

**Executive Summary**

- Paddy Power has grown from a retail only bookmaker operating exclusively in the Irish market into an international business with a strong online focus and a proven ability in growing brand awareness. Since its market debut in late 2000 the company's earnings have grown at a CAGR of over 26%.
- The company has ambitious international expansion plans and has undertaken a number of strategically significant moves in the past six months as (1) it entered the Australian market for the first time with the acquisition of a 51% holding in Sportsbet and (2) announced it is to partner with France's PMU in launching an online sportsbetting business when the French market opens up in the first half of 2010.
- Paddy Power's UK retail presence is still in the early stages of development with the company currently only holding a c.1% share of this market. This leaves considerable scope for further UK expansion. The sale by the UK government of the Tote has the potential to change the competitive landscape in the UK and offers Paddy Power an express route to building out its currently sub-optimal UK estate. The purchase of select assets from the Tote would be of most interest to Paddy Power, in our view.
- The potential of the Australian acquisition was highlighted in Paddy Power's most recent IMS (12 November) with Sportsbet's number of active customers growing by in excess of 100% year-on-year since the start of July. The combined Australian business (Sportsbet & IAS) is the largest corporate bookmaker in Australia with over 40% market share giving Paddy Power instant scale in a large and fast growing market.
- The entry into the French online market through the B2B channel highlights what is a significant development in the company's future growth strategy. Given the attractive risk/reward profile it is possible that the use of a partnership approach will be replicated by Paddy Power as changes in the regulatory environment in Europe open up further opportunities.
- Paddy Power has differentiated itself from peers that also have both a retail and non-retail presence due to its strategic focus on developing the strength of its online platform. This is reflected in the higher proportion of total profits it generates from the online channel (80% v Ladbrokes 21% and William Hill 24%) and highlights the reason a valuation premium is warranted.
- Paddy Power currently trades on a FY10 PE of 18.2x, EV/EBITDA multiple of 10.4x and yield of 2.3%. The current rating represents a hefty 95% premium to Ladbrokes and William Hill on a PE basis. Given the different balance sheet structures a comparison based on EV/EBITDA provides a more representative picture with Paddy Power still commanding a 25% premium much of which can be justified by its higher online exposure. Comparisons with pure online operators show the EV/EBITDA premium disappear but Paddy Power still maintaining a 39% premium based on PE.
- We consider the Paddy Power investment case to be compelling given its proven management team, high exposure to structural growth in the online market and its strong financial position which supports the company's future expansion in both existing and new markets. Following a stellar performance during 2009 (+82% year to date against a 24% rise in the overall Irish index) the current valuation looks full but any sector weakness should be used as an opportunity to invest.

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Price (€)	Mkt cap (€m)	Net cash (€m)	EPS 2009F	EPS 2010F	PE 2009F	PE 2010F	EV/ EBITDA 2009F	EV/ EBITDA 2010F	Dividend Yield (%)
24.40	1168	79	1.14	1.34	21.3	18.2	13.0	10.4	2.3%

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## Overview

Paddy Power started out in 1988 as a retail bookmaker operating exclusively in the Irish market. The company added an Irish telephone service through its 'Dial-a-bet' brand in 1996. By mid-2000, the company had entered the online market with paddy.com. In late 2000, the company floated on the equity markets with its primary listing in Dublin.

Expansion beyond Ireland came with the opening of the company's first UK shop in late 2000. By 2001, both a telephone and online service were being offered in the UK market.

Today Paddy Power is the leading bookmaker in Ireland with an estimated market share of 29% (based on turnover) through its 198 shops. The company is also present on the UK high street where its more modest c.1% market share is targeted for future expansion. Paddy Power's largest division is online where it predominately serves customers located in the UK and Ireland. In May of this year Paddy Power expanded into the Australian market with the acquisition of a 51% stake in Sportsbet, a leading Australian bookmaker. Most recently, the company announced a B2B deal with France's PMU to launch an online sports betting product in the French market from 2010.

The company's core market is sportsbetting, however the product line has expanded considerably in recent years to include casino, poker, spreadbetting, bingo and other games. The range of sporting events offered to customers has grown continuously as the company began to offer markets in lesser followed sports and growing its "betting in running" offering. Novelty bets are a strong part of Paddy Power's heritage and here too the number of markets offered has been expanded significantly.

## Strategy

Paddy Power competes under three principal areas - brand, value and product. The company has built strong brand awareness through its distinctive marketing strategy which aims to marry the Paddy Power brand with entertainment and fun. In 2002, the company changed its corporate name from Power Leisure plc to Paddy Power plc thereby enhancing the brand awareness of Paddy Power and providing a single connection between the corporate entity and its core operations. The provision of market differentiating offers such as money back specials and paying extra places in certain events is used to strengthen the company's association with offering good value to customers. In terms of product, both the quantity of markets and the quality of the delivered product, whether in retail or non-retail, are key to driving future growth.

Expansion to date has been targeting markets where betting and gaming is fully regulated. This requirement was to the forefront when making the decision to enter the legalised Australian market earlier this year. In 2007, Paddy Power launched a Spanish language website following the deregulation of two regions within the Spanish market. The Spanish offering has been held back by the lack of legislative clarity post deregulation. Paddy Power has exited markets where the legal landscape shifted unfavourably, such as Germany, where changes to legislation in 2008 extended state monopolies and made online betting and gaming activity illegal.

Aside from the legal landscape, other considerations when assessing the attractiveness of potential new markets are the size and growth prospects of the market and the extent of the sports betting culture that exists in the prospective market.

## Bull Points

**Net cash position supports future growth.** Paddy Power has used its strong balance position to expand into the Australian market. Further growth can be readily funded with the company forecast to exit FY09 with a net cash position of €78.6m. The strong cash position has allowed Paddy Power to maintain its progressive dividend policy at a time when leveraged peers had to suspend distributions in the wake of cash calls to shareholders. We see scope for an increase in the dividend payout ratio at Paddy Power to c.50% in the current year, up from 39% in FY08.

**Online to continue structural growth.** Paddy Power's online division has played an instrumental role in the company's development growing from representing 14% of operating profit at the end of 2003 to 80% in Q3 2009. The online business is a structural growth story benefiting from a net migration of customers from telephone and retail channels and higher levels of broadband penetration.

**Significant opportunities in UK retail.** Although first entering the UK retail market in late 2000 Paddy Power's estate size remains sub-optimal in the UK. The company currently has a c.1% market share compared to c.27% each for quoted peers Ladbrokes and William Hill. Paddy Power's target is to grow its current UK estate of 90 shops to "at least" 150 shops by 2011. A larger scale UK estate will reduce central overheads on a per shop basis and offer scope to drive further cost reductions. Beyond the 2011 target Paddy Power would still have ample scope for further UK expansion with the targeted 150 shops comparing to the current count of circa 4300 shops between Ladbrokes and William Hill cumulatively.

## Bear Points

**Leading Irish market position limits future expansion.** Paddy Power is the leading player in the Irish retail market with 29% market share (by turnover) through its estate of 198 shops. While in the near term there continues to be scope for further growth the current size of the company's Irish retail presence ultimately limits future expansion. We expect the roll out of new shops by Paddy Power to slow but for the company's overall market share to continue to grow as smaller competitors exit a currently very difficult Irish market.

**Online competition is heating up.** Paddy Power's early and sustained focus on developing a strong online offering has been a key differentiator between itself and its closest quoted peers. Consider that in the UK it has the fourth largest market share at 10%, despite its relatively small retail presence in this market. More recently, Ladbrokes and William Hill have sought to reverse an earlier decline in their online market shares by strengthening their online offerings. In William Hill's case this involved purchasing assets from Playtech, a leading developer of online gambling software, to create William Hill Online, while Ladbrokes' strategy has been to increase the marketing spend allocated to its online platform.

**Potential hike in Irish betting tax.** At present the Irish government levies a 1% betting tax on amounts staked in all retail bookmakers. It had been proposed that this betting tax would double to 2% of the amounts staked from 1 May 2009. While the required legislation has been passed its implementation has been postponed until a full review of the betting industry can be undertaken. Paddy Power estimate that should the higher rate of betting tax be introduced it would reduce operating profit by 9-10% in a full year. The industry review remains ongoing and is understood to be examining the possibility of extending the tax net to include non-retail channels (telephone and online).

## Entry into Australia offers attractive returns

The move to acquire 51% of Sportsbet for an initial consideration of €27.8m in May of this year sees Paddy Power enter a large, fast growing market that shares a common language and sports betting culture as the company's existing core markets of Ireland and the UK.

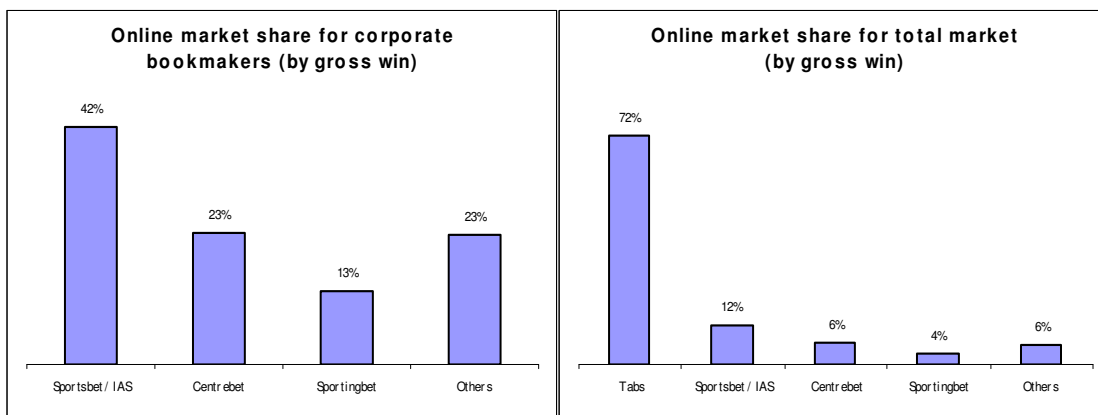
<b>Australian division</b>				
	<b>Dec 2009F *</b>	<b>Dec 2010F</b>	<b>Dec 2011F</b>	<b>Dec 2012F</b>
Amounts staked	438.0	1068.7	1229.0	1413.4
Gross win	26.3	69.5	79.9	91.9
Operating profit	3.9	13.9	16.0	18.4

*\* Sportsbet included for 6 months in 2009F. Acquisition of 51% completed on 1 July 2009.  
IAS included for 3 months in 2009F. Acquisition by Sportsbet completed on 2 October 2009.*

Sportsbet is a well established player in the Australian market operating for over 15 years. Attractively for Paddy Power the business generates over 90% of its gross profit from its online operations. The remaining 10% comes from telephone betting.

Sportsbet held a 19.98% stake in another Australian corporate bookmaker IAS (International All Sports) at the time of the Paddy Power's announcement on 14 May that it was to acquire 51% of Sportsbet. Within three weeks (3 June) Sportsbet announced it was to acquire the outstanding shares in IAS, with Paddy Power contributing €3.7m to the deal on a pro-rata basis. As with Sportsbet, IAS is pre-dominantly an online operator with c.80% of its business generated through this channel.

The combined Sportsbet/IAS business creates the largest corporate bookmaking business in Australia with 42% market share based on the most recent market estimates from June 2008. Paddy Power estimates that today Sportsbet/IAS has grown this market share further.



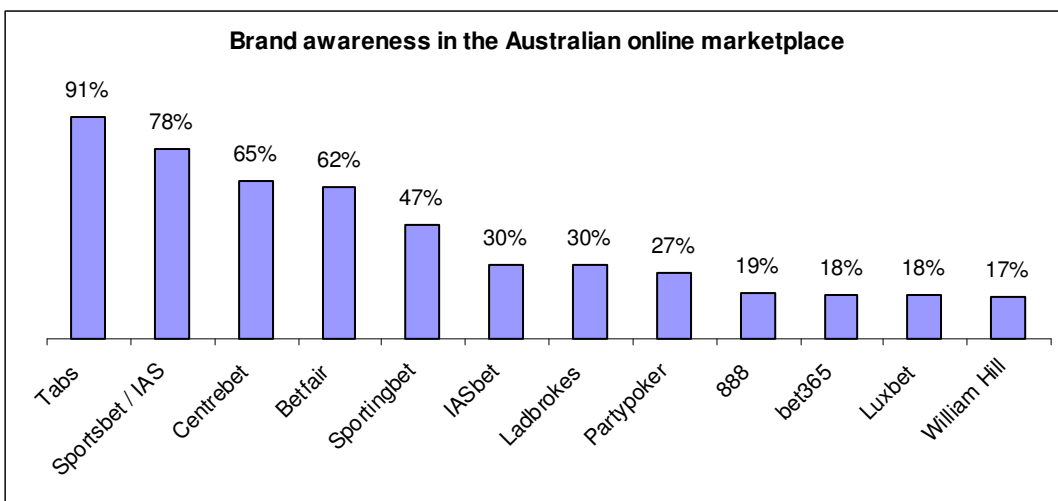
Tabs represents the state licences run by Tabcorp and Tatts primarily which currently hold a number of exclusive state betting licences across Australia. Recent amendments and judgments by state governments have allowed interstate corporate bookmakers, such as Sportsbet/IAS, increased access to previously sheltered markets.

The pace of regulatory change in Australia continues to grow. Recently, a ban on advertising was lifted allowing corporate bookmakers to actively market their offerings to Australian customers. This is significant given that corporate bookmakers such as Sportsbet/IAS do not have a retail presence with which to increase awareness of their businesses making it more difficult to compete with Tabs given its sizable retail presence across Australia.

Sportsbet/IAS has been extremely active in taking advantage of the opportunity to advertise with it now having the highest level of online brand awareness amongst the corporate bookmakers. A further strengthening of the Sportsbet/IAS franchises is to be expected given Paddy Power's demonstrable effectiveness in growing brand awareness through its distinctive marketing campaigns.

We expect the integration of the Australian businesses to be largely completed by early 2010. Once complete we see scope for Paddy Power to apply its expertise in driving increased website traffic and to explore the expansion of the existing product offering to cover additional sporting markets. At present Sportsbet/IAS business is weighted circa 80% towards horse racing with the remainder coming from other sporting bets. This highlights the potential to grow the mix of business generated from sports other than horse racing to a level closer to Ireland and the UK where the split between horse racing and other sports is broadly even.

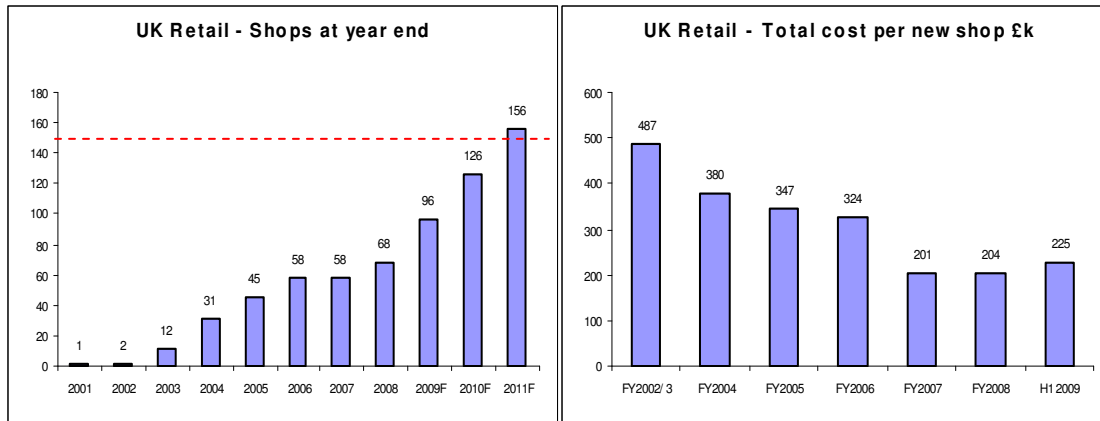
While significant regulatory changes have already taken place in Australia to make it attractive to foreign corporate bookmakers such as Paddy Power, Ladbrokes and William Hill, there remains a number of anomalies between the Australian betting market when compared to Ireland and the UK. For instance, while betting in running is legal through the telephone channel it is currently not permitted online. A further difference is that online games, poker and casino are not legal in Australia. The relaxing of some or all of these restrictions would further add to the attractiveness of Paddy Power's entry in the Australian market.



The Sportsbet deal includes the option for Paddy Power to acquire the outstanding shares in 2012 or 2013 for between 4-7x the final year EBITDA for the combined Sportsbet/IAS business. Such a structure has provided Paddy Power with a low risk entry into a new market while allowing it to move to a position of 100% control within a reasonable period.

## UK expansion to accelerate over next 2 years

Paddy Power currently has a total of 90 retail shops in the UK. The Group has stated that it intends to grow this number to at least 150 shops by 2011. Development activity has been ramped up in 2009 with 22 openings year to date, compared to 10 over the whole of 2008 (which also benefited from the acquisition of a chain of 8 shops in Northern Ireland).



The UK retail landscape holds a number of key attractions for Paddy Power over the Irish market -

### ***Dominant position in Irish market limits future growth***

Paddy Power is the dominant player in the Irish retail market with an estimated market share of 29% (by turnover). Impressively, turnover in its Irish shops is on average double that of other operators in the Irish market. The company continues to gain market share (+3% in H1 2009) in what is a shrinking market. We expect the trend of market share advances will continue as small, less well financed operators exit the sector against the difficult trading backdrop of a sharp contraction in the Irish economy. However, a function of the success achieved is that future growth will be limited given the leading position the company already commands in Ireland.

### ***In contrast, UK retail presence still in early stages of development***

The Group currently has only a c.1% share of the UK retail market. Our forecasts assume that Paddy Power will have 156 shops in the UK by 2011, although we see scope for this number to be exceeded. Looking beyond 2011, there is still ample scope for further UK expansion with Paddy Power's estimated market share still expected to be below 2%. A larger scale UK estate would also provide the benefit of reducing central overheads on a per shop basis and offers scope to extract additional cost savings.

### ***Expansion in retail supports online growth***

The opening of new retail locations serves to drive increased traffic to the company's website. This trend has been observed by Paddy Power with previous openings in both Ireland and the UK as customers awareness of the Paddy Power brand is increased through its presence on the high street.

***UK market does not suffer same oversupply as Ireland***

The UK has only half the number of betting shops per head of population compared to Ireland. In recent years the Irish market has seen a significant increase in shops due to growth of corporates (including Paddy Power) and the entry of independent operators into the market. Given the difficult economic backdrop the Irish market has not been able to sustain this sizable increase in shop numbers. An estimated 80 closures have already taken place in the past 12 months and Paddy Power anticipates that a further 90-140 closures are likely by the end of 2010. Paddy Power's management has outlined that it expects its number of new Irish openings to be at the lower end of the 6-10 per annum previously guided. Our Irish Retail forecasts are based on 7 openings in 2009 and 6 in 2010.

***Northern Ireland is a small but attractive piece of the UK opportunity***

Paddy Power entered the Northern Ireland retail market for the first time with the acquisition of McGranaghan Racing in May 2008. The chain of eight Belfast based shops were acquired for a net consideration of €23.6m (£19m). Northern Ireland is an attractive market given the strict restrictions on new betting shops which has seen the number of betting shops remain broadly unchanged for many years. Paddy Power's UK growth to date has been predominately achieved through organic expansion, however given the difficulty in gaining access to the Northern Ireland betting market an acquisition of a business such as McGranaghan Racing was the most attractive means by which to build a presence in the market.

***FOBTs are permitted in the UK, but not in Ireland***

A key difference in terms of shop layout in the UK versus Ireland is the presence of FOBTs (Fixed Odds Betting Terminals) in the UK. Machine gross win accounted for 37% of the total UK retail gross win in H1 2009 highlighting the importance of this income source to the UK business. Under UK legislation the number of FOBTs (machines) per shop is restricted to an upper limit of 4 (upper limit of 3 in Northern Ireland). In 2008 the UK Gambling Act extended the content allowed to be provided on machines. As the size of Paddy Power's UK retail estate grows towards its 2011 target the absolute contribution from machines will become even more significant.

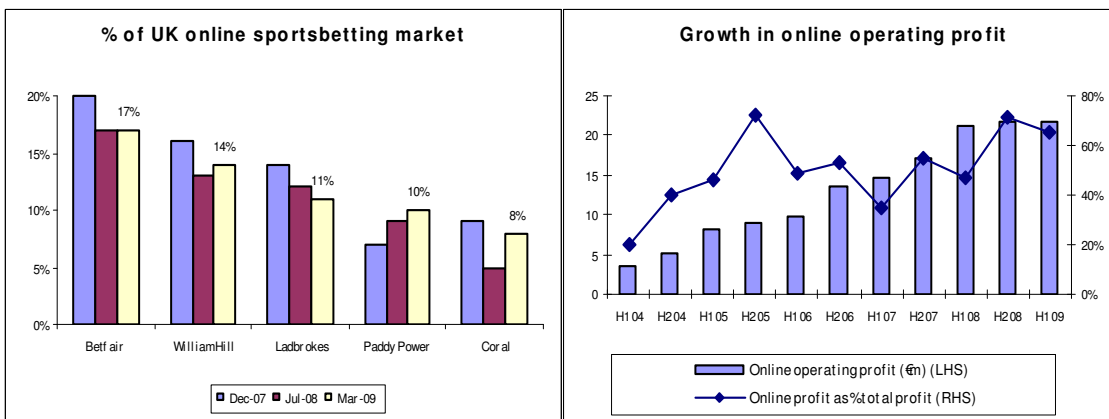
***Shops have longer opening hours and demand test has been removed***

In the UK, betting shops are permitted to open from 7am to 9.30pm from Monday through to Saturday and for a shorter period on Sundays. Opening hours in Ireland are more restrictive with 10.30am to 6pm permitted during the winter season (early September - early April) and from 10.30am - 9pm for the remainder of the year. The demand test that previously limited the number of betting shops in a particular location has been rescinded allowing Paddy Power's UK expansion to be undertaken in a less restrictive regulatory environment.

## Online channel continues to grow in importance

The online division overtook Irish retail as the largest contributor to group profitability for the first time in FY08 and is expected to grow to 67% of total profits in FY09, up from 57% in FY08. Our forecasts see this percentage rise to c.80% in FY10 (including the Australian division). The high exposure to online is the one of the main contributors to Paddy Power's valuation premium over quoted UK peers. Ladbrokes and William Hill generate 21% and 24% of their overall profits from their online operations.

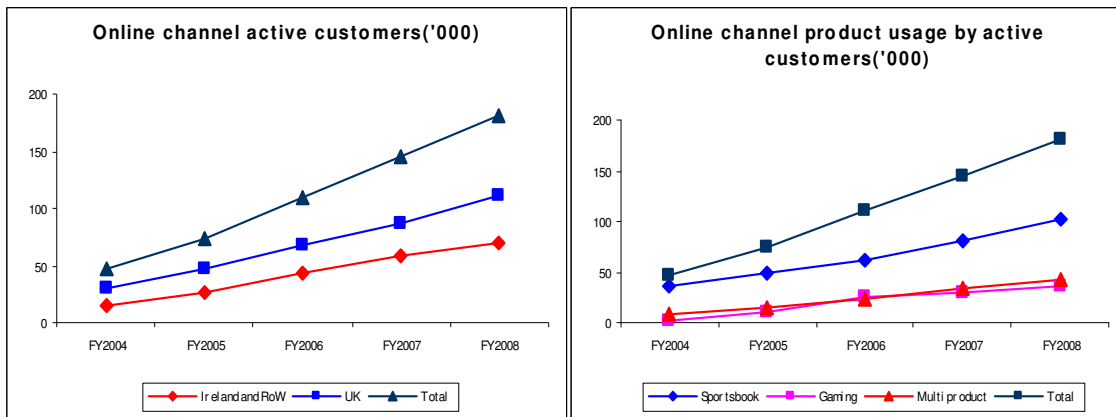
The UK represents the most mature online market in which Paddy Power currently operates with strong competition coming from a wide spread of companies. Paddy Power's online division has prospered in this highly competitive market growing its market share from 7% at the end of 2007 to 10% currently.



Critical to continued success online is the introduction of continuous site improvements and the roll-out of new products to drive increased activity. To this end Paddy Power has grown its online offering beyond the sportsbook to include casino, spreadbetting, bingo and other games. The gaming segment represented 48% of total online gross win in H1 2009 and we expect a similar split for the full year.

Online division - Gross win				
	Dec 2009F	Dec 2010F	Dec 2011F	Dec 2012F
Sportsbook	55.3 52%	64.2 54%	69.5 55%	75.1 55%
Gaming	51.6 48%	53.6 46%	57.9 45%	60.8 45%
Total	106.9	117.9	127.4	135.9

The online channel is particularly attractive given the structural growth that exists in this space with the projected growth in broadband availability underpinning future developments. As with other industries, offering products online has a number of advantage over the physical retail channel including access to larger pools of customers independent of location, lower costs (no shop leases, lower staffing requirements) and the ease with which new services can be rolled out.



## Outperforming in a difficult Irish retail market

The Irish betting sector has been impacted by the deterioration in economic conditions and uncertainty caused by proposed changes to taxing the industry. Against this backdrop Paddy Power's Irish retail business has strongly outperformed the general market. Like for like revenue declines have been limited to 4% in the 9 months to June 2009 at a time when the rest of the industry is estimated to have experienced an 18% drop in revenues.

Retail division - Ireland				
	Dec 2009F	Dec 2010F	Dec 2011F	Dec 2012F
Amounts staked	897.3	890.2	937.4	990.7
Gross win	105.0	108.6	114.4	120.9
Operating profit	14.3	10.8	13.1	15.6

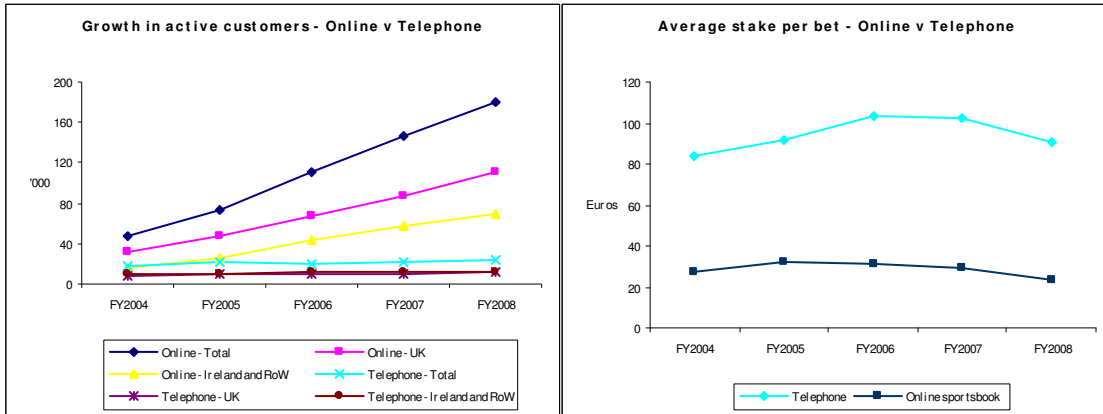
The total number of shops in the Irish market had grown consistently in recent years up from c.800 in 2000 to 1300 at the peak in 2008. The weakening in the economic backdrop has put a number of operators under pressure and has resulted in c.80 closures taking place in the past 12 months. Paddy Power estimates that a further 90-140 closures are likely by the end of 2010 given the challenging trading environment and current lack of regulatory clarity. This would represent a cumulative reduction of close to 15% in market capacity.



Paddy Power's Irish shops on average generate double the revenue per shop of its average competitor providing the company with a significant advantage in the current downturn. Paddy Power has no plans to close any Irish shops but is expected to add new shops at the lower end of the 6-10 range previously guided. In H1 four new shops were opened contributing to the growth in market share to 29%. Further market shares gains are expected to follow given the current pull back being undertaken by competitors.

## Telephone - Hanging up and logging on

Trading in the telephone division remains difficult as it continues to experience a net migration of customers switching over to the online channel. This is best seen in the graph below which shows the superior growth in active customers through the online channel in recent years.



This migration has had a limited impact on the average stake per bet achieved in the telephone channel which can be seen to have held up better than the online sportsbook average stake per bet both leading into and during the current downturn.

The reasons for this relative outperformance can be attributed to -

- The higher growth in the online channel brings more late adapters into the customer base which inevitably results in a lower average stake per bet given late adapters tend to be less ardent than early adapters.
- The launch of a dedicated “higher stake” telephone unit during FY08 will have had a positive impact on the average stake per bet achieved by the division.
- Telephone customers in general tend to consider betting as less of a discretionary/entertainment item of spending than online customers.

Absent a strong run of unfavourable sporting results, as seen in H1 2009, the telephone division is expected to remain profitable with a considerable reduction in the division’s cost base having been achieved (operating costs down 11% in H1).

Telephone division				
	Dec 2009F	Dec 2010F	Dec 2011F	Dec 2012F
Amounts staked	296.6	296.4	296.3	296.1
Gross win	16.9	19.3	19.3	19.2
Operating profit	0.8	2.8	2.8	2.8

## Entry into France heralds advance in European regulation

Paddy Power's announcement that it is to partner with PMU in providing an online sports betting product represents a significant development in the Group's strategy. PMU is the largest betting organisation in Europe (and second largest in the world) and holds a dominant position in the French market. The selection of Paddy Power as its partner in expansion into online sportsbetting represents an acknowledgment of Paddy Power's sportsbetting expertise and the strength of its online platform. The five year agreement adds a new revenue stream to Paddy Power's business model and acts as a powerful calling card for other state monopolies that will be considering similar moves into online sportsbetting as European regulation continues to evolve.

The risk/reward profile of a B2B deal such as agreed with PMU is positive given the low start-up costs involved, the market recognition and trust that the domestic player brings to the table and the upside potential offered through the partnership which sees Paddy Power share the after tax gross win.

The UK is the largest single online sports betting market in Europe. We estimate that France is currently the fourth largest market but see scope for this market to record a period of accelerated growth as regulation is introduced from the first half of 2010. Ahead of France in terms of size are Italy and Germany - two countries with opposing views on market regulation.

Key to Paddy Power's development to date has been that it only operates in markets where it is authorised to do so. This has seen the company swiftly exit from the German market when a ban on non-state authorised online betting was introduced in 2008. The German ban is currently subject to legal appeals and given that it has not prevented the growth of online betting (via offshore operators) the case for its repeal would appear to be gaining traction.

The example of the recent regulated market in Italy highlights the advantages of teaming up with a strong local operator as post the liberalisation of this market it has been existing domestic players which have benefited most as they successfully leveraged their local market knowledge and established marketing channels. Paddy Power has an existing online presence in Spain through its Spanish language website although performance to date has been held back by the slow progress of the Spanish government in delivering further clarity on market regulation.

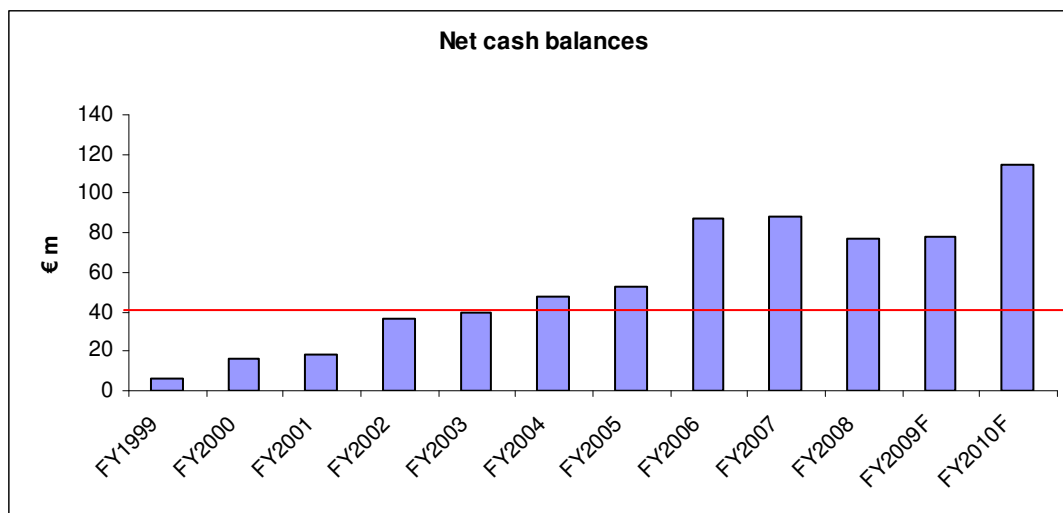
Behind the decision of European governments to move to regulate online betting is the reality that without such regulation states are losing out on considerable tax revenues. Given the projected structural growth of online betting this is set to become an even greater issue for governments in the periods ahead.

Our Paddy Power forecasts assume a modest initial contribution from the PMU deal. The revenue sharing agreement is expected to breakeven in its first full year (FY10) and to contribute between €1-2m in operating profit by FY11. More significant is the longer term potential of this and similar future B2B deals to Paddy Power in a European market that is marching towards greater regulation.

## Balance sheet can readily facilitate €290m in gross debt

We forecast that Paddy Power will finish FY09 with €78.6m in net cash. The graph below highlights the consistent policy of holding a net cash position that has been maintained by Paddy Power since before it became a publically quoted company in late 2000. The rationale to holding such high levels of cash has been to provide the company with scope to exploit organic and acquisitive growth opportunities as they arise. For investors a decision by Paddy Power to raise an appropriate level of debt would clearly signal the company's growth plans beyond FY10.

In our view, the Group's balance sheet structure could support gross debt of over €290m on the basis of a net debt to EBITDA ratio of 2.5x and in the process providing additional capital backing for the company to continue to grow its international presence. Assuming €215m in net debt (and a 7% interest cost) this would result in interest cover remaining comfortable at 4.5x. As Paddy Power moves forward with its expansion plans we do not consider further share buybacks as likely over the medium term.



## A move on the Tote would require a change to capital structure

In October, the UK government once again raised the 'For Sale' sign over the Tote. The state-owned business, which runs betting shops and on-course betting, is for sale along with a number of other government assets. The Tote comprises circa 515 betting shops and an exclusive licence to run pool betting in the UK. In 2006, the price tag placed on the business was in the region of £400m. By late 2008, this figure had dropped to below £280m and recent market commentary points to a current valuation of closer to £200m.

No timeline for the sale of the Tote has been provided. We expect that Paddy Power would be interested in looking at the Tote business given the instant scale it would give the company in the UK retail betting market. Paddy Power's current small size would also be viewed as a positive from an OFT viewpoint compared to a possible sale to larger UK bookmakers such as Ladbrokes and William Hill which it is expected would raise competition concerns. Other potential acquirers previously included Gala Coral but we now see it as unlikely to be in a position to bid given the current constraints on its balance sheet.

Given the level of interest expected from bookmakers and the related competition issues a piecemeal sale of the Tote assets may prove the preferable option for the UK government. This should suit Paddy Power which we think would be far more interested in acquiring selected locations rather than the entire estate, thereby remaining firmly weighted towards the online market and avoiding what could be sizable rationalisation costs.

## Valuation

Paddy Power's shares currently trade at a significant premium to UK peers Ladbrokes and William Hill on both PE and EV/EBITDA metrics as shown below. Given the different balance sheet structures comparing the three companies on EV/EBITDA is the most appropriate metric, in our view. On this basis Paddy Power currently trades at a 25% premium based on FY10 estimates.

Given that Paddy Power generates a greater proportion of total profitability from the online channel compared to Ladbrokes and William Hill (Paddy Power 80% compared to Ladbrokes 21% and William Hill 24%) it is instructive to look beyond simply these two peers for valuation purposes.

The online peers have a more similar balance sheet structure to Paddy Power (majority have a net cash position) and so a valuation comparison based on PE multiples can more readily be applied. When compared to online peers Paddy Power's premium rating is maintained although the differential reduces on PE metrics (+39% based on FY10 estimates) and is eliminated when based on EV/EBITDA multiples (-9% based on FY10 estimates).

There has been much positive news flow in recent months including acquisitions in Australia, a planned entry into the French online sportsbetting market and a return to more normalised sporting results outcomes in the October - November period.

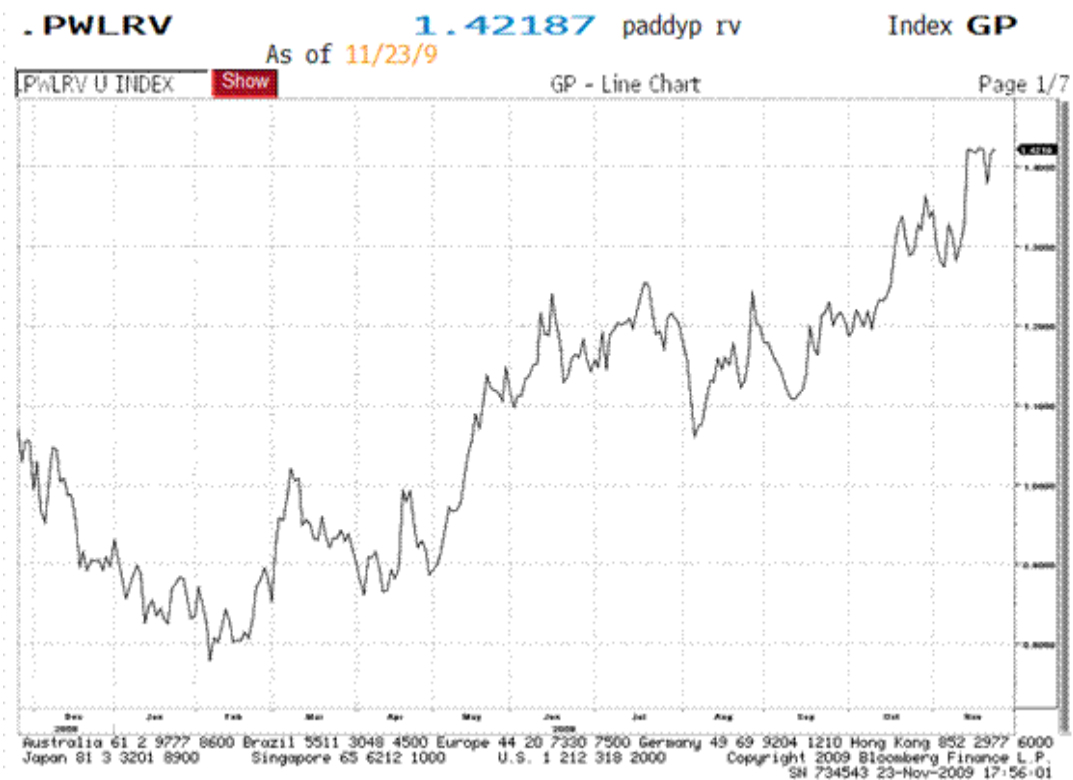
Paddy Power's growth story remains firmly intact with returns to date clearly impressive. We consider the investment case to be compelling given its proven management team, high exposure to structural growth in the online market and its strong financial position which supports the company's future expansion in both existing and new markets. Following a stellar performance during 2009 (+82% year to date against a 24% rise in the overall Irish index) the current valuation looks full but any sector weakness should be used as an opportunity to invest.

		Price	Mkt cap	Net debt /	PE	PE	EV/EBITDA	EV/EBITDA	Dividend
			(m)	(cash)	Yr1	Yr2	Yr1	Yr2	yield
<b>Paddy Power</b>	<b>EUR</b>	<b>24.40</b>	<b>1168</b>	<b>-79</b>	<b>21.3</b>	<b>18.2</b>	<b>13.0</b>	<b>10.4</b>	<b>2.3%</b>
<b>Retail &amp; Online</b>									
Ladbrokes	GBP	132.30	1193	1093	6.8	8.9	7.9	8.9	3.9%
William Hill	GBP	186.50	1307	993	10.3	9.9	8.3	7.7	3.7%
<b>Average Retail &amp; Online</b>					<b>8.5</b>	<b>9.4</b>	<b>8.1</b>	<b>8.3</b>	
<b>Online</b>									
888	GBP	110.20	382	-98	18.9	15.4	20.2	17.0	3.1%
bwin	EUR	37.75	1337	-134	21.3	16.1	12.4	10.4	1.8%
Partygaming	GBP	257.50	1049	-201	18.2	15.1	18.8	15.6	0.0%
Playtech	GBP	423.00	1016	-32	12.5	10.7	11.9	10.3	4.0%
Sportingbet	GBP	69.25	335	-40	11.5	10.3	7.0	6.4	1.4%
Unibet	SEK	197.00	5563	13	15.6	11.2	10.7	8.5	4.3%
<b>Average Online</b>					<b>16.3</b>	<b>13.1</b>	<b>13.5</b>	<b>11.4</b>	
<b>Average All (excl Paddy Power)</b>					<b>14.4</b>	<b>12.2</b>	<b>12.1</b>	<b>10.6</b>	
<b>Average All (incl Paddy Power)</b>					<b>15.2</b>	<b>12.9</b>	<b>12.2</b>	<b>10.6</b>	
<b>Paddy Power premium -</b>									
Vs. Retail & Online					151%	95%	60%	25%	
Vs. Online					31%	39%	-4%	-9%	
Vs. All					48%	50%	7%	-2%	

## Paddy Power share price



## Paddy Power vs FTSE Travel & Leisure sector



## Income statement

	2008	2009F	2010F	2011F	2012F
<b>Amount staked</b>					
Online	694.9	865.1	933.4	1,009.4	1,089.9
Retail - Ireland	935.4	897.3	890.2	937.4	990.7
Retail - UK	173.5	205.3	278.8	361.0	447.8
Telephone	297.1	296.6	296.4	296.3	296.1
Australia	-	438.0	1,068.7	1,229.0	1,413.4
	<b>2,100.9</b>	<b>2,702.4</b>	<b>3,467.6</b>	<b>3,833.1</b>	<b>4,237.9</b>
<b>Gross win</b>					
Online	105.7	106.9	117.9	127.4	135.9
Retail - Ireland	124.3	105.0	108.6	114.4	120.9
Retail - UK	32.5	34.9	44.9	54.9	65.5
Telephone	21.1	16.9	19.3	19.3	19.2
Australia	-	26.3	69.5	79.9	91.9
	<b>283.6</b>	<b>290.0</b>	<b>360.1</b>	<b>395.8</b>	<b>433.4</b>
<b>Operating profit</b>					
Online	42.8	44.9	50.6	56.7	59.8
Retail - Ireland	28.3	14.3	10.8	13.1	15.6
Retail - UK	1.2	1.2	2.3	4.2	6.2
Telephone	3.4	0.8	2.8	2.8	2.8
Australia	-	3.9	13.9	16.0	18.4
	<b>75.7</b>	<b>65.1</b>	<b>80.4</b>	<b>92.8</b>	<b>102.9</b>
Financial income	3.3	1.0	2.0	2.9	4.2
Exceptionals	2.7	-	-	-	-
<b>Profit before tax</b>	<b>81.7</b>	<b>66.1</b>	<b>82.4</b>	<b>95.7</b>	<b>107.1</b>
Income tax expense	- 12.9	- 10.6	- 14.0	- 16.3	- 18.2
Tax rate	16.0%	16.0%	17.0%	17.0%	17.0%
Minority interest (Australia)	- -	1.4 -	4.8 -	5.5 -	6.3
<b>Profit for the year</b>	<b>68.8</b>	<b>54.1</b>	<b>63.6</b>	<b>74.0</b>	<b>82.6</b>
Dividends	- 25.7	- 27.1	- 30.0	- 33.1	- 36.6
<b>Retained earnings</b>	<b>43.1</b>	<b>27.0</b>	<b>33.6</b>	<b>40.9</b>	<b>46.0</b>
<b>EPS diluted adjusted (€)</b>	<b>1.38</b>	<b>1.14</b>	<b>1.34</b>	<b>1.55</b>	<b>1.72</b>
DPS (cents)	54.0	56.7	62.4	68.6	75.5

## Balance sheet

	2008	2009F	2010F	2011F	2012F
Property, plant and equipment	68.0	104.5	110.8	111.0	108.6
Intangible assets	31.6	31.6	31.6	31.6	31.6
Goodwill	15.0	15.0	15.0	15.0	15.0
Deferred tax assets	1.2	1.2	1.2	1.2	1.2
<b>Total non current assets</b>	<b>115.9</b>	<b>152.4</b>	<b>158.6</b>	<b>158.8</b>	<b>156.4</b>
Trade and other receivables	5.6	4.1	3.1	3.1	3.1
Cash and equivalents	76.7	78.6	115.2	164.3	222.1
<b>Total current assets</b>	<b>82.3</b>	<b>82.7</b>	<b>118.3</b>	<b>167.5</b>	<b>225.2</b>
Trade and other payables	53.9	57.4	58.9	59.9	60.9
Derivative financial instruments	3.7	3.7	3.7	3.7	3.7
Current tax payable	1.5	1.5	1.5	1.5	1.5
<b>Total current liabilities</b>	<b>59.1</b>	<b>62.6</b>	<b>64.1</b>	<b>65.1</b>	<b>66.1</b>
Trade and other payables	5.7	5.7	5.7	5.7	5.7
Derivative financial instruments	0.0	0.0	0.0	0.0	0.0
Deferred tax liabilities	6.2	6.2	6.2	6.2	6.2
Minority interest (Australia)	-	1.4	6.1	11.6	17.9
<b>Total non current liabilities</b>	<b>11.9</b>	<b>13.2</b>	<b>18.0</b>	<b>23.5</b>	<b>29.8</b>
<b>Total equity</b>	<b>127.2</b>	<b>159.2</b>	<b>194.9</b>	<b>237.7</b>	<b>285.8</b>
Issued share capital	4.9	5.9	7.9	9.9	11.9
Share premium	11.3	11.3	11.3	11.3	11.3
Treasury shares	- 34.2	- 34.2	- 34.2	- 34.2	- 34.2
Shares held by LTIP trust	- 21.5	- 21.5	- 21.5	- 21.5	- 21.5
Other reserves	14.5	18.5	18.5	18.5	18.5
Retained earnings	152.2	179.2	212.8	253.7	299.7
	<b>127.2</b>	<b>159.2</b>	<b>194.9</b>	<b>237.7</b>	<b>285.8</b>

## Cashflow statement

	2008	2009F	2010F	2011F	2012F
<b>Operating profit</b>	<b>75.7</b>	<b>65.1</b>	<b>80.4</b>	<b>92.8</b>	<b>102.9</b>
Depreciation	16.9	18.9	21.3	23.8	26.4
Working capital	5.6	6.0	2.5	1.0	1.0
Other	10.1	-	-	-	-
<b>Operating cash flow</b>	<b>108.4</b>	<b>90.0</b>	<b>104.2</b>	<b>117.7</b>	<b>130.3</b>
Interest received	3.5	1.0	2.0	2.9	4.2
Tax	- 13.1	- 10.6	- 14.0	- 16.3	- 18.2
Capex	- 17.3	- 19.0	- 22.0	- 24.0	- 24.0
<b>Free cash flow</b>	<b>81.4</b>	<b>61.4</b>	<b>70.2</b>	<b>80.3</b>	<b>92.3</b>
Dividends paid	- 25.9	- 27.1	- 30.0	- 33.1	- 36.6
Share issues / repurchases	- 39.6	1.0	2.0	2.0	2.0
Acquisitions	- 23.6	- 36.4	- 5.6	-	-
Other	- 3.5	3.0	-	-	-
<b>Net increase / (decrease) in net cash</b>	<b>- 11.2</b>	<b>1.9</b>	<b>36.6</b>	<b>49.2</b>	<b>57.7</b>
Cash at start of year	87.9	76.7	78.6	115.2	164.3
<b>Cash at year end</b>	<b>76.7</b>	<b>78.6</b>	<b>115.2</b>	<b>164.3</b>	<b>222.1</b>

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