPENSATION

On January 1, 2006, we adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, or Statement 123(R), which is a revision of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, or Statement 123, under the modified prospective method. Statement 123(R) supersedes Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, or APB 25, and amends Statement of Financial Accounting Standards No. 95, Statement of Cash Flows. Statement 123(R) requires that all stock-based compensation to employees, including grants of employee stock options, be recognized in the income statement based on its fair value. Under the modified prospective method, results for prior periods have not been restated.

Stock-based compensation expense for the quarter and nine-month period ended September 30, 2006, is based on awards ultimately expected to vest, reduced for estimated forfeitures. Statement 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on historical experience. In our pro forma information required under Statement 123 for the periods prior to fiscal 2006, we accounted for forfeitures as they occurred. Under the fair value recognition provisions of Statement 123(R), we measure stock-based compensation cost at the grant date based on the value of the award and recognize the expense over the vesting period. Compensation expense for all stock-based payment awards granted prior to and subsequent to January 1, 2006, is recognized using the straight-line attribution method. Stock-based compensation expense is reflected in our Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) in selling and administrative expenses and the proceeds are reflected in our Condensed Consolidated Statements of Cash Flows in proceeds from stock-based compensation.

We have stock plans for key employees and nonemployee directors, which provide for the grant of nonqualified and incentive stock options and/or shares of restricted stock units, deferred stock and other equity awards in our Class B stock. The Compensation Committee of the Board of Directors, which is composed entirely of independent nonemployee directors, administers all the plans. These plans are designed to further our growth, development and financial success by providing key employees with strong additional incentives to maximize long-term stockholder value. The Compensation Committee believes that this objective can be best achieved through assisting key employees to become owners of our stock, which aligns their interests with our interests. As stockholders, key employees will benefit directly from our growth, development and financial success. These plans also enable us to attract and retain the services of those executives whom we consider essential to our long-range success by providing these executives with a competitive compensation package and an opportunity to become owners of our stock. At September 30, 2006, we had 471,182 shares of our Class B stock available for grant under these plans.

Stock options, exercisable for shares of our Class B stock, generally vest over a two- to four-year period from the grant date and expire ten years from the grant date.

Restricted stock unit grants provide for the issuance of our Class B stock if three-year cumulative operating income target thresholds are met. If the operating income minimum threshold is not achieved, the restricted stock units for that grant are forfeited.

One of our stock plans pertaining to nonemployee directors also allows for the issuance or deferral of our Class B stock as awards and payments for retainer, committee and meeting fees.

Finally, we also have an Employee Stock Purchase Plan, or ESPP, that provides substantially all regular full- and part-time employees an opportunity to purchase shares of our Class B stock through payroll deductions. The funds are withheld and then used to acquire stock on the last trading day of each quarter, based on that day's closing price less a 15% discount. ESPP expense is reflected in our Condensed Consolidated Statements of Operations and Comprehensive Income (Loss) in selling and administrative expenses and the proceeds are reflected in our Condensed Consolidated Statements of Cash Flows in proceeds from stock-based compensation. At September 30, 2006, we had 4,454 shares of our Class B stock available for purchase under this plan.

Valuation Information

Upon adoption of Statement 123(R), we began estimating the value of stock options on the date of grant using the Lattice Binomial model, or Lattice model. Prior to the adoption of Statement 123(R), the value of each employee stock option was estimated on the date of grant using the Black-Scholes model for the purpose of pro forma financial information in accordance with Statement 123. The Lattice model requires extensive analysis of actual exercise behavior data and a number of complex assumptions including expected volatility, risk-free interest rate, expected dividends and option cancellations.

The following table sets forth the assumptions used for the Lattice model in 2006 and the Black-Scholes model in 2005:

	Quarters Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	200
Expected volatility	37%	46%	37% - 38%	4
Risk-free interest rate	4.80%	3.90%	4.32% - 4.80%	3.80% - 4.1
Expected dividends	--	--	--	-

The expected life of stock options represents the weighted average period the stock options are expected to remain outstanding and is a derived output of the Lattice model. The expected life of stock options is impacted by all of the underlying assumptions and calibration of the Lattice model. The Lattice model assumes that exercise behavior is a function of the option's remaining vested life and the extent to which the option's fair value exceeds the exercise price. The Lattice model estimates the probability of exercise as a function of these two variables based upon the entire history of exercises and cancellations on all past option grants.

The weighted average expected life for options granted during the quarter and nine-month period ended September 30, 2006, using the Lattice model was 6.0 years and 5.9 years, respectively. The weighted average expected life for options granted during the prior year quarter and nine-month period using the Black-Scholes model was 6.0 years. The weighted average fair value per share for stock options granted during the quarter and nine-month period ended September 30, 2006, was $4.17 and $6.03, respectively, using the Lattice model, and the weighted average fair value per share for stock options granted during the prior year quarter and nine-month period was $6.35 and $5.85, respectively, using the Black-Scholes model.

Stock Option Activity

The following table sets forth stock option activity for the nine-month period ended September 30, 2006:

	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2005	3,374,135	$ 15.85
Granted	805,500	13.64
Exercised	(13,666)	10.84
Canceled	(366,053)	14.02
Outstanding at September 30, 2006	3,799,916	$ 15.57

At September 30, 2006, the weighted average remaining contractual lives of options outstanding and options exercisable were 5.8 years and 4.6 years, respectively. At September 30, 2006, the number of options exercisable and the weighted average exercise price of options exercisable were 2,711,750 and $16.56, respectively.

There were no options exercised in the current quarter. For the nine-month period ended September 30, 2006, we had proceeds of $0.1 million from exercises of stock options. The aggregate intrinsic value for options exercised during the nine-month period ended September 30, 2006, was approximately $0.1 million. There were 135,000 options granted in the current quarter, which had an aggregate intrinsic value of $10 thousand. The aggregate intrinsic value of options outstanding at September 30, 2006, was $10 thousand and there was no aggregate intrinsic value of options exercisable at September 30, 2006. The aggregate intrinsic value for options granted during the quarter and nine-month period ended September 30, 2005, was $17 thousand and $1.2 million, respectively. The aggregate intrinsic value for options exercised during the quarter and nine-month period ended September 30, 2005, was $0.1 million and $0.4 million, respectively.

As a result of adopting Statement 123(R) on January 1, 2006, our income (loss) from continuing operations before income taxes, income (loss) from continuing operations and net income (loss) for the quarter and nine-month period ended September 30, 2006, were $0.8 million and $2.3 million lower, respectively, than if we had continued to account for stock-based compensation under APB 25. Basic and diluted EPS for the quarter and nine-month period ended September 30, 2006, were $0.02 and $0.07 lower, respectively, than if we had continued to account for stock-based compensation under APB 25.

The following table sets forth stock-based compensation expense related to stock options and to our ESPP for the current quarter and nine-month period and pro forma amounts for the prior year quarter and nine-month period (in thousands, except per share amounts):

	Quarters Ended September 30,		Nine Months September
	2006	2005	2006
Stock options	$ 803	$ 737	$ 2,308
ESPP	6	4	20
Total	$ 809	$ 741	$ 2,328
Net income (loss)			
As reported	$ 1,137	$ 3,178	$ (1,381)
Fair value of stock-based compensation excluded from net income, gross		(741)	
Pro forma		$ 2,437	
Basic and diluted EPS			
As reported	$ 0.03	$ 0.10	$ (0.04)
Pro forma		$ 0.07	

As of September 30, 2006, there was $4.9 million of unrecognized stock-based compensation expense related to non-vested stock options, which will be recognized over a weighted average period of 1.5 years.

Restricted Stock Unit Activity

At September 30, 2006, we had 453,000 restricted stock units outstanding, none of which were vested, and all of which were performance-based awards contingent upon meeting certain performance goals. There were 45,000 restricted stock units granted in the current quarter.

The following table sets forth the restricted stock units outstanding at September 30, 2006:

	Number of Shares	Weighted Average Grant-Date Fair Value
Outstanding at December 31, 2005	319,000	$ 13.07
Granted	233,500	13.51
Canceled	(99,500)	13.42
Outstanding at September 30, 2006	453,000	$ 13.22

Stock-based compensation expense related to restricted stock units was $0.3 million and $0.5 million for the quarters ended September 30, 2006 and 2005, respectively, and $0.5 million and $1.2 million for the nine-month periods ended September 30, 2006 and 2005, respectively. As of September 30, 2006, there was $2.1 million of unrecognized stock-based compensation expense related to non-vested restricted stock units, which may be recognized over a weighted average period of 1.5 years.

Other Equity Awards

We issued 33,981 shares and 49,716 shares of our Class B stock during the quarter and nine-month period ended September 30, 2006, respectively, related to other equity awards. Stock-based compensation expense related to other equity awards was $0.3 million and $37 thousand for the quarters ended September 30, 2006 and 2005, respectively, and $0.5 million and $0.2 million for the nine-month periods ended September 30, 2006 and 2005, respectively.

Employee Stock Purchase Plan

Stock-based compensation expense related to our ESPP was $6 thousand and $20 thousand for the quarter and nine-month period ended September 30, 2006, respectively.

Income Taxes

On November 10, 2005, the FASB issued Staff Position No. 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards, or Staff Position 123(R)-3. We have elected to adopt the alternative transition method provided in Staff Position 123(R)-3 for calculating the tax effects of stock-based compensation pursuant to Statement 123(R). The alternative transition method simplifies the calculation of the beginning balance of the additional paid-in-capital pool, or APIC pool, related to the tax effect of employee stock-based compensation. This method also has subsequent impact on the APIC pool and Condensed Consolidated Statements of Cash Flows relating to the tax effects of employee stock-based compensation awards that are outstanding upon adoption of Statement 123(R).

Under Statement 123(R), the income tax effects of share-based payments are recognized for financial reporting purposes only if such awards would result in deductions on our income tax returns. The settlement of share-based payments to date that would have resulted in an excess tax benefit would have increased our existing net operating loss, or NOL, carry forward. Under Statement 123(R), no excess tax benefits resulting from the settlement of a share-based payment can result in a tax deduction before realization of the tax benefit; i.e., the recognition of excess tax benefits cannot be recorded until the excess benefit reduces current income taxes payable. Additionally, as a result of our existing NOL carry forward position, no tax benefit relating to share-based payments has been recorded for the quarter and nine-month period ended September 30, 2006.

(I) BENEFIT PLANS

We currently maintain a practice of paying a separation allowance under our salary continuation policy to employees with at least five years of continuous service who voluntarily terminate employment with us and are at age 60 or thereafter. For the quarter and nine-month period ended September 30, 2006, payments made under this policy were $37 thousand and $0.3 million, respectively.

(J) SEGMENT INFORMATION (1)

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

	Quarters Ended September 30,		N
	2006	2005	
Net revenues			
Entertainment	$ 50,198	$ 47,790	$ 148
Publishing	24,585	27,224	71
Licensing	7,514	5,870	24
Total	$ 82,297	$ 80,884	$ 244
Income (loss) before income taxes			
Entertainment	$ 5,851	$ 7,170	$ 18
Publishing	(891)	(704)	(4
Licensing	4,632	3,284	13
Corporate Administration and Promotion	(5,758)	(4,401)	(18
Restructuring expenses	(118)	--	(2
Gains on disposal	--	--	
Investment income	527	661	1
Interest expense	(1,471)	(1,425)	(4
Amortization of deferred financing fees	(134)	(135)	
Minority interest	--	(384)	
Debt extinguishment expenses	--	--	
Other, net	(165)	(294)	

Total	$ 2,473	$ 3,772	$ 2

	September 30, 2006
Identifiable assets	
Entertainment	$ 288,884
Publishing	37,249
Licensing	9,399
Corporate Administration and Promotion	98,746
Total	$ 434,278

(1) Certain amounts reported for the prior periods have been reclassified to conform to the current year's presentation.

(K) SUBSEQUENT EVENT

On October 19, 2006, we entered into an agreement with DirecTV, Inc., or DirecTV, to extend our existing relationship for the distribution of our channels to DirecTV subscribers.

The agreement grants DirecTV the non-exclusive right to transmit our Playboy TV, Spice Xcess and Club Jenna networks in the U.S. to customers of DirecTV for a period ending on November 15, 2008. Prior to this extension, we provided DirecTV with Playboy TV and two additional channels through our existing agreement. We anticipate that transmission of the new networks will commence on November 16, 2006.

Under the terms of the new agreement, our revenue will reflect the contractual share of revenues received from DirecTV's residential customers who purchase the right to view our networks' programming, subject to DirecTV receiving certain minimum revenue amounts from the networks other than Playboy TV.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the Condensed Consolidated Financial Statements and accompanying notes and with our Annual Report on Form 10-K for the year ended December 31, 2005. All period references are to our fiscal periods unless otherwise indicated.

RESULTS OF OPERATIONS (1)

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

	Quarters Ended September 30,

	2006	2005	
Net revenues			
Entertainment			
Domestic TV	$ 20.5	$ 25.4	$
International	14.3	12.2	
Online subscriptions and e-commerce	12.6	9.0	
Other	2.8	1.2	
Total Entertainment	50.2	47.8	
Publishing			
Playboy magazine	19.7	22.5	
Special editions and other	3.2	3.2	
International publishing	1.7	1.6	
Total Publishing	24.6	27.3	
Licensing			
International licensing	5.5	4.3	
Domestic licensing	1.3	1.2	
Marketing events	0.3	0.1	
Other	0.4	0.2	
Total Licensing	7.5	5.8	
Total net revenues	$ 82.3	$ 80.9	$
Net income (loss)			
Entertainment			
Before programming amortization and online content expenses	$ 16.7	$ 16.8	$
Programming amortization and online content expenses	(10.9)	(9.7)	
Total Entertainment	5.8	7.1	
Publishing	(0.8)	(0.7)	
Licensing	4.6	3.3	
Corporate Administration and Promotion	(5.8)	(4.3)	
Segment income	3.8	5.4	
Restructuring expenses	(0.1)	--	
Operating income	3.7	5.4	
Nonoperating income (expense)			
Investment income	0.6	0.6	
Interest expense	(1.5)	(1.4)	
Amortization of deferred financing fees	(0.1)	(0.1)	
Minority interest	--	(0.4)	
Debt extinguishment expenses	--	--	
Other, net	(0.2)	(0.4)	
Total nonoperating expense	(1.2)	(1.7)	
Income (loss) before income taxes	2.5	3.7	
Income tax expense	(1.4)	(0.5)	
Net income (loss)	$ 1.1	$ 3.2	$

Basic and diluted earnings (loss) per common share	$ 0.03	$ 0.10	$

(1) Certain amounts reported for the prior periods have been reclassified to conform to the current year's presentation.

Revenues increased $1.4 million, or 2%, and decreased $2.3 million, or 1%, for the quarter and nine-month period, respectively, as higher revenues from our Entertainment and Licensing Groups were offset for the quarter and nine-month period by lower revenues from our Publishing Group.

Segment income decreased $1.6 million, or 28%, and $15.6 million, or 66%, for the quarter and nine-month period, respectively, due to lower results from our Entertainment and Publishing Groups and higher Corporate Administration and Promotion expenses, partially offset by improved results from our Licensing Group. Stock option expense of $0.8 million and $2.3 million for the quarter and nine-month period, respectively, a result of our implementation of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, at the beginning of 2006, also impacted segment income.

Operating income of $3.7 million and $6.0 million for the quarter and nine-month period, respectively, included $0.1 million and $2.0 million of restructuring expense for the quarter and nine-month period, respectively, primarily related to a cost reduction plan we implemented during the second quarter of this year.

Net income of $1.1 million for the quarter was $2.1 million unfavorable compared to the prior year period as a result of the lower operating results previously discussed. The net loss of $1.4 million for the nine-month period improved $3.9 million over the prior year period as the lower operating results previously discussed were more than offset by debt extinguishment expenses of $19.3 million in the prior year period.

Several of our businesses may 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 revenue and profit contribution before programming amortization and online content expenses of each of our Entertainment Group businesses.

Revenues from our domestic TV business decreased $4.9 million, or 19%, and $11.8 million, or 16%, for the quarter and nine-month period, respectively.

Playboy TV network revenues decreased $1.6 million and $4.3 million for the quarter and nine-month period, respectively, as cable revenues decreased

$1.5 million and $3.0 million for the quarter and nine-month period, respectively. The decrease was due to the impact of a consumer shift from pay-per-view, or PPV, to video-on-demand, or VOD, purchasing. Playboy TV may be favorably impacted by the continued rollout of our monthly service with a subscription-VOD component.

Movie network revenues decreased $3.9 million and $7.7 million for the quarter and nine-month period, respectively. These decreases were due to both lower PPV buying trends as mentioned above and a decrease in the overall carriage of adult linear networks. We continue to expect these trends to negatively impact our movie networks. Revenues from VOD decreased $0.7 million for the nine-month period primarily due to a decrease in buys, as competitive pressure increased within several distribution platforms. We expect VOD performance to improve as we implement new marketing initiatives. Also contributing to the lower movie network revenues was the loss of two channels and the addition of a new competitor on the largest satellite TV provider. We expect the loss of carriage to unfavorably impact movie network revenues and profitability at least through the first quarter of 2007. Movie network revenues for the current quarter were also unfavorably impacted by adjustments to previously estimated revenues.

The prior year nine-month period was favorably impacted by the discontinuation of a distributor's high-definition subscription service agreement, which resulted in the accelerated recognition of $1.4 million of deferred revenues associated with the agreement.

Revenues associated with our studio facility increased $0.5 million and $0.9 million for the quarter and nine-month period, respectively, primarily due to the addition of new clients.

Profit contribution from our domestic TV business decreased $4.3 million for the quarter as a result of the lower revenues previously discussed, partially offset by an adjustment for revenue sharing in the prior year quarter. Profit contribution for the nine-month period decreased $15.0 million as a result of the lower revenues previously discussed combined with increased expenses primarily due to marketing and staffing.

International revenues increased $2.1 million, or 17%, and $3.8 million, or 10%, for the quarter and nine-month period, respectively. International television revenues increased $1.0 million and $2.9 million for the quarter and nine-month period, respectively, primarily due to increased direct-to-home and cable revenues from our U.K. networks combined with favorable foreign currency exchange rates. Lower revenues from several third-party network licensees impacted the nine-month period. International online and wireless revenues increased $1.1 million and $0.9 million for the quarter and nine-month period, respectively, primarily due to higher royalties from licensees. International profit contribution increased $1.8 million and $2.2 million for the quarter and nine-month period, respectively, principally due to the higher revenues previously discussed combined with lower marketing expenses, partially offset by increased television network distribution expenses, in part related to our additional networks.

Online subscriptions and e-commerce revenues increased $3.6 million, or 41%, and $6.4 million, or 21%, for the quarter and nine-month period, respectively, primarily due to our acquisition of an affiliate network of websites late in the prior year quarter combined with our acquisition of Club Jenna, Inc., or Club Jenna, a multi-media adult entertainment business, in the current nine-month period. Offsetting the above were costs associated with the acquired businesses and increased investments in technology and marketing initiatives. The prior year nine-month period was favorably impacted by a $1.2 million payment we received as a result of the discontinuation of a marketing alliance.

Revenues from other businesses increased $1.6 million, or 146%, and $3.3 million, or 98%, for the quarter and nine-month period, respectively, primarily due to worldwide DVD and advertising revenues from the acquired businesses combined with revenues resulting from the current-year launch of Playboy Radio on SIRIUS Satellite Radio. Profit contribution increased $1.0 million and $1.6 million for the quarter and nine-month period, respectively, primarily due to the revenue increases previously discussed, partially offset by costs associated with our acquired businesses.

The group's administrative expenses increased $0.3 million for the quarter and decreased $2.1 million for the nine-month period. Both periods were impacted by the elimination of our intra-company agreements related to trademark, content and administrative fees that had been paid by Playboy.com, Inc., or Playboy.com, to us as a result of our October 2005 repurchase of the remaining minority interest of Playboy.com. The nine-month period was partially offset by higher staffing-related expenses, in part associated with our acquired businesses.

Programming amortization and online content expenses increased $1.2 million and $0.9 million for the quarter and nine-month period, respectively, primarily due to new programming costs to support our acquired businesses and Playboy Radio, partially offset by a change in the mix of television programming. We now expect our programming and online content cash investments for the current year to be approximately $43.3 million and our programming amortization and online content expenses to be approximately $41.0 million.

Segment income for the group decreased $1.3 million, or 18%, and $10.2 million, or 36%, for the quarter and nine-month period, respectively, due to the previously discussed operating results.

PUBLISHING GROUP

Playboy magazine revenues decreased $2.8 million, or 12%, and $8.4 million, or 12%, for the quarter and nine-month period, respectively. Advertising revenues decreased $1.4 million, or 18%, for the quarter due to an 11% decrease in average net revenue per page coupled with 7% fewer advertising pages. Advertising revenues decreased $4.8 million, or 22%, for the nine-month period due to 19% fewer advertising pages coupled with a 3% decrease in average net revenue per page. Advertising sales for the 2006 fourth quarter magazine issues are closed, and we expect to report approximately 10% higher advertising revenues and a 14% increase in advertising pages compared to the 2005 fourth quarter. Subscription revenues decreased $1.1 million and $3.0 million for the quarter and nine-month period, respectively, primarily due to lower average revenue per copy combined with fewer copies served. For the nine-month period, subscription revenues were favorably impacted by a lower provision for unpaid copies as a result of improved payment experience. Newsstand revenues decreased $0.3 million for the quarter primarily due to 12% fewer copies sold combined with unfavorable variances related to prior issue adjustments. Newsstand revenues decreased $0.6 million for the nine-month period primarily due to 17% fewer copies sold. The decreases in both periods were partially mitigated by the impact of a $1.00 and C$1.00 cover price increase effective with the February 2006 issue.

Revenues from special editions and other were flat and increased $0.4

million, or 5%, for the quarter and nine-month period, respectively. Special editions revenues for the quarter were flat primarily due to an unfavorable variance related to prior issue adjustments combined with 12% fewer newsstand copies sold, offset by the impact of a $1.00 and C$1.00 cover price increase effective with the November 2005 issues. Special editions revenues increased $0.4 million for the nine-month period, primarily due to the cover price increase previously discussed combined with a favorable variance related to prior issue adjustments, partially offset by 13% fewer newsstand copies sold.

International publishing revenues were flat for the quarter and nine-month period.

The group's segment loss was flat and increased $1.5 million, or 43%, for the quarter and nine-month period, respectively, as the lower revenues from Playboy magazine previously discussed were offset for the quarter and nine-month period by lower subscription acquisition amortization, editorial content, manufacturing, advertising sales and marketing expenses.

Despite negative industry trends, our goal this year is to maintain a loss that is consistent with that of the prior year.

LICENSING GROUP

Licensing Group revenues increased $1.7 million, or 28%, and $3.9 million, or 19%, for the quarter and nine-month period, respectively, primarily due to higher international royalties, principally from Europe. The group's segment income increased $1.3 million, or 41%, and $2.1 million, or 20%, for the quarter and nine-month period, respectively, due to the revenue increases previously discussed, partially offset by higher growth-related costs.

CORPORATE ADMINISTRATION AND PROMOTION

Corporate Administration and Promotion expenses increased $1.5 million, or 31%, and $6.0 million, or 47%, for the quarter and nine-month period, respectively, primarily due to the elimination of our intra-company agreements related to trademark, content and administrative fees as a result of the previously discussed Playboy.com minority interest repurchase. The nine-month period also reflected higher promotional spending.

RESTRUCTURING EXPENSES

In the second quarter of 2006, we implemented a cost reduction plan that will result in lower annual programming and editorial investments as well as other discretionary expenses. As a result of the 2006 restructuring plan, we reported a charge of $2.1 million related to costs associated with a workforce reduction of 15 employees.

INCOME TAX EXPENSE

Our effective income tax rate differs from U.S. statutory rates. Our income tax provision consists of foreign income tax, which relates to our international networks and withholding tax on licensing income for which we do not receive a current U.S. income tax benefit due to our net operating loss position. Our income tax provision also includes deferred federal and state income taxes 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 September 30, 2006, we had $21.7 million in cash and cash equivalents compared to $26.1 million in cash and cash equivalents at December 31, 2005. We also had $10.0 million of auction rate securities included in marketable securities and short-term investments at September 30, 2006, compared to $21.0 million at December 31, 2005. The decrease is primarily related to our acquisition of Club Jenna in the current nine-month period. Total financing obligations were $115.0 million at both September 30, 2006 and December 31, 2005.

At September 30, 2006, cash generated from our operating activities, existing cash and cash equivalents and marketable securities and short-term investments were fulfilling our liquidity requirements. We also have a $50.0 million credit facility, which can be used for revolving borrowings, issuing letters of credit or a combination of both. At September 30, 2006, there were no borrowings and $10.6 million in letters of credit outstanding under this facility, resulting in $39.4 million of available borrowings under this facility.

CASH FLOWS FROM OPERATING ACTIVITIES

Net cash provided by operating activities was $5.3 million, a decrease of $16.1 million compared to the prior year period primarily due to the operating results previously discussed.

CASH FLOWS FROM INVESTING ACTIVITIES

Net cash used for investing activities decreased $23.1 million compared to the prior year period due to available cash being used to fund acquisitions and operations.

CASH FLOWS FROM FINANCING ACTIVITIES

Net cash used for financing activities was $8.0 million for the nine-month period compared to net cash provided by financing activities of $4.8 million in the prior year period. The current and prior year periods reflect payments of acquisition liabilities of $8.3 million and $5.9 million, respectively. The prior year period also reflects the issuance of $115.0 million of 3.00% convertible senior subordinated notes due 2025, or convertible notes, and the use of the proceeds to pay $95.2 million in connection with the purchase and retirement of all of the $80.0 million outstanding principal amount of 11.00% senior secured notes issued by one of our subsidiaries and $5.1 million of related financing fees. Proceeds from the convertible notes offering were also used to purchase 381,971 shares of our Class B stock for $5.0 million.

EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS

The positive effect of foreign currency exchange rates on cash and cash equivalents during the nine-month period was due to the weakening of the U.S. dollar against foreign currencies, primarily the pound sterling. Conversely, the negative effect of foreign currency exchange rates on cash and cash equivalents during the prior year period was due to the strengthening of the U.S. dollar against foreign currencies, primarily the pound sterling.

RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board, or the FASB, issued Statement of Financial Accounting Standards No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R), or Statement 158. Statement 158 requires an entity to (a) recognize in its statement of financial position an asset or an obligation for a defined benefit postretirement plan's funded status, (b) measure a defined benefit postretirement plan's assets and obligations that determine its funded status as of the end of the employer's fiscal year and (c) recognize changes in the funded status of a defined benefit postretirement plan in comprehensive income in the year in which the changes occur. We are required to adopt the recognition and related disclosure provisions of Statement 158 effective at the end of 2006. The measurement date provision of Statement 158 is effective at the end of 2008. We are currently evaluating the impact of adopting Statement 158 on our future results of operations and financial condition.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or Statement 157. Statement 157 provides enhanced guidance for using fair value to measure assets and liabilities. We are required to adopt Statement 157 effective at the beginning of 2008. We do not expect the adoption of Statement 157 to have a significant impact on our future results of operations or financial condition.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109, or FIN 48. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on description, classification, interest and penalties, accounting in interim periods, disclosure and transition. We are required to adopt FIN 48 effective at the beginning of 2007. We are currently evaluating the impact of adopting FIN 48 on our future results of operations and financial condition.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

At September 30, 2006, we did not have any floating interest rate exposure. All of our outstanding debt at that date consisted of the 3.00% convertible senior subordinated notes due 2025, or 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. At September 30, 2006, the convertible notes had an implied fair value of $102.3 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 vigorously pursued an appeal with the State Appellate Court sitting in Corpus Christi challenging the verdict. We have posted a bond in the amount of approximately $9.4 million, which represents the amount of the judgment, costs and estimated pre- and post-judgment interest, in connection with the appeal. On May 25, 2006, the State Appellate Court reversed the judgment by the trial court, rendered judgment for us on the majority of the plaintiffs' claims and remanded the remaining claims for a new trial. On July 14, 2006, the plaintiffs filed a motion for rehearing and en banc reconsideration, which we opposed. On October 12, 2006, the State Appellate Court denied plaintiff's motion. We, on advice of legal counsel, believe that it is not probable that a material judgment against us will be obtained. In accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, no liability has been accrued.

ITEM 1A. RISK FACTORS

There have been no material changes to our Risk Factors as contained in our Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 6. EXHIBITS

Exhibit Number Description

10.1		Fourth Amendment to the Amended and Restated Credit Agreement, effective April 1, 2005, or the Credit Agreement, among PEI Holdings, Inc., as borrower, and Bank of America, N.A., as Agent, and the other lenders from time to time party thereto
	10.1.1	Fourth Amendment, dated as of July 21, 2006, to the Credit Agreement, or the Fourth Amendment
	10.1.2	Reaffirmation of Guaranty, dated as of July 21, 2006, by each of the Guarantors, pursuant to the Fourth Amendment
10.2		Fifth Amendment to the Credit Agreement, or the Fifth Amendment
	10.2.1	Fifth Amendment, dated as of September 28, 2006, to the Credit Agreement
	10.2.2	Reaffirmation of Guaranty, dated as of September 28, 2006, by each of the Guarantors, pursuant to the Fifth Amendment
	10.2.3	Joinder and Amendment No. 1 to Master Corporate Guaranty, dated as of September 28, 2006, by Playboy Enterprises, Inc., Playboy Enterprises International, Inc., Spice Hot Entertainment, Inc. and Spice Platinum Entertainment, Inc., and accepted by Bank of America, N.A., as agent for the Lenders
10.3*		Satellite Capacity Lease, dated as of August 21, 2006, by and among Playboy Entertainment Group, Inc., Spice Hot Entertainment, Inc. and Transponder Encryption Services Corporation
10.4		Amended and Restated Playboy Enterprises, Inc. Board of Directors' Deferred Compensation Plan, effective January 1, 2005
10.5		Amended and Restated Playboy Enterprises, Inc. Deferred Compensation Plan, effective January 1, 2005
10.6		Fourth Amendment, dated as of August 30, 2006, to the Playboy Enterprises, Inc. Employees Investment Savings Plan (as amended and restated effective January 1, 1997)
10.7		Amendment to the Second Amended and Restated Playboy Enterprises, Inc. 1995 Stock Incentive Plan, effective August 30, 2006
10.8		Selected Employment and Termination Agreements
	10.8.1	Employment Agreement dated as of September 15, 2006, between Playboy Enterprises, Inc. and Robert Meyers
	10.8.2	Severance Agreement dated as of September 18, 2006, between Playboy Enterprises, Inc. and Robert Meyers
10.9		Chicago Office Lease Documents
	10.9.1	Sixth Amendment to April 7, 1988 Lease effective May 1, 2006
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.

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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: November 8, 2006

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)

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EXHIBIT INDEX

Exhibit Number	Description
10.1	Fourth Amendment to the Amended and Restated Credit Agreement, effective April 1, 2005, or the Credit Agreement, among PEI Holdings, Inc., as borrower, and Bank of America, N.A., as Agent, and the other lenders from time to time party thereto
10.1.1	Fourth Amendment, dated as of July 21, 2006, to the Credit Agreement, or the Fourth Amendment
10.1.2	Reaffirmation of Guaranty, dated as of July 21, 2006, by each of the Guarantors, pursuant to the Fourth Amendment
10.2	Fifth Amendment to the Credit Agreement, or the Fifth Amendment
10.2.1	Fifth Amendment, dated as of September 28, 2006, to the Credit Agreement
10.2.2	Reaffirmation of Guaranty, dated as of September 28, 2006, by each of the Guarantors, pursuant to the Fifth Amendment

	10.2.3	Joinder and Amendment No. 1 to Master Corporate Guaranty, dated as of September 28, 2006, by Playboy Enterprises, Inc., Playboy Enterprises International, Inc., Spice Hot Entertainment, Inc. and Spice Platinum Entertainment, Inc., and accepted by Bank of America, N.A., as agent for the Lenders
10.3*		Satellite Capacity Lease, dated as of August 21, 2006, by and among Playboy Entertainment Group, Inc., Spice Hot Entertainment, Inc. and Transponder Encryption Services Corporation
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