# 20.10 Operating System

## Operating & Financial Review

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Paddy Power is an international betting and gaming group. Operations are divided across Online, Retail and Telephone channels. Betting and gaming services are provided predominantly to consumers, mainly in the UK, Ireland and Australia, but also to business-to-business clients globally.

The profile of the Group's activities has changed significantly over recent years with the online channel accounting for 72% and non-Irish customers accounting for 64% of operating profit in 2010.

| **Operating Profit by Division (€m)** | 2010 | % of Group | 2009 | % of Group |
|---|---|---|---|---|
| Online (ex Australia) | 57.5 | 55% | 45.7 | 69% |
| Online Australia | 19.5 | 19% | 4.6 | 7% |
| Irish Retail | 17.6 | 17% | 16.3 | 24% |
| UK Retail | 7.4 | 7% | 1.3 | 2% |
| Telephone (ex Australia) | 1.8 | 2% | (1.2) | (2%) |
| **Group** | **103.8** | **100%** | **66.7** | **100%** |

*(Online Australia also includes legacy telephone operations accounting for less than 10% of gross and operating profit in 2010)*

| **Operating Profit by Geography (€m)** | 2010 | % of Group | 2009 | % of Group |
|---|---|---|---|---|
| UK | 45.7 | 44% | 29.4 | 44% |
| Australia | 19.5 | 19% | 4.6 | 7% |
| Ireland and Rest of World | 38.6 | 37% | 32.7 | 49% |
| **Group** | **103.8** | **100%** | **66.7** | **100%** |

*(Online and Telephone operating profit allocated by geography based on average divisional profit margins applied to gross win)*

## Sporting Results and Trading

Sporting results in the first half of the year threw up a rare, unusual and bizarre overall gross win percentage – in line with our expectations. The fact that the swings and roundabouts balanced out highlights the potential benefits of an ever increasing diversity of events and markets.

The second half of the year got off to a great start with the concluding stages of the World Cup pushing up our total stakes on the tournament to €86m and gross win to €18m. Thankfully, the combination of the Germans and optically challenged referee's assistants did take out some of the teams carrying our biggest liabilities. Nonetheless, we did get stung by Paul Oktopus correctly predicting the winner in all of Germany's World Cup matches from his office in the Sea Life Aquarium, landing punters a few squid. Always keen to embrace new innovations we lost no time in appointing his first cousin, Paddy the Psychic Octopus, to the senior management team to predict the outcome of major sporting events. With a gross win percentage 1% above our normal expectations in the second half of the year, we're thinking of donating Paddy to the Irish government in the national interest.

Paddy's achievement was all the more heroic given our ongoing commitment to give better value than the competition through extra places for each-way bets (e.g. seven in the British Open), justice payouts on selections that let our punters down (e.g. Andy Murray when Nadal withdrew during the Australian Open) and early payouts on selections that we figured weren't going to let our punters down (e.g. So You Think in the Cox Plate). In the crazy world of sports where Andy Carroll is only slightly cheaper than Zinedine Zidane and more expensive than David Villa, at least our commitment to great value and entertainment for our punters will not change.

IMPORTANT:
Almost two thirds of Paddy Power's profits were generated outside of Ireland in 2010.

Volcano Betting
1105 DUBLIN CANCELLED
1245 LONDON CANCELLED
1325 PARIS CANCELLED
1620 MELBOURNE CANCELLED
Paddy Power plc
FRUSTRATED
STRESSED
QUITE ANNOYED
HAPPY
ANNOYED
REALLY ANNOYED
MAD
ANGRY
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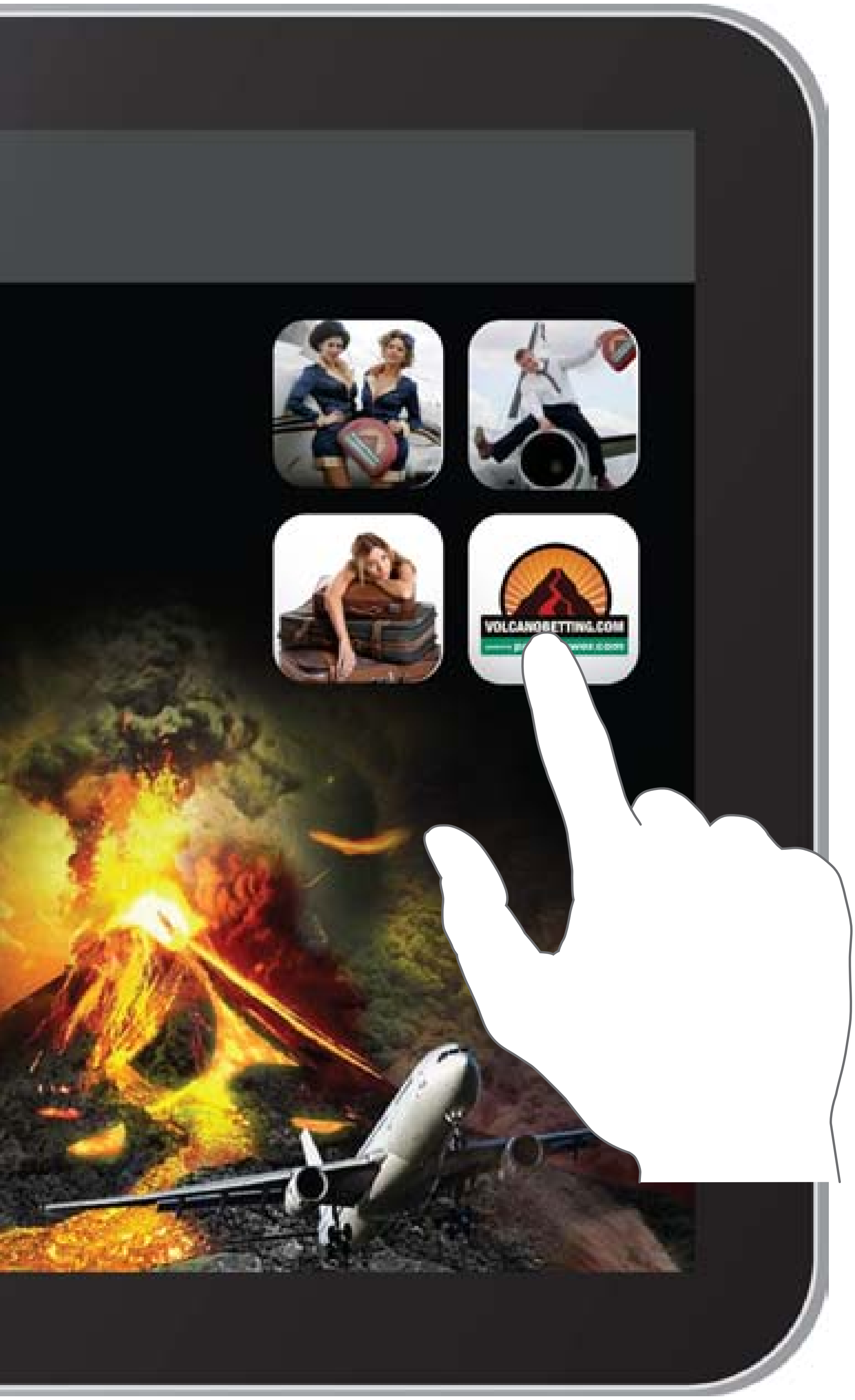


## Volcano Betting

In April, air travel in Europe literally ground to a halt courtesy of a previously inactive Icelandic volcano with an unpronounceable name. Eyjafjallajökull's impact on air travel was immediate and, with no end in sight, we spotted opportunity in adversity and launched volcanobetting.com.

Volcanobetting.com allowed would-be holidaymakers to place a bet on a wide range of UK or Irish airports closing for at least a one hour period due to volcanic ash contamination on any given date between June 1st and August 31st. The odds on offer varied by airport and by date; as an example a £1,000 holiday leaving London Heathrow on July 18th could be covered by placing a bet of £50 at 20/1.

Turnover was literally flying in the first two weeks before the worst thing that could happen happened; the volcano stopped erupting. Short lived but much loved, volcanobetting.com, just like Eyjafjallajökull, remains dormant…… for now!

## ONLINE

| €m | 2010 | 2009 | % Change | % Change in CC |
|---|---|---|---|---|
| Sportsbook gross win | 176.7 | 80.3 | +120% | +105% |
| Gaming & other gross win | 72.8 | 52.5 | +39% | +34% |
| **Total gross win** | **249.5** | **132.8** | **+88%** | **+77%** |
| **Operating profit** | **75.0** | **49.4** | **+52%** | **+44%** |
| % of Group operating profit | 72% | 74% | | |
| **Active customers** | **838,043** | **537,202** | **+56%** | |

*(Active customers defined as those who have bet in the reporting period, excluding indirect B2B customers and Australia pre Q4'09)*

Last year our online operations generated €250m of gross win and €75m of operating profit. Operating profit growth of €26m comprised paddypower.com growth of €12m and Australian growth of €14m (of which €4m arose from having a full year contribution).

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IMPORTANT:
Paddy Power's online earnings have a unique profile with 71% of revenue generated from sports betting and our profits generated from the legal regulated markets of the UK, Australia and Ireland.

Paddy Power's online earnings have a unique profile with 71% of revenue generated from sports betting and our profits generated from the legal regulated markets of the UK, Australia and Ireland. We see this strength in sports betting as a significant asset, as it is the largest individual segment in online gambling, and also has the highest potential for product differentiation and barriers to successful new entrants. A strong sportsbook position can also enhance gaming profitability and growth when backed up by investment in product, marketing and intelligent cross selling. Whilst regulations currently preclude the Group from availing of this opportunity in Australia, gaming contributes almost as much revenue as sports betting for paddypower.com.

In constant currency versus proforma comparatives, online gross profit increased by 51% and operating costs by 66%, reflecting in part investment in key areas such as mobile betting to ensure the Group remains part of the 'big-get-bigger' segment of online operators. Overall, we significantly strengthened our market position in 2010, ending the year with more customers, more scale and more capabilities, as well as significantly higher profits, compared to a year previously.

## ONLINE DIVISION (Excluding Australia)

| €m | 2010 | 2009 | % Change | % Change in CC |
|---|---|---|---|---|
| Amounts staked | 1,126.0 | 856.4 | +31% | +29% |
| Sportsbook gross win | 90.9 | 55.3 | +64% | +61% |
| *Sportsbook gross win %* | *8.6%* | *6.9%* | | |
| Gaming & other gross win | 72.8 | 52.5 | +39% | +34% |
| **Total gross win** | **163.7** | **107.8** | **+52%** | **+48%** |
| Gross profit | 143.0 | 94.6 | +51% | +47% |
| Operating costs | (85.5) | (48.9) | +75% | +72% |
| **Operating profit** | **57.5** | **45.7** | **+26%** | **+20%** |

The online division (excluding Australia) grew its profits by 26% in the period to €58m (or by 20% in constant currency excluding a €2.1m benefit from positive exchange rate movements). An improvement in sports results contributed to this increased profit but sportsbook stakes and gaming gross win also grew substantially, by 28% and 34% respectively in constant currency. Active customers increased by 44%, driven by 56% growth in UK customers. Both sportsbook and gaming active customers grew strongly, up 45% and 48% respectively.

After negligible operating cost growth in 2009, costs increased by 72% in constant currency. Increased taxation was a significant factor with the extension of payroll taxes in Ireland and higher UK VAT adding almost €3m or 6% to online costs. Further cost increases arose as a result of revenue growth, and specific investment decisions taken in a wide range of areas to drive future growth including:

- Increased investment in proven initiatives such as streamed live sports online, terrestrial TV advertising in the UK for both Sportsbook and Gaming, enhanced gaming promotions and further investment in website development;
- Exploiting new opportunities such as the potential from pay-per-click advertising, smart phone usage and other geographies;
- People costs linked to direct volume growth, a step-up in our infrastructure in areas such as B2B and IT, and performance related pay.

As well as driving growth, these investments contribute to the quality of our customers' experience and we were pleased to win best Customer Relations Operator at the E-Gaming Review awards in 2010.

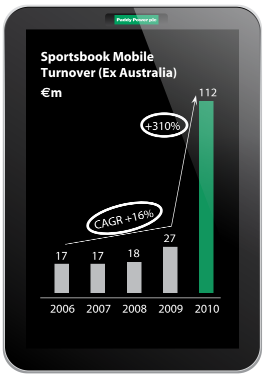
| **Online Channel Active Customers** | **2010** | **2009** | **% Change** |
|---|---|---|---|
| UK | 474,617 | 304,301 | +56% |
| Ireland and Rest of World | 167,672 | 142,100 | +18% |
| **Total** | **642,289** | **446,401** | **+44%** |

| **Online Customers Product Usage** | **2010** | **2009** | **% Change** |
|---|---|---|---|
| Sportsbook only | 355,842 | 253,233 | +41% |
| Gaming only | 85,613 | 62,108 | +38% |
| Multi-product customers | 200,834 | 131,060 | +53% |
| **Total** | **642,289** | **446,401** | **+44%** |

*(Active customers defined as those who have bet in the reporting period, excluding indirect B2B customers)*


## (A) Sportsbook

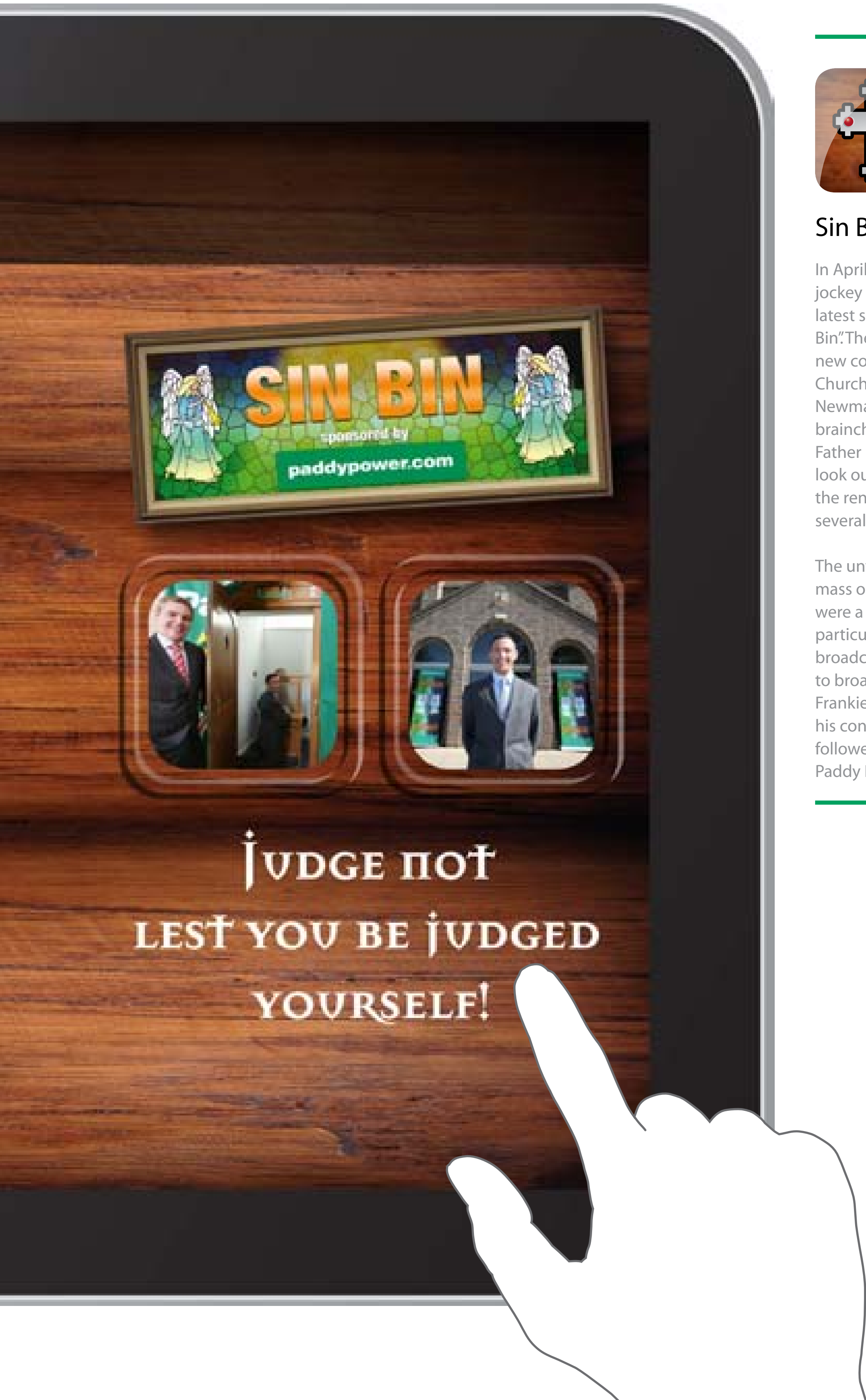
The amounts staked on the online sportsbook increased by 28% in constant currency to €1.053 billion. Within this, bet volumes grew 50% to 63.8m while the average stake per bet decreased by 15% in constant currency to €16.52. The reduction in average stake per bet is due to a combination of factors, including the significant growth in active customers and more challenging economic circumstances. We saw strong growth in both racing and football turnover as a result of continued development of our product which included significant investment in live betting markets and a new live betting interface. This expansion in the choice of markets, together with the option of mobile betting, contributed to growth in the average number of bets per customer, partially offsetting the reduction in average stake per bet.




Sportsbook gross win increased by 61% in constant currency. This growth was helped by a rebound in the gross win percentage to 8.6%, which was above the upper end of our normal expected range of 7.0% to 8.0%. This improvement was despite our biggest ever Money-Back Special refund being triggered when Spain and Holland finished 0:0 in the World Cup final, which resulted in over 25,000 online customers receiving back their losing stakes (and over 50,000 customers across the Group).

The Paddy Power book of course goes way beyond sport. Special events such as the Royal nuptials generate much to bet on from the stag night to the dress (Paddy gave his views on both to the media outside Buckingham Palace despite, we suspect, a small chasm between his knowledge of the two subjects). Sometimes even Paddy's 'expertise' reaches its limits though, resulting in us commissioning and publishing independent political opinion polls, reinforcing our leadership position in political betting. There is almost no subject for which our traders cannot provide a betting market. Their diverse output generated great interest at home and abroad, ranging from our volcano eruption betting which was covered in National Geographic magazine, the name of Apple's next device (The Economist) and the next species to become extinct (Wall Street Journal).

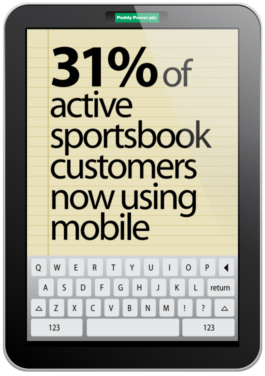

Sin Bin
penance generator
10 Hail Marys
10 Our Fathers
10/1 No. 4 Newmarket 3.30
father paddy 10 mins ago
20 Hail Marys
1 Decade of the Rosary
33/1 No. 8 Leopardstown 4.40
father paddy 30 mins ago
Paddy Power plc




## Sin Bin

In April, we teamed up with champion jockey Frankie Dettori to unveil our latest sponsorship, the "Paddy Power Sin Bin". The celestial sponsorship funded a new confession box for St. Etheldreda's Church in the home of UK flat racing, Newmarket. The sponsorship was the brainchild of Newmarket Parish Priest Father Michael Griffin who was on the look out for innovative ways to finance the renovation of his church which was several years overdue.

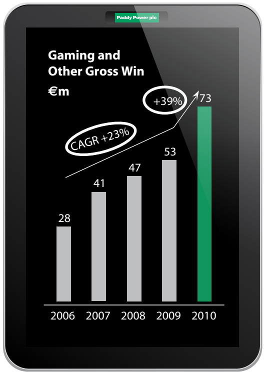
The unveiling took place after 10 o'clock mass on April 27th. The congregation were a little bemused by the whole affair, particularly when a Sky News outside broadcast unit descended on the Church to broadcast the unveiling live on TV. Frankie Dettori had the honour of having his confession heard first in the Sin Bin followed by the perennially penitent Paddy Power.




There were, as always, numerous product innovations in the year, but the stand-out highlight was mobile. After a few false dawns and several dodgy ringtones, the year of the mobile came with turnover up over 300% to €112m, or 11% of total sportsbook stakes. In January to February of this year, 31% of our online sportsbook customers transacted with us via mobile, generating 19% of the total amounts staked. We were first-to-market with a series of award winning mobile applications. These releases were backed up with a major brand advertising campaign in the UK and Ireland showcasing our technology credentials (for those that might mistake us for just a 'cheeky chappy'). In addition, we made significant investment in the evolving mobile advertising channels. We expect more innovation and growth this year as we continue to adapt our smartphone platform to the demands of the mobile user.

## (B) Gaming & Other

Gaming and other revenue increased by 34% in constant currency to €73m driven by growth in Games, Casino and Bingo. Significant enhancement to the quality of our gaming offer and promotions expertise encouraged us to conduct more direct customer acquisition for gaming. TV advertisements were run for the first time for both Games and Bingo in June and good results led to further campaigns, as well as increased focus on pay-per-click advertising for gaming.




Growth in sportsbook customers is a key potential driver for Games and Casino growth. To leverage that opportunity, significant investments have been made in expertise, analysis and technology to customise cross-selling, ongoing promotional offers and product presentation. This customisation is to the preferences and behaviours of players, both in their early life and as they evolve over time. Progress and investment in this area is highlighted by the 53% increase in active multi-product customers.

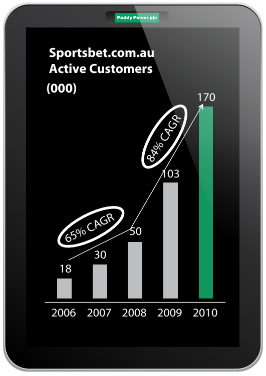
Our ability to offer more games more quickly accelerated last year and we increased our selection of games to over 200. Last year we introduced over 100 new games, versus 52 in 2009, incorporating innovative promotions such as '20 Games in 20 Days' in April and '24 Games in 24 Hours' in October (the 'techies' are all getting full Star Trek box sets if they manage '60 Games in 60 Minutes'). We also took advantage of the increased appetite for live streamed product with further investment in our Live Casino offer. In addition, Paddy Power benefited from a competitive market amongst technology suppliers: we now use over 15 suppliers across Games and Casino, giving us 'best of breed' products for our customers and flexible competitively priced supply.

Bingo was our fastest growing gaming segment last year which exemplifies how Paddy Power can adapt its capabilities to new areas. Bingo's performance was driven by our core strengths in distinguishing our product from the rest of the pack, and online and offline marketing that combines creativity with detailed analytics behind the scenes.

Our Poker business continues to perform well relative to its peers but faces ongoing challenges from sites taking play from the U.S. In this context, we were pleased to increase new player sign-ups helped by our sportsbook growth, another successful Irish Open Poker Tournament (which attracted record player numbers) and the towering achievement of a world record chip stack at our Irish Winter Festival. The last time we piled chips so high involved two slices of buttered bread and the mother of all hangovers!

B2B revenues grew strongly, as expected, with the commencement of service to PMU in June and we aim to build a portfolio of such deals in markets where a B2B entry offers a more attractive risk reward profile than B2C. We also transact with business customers through our sports risk management business (Airton Risk Management). It targets companies with exposures to sporting results from marketing or player bonus arrangements and enjoyed a turnover boost from the World Cup.

For some time, we have been evaluating options to further invest in Paddy Power Trader to grow its contribution to a worthwhile level. We have concluded that the balance of risk and reward is not favourable for such an investment relative to our other opportunities and we are winding down the service. The decision does not give rise to any material costs or impact on our expected profits over the coming years.




## ONLINE AUSTRALIA DIVISION

| €m | 2010 | 2009 |
|---|---|---|
| Amounts staked | 1,230.4 | 450.3 |
| **Gross win** | **97.0** | **31.8** |
| *Sportsbook gross win %* | *7.9%* | *7.1%* |
| **Gross profit** | **75.3** | **22.3** |
| Operating costs | (55.8) | (17.7) |
| **Operating profit** | **19.5** | **4.6** |
| Active customers | 198,132 | 92,820 |

*(Active customers defined as customers who have bet in the reporting period for 2010 or post acquisition in quarter 4 for 2009)*

*(The division also includes legacy telephone operations accounting for less than 10% of gross and operating profit in 2010)*

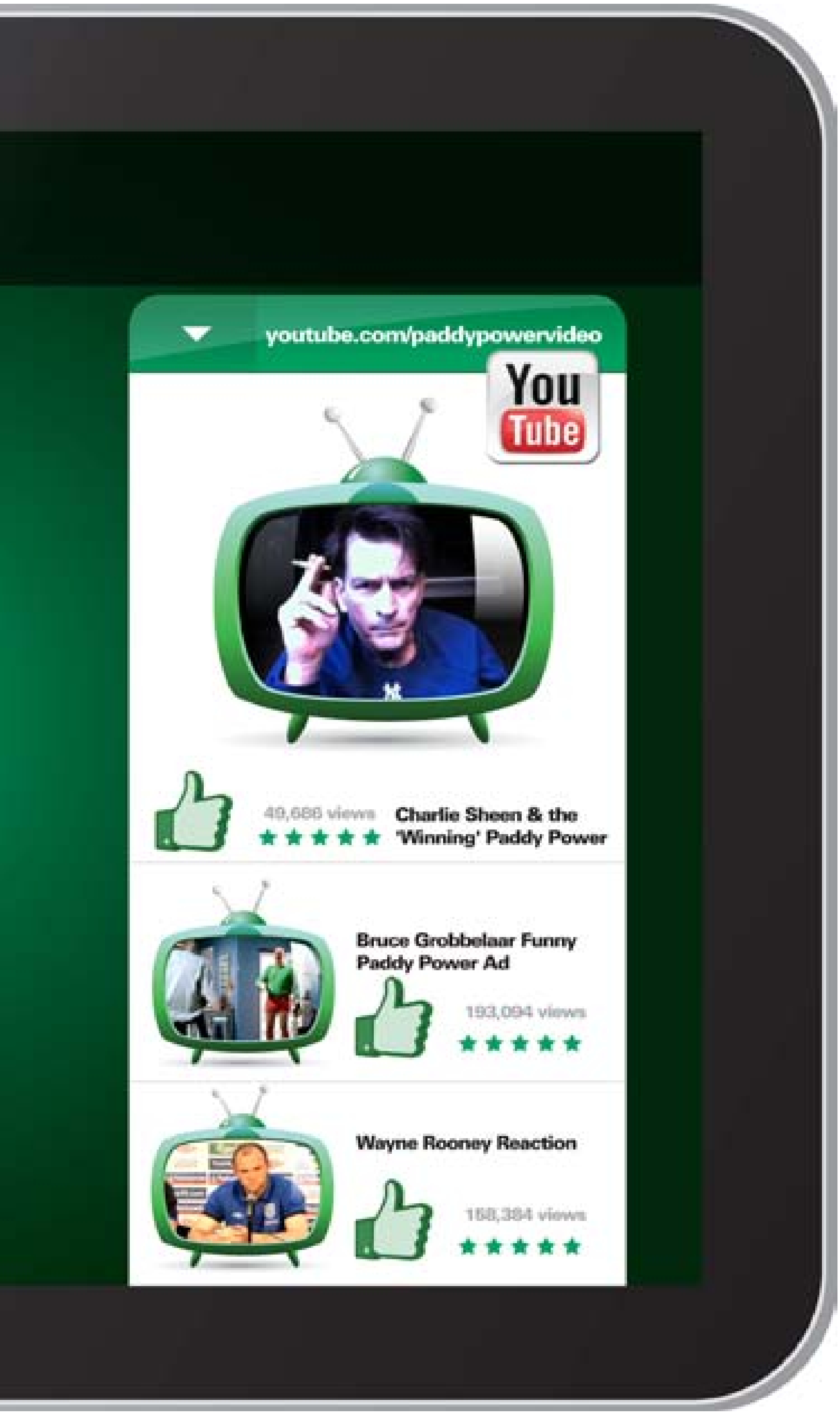
Our Australian operations generated excellent financial results last year driven by a strong performance from our mass market online brand, sportsbet.com.au. In constant currency versus pro-forma comparatives, online gross win grew by 44%, amounts staked by 20% and bet volumes by 28%. Online active customers were up 46% last year as compared to 2009 pro-forma comparatives, with growth of 66% in active customers of sportsbet.com.au.

The gross win percentage increased significantly to 7.9% and, assuming normal sports results and channel mix, we would expect a gross win percentage around this level going forward. This represents a significant increase in expectations versus, for example, the 6.2% achieved by Sportsbet pre-acquisition in the year ended 30 June 2009. The increase reflects risk management process changes and an emphasis towards a more mass-market (albeit lower staking) online customer base, and away from lower margin telephone business. In constant currency versus pro-forma comparatives, these changes lower growth in turnover, up 11% last year, but more importantly, maintain strong growth in gross win, up 25% last year.

The level of deductions between gross win and gross profit also improved at 23% of gross win in 2010 compared to 30% in 2009. This was driven by a reduction in the betting duty levied by the Northern Territory and agreements reached in the second half of last year with Racing Victoria Limited, Queensland Racing and South Australia's racing bodies to calculate their product fees as a percentage of gross win (rather than turnover) until at least June 2012. This issue continues to be the subject of litigation with other Australian racing bodies, including Racing New South Wales ('RNSW'). In June last year, a Federal Court judgement in the RNSW case was delivered substantially in Sportsbet's favour, but the full Federal Court later upheld an appeal by RNSW against this judgement. Sportsbet subsequently lodged an application for leave to appeal to the High Court with a decision on the application to appeal expected on 11 March. New South Wales has also recently introduced legislation which has stopped the exploratory trials of the Sportsbet 'Betbox' branded online access terminals.

IMPORTANT:
Our Australian operations' online gross win grew by 44% and amounts staked by 20% in constant currency versus pro-forma comparatives.


Social Paddy
twitter.com/paddypower
facebook.com/paddypower
paddypower
Waiting at Gloucester airport to welcome my guests off the #partyplane. We're going to the #GoldCup. It's going to be mad craic @hectoron2fm
Still can't believe Cheltenham is over. There's a hole in my life! Anyone want to talk about the Grand National...
pphorseracing R moore is evs fav with pp for gb jocks flat title begining at catterick tomorow. K fallon 3, p hanagan 4, r hughes 7, 20 bar #horseracing
@ACinq9 @posephoto #Uruguay 7/5. On paper they're the better team but sometimes in int friendlies the home team is the only one up for it!
pphorseracing Dream ahead just did 1st gallop with vainglory. Very relaxed indeed & grown enormously. V muscular #horseracing
#Ireland 2/1 to beat #Uruguay tonight, I think that's a decent enough price in a friendly – they'll want to impress the crowd (both of them)
Paddy Power
Paddy Power plc




## Social Paddy

It's been a great year for us in the world of Social Media. Our Twitter, Facebook and YouTube channels attracting more and more followers, fans and viewers than ever before. We've had hundreds of thousands of viewers for our television adverts and our now famous "Nob Nation" videos produced by Ireland's leading video satirists.

On Facebook we've gone from strength to strength and have more "fans" than the next ten competing bookmakers combined! During Cheltenham our page was abuzz with the tips flying backwards and forwards as our fans really got stuck in.

Meanwhile we're also more active than ever in the "Twittersphere", in daily contact now with over 10,000 followers. There is no better way to keep in touch with our customers and with channels devoted to customer service, our special offers and even showbiz, politics and racing, we've got every angle covered!

## RETAIL

Both our retail businesses grew their profits last year despite the challenging economic backdrops. UK Retail clearly has a strong opportunity to grow profits as we expand the size of the estate, however the EBITDA from the existing units also grew strongly. Irish Retail profitability also increased as it benefited from consumers continuing to respond to its value offering and a normalisation of sporting results.

We expect to continue to grow our retail market share in both the UK and Ireland by offering outstanding value to more price conscious consumers. New innovative offers introduced in 2010 included paying out on two winners where an early leader, frustratingly for punters, fails to finish the job ('Winner Winner'), extending our unbeatable money back on all losers to greyhound racing and an unparalleled level of daily price enhancements.

Product innovation continues across all aspects of the retail offering. Newly introduced Self Service Betting Terminals give customers further service and choice about how they want to bet – they're similar to the express self-service checkouts at supermarkets, only with the added distinction of actually being quick! Our shop audio team now also communicates key time-sensitive news impacting odds and alerts for major Paddy Power specials on Twitter. Such developments leverage online expertise in a retail setting driving more benefits out of the multi-channel approach.

### IRISH RETAIL DIVISION

| **€m** | **2010** | **2009** | **% Change** |
|---|---|---|---|
| Amounts staked | 908.4 | 949.1 | -4% |
| **Gross win** | **109.6** | **106.0** | **+3%** |
| *Gross win %* | *12.1%* | *11.2%* | |
| **Gross profit** | **100.3** | **96.2** | **+4%** |
| Operating costs | (82.7) | (79.9) | +4% |
| **Operating profit** | **17.6** | **16.3** | **+8%** |
| Shops at year end | 207 | 198 | +5% |

The amounts staked within Irish Retail decreased by 4% to €908m; however gross win increased by 3% to €110m, driven by an improved gross win percentage. We opened nine new shops last year, including two which we acquired. Excluding the impact of new shops, like-for-like amounts staked were down 7%, gross win was up 0.2% and operating costs up 1%. The reduction in like-for-like stakes was due entirely to a fall in average stake per slip of 11% to €18.16, with the number of slips increasing by 5% despite the increased year on year weather disruption to events in January and December.

IMPORTANT:
Both our retail businesses grew their profits last year despite the challenging economic backdrops.

## UK RETAIL DIVISION

| €m | 2010 | 2009 | % Change | % Change in CC |
|---|---|---|---|---|
| Amounts staked | 276.3 | 198.3 | +39% | +34% |
| OTC gross win | 30.0 | 21.3 | +41% | +36% |
| *Sportsbook gross win %* | *11.9%* | *11.6%* | | |
| Machine gross win | 24.2 | 14.1 | +72% | +66% |
| **Total gross win** | **54.2** | **35.4** | **+53%** | **+47%** |
| **Gross profit** | **45.8** | **30.0** | **+53%** | **+47%** |
| Operating costs | (38.4) | (28.7) | +34% | +30% |
| **Operating profit** | **7.4** | **1.3** | **+484%** | **+351%** |
| Shops at year end | 124 | 93 | +33% | |

*(Machine gross win above and throughout this statement is after the deduction of VAT at 17.5% in 2010 and 15% in 2009)*


UK Retail operating profit increased almost six-fold from €1.3m to €7.4m. New shops opened in 2010, and a full year impact from openings in 2009, were, as expected, an important driver of this growth; however our existing shops also significantly increased their profitability driven by the introduction of new 'Storm' FOBT machines, as well as the benefit of the World Cup, more normal sports results and stronger sterling (which added approximately €0.4m to profit).

In constant currency, turnover grew 34% to €276m, while gross win increased by 47% to €54m. Like-for-like gross win grew 12% in constant currency: this comprised machine growth of 20% and over-the-counter ('OTC') growth of 7% on like-for-like OTC turnover up 2%. The average OTC stake per bet was down 3% in constant currency to €15.70 while like-for-like bet numbers grew 5%.

There were 492 machines installed at year end, an increase of 124 compared to last year as a result of new shop openings. The average gross win per machine per week including VAT was £1,072, an increase of 24% compared to last year.

Operating costs grew 30% in constant currency driven by a 35% increase in average shop numbers. Like-for-like costs (including central costs) were up 2.6% in constant currency reflecting in part the 2.5% increase in UK VAT last year. The further increase in UK VAT to 20% from January 2011 will reduce the Group's profits by approximately €1.3m at current levels of activity, with the majority of this impact within UK Retail. Costs will also increase next year by some €0.2m as a result of changes to the UK Horseracing Levy effective from April 2011. We await detailed provisions from the Treasury on the expected replacement of the existing VAT and AMLD regime for machine taxation with a gross profits tax ('GPT') effective next year. While we are hopeful the Treasury remain true to their original objective for any change to be tax neutral, the change could adversely impact efficient machine and expanding operators such as Paddy Power.

We opened 31 new shops last year, including seven which we acquired, at an average capital cost per unit of €314,000 (£267,000) including lease premia and acquisition costs. EBITDA per shop pre central costs averaged €164,000 (£141,000), an increase of 29% in constant currency. After central costs, EBITDA and EBIT per shop were £100,000 and £58,000 respectively, despite the estate not being mature or at its optimal scale as yet.


Paddy Power plc
Psychic Power
Europe?
Vs
USA?
Predict

## Psychic Power

Following the phenomenal success of Paul the Psychic Octopus at predicting the results of selected 2010 World Cup matches from his home in Oberhausen, Germany, we joined forces with the National Sea Life Centre in Bray to give Paul's Irish cousin, Paddy, a shot at predicting the outcome of sporting events a little closer to home.

'Paddy the Psychic Octopus' took up residence in his new home at Sea Life in Bray at the beginning of August and began his psychic training. Paddy's first prediction on the All Ireland Hurling Final proved right on the money when the intuitive cephalopod chose to feed from a perspex feeding box adorned in the Tipperary colours.

Buoyed by Paddy's apparent psychic ability, we planned a major media event around the 2010 Ryder Cup where Psychic Paddy would predict the winner of the historic golf event live via webcam. However, psychic Paddy had other plans and, to the disbelief of shocked Sea Life staff, laid hundred of eggs in his aquarium home. Sadly the laying of eggs marks the end of the octopus life cycle and we never got to see his (or rather her) Ryder Cup prediction.

## TELEPHONE DIVISION (Excluding Australia)

| €m | 2010 | 2009 | % Change | % Change in CC |
|---|---|---|---|---|
| Amounts staked | 293.2 | 297.4 | -1% | -3% |
| **Gross win** | **19.0** | **14.9** | **+27%** | **+25%** |
| *Gross win %* | *6.5%* | *5.0%* | | |
| **Gross profit** | **18.9** | **14.9** | **+27%** | **+24%** |
| Operating costs | (17.1) | (16.1) | +6% | +5% |
| **Operating profit / (loss)** | **1.8** | **(1.2)** | **n/a** | **n/a** |


Our telephone business is an integral part of our full service offering to customers. Not the kind of full service Charlie Sheen has been enjoying mind. Recent years have been a story of two very different geographic performances. Ireland remains very difficult with amounts staked down 13% last year, and down a full 31% versus 2007, driven by reductions in average stake per bet. However, we managed to recoup that by continuing to take market share in the UK, helped by a materially better value offer than the competition. UK active customers were up 20% and amounts staked up 5% last year. With turnover broadly maintained by the performance in the UK, a return to a normal gross win percentage restored the channel to profitability.

Bet volumes grew strongly by 19% to 5.3m, driven by growth in active customers of 14% and increased bets per customer of 4%. The average stake per bet decreased by 18% in constant currency to €55.30 due to the weak economic conditions and the impact of attracting incremental but smaller than average sized bets from some customers.

Operating costs grew by 5% in constant currency driven by growth in bet volumes and new customer acquisition costs, particularly in the UK market. Many new telephone customers also go on to bet with Paddy Power online, boosting the overall return on customer acquisition spending.

| Telephone Channel Active Customers | 2010 | 2009 | % Change |
|---|---|---|---|
| UK | 49,223 | 40,849 | +20% |
| Ireland and Rest Of World | 23,902 | 23,107 | +3% |
| **Total** | **73,125** | **63,956** | **+14%** |

*(Active customers defined as those who have bet in the reporting period)*

## Brand

Notwithstanding all the other changes in our business, the Paddy Power brand – and brand values of fun, occasional irreverence and putting the customer first – remains our greatest asset and source of difference, and we continuously invest in it to stay ahead. Like Pamela Anderson visiting a plastic surgeon.

Putting the customer first and fairness are core principles at Paddy Power. There are lots of small, low profile ways we do this such as by being transparent about charges and terms. However, it's our approach to certain official results that demonstrates the difference most prominently. As we put it when refunding backers of Dustin Johnson when he missed out on the play-off for the USPGA after a ruling that he grounded his club in sand: 'Dustin may have to live with the fact that rules have robbed him of a chance to win a major but we don't have to live with such strait-jacket nonsense'. Some of our competitors actually stated that they 'never gave the idea of refunding a moment's thought' – a stark contrast which we advertised with the question, 'Who do you bet with?'. We believe that the differentiation, loyalty and turnover that this approach generates more than covers any short term cost.

The ongoing investment in the brand highlighted throughout this statement is of course not just done because it's fun; it continues because it delivers measurable, cost effective results. This is illustrated not only in the financial performance of the business but equally in the brand loyalty of our clients and the ability of the brand to appeal across different platforms, driving growth despite the current tough times.

IMPORTANT:
The Paddy Power brand – and brand values of fun, occasional irreverence and putting the customer first – remains our greatest asset and source of difference, and we continuously invest in it to stay ahead.

## Taxation

Following the strong performance in UK Retail, a deferred tax asset of €1,770,000 in respect of accumulated losses in Great Britain was recognised over the course of last year. Excluding this credit and the €7,116,000 gain on the revaluation of the Sportsbet buyout call options, the underlying effective tax rate was 15.7%, compared to 13.0% in 2009. The increased rate was as a result of the addition of Australian profits to the mix with an effective corporation tax rate of 30% under the historic structure which included minority shareholders. Over the next two years, assuming no other changes, the Group would expect its effective tax rate to gradually fall to approximately 14%.

Upon the implementation in September 2007 of the UK Gambling Act 2005, we significantly reduced the cost of deductions between gross win and gross profit within the Online and Telephone divisions. In 2010, the Department for Culture, Media and Sport in the UK consulted on proposals to introduce new license requirements for overseas-based online firms providing services to UK consumers. No policy changes have been announced to date.

## Cash Flow, Cash Balances and Foreign Exchange

Net cash generated from operating activities was €160m in 2010, up €75m compared to 2009. This was driven by operating profit post tax growth of €35m, increased working capital inflows of €27m driven by strong online growth, and higher depreciation and share based incentive charges of €14m. Capital expenditure was €24m, mainly connected with the organic opening and upgrading of retail outlets. Despite our retail expansion, capex has remained broadly in line with depreciation, helped by the quality materials and equipment previously invested in the estate all wearing well. Expenditure on acquisitions was €19m related to the additional 9.8% of Sportsbet purchased in February 2010, Sportsbet contingent consideration paid in August 2010 and retail shops acquired.

Last year, sterling and Australian dollar denominated operating profits were approximately £64m and AUD34m respectively. Accordingly, Group operating profit year-on-year can be positively impacted by a weaker Euro versus these currencies and adversely impacted by a stronger Euro versus these currencies.

As at 31 December 2010, the Group had net cash of €159m (2009: €75m) including cash balances held on behalf of customers of €42m (2009: €33m). This is net of third party debt within the Group's Australian operations of €5m which the Group can now manage more efficiently with 100% ownership. Net cash at 28 February 2011, less cash expenditure of AUD123m (€91m) related to last week's acquisition, remained strong at €87m or €47m excluding customer balances.

**Patrick Kennedy**
*Chief Executive*

**Jack Massey**
*Finance Director*

4 March 2011