

Directors' Report

Paddy Power plc
Annual Report 2006

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The directors submit their report together with the audited financial statements for the year ended 31 December 2006.

Principal Activities

The Group provides sports betting services through a chain of licensed betting offices ('Paddy Power Bookmaker'), together with telephone betting ('Dial-a-Bet') and online interactive betting services ('paddypower.com'). It provides online gaming services principally through 'paddypower.com', 'paddypowercasino.com', 'paddypowerpoker.com' and 'paddypowerbingo.com'. It provides its services principally in Ireland and the United Kingdom.

Results

The Group's profit after taxation of €41.2m reflects an increase of 53% on the 2005 profit figure of €27.0m. Basic earnings per share amounted to 81.9 cent compared with 54.1 cent in the previous year, an increase of 51%. The financial results for the year are set out in the consolidated income statement on page 43. Shareholders' funds at 31 December 2006 amounted to €128.1m (2005: €96.1m).

Dividends

An interim dividend amounting to 9.43 cent per share was paid during 2006. The directors recommend that a final dividend of 22.77 cent per share, amounting to €11.7m, be paid on 25 May 2007 to shareholders registered at close of business on 16 March 2007. This would make a total distribution of profit to shareholders of €16.5m in respect of the year ended 31 December 2006 (2005: €10.3m).

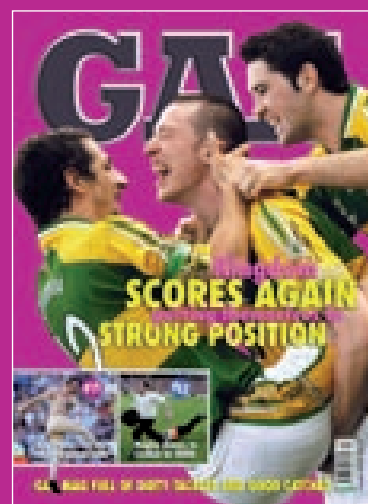
Business Review and Key Performance Indicators

A detailed commentary incorporating key performance indicators by channel including active customers, average slip/bet values, bet volumes, gross win and gross profit is contained in the Operating & Financial Review on pages 9 to 18.

Principal Risks and Uncertainties

The principal risks and uncertainties facing the Group and Company, as required to be disclosed in accordance with the terms of European Accounts Modernisation Directive (2003/51/EEC), include those that could arise from adverse developments in the following areas:

- the regulatory, taxation or legislative environment applicable to the Group's activities;



It only happens a couple of times a year that Croke Park is full of beefy, testosterone oozing men with steam coming off their bodies hugging and kissing each other. That's All Ireland Final day.

One of the sights for sore eyes of the football Championship was the vision of Ciarán McDonald's blond flowing locks swaying in the wind as he ran rings around his opponents. He inspired Mayo to another All Ireland Final.

How unlucky they were to come up against the mighty Kingdom led by their own Kieran, that monster of a man, Kieran Donaghy. It was a case of men against boys and Kerry dominated Mayo from start to finish as they piled on the pain. Mayo deserved more but the Kingdom collected.

One of the imponderables of the year was how Cork could be favourites to beat Kilkenny in the Hurling final. Cork had a few scares along the way, most memorably against Limerick and coming from behind to beat Waterford.

The Cats on the other hand were awesome all season, they never got out of second gear and were unbeaten. They ultimately got the cream.

GAA

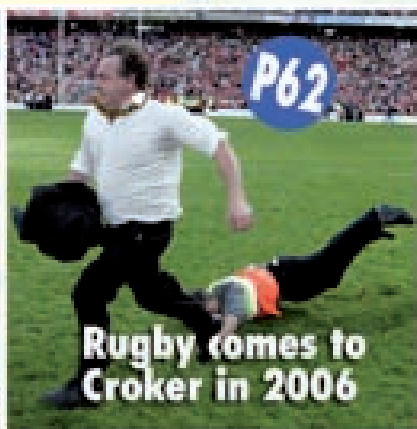


Kingdom **SCORES AGAIN** putting themselves in **STRONG POSITION**



P19

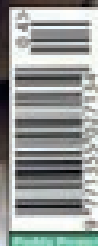
Dub shows his stuff
at All-Ireland Semi



P62

Rugby comes to
Croker in 2006

GAA MAG FULL OF DIRTY TACKLES AND GOOD CATCHES



October 2006 €1.12

Hole in One

THE MAGAZINE TO RAISE YOUR GAME!

EXCLUSIVE

Ella's plans to bogey Europe's Ryder Cup hopes

"That's some birdie if ever I saw one"

"Get me a copy of Dubliner Mag"

"Lucky b*@tard"

"Ole!"

**ALL REVEALED
INSIDE**

A Power Media Publication



November 2006 €1.80

PLUS TOP TIPS TO IMPROVE YOUR STROKE, BALL POSITION AND FOLLOW THROUGH!!



"I'm such an idiot", said Phil Mickelson. "I usually hit the ball 10 yards further in that situation", said Monty. "The mistakes that cost me were putts not going in": genius insight from Jim Furyk.

"Did he win? I went to bed", said the punters who backed Ogilvy. "I can't believe that muppet threw it away", said many a punter on Mickelson, Monty & Furyk. "I can't believe we got our money back!" said the Paddy Power punters.

That was the big special, money back if you're second and that was the US Open – it's not all about the Ryder Cup you know!

But what an event it was. Roads were built, photos were doctored, magazines were sued, pints were sunk and punts were landed – apparently there was a bit of golf too!

The Europeans looked pretty in pink but their golf hit a purple patch that left the Americans trailing in their wake. It wasn't much of a contest but it was the Ryder Cup in Ireland.

Directors' Report (continued)

- the intensity of competition in the Group's markets;
- the economic, demographic, technological and other macro factors affecting demand for the Group's products;
- social, media or political sentiment towards the Group and its businesses;
- relationships with key suppliers, particularly those supplying software platforms to support existing and future products and data required for sports betting;
- disruption to the sporting calendar due to weather or other factors;
- the ability of the Group to attract and retain key employees;
- the ability of the Group to manage its bookmaking risk so as to achieve gross win margins within the percentage ranges that it has guided;
- the ability of the Group to avoid disruption to its key information technology systems.

The Board regularly monitors all of the above risks and appropriate actions are taken to mitigate those risks or address their potential adverse consequences.

Further details in relation to the Group's trading risk function are included in the Trading & Risk Management section of the Operating & Financial Review on page 16. The composition and responsibilities of the Risk Committee are set out on pages 34 and 35. The Board has also established financial risk management objectives and policies which have been implemented by executive management, details of which are given in Note 26 on page 75.

Market Research

The Group undertakes continuing market research across all business divisions in both Ireland and the UK. In 2006, research undertaken included brand research and customer satisfaction surveys.

Directors' Report (continued)

Events Since the Year End and Future Developments

There have been no significant events affecting the Group since the year end other than the recommendation to pay dividends to shareholders as noted above. The directors do not anticipate any substantial changes to the nature of the business.

Own Shares Held

The Paddy Power plc Employee Benefit Trust ('the Trust') was established to manage the long term incentive plan. During the year ended 31 December 2006, the Trust purchased 280,000 (2005: 190,000) Paddy Power plc shares at a cost of €3.7m (2005: €2.6m). During 2006, the Trust transferred 55,500 (2005: nil) ordinary shares that had vested to a former director of the Company, John O'Reilly. At 31 December 2006 the Trust held 654,500 (2005: 430,000) ordinary shares in Paddy Power plc, representing 1.28% (2005: 0.85%) of the issued share capital.

Substantial Holdings

Details of interests of over 3% in the ordinary share capital which have been notified to the Company are set out below:

	Holding at 2 March 2007	%
Fidelity Investments Ltd	5,071,042	9.90%
Nordea Investment Funds SA	3,814,800	7.45%

Board of Directors and Company Secretary

Tom Grace was appointed to the Board on 3 January 2006 and Jack Massey was appointed to the Board on 25 April 2006. Both were elected by the shareholders at the AGM in May 2006 along with Fintan Drury who was re-elected after retiring by rotation. Stephen Thomas resigned from the Board on 16 May 2006, having completed a full three year term. Patrick Kennedy, Stewart Kenny, Nigel Northridge and David Power retire from the Board by rotation in 2007 and, being eligible, offer themselves for re-election. Further information on the dates of appointment of the directors is given in the Remuneration Committee Report on page 40. On 2 March 2007, Nuala Hunt resigned as Company Secretary and David Johnston was appointed as Company Secretary in her place.

Directors' Remuneration

Details of directors' remuneration are given in the Remuneration Committee Report on pages 38 to 40 and in Note 6 to the financial statements on pages 57 and 58.

Directors' and Secretary's Interests

The interests of the directors and secretary who held office at 31 December 2006 in the share capital of Paddy Power plc, all of which were beneficially owned, were as follows:

	Number of ordinary shares of €0.10 each	
	31 December 2006	31 December 2005 (or date of appointment if later)
Fintan Drury	19,400	19,400
Patrick Kennedy	16,000	3,000
Breon Corcoran	70,448	70,448
Jack Massey	5,000	5,000
Tom Grace	5,000	5,000
David Power	4,398,788	4,398,788
Nigel Northridge	3,000	1,000
Stewart Kenny	419,832	419,832
Brody Sweeney	-	-
Nuala Hunt (Secretary)	14,000	3,500

There have been no changes in the above shareholdings between 31 December 2006 and the date the directors approved these financial statements.

Directors' Report (continued)

The directors and the company secretary, who held office at 31 December 2006, had the following movements in share options during the year and held the following share options at 31 December 2006:

	Number of options at start of year	Options exercised during the year	Options granted during the year	Number of options at end of year	Exercise price (a)	Exercise period
Patrick Kennedy (b)	-	-	1,785	1,785	€11.29	5 December 2011 – 5 June 2012
Breon Corcoran	20,000	-	-	20,000	€8.15	24 February 2007 – 24 February 2010
Breon Corcoran	1,020	-	-	1,020	€11.60	6 October 2008 – 6 April 2009
Nuala Hunt (Secretary) (c)	25,000	25,000	-	-	€5.25	24 July 2005 – 24 July 2008
Nuala Hunt (Secretary)	8,000	-	-	8,000	€8.15	24 February 2007 – 24 February 2010
Nuala Hunt (Secretary)	1,020	-	-	1,020	€11.60	6 October 2008 – 6 April 2009

(a) The market price of the Company's shares at 31 December 2006 was €15.06 and, for the year then ended, the Company's daily closing share price ranged between €11.90 and €16.29 (2005: ranged from €10.37 to €15.95 and was €12.10 at year end).

(b) The options granted during the year were under the terms of the Company's Sharesave Scheme (see Note 19).

(c) These options were exercised on 1 March 2006 when the market price of the shares was €13.00.

During the financial year ended 31 December 2006 the executive directors had the following interests and were conditionally granted the following shares under the Long Term Incentive Plan scheme:

	Grants outstanding at start of year	Granted during year	Grants outstanding at end of year	Date shares granted	Share price at date of grant
Patrick Kennedy	70,000	80,000	150,000	9 March 2006	€12.55
Breon Corcoran	95,000	85,000	180,000	9 March & 25 May 2006	€12.55 & €13.68
Jack Massey	-	35,000	35,000	25 May 2006	€13.68

The awards are subject to the rules of the scheme and will vest if the growth performance targets are met over the minimum vesting period. Further details of the scheme are outlined in the Remuneration Committee Report and in detail in Note 19 of the consolidated financial statements.

Transactions with directors and parties related to them have been disclosed in Note 6 to the financial statements on page 58. The directors and secretary have no interests in shares in any other Group companies.

Employees

Enthusiastic, energised and customer focused employees are critical to Paddy Power's success. These employee qualities have been a recurring feature at the Group and were perhaps best exemplified in 2006 by the dedication of our retail staff

in embracing new technology and ways of working thereby ensuring the successful roll out of EPOS across the retail estate and significant enhancements to customer service.

The Group continued to attract new talent as well as focusing on the development and retention of employees. Opportunities for employment, training and development are determined on the basis of each individual's ability and performance record, irrespective of their gender, ethnic origin, nationality, age, religion, sexual orientation or disability. Employee policies are aligned to our business needs and take into account external legislation and internal codes of conduct as well as Paddy Power's values as an organisation. We continue to engage proactively with our staff, for example through our established retail employee communications group.

Directors' Report (continued)

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Safety, Health and Welfare at Work Act 2005

Paddy Power is committed to the safety and well being of employees at work and has taken all the necessary steps to ensure compliance with the Safety, Health and Welfare at Work Act 2005. The Act imposes certain obligations on employers in respect of health and safety in the workplace. Appropriate measures have been taken to ensure that health and safety standards are complied with at all relevant locations and that all applicable Group companies meet the requirements of the Act. These measures include Safety Statements at all locations and induction training in health, fire and general safety for all new employees, conducted by our area trainers at the start of employees' induction training. All of our appointed contractors must submit an up to date Health and Safety Statement and proof of their public liability insurance before we award any contract. Prior to the commencement of any major works within the Group, the appointed contractor must submit a 'method statement' describing how the proposed works will be carried out safely. We service all of our essential emergency and fire alarm systems on a quarterly basis to protect our staff and to ensure that we comply with relevant statutory regulations.

Political Donations

No political donations were made by the Group during the year which require disclosure in accordance with the Electoral Acts 1997 to 2002.

Corporate and Social Responsibility

Paddy Power appreciates that it has important responsibilities to its customers and the broader community, as well as to its employees and shareholders. The Group is committed to acting fairly and properly in all its dealings with all stakeholders. Set out below are brief overviews of some areas of particular focus for the Group:

Responsible Gambling

We strive to protect the small number of our customers who may have difficulties with gambling. If a customer does develop a problem with gambling we actively refer them to the relevant experts who can help. Part of the reason we are in a position to do this is our close association with Gamcare, a registered charity and leading authority on the provision of information, advice and practical help to promote responsible gambling. All of our customer service staff undergo regular Gamcare training to ensure they offer the most professional service possible to those who might be suffering from a problem with gambling. We believe the most effective approach is to provide customers with information about problematic

behaviour signs and offer them a range of self exclusion options. In this context, we offer our customers the option of setting limits on the maximum value and frequency of their deposits. In addition, we have strict processes in place to ensure that any customers who wish to go further and exclude themselves completely from transactions with Paddy Power can do so. We also recommend that those with gambling problems install software to block certain types of online sites.

It is illegal for anyone under the age of 18 to open an account, or to bet, with Paddy Power and we take our responsibilities in this area very seriously. We carry out electronic age verification checks whenever a potential customer is proposing to use a payment method that might be available to someone under 18 years of age and the public data infrastructure exists for us to complete such checks. In this regard, we also work very closely with age verification software providers to help develop new and better ways of verifying the age of potential customers over the increasing range of payment methods available. We also recommend that our online customers install filtering software if they share their computer with anyone under the age of 18. Staff in our shops are trained to be vigilant, to request reliable proof of age if they are in any doubt and to refuse bets from anyone under the age of 18.

Environment

Paddy Power has a proactive approach to helping all personnel conduct business in a manner that protects the environment. The Group encourages efficient use of resources, recycling wherever possible and is compliant with all relevant environmental legislation. The Group has introduced a complete waste management policy in head office and retail shops nationwide and everything from glass to general office paper is recycled. Examples of environmental initiatives adopted in 2006 include:

- installation of long life energy efficient light bulbs in all new and refurbished shops;
- use of more efficient, and lower cost, combined heat and power ('CHP') generated electricity in all Irish shops;
- replacement of night storage heating in shops with lower electricity consumption split heating and cooling systems;
- reducing the level of packaging waste in respect of all cased goods and furniture;
- installation of more water efficient flushing systems in newly fitted shops to reduce water consumption; and
- a charity-administered mobile phone and used inkjet cartridge recycling programme in our head office.

Directors' Report (continued)

We also want to keep the environmental impact of our annual report package to a minimum. The paper used was manufactured in a mill with ISO1 4001 accreditation and the report contains 80% minimum de-linked post consumer waste content. Shareholders are also encouraged to elect to receive electronic means of communication.

Charities

Paddy Power maintains relationships with a large number of charitable organisations, ranging from those supporting the local communities in which our shops play a key role, through to national charities focusing on the welfare of specific groups. During the year the Group spent €111,279 on charitable donations (2005: €81,505).

Books of Account

The measures which the directors have taken to ensure that proper books of account are kept are: the appointment of suitably qualified personnel, the adoption of suitable policies for recording transactions, assets, and liabilities, and the appropriate use of computers and documentary systems. The Group and Company books of accounts are kept at Airton House, Airton Road, Dublin 24.

Auditor

In accordance with Section 160 (2) of the Companies Act 1963, the auditor, KPMG, will continue in office.

Going Concern

The directors are satisfied that the Group has adequate resources to continue in business for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the financial statements.

On behalf of the Board



Patrick Kennedy

Chief Executive



Jack Massey

Finance Director

2 March 2007