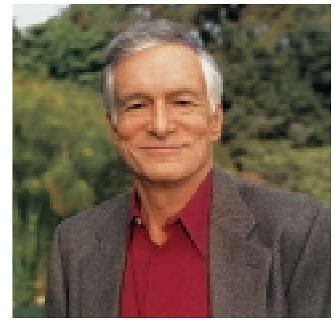

Photo by Eddie Sanderson

Christie Hefner, Chairman and Chief Executive Officer, and Hugh M. Hefner, Founder and Editor-in-Chief

TO OUR SHAREHOLDERS

2002 was a year of significant successes both operationally and financially. Not only did we swing to an operating profit from a loss and to positive free cash flow from negative, but we also put our businesses on the path to achieving even better results in 2003 and beyond.

Our 2002 accomplishments included:

- restructuring the ownership of our international TV joint ventures to increase our equity stake and profit potential while giving us operating control of most of our overseas networks;
- developing an online subscription model that helped us to achieve our goal of reaching breakeven in online by year-end and to position that business for profitability in 2003;
- hiring a new editorial director of *Playboy* magazine who will lead the magazine into its second 50 years;
- continuing the growth of our high-margin licensing business, including a successful auction of photos, artwork and memorabilia; and
- expanding our management team with the addition of David Zucker, our new president and chief operating officer, while reducing our corporate overhead.

Though it is gratifying to look back on our achievements, our focus is on the future. In 2003, we expect operating profit to almost double compared with 2002 as we benefit from a significant improvement in online results, increased profits from licensing and continued profitability of entertainment.

Entertainment Will Remain Largest Profit Contributor

In 2002, the strength of our domestic TV networks led to an 8% increase in Entertainment Group segment profit, to $32.4 million. Fueling the gain was the contribution from our domestic TV business, particularly the three movie networks we acquired in July 2001. At year-end, we had grown 32% in digital TV carriage and had concluded an agreement with Adelphia, the only major cable operator that had not previously carried our services. We have already rolled out our networks in more than one million of Adelphia's digital households.

In 2003, we are expecting domestic TV revenues to be flat after two years of strong revenue growth. This near-term flattening combined with a lower international TV profit contribution, due to the change from the licensing model under our former joint venture agreement to an owner-operator business model, will lead to a one-year decline in Entertainment Group profitability.

Beyond that, the opportunity for growth is great. We are in front of only one-third of U.S. cable homes, and the greater channel capacity offered by digital technology allows us to add both more homes and more networks. As our annual investment in programming is expected to be constant, there is great leverage on that growth.

The same combination of operating leverage and growth potential is what makes international TV attractive to us. In 2002, we reached an agreement with Claxson Interactive Group Inc. to restructure the ownership of our international television joint ventures, creating greater long-term profit potential.

During the last three years, the venture with Claxson has successfully built that business by launching 15 new networks, growing household reach to more than 30 million, increasing revenues 139% and paying us licensing fees for the trademarks and programming. We agreed to exchange future payments owed to us by the joint venture for additional equity and, as a result, assumed 100% interest in 13 international networks and increased our equity in two other networks while retaining our minority 19% ownership position in the Latin American venture.

With our new ownership position, we expect to report significantly higher revenues—approximately $35 million in 2003 versus $16 million in 2002—as well as the expenses of the international networks, including distribution, sales and marketing and administrative costs. The international TV business is already profitable, although the profits in 2003 will be lower than the license fees we reported in 2002.

We believe international TV has significant revenue and profit growth potential in the long term, as we leverage Playboy's global brand recognition and capitalize on our ability to use programming created for our domestic TV networks. We are in only 10% of the TV households in the countries where our networks are now available, and we have yet to enter such sizable markets as Italy, Germany and Australia.

As always, the success of our TV operations rests on the appeal of our programming. Working from our new studio, we will create approximately 250 new hours for Playboy TV in 2003 and also license approximately 650 movies for our networks, all for under $45 million.

Online Will Be 2003 Growth Driver

Online's swing from the investment phase of the past years to operating profitability in 2003 will be the biggest factor in our growth in operating profit this year. As the group's quarterly losses narrowed over 2002, reaching profitability for the month of December 2002, it became evident that we have developed a successful business model that capitalizes on high-margin revenue streams and a low fixed-cost structure.

Subscriptions are expected to be our largest revenue stream in 2003, and offering a variety of content for pay will be the core of our online business going forward. In 2002, online subscription revenues rose by 66%, to $11 million. Our foundation subscription service, *Playboy Cyber Club*, continued to add customers even as we increased its monthly and annual prices. We also launched a number of new clubs, including *PlayboyNet*, a site that organizes content thematically, and *PlayboyTV Jukebox* and VOD services, which allow us to take advantage of the broadband computer capabilities that are now available in approximately one-fifth of U.S. households. We expect 2003 to be the fourth year in a row with a more than 60% increase in subscription revenue.

Like TV, online benefits from the leverage of a fixed-cost business and predictable revenue streams. Of great benefit to us, however, and unlike TV, is the fact that in the online world we deal directly with our customers. As a result, we keep 100% of the retail price of our service instead of splitting revenue with a distributor, and we can easily test different services, pricing and marketing concepts and quickly implement those that are most effective.

Our other major online revenue stream, e-commerce, showed profit margin growth despite lower revenues as we focused our efforts, particularly on the direct commerce side, on managing for profitability. We now offer more than 1500 Playboy-branded products, including apparel, accessories, collectibles and DVDs. The improved margins are a result of a better product mix and more-targeted customer offers combined with the benefits related to the proprietary nature of our offerings. Our other online revenue streams—advertising, international and gaming—also showed year-over-year revenue and profit growth.

Our online success comes from leveraging the power of the Playboy name—one of the most-often-searched words on the Internet—and the content from our other businesses, in the form of our extensive video, photo and editorial libraries. Moreover, *Playboy.com* has been aggressive in the creation of its own compelling content, some of which is now being repurposed in video releases and in the magazine.

Publishing and Licensing Create Powerful Brand Image

As our TV and online businesses demonstrate, the Playboy brand is a powerful competitive advantage. The Publishing and Licensing Businesses Groups are integral to maintaining the sexy, young, fun image that is the source of the brand's appeal.

Playboy's position as the most popular monthly men's magazine in the world is undisputed. After 36 years of dedicated service, Editorial Director Arthur Kretchmer decided to leave the company. To replace him, we hired Jim Kaminsky, who had top experience at both *Men's Journal* and *Maxim,* and moved the magazine's editorial base from Chicago to New York. Working with Editor-in-Chief Hugh Hefner and the creative team, Jim is making changes that are reenergizing the magazine in ways that are already noticeable, making it easier to read and more dynamic visually while retaining the sophistication and quality that have been *Playboy*'s hallmarks.

Licensing continues an evolution of its own, fueling high-margin growth through the launch of new categories of product, in new countries and with new distribution methods. In 2002, we opened our first freestanding Playboy concept store, funded by our local partner, SuperLovers Co., Ltd. Located in the upscale Aoyama shopping district of Tokyo, the store features young, fashion-forward clothing and accessories. We expect to open other concept stores funded by local partners in major urban areas. We also successfully completed an auction of art, photography and memorabilia in 2002. As part of our 50th anniversary, we will be holding a special auction in December, the first to also feature original manuscripts from the early years of the magazine.

Celebrating 50 Years of *Playboy*

In December, we will release the January 2004 issue of *Playboy* magazine, which marks the beginning of our second 50 years. The celebration, which begins this April with a three-month search for the 50th Anniversary Playmate, will continue through mid-2004. Special features related to our 50th and updates on celebratory events are available at *www.playboy.com/50th*.

As we look to the future, we have every reason for optimism. We completed a recapitalization early this year that consolidated our debt, allowed us to pay in cash the 2003 tranche of the deferred acquisition price for the movie networks we acquired in 2001, eliminated our Playboy.com debt and gave us greater financial flexibility going forward. We have a talented and experienced management team in place. We expect to report significant operating profit growth in 2003, and our businesses are well positioned for the future. Our 50th year promises to be a very good one.

Sincerely,

Christie Hefner
Chairman and Chief Executive Officer
March 28, 2003