

## FINANCIAL REVIEW

The Group has no discontinued operations and all activities are considered core.

### TURNOVER

Bookmaking turnover is recorded as the amount staked by the customer with customer winnings recorded as a cost. However, given the high predictability and low inherent gross win percentage in the casino and FOBT products, their turnover is recorded as net customer losses i.e. amount staked less customer winnings ("the drop"). The impact of this is that the relevance of turnover growth in the online division as a measure of business growth is reduced.

As always the sporting calendar will vary from year to year with regard to high profile sporting tournaments. In 2003 the Rugby World Cup took place, while in 2004 we had the benefit of the European Football Championships. While these types of events can have a small impact on year-to-year comparisons, they do not impact trends in any material way.

Turnover for the year to 31 December 2004 was €1,165.2m (2003: €913.6m) an increase of 27.5% on 2003. Turnover growth has been strong across all three channels ranging from 25.0% to 33.3%.

Retail turnover grew by 25.0% in 2004 from €551.1m to €688.7m. The Irish estate grew by 18.4% to €628.1m from €530.6m in 2003. Like-for-like growth rates within Ireland were 14.1% in 2004 reflecting the continued strength of the market and Paddy Power's strong position within it. Like-for-like growth includes the impact of our continuing refurbishment programme referred to in the operations review, but excludes the impact of the six

new outlets opened during the year. We continue to invest in new in-shop display systems which, through the display of additional product, will continue to drive turnover growth.

The UK retail estate saw turnover growth of 198.3% to reach €60.6m (2003: €20.5m) as the rollout of the estate continued with eight of the 31 (2003: 12) outlets opened in December 2004. We are pleased with the turnover growth in the UK which has been driven by growth in the number of outlets, improving brand recognition and continued product development. Customers now have the ability to take advantage of our larger estate by placing and collecting bets in different outlets.

The online division continued to see strong growth with turnover increasing by 29.7% to €240.0m (2003: €185.1m). Growth in the sportsbook was 22.4% which was driven by continued improvement in the online product offering. The quality of the product was recognised during the year when paddypower.com was voted the best online bookmaker by the Racing Post readers in 2004.

Also included in online turnover is the turnover from gaming products of €13.4m (2003: nil) driven by the casino, fixed odds games and peer-to-peer games, all introduced in 2004.

The telephone business continued to develop in both markets, growing by a total of 33.3% to €236.5m (2003: €177.4m). The UK now accounts for 46.67% of this turnover increasing from 37% in 2003, as we continue to expand in this relatively new market for Paddy Power.

### Average slip/bet values by channel

	2004	2003	Change
	€	€	%
<b>Retail</b>	<b>18.21</b>	16.98	7.2
<b>Telephone</b>	<b>83.45</b>	67.64	23.4
<b>Online</b>	<b>27.09</b>	27.18	(0.3)

(Note: Retail slips can contain more than one bet per slip, while other channels have a single bet per slip. Online comprises the sportsbook only.)

Average bet size continues to develop in the retail estate. Average bet size in the UK estate is larger than in the Irish estate due to the different age profiles of the estates. However, it is similar to the average of our equivalent new Irish shops. Given the different cost dynamics of handling bets through each channel, we continue to seek a higher average bet size in the telephone channel where the cost of delivery is higher. The overall stake patterns are consistent with the previous year and with our expectations.

Gaming machine income continues to grow in our UK estate with 97 machines installed at year end. Average gross drop per machine per month was €2.5k although this is improving in the latter part of the year due to a change in machine suppliers and a changing mix between FOBTs and AWP machines. Gaming machines are not generally permitted in Ireland.

### Bet volumes

	2004	2003	Change
	€'000	€'000	%
<b>Retail</b>	<b>37,811</b>	32,464	16.5
<b>Telephone</b>	<b>2,835</b>	2,623	8.1
<b>Online</b>	<b>8,363</b>	6,808	22.8

(Note: Retail volumes refer to the number of slips processed while other channels refer to the number of bets processed. Online comprises the sportsbook only.)

### GROSS WIN AND GROSS PROFIT

Gross win is measured as the amounts staked (excluding betting tax and levies) less the amount returned to customers as winnings. Gross profit is measured as gross win less discount on bets and gross win taxes. Customer drop from the casino, FOBTs and most other gaming products are included in gross win at 100% margin.

Gross win percentages by channel are set out in the table below:

#### Gross win %

	<b>2004 12 mths to 31 Dec %</b>	2004 6 mths to 31 Dec %	2003 12 mths to 31 Dec %
<b>Retail</b>	<b>12.88</b>	11.61	12.32
<b>Telephone</b>	<b>8.31</b>	6.66	7.43
<b>Online</b>	<b>10.73</b>	9.69	7.31

Gross win percentages in the sportsbook are driven by a number of factors including the underlying margin in the odds, the mix of events, the mix of bet types, customer behaviour, the accuracy of the odds offered and the run of results. In particular the run of results has a significant impact on margin, with winning favourites giving poor results for the bookmaker and vice versa. In contrast, the gross win percentage from gaming activities is lower, but less volatile given the inherent mathematics and different customer betting patterns.

The first half of the year saw strong gross win driven by continued turnover growth, a good run of sporting results together with the new gaming revenues from the online casino and peer-to-peer games. The second half of the year saw continued growth in turnover and improvement in the performance of the casino while sporting

results in the fourth quarter, particularly in the busy December period, were poor. The benefits of the increased gaming revenues can be clearly seen in the second half where its predictability mitigated the impact of poor sporting results. As the casino and other non-bookmaking income grows, overall gross win volatility should reduce.

We continue to expect the sportsbook gross win percentage to fall within annual ranges for each channel as follows:

Retail	12% – 14%
Telephone	8.5% – 9.5%
Online	7.5% – 8.5%

Gross win increased by 41.8% compared to an increase in turnover of 27.5% as set out below. This reflects improved gross win across the sportsbook together with €7.9m (2003: nil) of online gaming drop.

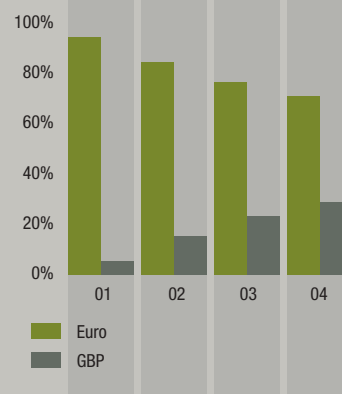
#### Gross win by channel

	<b>2004 €'000</b>	2003 €'000	Change %
<b>Retail</b>	<b>88,701</b>	67,907	30.6
<b>Telephone</b>	<b>19,664</b>	13,179	49.2
<b>Online</b>	<b>25,745</b>	13,524	90.4
<b>Total</b>	<b>134,110</b>	94,610	41.8

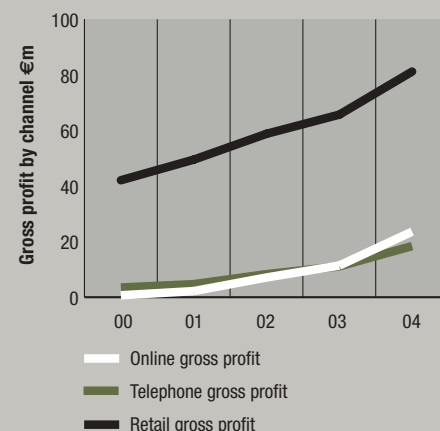
Gross win in the UK shops is developing and we have seen continued improvement as the estate develops and the volume of bets increases. We expect margin to continue to improve over time as the shops increase their bet volume and enhance their product mix.

Gross profit reflects the application of UK/Isle of Man betting taxes to the gross win and discounting of bets in Ireland. For business conducted under a UK betting licence, 15% of the bookmaker's gross win is paid in betting tax, while for business

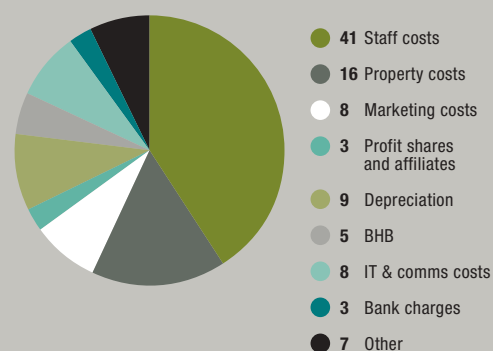
#### TURNOVER BY CURRENCY



#### GROSS PROFIT BY CHANNEL



#### OPERATING COSTS BY CATEGORY (%)



## FINANCIAL REVIEW (CONTINUED)

conducted under an Isle of Man betting licence, 1.5% of gross win is paid in betting tax.

Gross profit in the year grew by 39.7% to €123.2m. This reflects the increased gross win above offset by an increased level of discounted bets in Ireland and a change in mix of gross win based betting taxes. There was no change in the gross win tax rates in the period.

### OPERATING PROFIT

2004 operating profit was €31.1m, an increase of 58.6% over 2003. This excellent performance was driven by the 39.7% increase in gross profit referred to above offset by a 34.3% increase in operating costs.

#### Operating profit by channel

	2004 €'000	2003 €'000	Change €'000
<b>Retail</b>	<b>17,752</b>	17,402	350
<b>Telephone</b>	<b>4,552</b>	861	3,691
<b>Online</b>	<b>8,830</b>	1,369	7,461
<b>Total</b>	<b>31,134</b>	19,632	11,502

The retail division was almost flat for the year as the 13.55% increase in the operating profit for the Irish estate was offset by expected start up losses in the UK estate. We believe that losses in the UK have now peaked and expect the core estate of UK shops to trade profitably in 2005 and beyond. Continued investment in both management and new outlets means that we do not expect an overall profit from the UK until 2006, and we remain confident that the UK retail estate will be a significant profit contributor over time. We expect the Irish estate to show continued earnings growth and cash generation.

The telephone business had an excellent operating profit of €4.6m (2003: €0.9m) driven by strong turnover, an improvement in the average stake size, improved gross win percentage and good cost containment. As noted above, the cost dynamics of this channel differ from the other channels given the capacity constraints of a call center and the high costs per transaction. Good earnings growth is dependent on increasing the average contribution per call, tight cost control as well as absolute turnover growth.

The online business had an outstanding year as its profit contribution rose to €8.8m from €1.4m. This reflects the combination of strong gross profit growth within the core business and new gaming revenues. The relatively fixed cost nature of the business allowed approximately 60% of the gross profit increase to fall to operating profit.

While overall costs have increased by 34.3% this must be looked at in the context of a 27.5% increase in turnover and a 39.7% increase in gross profit. Costs are driven by both turnover and by gross profit (i.e. commissions, BHB levies, etc.) as well as the need for investment in marketing new products, development of the brand and investment in the new UK retail division. We remain confident that the cost base is correctly sized for the business.

### TAX RATE

The corporation tax charge for the year was €4.6m (2003: €2.9m) representing an effective tax rate of 14.5% (2003: 14%). This compares with the statutory rate in Ireland of 12.5% and the UK statutory rate of 30%. No corporation tax is payable in the UK in respect of 2004 due to tax losses. The Group's effective tax rate remains above the statutory rate due to the disallowance of certain expenses and this is likely to continue going forward.

### CASH FLOW, CASH BALANCES AND FOREIGN EXCHANGE RISK

Cash balances at 31 December 2004 were €47.2m (2003: €39.2m), an increase of €8.0m. This includes cash held in customer accounts of €6.5m (2003: €4.8m).

Cash from operating activities totalled €45.0m, an increase of €12.9m from 2003. Cash from operating activities included net cash inflow from customer accounts of €1.7m. Interest income was €1.0m, an increase of €0.2m, reflecting higher average cash balances offset by lower average interest rates. Capital expenditure increased by 27.5% to €27.2m from €21.4m in 2003.

The significant capital expenditure reflects the high levels of property activity in both Ireland and the UK due to the expansion and refurbishment of the retail estate. We expect this to continue as we expand at similar rates in the future.

Cash balances are invested in accordance with defined treasury policies approved by the Board. These policies limit the risk rating of institutions that can be used, the concentration of risk with any one institution or within any category of institutions and the term of deposits. Cash balances are substantially invested in short-term bank deposits with maturities of 120 days or less. At the year end all deposits were available at twenty four hour notice.

The Group has no borrowings. Interest rate exposure is thereby limited to interest income on deposits and the impact of the economy in general. The Group remains highly cash-generative and this, together with existing cash balances, will be used to fund expansion. As has been previously stated, only on determination of the scale of expansion in the UK, which is partly dependent on the timing of deregulation, can the Board clearly identify potential surplus cash. Should the Group not require any of its cash reserves, the Board will determine the best method of returning it to shareholders. The Company has the ability to buy back its own shares, which was granted by shareholders during 2004.

Foreign exchange risk in the business is small. As the Group expands in the UK it will require sterling to fund its capital expenditure. Much of this can be naturally hedged from the sterling gross profit generated in sterling from the online and telephone divisions, as these divisions primarily have a euro cost base and so generate surplus sterling. Group policy allows the Group to hedge the foreign exchange exposure for up to six months. At the year end, no foreign exchange contracts were open. The Group's functional currency is the euro and translation risk exists with its sterling subsidiaries.

#### EMPLOYEES

The average number of employees of the Group during 2004 was 1,076 (2003: 913). At the year end, the total number of employees was 1,199 (2003: 1,032).

#### SHARE PRICE

The Group's share price traded in the range of €7.15 to €11.00 in 2004 with the year's high reached on 25 November 2004.

The share price at 31 December 2004 was €10.85 (2003: €7.15) giving a market capitalisation of €543m (2003: €342m). The year end free float (shares not held by the directors or related parties) was 88.03% (2003: 78.8%).

Following a change implemented by the London Stock Exchange on 20 December 2004, the shares are now quoted only in euro.

#### TRADING AND RISK MANAGEMENT

The Group manages its betting risk through a central risk management and trading team whose role is to compile the initial odds and, subsequently, manage the odds and risk exposures through the life of the event. Risk limits are in place within the trading room and compliance with limits is reported daily to senior management and internal audit. Internal audit also carries out reviews of the risk function.

A betting risk management sub-committee of the Board was established in 2003 under the chairmanship of David Power, a non-executive director. This Committee sets overall policy for betting risk. Limits are agreed with the Committee and set annually but are subject to review by the Committee at any time.

The Group does not offer credit betting.

#### DIVIDEND

The 2004 interim and proposed final dividend total 18.72 cent per share, (2003: 12.89 cent per share), amounting to €9.3m (2003: €6.2m) an increase of 45.2% on 2003. This represents dividend cover of 2.94 times (2003: 2.85). It is the Board's intention to pay approximately one third of after tax earnings in annual dividends on average.

#### INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)

The Group is preparing for the implementation of IFRS in 2005. A review has been completed on the differences between current standards and IFRS. With the exception of accounting for share based payment schemes the impact of the changeover will be limited to a small number of areas of disclosure. The different accounting treatment for both share option schemes and the long-term incentive plan will give rise to small balance sheet and profit and loss account adjustments. Our estimate is that the impact on the 2004 EPS of accounting under IFRS would have resulted in a reduction in EPS of less than one cent.

#### OUTLOOK

Trading for the year to date is satisfactory.

While the pendulum of sporting results will continue to swing between Paddy Power and the punters, we look forward to continued growth across all channels in line with our stated objectives.



**Ross Ivers**

*Finance Director*

22 February 2005