

## OPERATIONS REVIEW

Although Paddy Power is primarily a small stake fixed odds bookmaker, 2004 has seen a move into non-bookmaking activities through the online casino, fixed odds betting games and peer-to-peer games. Our UK retail estate also operates fixed odds betting terminals (FOBTs).

The past year has been a very busy one across all three divisions as we continue to see significant expansion. This has been driven by the growth in the two key economies in which we operate, together with an increase in brand awareness, distribution capacity and new product launches. The quality of our core bookmaking product continues to lead the market, driven by both our investment in product development and ongoing focus on our customers. Volume growth in bets layed continued in all divisions which in turn drives turnover, operational complexity, costs and ultimately profit.

Customer service is, as always, central to our philosophy. We continue to lead the market in generosity, be it via contracted money back specials or just refunding money when it was fair to do so, and we remain the benchmark that others must attempt to follow.

### THE RETAIL DIVISION – BETTING OFFICES

The retail estate finished the year with 174 outlets (2003: 149), with 143 (2003: 137) in Ireland and 31 (2003: 12) in the UK.

It was a year of significant activity in the Irish and UK retail divisions with both finishing the year with record numbers of outlets. However, just as important as the expansion of the estate, is the continued commitment to the existing estate through an ongoing programme of refurbishments, extensions and relocations. This continuous improvement in the quality of our retail

space, together with the increasing investment in screens/broadcasting technology, is key to driving the excellent like-for-like sales growth that we have enjoyed. Investment in capital across the retail estate totalled a record €23.1m in 2004.

Six (2003: 8) new outlets were opened in Ireland during the year. 2005 is expected to see approximately eight new outlets opened. In addition to new openings, four (2003: 10) relocations, four extensions (2003: 3) and 27 (2003: 10) refits were undertaken during 2004. The total number of premises developed totalled 41 (2003: 31), a new record for the Irish business. This process will continue through 2005 and at the time of writing we have already completed one relocation, two extensions and seven refits. We also continue to operate four racecourse shops as well as the stadium shops at Lansdowne Road. There were five (2003: 5) surplus property leases at year end.

Expansion in the UK continues apace with the retail estate increasing to 31 outlets (2003: 12) as at the year end. In addition, successful licence applications mean that a further five licences are held at the year end and these outlets will be opened during 2005. We expect to have between 45 and 50 outlets opened by the end of 2005. Our 31 outlets in the UK include two outlets purchased during 2004.

Having now established over 30 outlets in the UK, 2005 will see a requirement to focus on the additional operational aspects of running the enlarged UK estate as well as continuing to open new outlets in line with our stated objectives. The UK team is now *in situ* in our new office in London and the divisional management structure is in place.

The Group commenced testing an EPOS solution in late 2004. Having completed

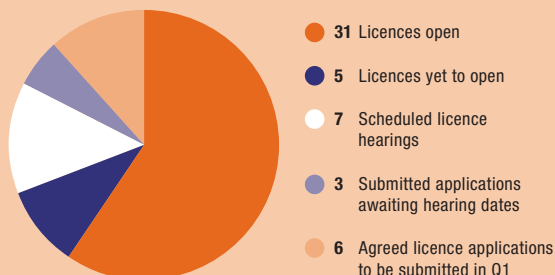
head office trials this is now in place in a small number of outlets where it is undergoing field testing and modification. Subject to satisfactory performance, a more extensive test will be undertaken in mid 2005 before a final decision is made on a full estate roll-out. The cost of installing EPOS in the current estate would be approximately €8 million.

While there are many potential benefits of EPOS to both our customers and to Paddy Power, our intention would be to use it to improve the quality of customer service by increasing the speed and accuracy of payout and expanding the product range. The improved availability of risk information from the retail estate should also help manage the gross win percentage over time. The technology infrastructure to support EPOS should also allow other benefits as it would provide an intranet communications infrastructure within the estate, allowing e-mail communication and local printing of marketing material and coupons. It would also provide an infrastructure for customer facing information terminals or even internet access.

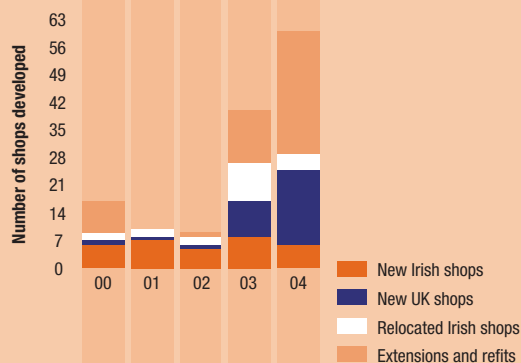
Investment in technology has also continued with the installation of the new screens system throughout the retail estate. The system, which allows for a 24 screen display, is now installed in all of our UK estate and has been refitted into 75 outlets in Ireland. It is expected that, by end of 2005, all of the estate that can be refitted will be. This is expected to be approximately 110 of the Irish outlets.

In conjunction with these improvements in our outlets, the head office screens technology is also changing with a new version of our current software being implemented. This will allow us to tailor screen content for different geographies.

### 52 UK SHOPS IN PROGRESS



### RETAIL ESTATE DEVELOPMENTS



### NON RETAIL

Non retail comprises the online division (internet betting, casino, and interactive TV) and the telephone division.

#### Active Customers (Online)

	2004	2003
Ireland + rest of world	16,721	14,026
UK	29,982	22,174

#### Active Customers (Telephone)

	2004	2003
Ireland + rest of world	10,207	9,601
UK	8,326	8,361

(Active customers are defined as those who have bet on the sportsbook in the last three months)

### THE ONLINE DIVISION

The online division has seen significant development in 2004 as it has moved from being a bookmaking business to an increasingly "leisure betting and gaming business". There have been significant ongoing improvements to the product offering over the course of the year. These range from relatively simple activities such as relaying out a web page and reskinning the website through to the introduction of new functionality and products.

The online division remains the fastest moving part of the business and 2004 has seen the introduction of a significant number of gaming products. The most prominent of these is the Paddy Power Casino which was launched in the UK in early 2004. We have seen continued growth in this business over the course of the year and it has generated a significant gross win contribution in 2004, as discussed in the financial review. In addition to the casino there have been a host of smaller product launches. These include Paddy Park, Hi-Lo, Penalty Shoot Out, and Spin 2 Win, the first two of which are available as mobile games. All of these activities are algorithm based, thereby reducing our reliance on sporting activity and consequently reducing the volatility of earnings over time.

In addition to the gaming products noted above, 2004 also saw the addition of a suite of peer-to-peer games where Paddy Power takes no risk position in the game but earns its income by way of a commission on betting between two third parties. Early 2005 saw the launch of our poker product from which we earn commission and which will further insulate us from the short-term impact of sporting results.

Notwithstanding the increased emphasis on non-bookmaking products, we have also seen considerable investment in the core

bookmaking product as we continue to improve the range of events covered, and the depth of markets offered on each event. This is discussed further in the trading and risk management section of this review.

### THE TELEPHONE DIVISION

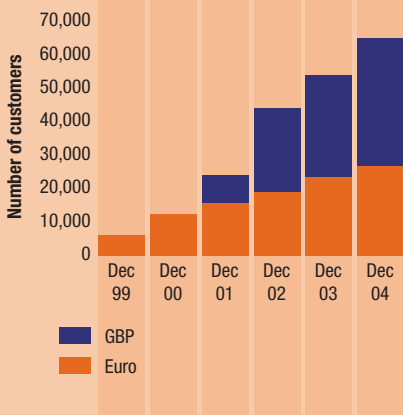
The telephone business has continued to develop in Ireland and the UK reflecting our market leading position in Ireland and relative newcomer status in the UK. As discussed below and in the 2004 interim statement, our UK business has been slightly repositioned over the course of the year given the different characteristics of the telephone business and our different position in the UK market as compared to Ireland.

The telephone business is characterised by a high variable cost structure. Cost is primarily driven by the volume of bets processed, not their value. This is compounded by the need to flex the call center staffing to handle the varying call volume levels experienced over the course of any given week. Consequently there is a need to have a higher average bet value than the other channels.

Our telephone customer base continues to develop. Given our leading position in the Irish market, the telephone business plays several roles. As well as servicing our core

## OPERATIONS REVIEW (CONTINUED)

### NON RETAIL ACTIVE CUSTOMERS



telephone customers, it provides an alternative means of access for customers who cannot get to an outlet or the internet. It also provides access outside outlet opening hours.

In the UK, the emphasis differs, as there is a smaller retail estate to support. Following the repositioning of the telephone business in 2004, we expect that as the UK retail estate and online businesses grow they will provide additional support to the UK telephone business.

In 2004, product development, driven by the trading and risk management group, has also been a key feature of the telephone business particularly in the area of betting-in-running. While betting-in-running is predominantly a football and golf activity, the US presidential elections also saw significant betting taking place throughout the night of the results.

### TRADING AND RISK MANAGEMENT

One of the core skills of a bookmaking business is the compilation of odds and the trading of the "book". Together with a significant product development role this activity is undertaken through our trading and risk management group.

This group has been busy in 2004 under its new head. The increasing size of the business creates many new opportunities and, therefore, warrants continued investment in this function. Secondary markets which were previously too small to justify investment have reached critical mass e.g. financial betting. Investment in sophisticated mathematical models and processes that were previously uneconomic have become viable. Furthermore, opportunities in the online division create a demand for new products that can also be marketed through the telephone and retail

channels. In addition, the increasing size of the UK retail division is changing the overall risk profile of the business due to a different product mix in our UK estate i.e. increased football business.

The increasing size and complexity of these activities demands increasingly structured internal processes. 2004 has seen changes to staff roles together with more detailed trading rules and limits. Rather than restrict the activities of the division, these processes have improved its operation and are reflected in our market leading product range.

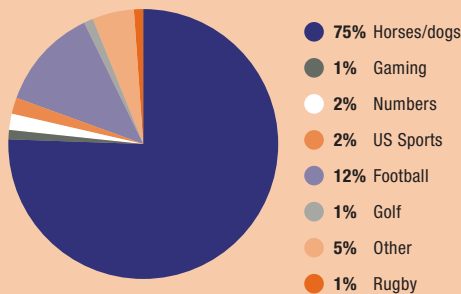
The number of events and associated markets that Paddy Power now offers continues to increase with over 118,000 events bet on in 2004. While the amount of money taken on each event varies, there remains a number of very popular high turnover betting events during the year. However, the gross win percentage continues to be determined by the overall mix rather than a few key events. For instance in the non retail business, the top 1,100 events only account for 10% of turnover.

### MARKETING

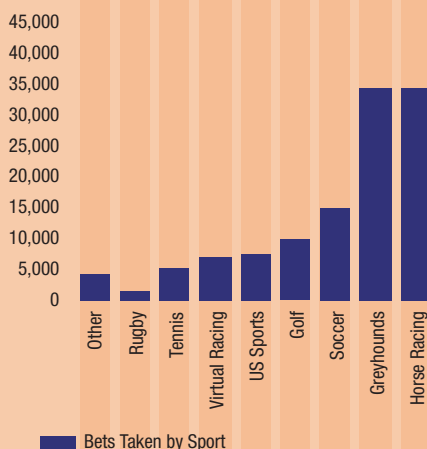
The Paddy Power brand has been built over 16 years thanks to a constant focus on fun (sometimes irreverent) and innovation and we are committed to maintaining our position as the punter friendly bookmaker. Irrespective of the size and type of marketing activity undertaken, it all contributes to our punter friendly image and overall brand recognition. Our brand remains a key point of differentiation.

Some of the highlights of 2004 include our ongoing sponsorship of all live horse racing coverage on RTÉ, our sponsorship of the Football Association of Ireland and the Irish

### TURNOVER BY SPORT



### MARKETS PRICED BY SPORT



Rugby Football Union. Our racing sponsorships include the very successful Paddy Power Gold Cup in Cheltenham and the Paddy Power Chase in Leopardstown. Our more fun sponsorships, such as Brock the Jack Russell, who added so much to this year's Australian/Gaelic Compromise Rules match between Ireland and Australia, continue to be a strong feature of our marketing activity.

Much of this activity is opportunistic. Coverage of our market leading customer friendly pursuits generates significant exposure through betting related media and, most importantly, word of mouth. From the payment of €424,710 in January 2004 to Catherine Egan as Ireland's largest single winning bet with a bookmaker, refunding money recently for the Tottenham goal that was, but was not, given against Manchester United to the plethora of other events throughout the year, Paddy Power continues to lead the way. We continue to be the most frequently mentioned bookmaker in the Irish media and have clearly broken into the top echelon of UK bookmakers on the basis of media mentions. This success is driven by hard work together with the quality of the underlying product, accessibility and the customer friendly nature of the brand.

#### PEOPLE

I talked at length last year about the importance of people to the organisation and referred to a number of senior appointments that were made or were in the process of being made. Now, a year on, I am more convinced than ever of the need to continue to invest in quality people throughout the organisation.

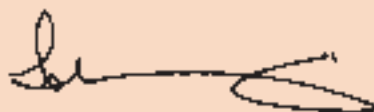
Having put in place a very capable senior management team, attention must now turn to succession planning and development of

talent throughout the organisation. We are putting in place plans to develop the next layer of talent to ensure that we will have the best cashiers in the shops, the best shop managers and the best telephone operators in the call center.

Paddy Power is a fast growing Company and our people needs are evolving. We need more of our existing skill sets as well as new ones. This opens opportunities for both internal promotions and for attracting new talent. This growth brings challenges to the Paddy Power culture. As we bring new people into the organisation it is imperative that the training and induction process ensures that the values of the organisation are made clear and that people subscribe to these values. This is particularly important in the UK retail business where the organisation is relatively new and staff numbers are growing. It is essential that they are fully integrated into the distinctive Paddy Power culture.

#### LOOKING FORWARD

2005 promises to be another exciting year for all in Paddy Power as we continue with our successful organic growth based strategy. This will deliver expansion of both the Irish and UK retail estates, while the non retail business will see the development of its existing business channels and products, supplemented by the addition of new products such as the new poker business.



**John O'Reilly**

*Chief Executive*

22 February 2005