To Our Shareholders

Our ability to deliver on the strategies that we outlined in last year's letter to shareholders resulted in a 64% increase, to $39.2 million, in 2001 Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), compared with the previous year and a narrowing of both operating and net losses. This significant improvement and the year's underlying across-the-board accomplishments put us in position to project a swing to operating profit in 2002.

OUR 2001 ACCOMPLISHMENTS INCLUDED:

- the acquisition of additional movie networks, which substantially increased the number of households our programming reaches, has increased our market share, leveraged our overhead and contributed to a 17% growth in Entertainment Group EBITDA for the year;
- the reduction of the Online cost structure and the launch of online gaming, which will move us closer to our stated goal of Online's reaching operating profitability during 2002;
- increasing profitability in Licensing, aided by the launch of Playboy underwear at Bloomingdale's;
- maintaining profitability in Publishing in an enormously difficult advertising and circulation environment;
- the sale of our music catalog, which, together with our video catalog, was primarily responsible for the year-over-year decline in total revenues and the winding down of that line of business; and
- a companywide restructuring and other cost-control efforts that contributed to a 6% decrease in corporate expense for the year.

ENTERTAINMENT GROWTH CONTINUES

Growth in our domestic television business was responsible for the Entertainment Group's EBITDA increase to $75.5 million in 2001. Happily, we believe this growth will continue in 2002. The continued rollout of digital TV services and the addition of three adult-movie networks to our operations last July are expected to continue to drive growth in the group's EBITDA this year.

Buy rates from both cable and satellite direct-to-home (DTH) operators have demonstrated that television programming aimed at adult audiences is very popular with consumers. As cable operators have upgraded to the digital technology that DTH operators already use, cable systems are able to carry more pay services in an environment that also offers enhanced parental control. With this new digital technology in place, we benefit from increased access to new households as well as higher buy rates for our TV networks.

In the second half of 2001, the number of U.S. digital cable households reached critical mass, resulting in year-over-year and quarter-over-quarter revenue gains from our Playboy and Spice TV networks in the last two quarters. During the year, Playboy TV's digital cable reach more than tripled, to 10.3 million households. By year-end, the number of U.S. digital cable households had surpassed that of analog cable households for the first time. In the fourth quarter alone, access of our domestic networks grew 10% from the September quarter, to 113 million household units. As a result, we expect continued growth of both households and revenues in 2002.

Our domestic TV revenues were and will continue to be augmented by the addition of three adult-movie networks to our lineup last July. The Hot Network, The Hot Zone and Vivid TV will be added to the Spice portfolio. With the addition of these networks, we now are able to offer a range of services, allowing cable and DTH operators to choose the services most appropriate for their consumers.

Success in television is dependent on the programming. For Playboy TV, we create original programming in a variety of formats. As planned, we added more than 200 new hours of programming last year. Among the debuts were two 13-part series, *Sexy Urban Legends* and a new reality show, *7 Lives Xposed*, that created cross-platform value as *Playboy.com* aired additional footage and regular updates. Plans for *7 Lives Xposed Part II* are under way.

The Spice networks, The Hot Network, The Hot Zone and Vivid TV air movies that we acquire from other producers. To ensure a supply of quality product, last year we negotiated and extended output deals with the industry's major suppliers. In 2002, we expect to spend approximately $45 million, compared with $37 million last year, on programming for all of our networks.

Our plans to become anchor tenants in the new studio and operations center we told you about last year are on track. When we move in this summer, we will be able to cost-effectively develop additional new content and produce more episodes of our existing programs. The facility will also allow us to create digital programming for all of our online properties.

Our original programming not only airs on domestic TV but also is used on the networks that encompass the Playboy TV International (PTVI) joint venture in which we own a 19.9% equity stake. In its second full year of operations, PTVI launched Playboy TV and an adult movie service in Greece, Poland and Turkey and launched Spice in New Zealand, Taiwan and the U.K., increasing global household reach by 18% at year-end, to more than 30 million households. PTVI owns Playboy, Spice and local movie services in 53 countries.

PLAYBOY.COM WILL REACH PROFITABILITY

While the Entertainment Group will remain the profit driver for the Company in 2002, the online business is expected to reach its own very important goal – profitability. The catalysts for that achievement:

- multiple, high-margin revenue streams;
- significantly reduced cost structure;
- strategic partnerships and alliances;
- low-cost marketing due to the power of the brand; and
- the ability to leverage Playboy's library, promotion and product assets.

For our online business to reach profitability during 2002, we need to carefully manage our costs against anticipated revenues. While we did better on the expense side in 2001 than projected, our revenue growth fell short of expectations, primarily because of the sharp decline in advertising and the delayed launch of our online gaming and Spice subscription sites, which resulted in a higher-than-anticipated loss for the year.

Nevertheless, online revenues increased 9% in 2001, led by higher e-commerce and subscription sales, and we reduced the operating loss from 2000 results. In response to market conditions, we consolidated the publishing and online ad sales and marketing teams and now are seeing the benefits of those actions. With a larger sales team, we believe we can report modest growth in online advertising for 2002.

Our largest revenue stream continues to be e-commerce, and our focus on proprietary Playboy-branded products produces high margins. Our fastest-growing revenue stream is subscription. *Playboy Cyber Club* subscribers increased 50%, topping the 100,000 mark at year-end and making us one of just a few print publications to launch and operate a successful online pay service. Currently, the subscriber count has increased an additional 10%, and we believe we can continue growing that number. In addition, we have added a Spice subscription service, which we are marketing on our television networks and to *Playboy.com* exit traffic.

We also reported our first international online revenues in 2001, reflecting the launch of the German site, *Playboy.de*, which is patterned after the U.S. site and is operated in a joint venture with Tomorrow Focus AG. We also closed a deal for the most wired Asian country, Korea, and are in soft launch there. We expect to close deals in two more markets this year.

The addition of online gaming to our revenue streams will further enhance the group's growth. In the latter part of last year, we launched three Web-based gaming sites: sports wagering, casino games and pari-mutuel wagering. All three are operated by partners who bear the start-up costs and who are repaid through a revenue-share arrangement. While sports wagering and casino games are not available to U.S. bettors, we are generating traffic to these sites from the U.K., Hong Kong and other countries. With the base of users growing steadily, we expect to report online gaming revenues for the first time in the first quarter of 2002.

We believe the combination of growth from all of these revenue streams with reduced costs will allow us to achieve profitability in 2002.

USING THE BRAND TO FULL ADVANTAGE

Playboy is blessed with one of the best-known and most popular brands in the world. The driver of that brand image is *Playboy* magazine, the best-selling monthly men's magazine in the U.S. and the world. In 2001, we fared better than most other publishers, reporting essentially flat advertising revenues through the first nine months and a year-end decline of only 4%. On the circulation front, the magazine's sales remained strong in a difficult environment.

By leveraging the Playboy brand and trademarks via Licensing, we saw growth in both products and outlets, in the U.S. and around the world. In 2001, our men's underwear line was launched in Bloomingdale's and we finalized the location of our first freestanding boutique, which will open in Tokyo in 2002. We expect to increase Licensing profits in 2002 through additional licensees and outlets.

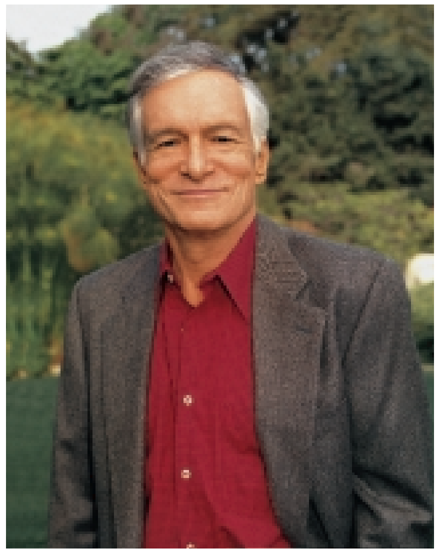
LOOKING AHEAD

Our goals for operating profitability and increased EBITDA in 2002 are ambitious but achievable.

We have not lost sight of our goal of reaching $1 billion in market capitalization for Playboy by 2004. We made substantial progress during 2001 in spite of the difficult stock market, showing a 72% increase in market cap to just over $400 million at year-end. The progress we made across all of our businesses and the cost control measures we undertook in 2001 put us in position to take Playboy forward into 2002. I look forward to reporting to you on our progress.

Sincerely,

Christie Hefner
Chairman and Chief Executive Officer
March 21, 2002

Christie Hefner, Chairman and Chief Executive Officer and Hugh M. Hefner, Founder and Editor-in-Chief of *Playboy* magazine.