

Operations Review

Paddy Power is Ireland's largest betting and gaming company and has a significant UK operation. It operates through two main divisions; the retail division, which operates bookmaking shops in both Ireland and the UK, and the non retail division, which provides telephone bookmaking services in Ireland and the UK together with an online service that provides both bookmaking and gaming services in both markets.

2005 has seen continued expansion of each of the divisions. The retail estate has expanded in both countries. Active customer growth has continued in the existing non retail division, fuelled in part by the addition of significant new products and services in the online channel.

The Retail Division

2005 saw the continued implementation of our retail organic growth strategy in both Ireland and the UK. At 31 December 2005, the estate comprised 195 shops (2004:174), with 150 (2004:143) in Ireland and 45 (2004:31) in the UK.

New openings in both countries were in line with plans, with a bias to the second half of the year in both locations. In addition to the new shop openings, our refurbishment plan has continued throughout the year in Ireland as we improve the physical quality of the estate, the average size and the audio/visual facilities. Total capital investment across the retail estate was €24.3m (2004: €24.6m).

In Ireland, 7 (2004: 6) new shops were opened. In addition we also relocated 6 (2004: 4) shops, extended 4 (2004: 4) and refurbished 16 (2004: 27). The total number of premises developed in Ireland in the year was 33 (2004: 41). As we move through 2006, the level of the redevelopment work on the existing estate will decrease as the major shop fit upgrade programme that we have undertaken over the past three years is completed. The level of expenditure on maintenance capital is expected to decrease for two to three years before the next estate upgrade. We continue to operate 4 racecourse shops as well as the stadium facilities at Lansdowne Road. There were 7 (2004: 5) surplus property leases at the year end.

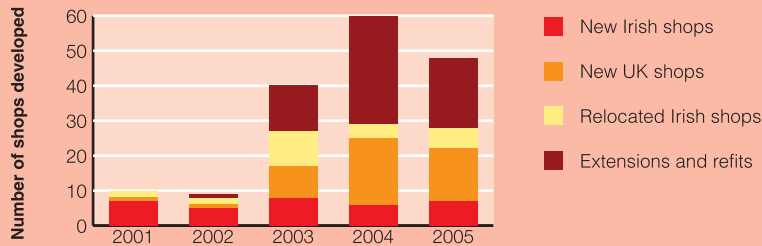
Expansion of the UK estate continued with 15 new shops being opened during the year. We also closed our oldest shop during the year. This had been acquired in 2000 in order for Paddy Power to undertake UK based advertising and did not form part of our UK roll out plan.

We enter 2006 with 45 shops open, 9 unopened licenses and a healthy pipeline of license applications across London. We plan to open up to 15 additional shops in London in 2006, assuming no changes to the existing legal process take effect in 2006. The management team is focused on achieving an improved financial performance in 2006 as the benefits of both scale and the maturity of the estate flow through.

The Group has been testing a new EPOS solution for some time. There are currently 72 test shops in operation in both Ireland and the UK and we are very pleased with the results of the testing. Subject to the satisfactory delivery of a small piece of remaining code in the next few weeks, it is intended to commence the full roll out soon thereafter. It is our intention to have the vast majority, if not the entire estate, installed by the end of 2006. Total capital expenditure on this project will be approximately €10.6m, €4m to cover the central system and €6.6m to cover the shops. €4.2m had been spent by 31 December 2005.

While there are many potential benefits of EPOS to both our customers and to Paddy Power, our intention is 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 will provide an intranet communications infrastructure within the estate allowing e-mail communication and local printing of marketing material and coupons. It will also provide an infrastructure for customer facing information terminals or even internet access. While we expect to see some benefits immediately in risk, security and marketing, it will be 2007 before the full benefits are realised.

RETAIL ESTATE DEVELOPMENTS



2005 saw the completion of the roll out of a new screen system which provides a greatly improved experience for the customer. In addition to enhanced graphics it now supports 24 information screens, increased from 16, allowing us to add dedicated sports gantries across the majority of the estate. This in turn allows us to offer vastly improved betting options on sports particularly on "Betting in Running". The new system also supports customer information terminals giving the customer full access to all current prices and results. In addition, it allows grouping of shops which enables the tailoring of the screen content for local preferences.

New InfraRed technology has also been fully rolled out in 2005 and allows us to control all live television pictures from a central production studio. This enables us to coordinate the audio, information screens and the television screens in the shops, thus greatly improving the in-shop experience for customers.

Non Retail Division

The non retail division comprises telephone betting, online and interactive television operations.

Active Customers	Online		Telephone	
	2005	2004	2005	2004
Ireland and Rest Of World	25,646	16,721	10,783	10,207
UK	48,015	29,982	10,148	8,326
Total	73,661	46,703	20,931	18,533

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

The Online Channel

The significant expansion of the online operation seen over the previous four years continued in 2005 with record levels of activity throughout the business. The gradual shift of this channel away from bookmaking into online betting and gaming accelerated in 2005 as the take up of the new products launched in 2004 grew significantly. These were supplemented in 2005 by the launch

of poker, which has performed very well in its first year of operation. Ongoing development of the core sportsbook product has continued with a range of ancillary features being added to increase the overall attractiveness of the site.

Online Active Customers	2005	2004
Sportsbook Only	48,137	35,321
Gaming Only	11,277	2,338
Multi product customers	14,247	9,044
Total	73,661	46,703

The development of the management team has been a major feature of the non retail division over the year. The addition of new product lines and the speed of their growth required that responsibilities for individual product lines be split into separate management teams. We are delighted with the calibre of the individuals that we have attracted, who have come from a wide range of leading e-commerce companies.

2006 will see an expansion of the online channel into continental Europe with at least one European language being added. We recruited a dedicated European team in 2005 to manage this project initially based in Dublin. We expect to be operational in quarter two and to run at a small loss for 2006.

The Telephone Channel

2005 was another year of significant development for the telephone business.

Over the past three years we have been actively engaged in increasing the average telephone stake size to reflect the higher delivery costs of this channel in comparison to both the online and retail channels. As part of this process we encouraged lower staking customers to switch to the online channel. We have also made a number of improvements to the telephone service during the year.

The changing profile of our telephone customers, together with the service changes and improved operational efficiencies, greatly improved the profitability of the business.

Operations Review (continued)

However, notwithstanding the changes we have made, the underlying growth in the business means that our current facility in Dublin is reaching capacity. We will therefore be moving the call centre in 2006 to a new building beside our existing headquarters in Dublin. This will increase the call centre capacity by an initial 25% and also offers additional capacity as needed over the next few years. It also frees up space in our head office to facilitate the expansion of our other businesses.

Trading and Risk Management

Trading and risk management is at the heart of a bookmaking business and 2005 has seen continued development of this function. It is responsible for the creation and pricing of all markets and the trading of those markets through their life.

Betting has become more sophisticated as the number of events and the number of markets on each event increase. The increasing promotional capabilities in the retail business through its expanded screens system, together with the almost unlimited ability to promote product on the internet, requires an ever expanding product range. At the same time the speed of information flows is greater, requiring greater management of the betting markets offered.

These changes in the speed and quantum of information also provide additional opportunities to create markets. Live sport together with improved technology allows "Betting in Running" to be offered through the internet and telephones. With the advent of EPOS it can also be done effectively through the shops.

The ability to hedge markets has substantially changed over the past few years as betting exchanges have grown. While providing a previously unavailable method of hedging, their growth has also led to a gradual change in the way that the on track bookmakers manage risk. This change impacts the value and role of the track based starting price system as it no longer fully reflects the weight of money bet at the track. The debate on the role of an off track starting price is set to continue and is an area that Paddy Power will watch with interest. Paddy

Power has used, and will continue to use, both the on and off track market and the betting exchanges as appropriate to manage risk.

The levels of changes noted above mean that continued investment in risk management is essential and has been ongoing through 2005. This investment takes several forms. The need to monitor price movements in the market place requires increased technology to ensure that our relative position in the market is clearly understood in detail at all times. Investment in back office efficiency is essential to ensure that pricing and trading decisions are implemented across all the business channels as quickly as possible and with minimum risk of error. Increased headcount is needed as more sports are covered and specialist traders are put in place in each area. However, increased automation and sophisticated mathematical model allows greater productivity from individual traders who can cover more markets with greater accuracy. Some of the solutions noted above come from the EPOS implementation while others require separate solutions. 2006 will see continued investment in risk as Paddy Power further develops its market leading risk management operation.

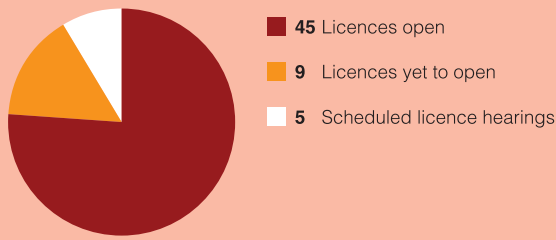
These actions will improve the overall quality and productivity of the risk management operation and help generate incremental revenue through new products launches. They will however have a limited impact on gross win percentages given the need to operate within a very competitive market place.

Marketing

2005 was another very productive year for the marketing team as they reinforced Paddy Power's brand recognition and positioning in Ireland while building on the brand growth achieved in 2004 in the UK.

Our approach to our brand has remained consistent. Small stake betting is about entertainment and Paddy Power continues to position itself as fun, fair and friendly. Our approach to marketing can be best illustrated through highlighting some key marketing events in 2005.

59 UK SHOPS IN PROGRESS



The Papal elections in April generated significant media and customer interest. A quick decision was taken to send a team to Rome for the conclave with specially prepared marketing materials, backed up by a Paddy Power Papal Elections website. It was a risk that paid off handsomely, generating global coverage of Paddy Power, significant revenue and increasing our brand awareness to both our customers and investors.

In September, after only seven matches, we declared Chelsea “winners” of the English Premiership and paid out all winning bets. As well as delighting many customers and demonstrating the Paddy Power difference, it generated substantial media coverage.

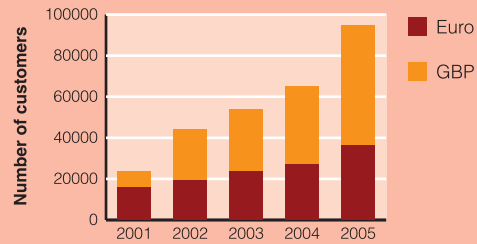
Both of these events illustrate Paddy Power’s core principles of being creative and fast moving. This willingness to make quick decisions enables us to gain first mover advantage. They also show that we are prepared to take risks in areas that clearly demonstrate our brand values.

Our Irish outdoor brand campaign in September emphasised that Paddy Power was no longer just about sports betting but encompassed a whole selection of online games. As our posters said “there’s a place for fun and games” and paddypower.com is it. While the campaign generated unexpected debate it was very successful in reinforcing the notion that Paddy Power is about fun and entertainment.

These high profile “one off” events are balanced with a whole range of more traditional sponsorship deals covering sports, horse racing and entertainment using television, radio and print media. In 2005, we also increased our online sponsorships, becoming official online betting partner to both Arsenal and Liverpool football clubs to add to our Charlton Athletic and Aston Villa deals. In addition, as official betting partner to the Big Brother TV show, we generated significant exposure in the UK, capturing an audience that we would not normally reach through the more traditional sporting sponsorships.

As always, novelty betting is a great source of entertainment for customers and is another area where Paddy Power’s sense of fun can be demonstrated. It can also generate very significant commentary and discussion especially when it goes

NON RETAIL ACTIVE CUSTOMERS



“wrong.” In June 2005 it went “wrong” when betting on the colour of the Queen’s hat at Ascot. Who would have thought a brown hat at 12/1 would be a winner? Well, one “lucky” customer did as, only two hours before the Queen appeared at Ascot, a four thousand pound bet was placed with the price already having shortened to 8/11.

The willingness to take risks continues in 2006. As early as the second week of January, we took short term sponsorship deals for Burton Albion FC in their FA Cup match against Manchester United and for Roy Keane’s debut match for Celtic. Upset results in both games delivered excellent exposure for us.

People

Staff numbers increased significantly to 1,374 from 1,199 by the year end as the organisation grew both in Ireland and the UK. Having the right people is fundamental to the success of Paddy Power and, as we continue to grow and change, there is a constant need for more people and new skills. Some of these will be hired from outside the organisation and some will be developed in house.

As planned, 2005 has seen significant investment in the training and development of staff throughout the organisation. Working through our own human resources team and with the aid of external specialists, we have developed a series of very successful in-house training courses covering a variety of management skills. In addition, a significant number of new staff have joined us and, as mentioned earlier, we are delighted with the calibre of the staff we have attracted to the online channel and to the organisation as a whole.

Patrick Kennedy
Chief Executive

28 February 2006