

# Financial Review

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

## Revenue

Sports betting revenue represents the amount staked (excluding revenue based betting taxes or levies) by the customer including the revenue from free bets. Gaming revenue represents net customer losses. Poker revenue represents the commission ("rake") earned by Paddy Power. For gaming and poker, revenue is equal to the gross win (see below).

Revenue for the year to 31 December 2005 was €1,371.7m (2004: €1,159.7m), an increase of 18.3 % on 2004. Revenue growth has been strong across all three channels ranging from 5.6 % to 39.7 %.

Retail revenue grew by 15.3% in 2005 from €688.7m to €794.3m. Irish retail revenue grew by 12.1% to €703.7m from €628.1m in 2004. Like-for-like growth rates within Ireland were 8.65%, reflecting the continued market growth 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 seven new outlets opened during the year. We continue to invest in new in-shop display systems as detailed in the operations review which, through the display of additional product, will continue to drive revenue growth. There were no significant changes in opening hours of the estate during the year.

UK retail revenue grew by 49.4% to €90.5m (2004: €60.6m). We are pleased with the revenue growth in the UK, which has been driven by growth in the number of shops, an increase in brand recognition, continued product development and improved display systems.

The online channel continued to see strong growth, with revenue increasing by 39.7% to €327.5m (2004: €234.4m). Growth in the sportsbook was 35%, which was driven by continued improvement in the online product offering, growth in the Paddy Power brand and continued growth in the online betting market. Casino and gaming products grew strongly with revenue from non bookmaking product totalling €17.2m (2004: €5.9m). This includes the rake income

from poker, which commenced in February 2005. 67% (2004:69%) of revenue in the online channel comes from the UK, with the vast majority of the balance from Ireland.

2005 saw an acceleration in the repositioning of the telephone business that commenced in 2004 as we increasingly focus on higher stake customers. As expected, 2005 saw some loss of lower value business, particularly in the second half of the year where we made a number of significant product changes. We remain very happy with the development of the business and, as noted in the operations review, we will be moving into an expanded call centre in 2006. Revenue for the year grew to €249.8m (2004: €236.5m). The UK now accounts for 36.4% of revenue (2004:46.7%) with the balance from Ireland.

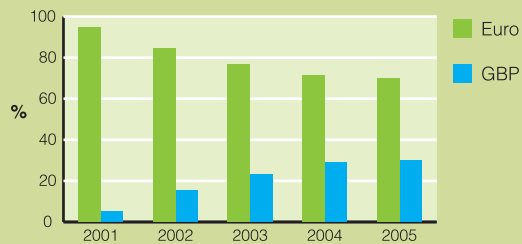
## Average slip/bet values by channel

	2005 €	2004 €	Change %
Retail	<b>19.03</b>	18.21	4.5
Telephone	<b>91.79</b>	83.45	10.0
Online	<b>32.59</b>	27.09	20.3

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

Average bet sizes are in line with expectations. Average bet size in the Irish retail business has continued to increase. As expected, we have seen a welcome reduction in the UK average as the shops start to mature. 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, while encouraging lower staking customers to use the internet.

Fixed odds betting terminals (FOBTs) income has grown in our UK estate with 172 machines installed at year end. Average gross drop per machine per month was €2.5k (2004: €2.5k). Gaming machines are not permitted in Ireland.

**TURNOVER BY CURRENCY (%)****Bet volumes**

	2005 '000	2004 '000	Change %
Retail	<b>41,744</b>	37,811	10.4
Telephone	<b>2,722</b>	2,835	-4.0
Online	<b>9,522</b>	8,363	13.9

(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 represents the gross betting or gaming profit (the difference between the amount staked and the amount paid in winnings) to Paddy Power before any other deductions. For poker and gaming income the gross win is equal to the revenue i.e. 100% margin.

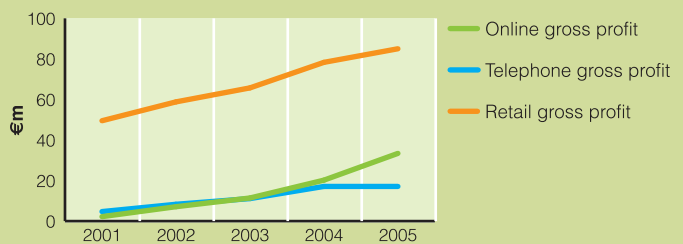
Gross profit is the gross win less betting taxes and levies, discounted bets, direct software supplier costs and data rights.

**Gross win percentages by channel**

	2005 12 months to 31 Dec %	2005 6 months to 31 Dec %	2004 12 months to 31 Dec %
Retail	<b>12.40</b>	12.43	12.88
Telephone	<b>7.79</b>	6.93	8.31
Online	<b>13.11</b>	14.85	10.98

**Gross win by channel**

	2005 €'000	2004 €'000	Change %
Retail	<b>98,460</b>	88,701	11.0
Telephone	<b>19,454</b>	19,664	-1.1
Online	<b>42,934</b>	25,745	66.8
Total	<b>160,848</b>	134,110	19.9

**GROSS PROFIT BY CHANNEL (€ MILLION)****Gross profit by channel**

	2005 €'000	2004 €'000	Change %
Retail	<b>84,976</b>	78,296	8.5
Telephone	<b>17,151</b>	17,151	0
Online	<b>33,443</b>	20,186	65.7
Total	<b>135,570</b>	115,633	17.2

(Note: These numbers include FOBT and gaming income.)

Total gross win increased by 19.9% to €160.8m (2004: €134.1m) while gross profit increased by 17.2% to €135.6m (2004: €115.6m). Bookmaking gross win percentages were poor in 2005. Over the course of the year results favoured the punter with the big horse racing results being particularly good for the customers. In addition, retail trading conditions in Ireland were tough as the level of tax-free betting and other concessions increased though the course of the year. The increased competition levels, combined with further expectations of a complete move to tax-free betting, gave rise to a revision to the expected annual gross win percentages in November. This reduced both the retail and phone gross win percentage range by 1% and 0.5% respectively, while increasing the online sportsbook gross win percentage range by 0.5%.

We now expect the annual bookmaking gross win percentages (i.e. excluding FOBT and gaming income) to be as follows:

Retail	11%-13%
Non Retail	8%-9%

Bookmaking gross win percentages will continue to be influenced by the level of pricing and trading concessions in the marketplace as well as bet type mix, sports mix, customer mix, risk management and, as always, the run of results. We continue to expect volatility in gross win percentages from year to year.

Gross win from online gaming was €17.2m (2004: €5.9m), comprising gross win from the casino, poker and fixed odds games. This is an increase of 192% and reflects the strong growth we have seen in our casino and games business together with

# Financial Review (continued)

the impact of the new poker business in 2005. In addition to generating absolute earnings growth, the increase in gaming revenue will continue to provide some insulation against the inherent volatility of the sportsbook.

Fixed odds betting terminals generated €4.3m (2004: €1.4m) of gross win, an increase of 217%.

Gross profit grew by 17.2%, reflecting the movement in gross win offset by the changes in the mix of betting taxes/discounts, software supplier costs, and data rights. Gross profit was 84% of gross win (2004:86%). Further change is expected in 2006 as a result of the changes in the Irish betting tax rules and the drop in BHB data rights charges.

Overall the business remains highly leveraged to small changes in the gross profit percentage.

## Operating Profit

Operating profit decreased in the year by 3.2%. This reflects the strong growth rates achieved across the business, the leverage impact of the changes in the gross win percentages, continued investment in the business and the growth of new products.

In the retail division operating profit declined by 47% as the higher revenue was offset by the poorer gross win percentages. Costs grew in line with expectations, reflecting the growth of both the Irish and UK estates.

In the telephone business operating profit declined by 20%. Despite continued revenue growth, this was also more than offset by the poor gross win percentages.

The online sportsbook saw continued growth in revenue which compensated for the lower gross win percentages. This was enhanced by the growth in the newer gaming products, giving an overall increase in operating profits of 92%.

The online channel now accounts for 56% of Group earnings compared to 28% in 2004, while the total non retail division accounts for over 66% (2004:43%).

## Tax Rate

The corporation tax charge for the year was €4.4m (2004: €4.7m) representing an effective tax rate of 14% (2004: 14.5%). 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 2005 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

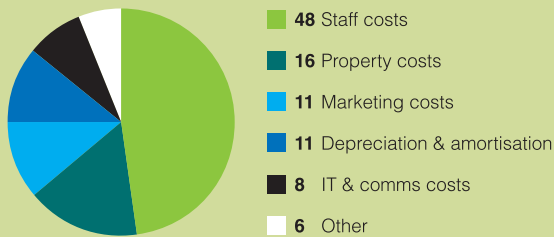
Cash balances at 31 December 2005 were €52.3m (2004: €47.2m), an increase of €5.1m. This includes cash held in customer accounts of €10m (2004: €6.5m).

Cash from operating activities totalled €41.4m, an increase of €0.2m from 2004. Cash from operating activities included net cash inflow from customer accounts of €3.5m. Interest income was €1.2m, an increase of €0.2m, reflecting higher average cash balances. Capital expenditure decreased by 7% to €25.7m from €27.7m in 2004.

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, although we should see a short term reduction as the refurbishment programme in Ireland temporarily slows down.

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 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

**OPERATING COSTS BY CATEGORY (%)**

with existing cash balances, will be used to fund expansion. Only on determination of the scale of expansion in the UK, which is partly dependent on the timing of deregulation and the potential for strategic acquisition to enhance our online business, 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.

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 presentation currency is the euro and translation risk exists with its sterling subsidiaries.

**Employees**

The average number of employees in the Group during 2005 was 1,255 (2004: 1,076). At the year end, the total number of employees was 1,374 (2004: 1,199).

**Share Price**

The Company's daily closing share price ranged between €10.37 and €15.95 in 2005. The share price at 31 December 2005 was €12.10 (2004: €10.85) giving a market capitalisation of €609m (2004: €543m). The year end free float (shares not held by the directors or related parties) was 89.02% (2004: 88.03%).

**Trading and Risk Management**

The Group manages its betting risk through a central risk management and trading team whose role it is to compile the initial odds and, subsequently, to manage the odds and risk exposures throughout 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 operates 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.

**Transition to International Financial Reporting Standards (IFRS)**

There has been no material impact on the financial results by the transition from Irish GAAP to IFRS as detailed in the notes to the financial statements.

**Dividend**

The 2005 interim and proposed final dividend total is 20.59 cent per share (2004: 18.72 cent per share), amounting to €10.3m (2004: €9.3m), an increase of 10% on 2004. This represents dividend cover of 2.63 times (2004: 2.94).

**Ross Ivers**  
Chief Financial Officer

28 February 2006