

888 Holdings business review over 2006 year

Introduction

888 Holdings plc is one of the world's most popular online gaming entertainment companies. They own and operate www.888.com, www.Casino-on-Net.com and www.PacificPoker.com which are among the most well known online brands.

2006 was really watershed to the industry but 888 Holdings was not exception due to the passing of the UIGEA in the United States in October 2006 that caused a major impact on their performance.

As a result of UIGEA and the new regulatory environment they had to take a swift action to meet this impact.

They did review its cost structure, operation structure and management focus.

To provide a clear understanding of how the impact of UIGEA was its accounting provides its continuing operations and discontinuing operations in the financial statements. Discontinued operations represent activities undertaken US customer facing, while continuing operations were non-US customer facing.

Results- continuing and discontinuing operations

Revenue

Total Net Gaming revenue (NGR) in 2006 was up 7% at US\$289.9 million (2005: US\$271.0 million) driven by 28% turnover growth from operations outside the US. NGR from the US was down by 10% reflecting the cessation of all real money games to US customers in October 2006 following the UIGEA.

Expenses

Operating expenses increased 6.2% to US\$77.5 million (2005: US\$73.0 million). This was primarily as a result of expansion of the customer facing employee base and maintaining the overall operating expense ratio of NGR at 27%, despite considerable decline in NGR following the withdrawal of US operations in October 2006.

Research and development expenses increased 71.2% to US\$19.4 million (2005: US\$11.3 million) due to the expansion of their product development, a direct result of their strategic decision to accelerate development and release of their innovative product range.

Marketing expenses fell 15.7% to US\$84.3 million (2005: US\$100.0 million) due to the cessation of their marketing activities to US based

customers in October 2006 following the enactment of UIGEA and their tightened control over the marketing activities focusing their efforts on attracting and retaining valuable customers.

Administrative expenses increased 14.8% to US\$23.1 million (2005: US\$20.1 million) as a result of an increase of US\$6.7 million in salaries to US\$14.6 million (2005: US\$7.9 million) and higher lobbying expenses partly offset by US\$4.7 million exchange gain (2005: US\$0.4 million exchange loss). The increased salaries reflected the change in management structure required for a quoted company and the payment due to the outgoing Chief Executive Officer under his agreement.

Reorganization costs

For a number of years the Group sought to minimize its exposure to the US market and as a result of the decision to cease real-money games offered to US customers in October 2006 the Group incurred relatively modest reorganization costs of only US\$4.0 million (2005: US\$nil). This amount primarily represents the cost of regrettable but necessary redundancies of US facing employees across the Group's three main operating units in Gibraltar, Antigua and Israel.

Profit before tax

As a result of increased revenues, keeping expenditure under control and better management of resources, profit before tax increased 34% to US\$90.5 million (2005: US\$67.4 million).

Strategy

They pursue to achieve profitable growth through the acquisition and retention of valuable customers by providing their customers with a differentiated, intentional customer experience. Their goal is to become *the* world leading online entertainment gaming company to exceed its pre-US shutdown annual revenue and profit. For this achievement they make their best effort to provide the best and the right customer experience. The cornerstones to achieve this are the followings:

Thinking global while acting local:

Providing a consistent, first class, relevant experience to customers.

Enhanced and innovative offering:

Offering a full range of entertainment options to customers.

State of the art integrated marketing:

Coordinating marketing channels to provide a strong relevant marketing

message using an integrated multi-channel approach to maximize the acquisition and retention of valuable customers.

Customer intimacy:

Using customer knowledge to maximize customer experience while prioritizing resources allocation to them.

Market leading customer service:

To provide the most positive customer interface possible.

Focused, efficient and effective organization:

They run the operation efficiently and maintain focus on particular plans and goals for remaining competitive.

Retaining loyal and quality employee:

The success is based on excellent people and continue bringing on board and promoting key talent.

The strength and its view of 888 holdings

In 2006 888 Holdings underwent two fundamental changes. The impact of UIGEA on the industry, competitive landscape and business environment are well documented. The impact on business was less severe than some of their competitors as in previous years one of their main strategic objectives had been to reduce reliance on the US market and diversify into other geographical markets. They will continue to build on the strength of brand and utilize unique experience and know-how, gained over years of operating in non-US markets, to accelerate geographical expansion and localization focus.

The other fundamental change has been management re-focus designed to utilize resources more efficiently in face of the changing business environment. The recruitment of several key senior management team members signified a shift in execution capabilities necessitated by the changes faced. This in turn led to a change in their management and regional operational focus which has allowed them to withstand the adverse effect of UIGEA. The key aspects of this are set out below.

Organization structure

The new organization structure is aimed at re-focusing the core elements of organization; marketing, R&D, product offering and support, but at the same time improving interfaces and communication between them. Marketing and CRM is now focused on a regional basis with the goal of recruiting the customer segment of the choice and providing the smoothest route from initial brand awareness to playing real money games.

R&D is focused on developing and integrating gaming and back office systems to ensure a shorter time to market of their innovative offering.

Product offering is focused on ensuring that they offer the best set of games and the widest selection of payment methods available in all locations. The final element is support function that is tasked with ensuring that they provide world class customer support, maintaining close, intimate contact with customers and thereby ensuring they leverage and deliver through all core functions.

Player growth

Attracting valuable new customers is a key driver of the business growth. During the year their continuing operations recruited more than 260,000 new First Time Depositors (FTD) from more than 920,000 new real play registrations despite the normal seasonal slowdown during the summer months which this year suffered particularly from the World Cup effect. Total customer registrations increased by 34.7% in 2006.

Player retention

The ability to retain customers is as an important factor in the success of the business as well as the ability to recruit them in the first place. High churn rates can mean that the cost of recruiting new customers outweighs their value, so recruiting and retaining customers with high lifetime values is a key component to profitability.

Key Performance Indicators- continuing operations (non-US)

The performance of the business is reviewed on the basis of a number of key determinants. These are analyzed below on a quarterly basis for the last two years for the Casino and Poker operations and for the business in total.

Casino

Year	2005				2006			
	1	2	3	4	1	2	3	4
NGR (US\$' 000)	20,227	21,856	21,647	21,498	21,496	22,531	22,646	22,088
Active customers	50,565	56,812	56,553	62,933	54,053	48,425	46,444	41,307
NGR(US\$) per active customer	400	385	383	342	398	465	488	535

The Casino has delivered a steadily increasing NGR per quarterly active customer in 2006 reaching US\$535 in Quarter 4 2006.

This follows the developments of the offering with greater localization and the rollout of new games, particularly the higher margin Video Slots introduced in early 2006, and the migration of customers to these games. Casino NGR increased further in Quarter 1 2007 with the introduction of Blackjack into Poker. This growth has compensated for, on an NGR basis, a decline in active customer levels after strong growth in 2005. Nevertheless the Casino offering has seen a steady annual growth in NGR with a similar seasonal pattern of quarter-by-quarter movement within each year.

Poker

Year	2005				2006			
Quarter	1	2	3	4	1	2	3	4
NGR (US\$'000)	5,254	7808	10,166	14,527	17,857	16,322	15,686	18,374
Active customers	61,710	92,489	105,714	119,116	134,710	122,087	132,995	147,805
NGR (US\$) per active customer	85	84	96	122	133	134	118	124

Poker has seen constant strong growth across all KPIs since Quarter 1 2005 demonstrating the value of the enhancements made to the product over the period. NGR per quarterly active customer has once again resumed its climb aided by the growth in liquidity from the continuing increase in active customers. Customer growth remained strong despite the seasonal pattern and the competition from the World Cup. The combination of these two factors have resulted in impressive NGR growth over the period which has continued in Quarter 1 2007.

Total

Year	2005				2006			
Quarter	1	2	3	4	1	2	3	4
NGR (US\$'000)	25,481	29,664	31,813	36,025	39,353	38,853	38,332	40,463
Active customers	112,275	149,301	162,267	182,049	188,763	170,512	179,439	189,112
NGR (US\$) per active customer	227	199	196	198	208	228	214	214

The combined KPIs reveal a healthy increase in NGR over the period which has continued with 16% growth in Quarter 1 2007. Active customer growth has been steady, coupled with a stable total NGR per active customer.

Products

Casino

Founded in 1997, Casino on Net, the major Casino brand, has consistently been

ranked as the leading online Casino brand in the world. The Casino continues to generate substantial business, and represented more than 55% of the Group's NGR in 2006. In the non-US business from Quarter 1 2005 to Quarter 4 2006 they experienced 9% NGR growth.

2006 has seen consistent development of their Casino offering. January 2006 saw a major update with new games, added promotional features and a more contemporary design. The Video Slot offering gives a unique playing experience and has proved a hugely popular feature with a growth rate of 227% from January to December for non-US customers. To capitalize on this they aim to add one new slot machine a month and with its greater margins they are actively promoting the feature across the customer base and across languages.

Their commitment to provide their diverse membership base with unique games, features and more convenient payment methods to support local markets, will further the international growth and the plan is to add more languages in 2007.

Poker

2006 has been in many ways a transition year for the Poker brand, Pacific Poker. The growth phase from a new, young and raw Poker room into a mature, competitive.

In January 2006 the Jackpot features "Bad Beat" and "Royal Jackpot", were introduced.

Multi-table, the ability to play at more than one table at the same time, was introduced in March 2006, and it was the most influential positive product upgrade of the year. 27% of the customers at any given time are using this feature, playing in two or more ring games and/or tournaments. This feature aids retention of their more experienced customers and obviously increases liquidity and profitability.

In Quarter 3, in an effort to increase their growing global reach and to connect between big offline tournaments and their online experience, they created a section dedicated to sending their customers to exciting offline tournaments around the world; customers can find online qualifying tournaments to the WSOP in Las Vegas, Aussie Millions in Melbourne, the European Poker and World Poker tournaments among others.

In October, following UIGEA and feedback from their customers, a major effort was made to revamp all their tournaments; sit and go and multi-table tournaments, reviewing buy-in amounts, fees, playing times, and guaranteed amounts. Initial results suggest this has had a positive effect, creating a more exciting environment for customers and increasing the appeal of their tournaments to their customers.

Bingo

Since the year end they have announced the acquisition of the online Bingo business from Globalcom Limited. The Bingo business operates its own leading network of 45 online Bingo sites including Bingoballroom.com, UK-Bingo.net, Bingofabulous.com and Twofatladies.com. In addition it provides Bingo solutions to business partners operating their own networks and other third party sites. This acquisition is a landmark step forward in delivering the strategy of a one stop shop providing their customers with all of their online gaming needs. This is already a well-established market leader, highly cash generative and profitable which uses its own proven and scalable software.

Bingo will be a valuable addition to their entertainment services, and they expect to be able to provide excellent cross-selling opportunities for customers worldwide.

Sportsbook

The Group continues to investigate opportunities to add a Sportsbook proposition to its offering to fulfill the one stop shop strategy. While this process continues they will continue to offer a sports betting option through their Betmate betting exchange.

In December 2006 the Group was awarded one of the Italian Sports Betting licenses issued by the Italian Government.

Customer service

Excellent customer service continues to be a central tenet of the Company's proposition. Their dedicated contact centers in Gibraltar and Antigua offer first class customer support 24/7 to their customers around the world. They offer support in 11 languages. During the year they further upgraded their call routing and call monitoring systems in Antigua to ensure the consistency of their global service.

The termination of real-money games to customers in the US resulted in an adjustment to staff numbers in the contact centers but they are maintaining the high standards of service previously enjoyed by their customers. During the year the following performance was attained by the Gibraltar contact centre:

Casino

98.9% of all phone calls in English answered within, on average, 18 seconds.

81.4% of all e-mails received in English replied to within, on average 20 minutes.

Poker

98.6% of all phone calls in English answered within, on average, 16 seconds.

76.5% of all e-mails received in English replied to within, on average 20 minutes.

Payments and Risk Management

In 2006 customers were offered a total of 21 different depositing and 10 different withdrawal methods. When customers enter 888.com they are offered a range of payment options tailored to suit their local market based on their physical location and from which they can choose their preferred method. The aim is to offer a wide selection of secure payment methods in each location so as not to restrict the ease of customer deposit or withdrawal.

Credit cards and debit cards are the most popular method of payment representing 86.7% of total deposits in 2006 (2005: 87.7%) followed by online wallets representing 11.7% (2005: 11.1%).

Deposits and withdrawals are carefully monitored by their in-house Fraud and Payment Risk Management department. This department has a depth of experience in fraud prevention from many years' operation and has integrated their internally developed prevention and verification procedures with conventional commercially available measures.

Marketing

They have created a world-leading brand through multi-channel integrated marketing across all media channels worldwide.

Their vision for marketing is:

to find every person worldwide, who wants to play games and to bring them to the 888 lobby to play;

to let them play more games, to play more often and to play more of the time; and in a safe, responsible and trustworthy environment.

The Group leads the industry in online marketing including search engine optimization, advertising banners, pop-ups on websites and portals and the new tools of viral advertising, RSS and others.

The Group is constantly copied as it pioneers the use of all media including traditional advertising, direct mail, sponsorships and public relations activities. Indirectly the Group also partners with affiliate sites to generate traffic and drive new customers to the site by paying a commission or revenue share to the affiliate. Finally, effective use of CRM tools, loyalty and VIP programmes allow a personalized brand experience for new and existing customers.

Employees

At the year end the Group had 736 employees (2005: 886) at the following locations; Gibraltar, Israel, Antigua, London.

The UIGEA had a dramatic effect on their financial performance.

However, due to their diversified customer base and internal structure the readjustment to compensate for this lost revenue was not too significant. It did, however, require an adjustment to those US facing parts of the operation and redundancies were unfortunate but inevitable. Overall headcount was reduced by 210 with the largest percentage losses being in the Antigua and Gibraltar support centers.

Responsible gaming

The Group is dedicated and committed to a policy of social responsibility. It has taken a proactive role in setting, maintaining and improving high standards of protection for its customers.

Principal risk and Regulatory and Compliance Review

The Group operates in a new and dynamic business environment. In addition to the day-to-day commercial risks faced by most enterprises the online gaming industry presents particular risks of which regulatory and compliance risks are highlighted.

The regulatory framework of online gaming in different countries around the world remains as dynamic and rapidly evolving as ever. While some jurisdictions have moved to curtail the activities of online gaming sites, others are currently contemplating liberalization and regulation of the industry. There are significant risks, unique to the online gaming industry, including from past activity in the US where customers of 888 generated in 2006 46% of its NGR. 888 Holdings is licensed and regulated in Gibraltar. In December 2005, the Government of Gibraltar enacted a new Gambling Act. The Act introduces a tailor-made regime for the regulation of remote gaming.

In the US, UIGEA added a new section to the United States Code making it illegal for anyone engaging in the business of betting or wagering to knowingly accept any credit, electronic funds transfer, check, draft etc. in connection with the participation of another person in unlawful Internet gaming. In essence, the bill prohibits online gambling operators from receiving the proceeds of financial transactions in connection with Internet gaming.

The EU Commission is challenging the online gambling regulatory regime of various European states, as the Commission holds that these regimes might infringe the enshrined freedom to provide services and freedom of establishment. This effort is reflected in, inter alia, the infringement proceedings initiated against several EU States. While these proceedings may, in the end, cause the European States to liberalize their gambling markets, it should be noted that

they could last for a very long time before resolutions or judgments are reached. Recently, the European Court of Justice issued its ruling in the Placanica case, involving criminal proceedings initiated against agents of Stanley International Betting placed in Italy. The court, although not calling for a liberalization of the European gambling market, placed heavier burdens on the European states if they maintain their restrictive policies toward online gambling. It remains to be seen what impact this judgment will have.

In Italy, the Group received a Sports Betting license, which allows it to offer Sports Betting services (supervised by the State Monopoly Authority). In France, during March 2007, Non-executive Director and former Chief Executive Officer, John Anderson, attended an interview with the French authorities. 888 Holdings is in consultation with its legal advisers with regards to this matter and closely monitors the situation for any developments.

In Israel, law enforcement authorities have raided the offices of several Internet portals and arrested several individuals on the suspicion that they had advertised online gaming sites in Israel, in contravention of the Israeli Penal Law..

Taxation.

The Group benefits from favorable fiscal arrangements in the jurisdictions in which it operates without which its results would be adversely affected. All gaming activities are based in Gibraltar where the Group currently benefits from a tax-exempt status. The tax-exempt status is due to be removed in 2010 when the Government of Gibraltar intends to introduce a fiscal regime that complies with EU requirements.

The replacement regime is still to be unveiled although the Gibraltar Government has pledged its commitment to maintain fiscal competitiveness. The Group is required to pay a gaming duty currently set at 1% of the gaming yield with an annual maximum cap of £425,000.

The Group's subsidiary in Israel, Random Logic Limited, and the Israeli branch of Intersafe Global Limited have each entered into separate transfer pricing agreements on an arm's length basis with the Israeli Income Tax Commissioner. The arrangements for Random Logic Limited are effective until 2010 while the position for the Intersafe Global Limited branch after 2007 has yet to be agreed. The operation in Antigua also benefits from a low tax regime and the current scale of the operation there mitigates against a significant exposure to any change.

2007 Plans

This year will see full implementation of their strategy which will provide the infrastructure for future growth. The Group will continue to expand its innovative product offering, platforms, diversify its geographical footprint and localization,

and extend its multi-channel customer acquisition campaigns including by striking additional strategic alliances with business partners. Finally, 888 Holdings will continue to offer the same, excellent, customer service as we always have.

Net Gaming Revenue by geographical market

	Year ended 31 December 2006 US\$'000	Year ended 31 December 2005 US\$'000
Continuing operations		
UK	70,562	53,871
Europe	57,056	47,289
Americas (excluding US)	17,601	12,007
Rest of World	11,781	9,815
	157,000	122,982
Discontinuing operations		
US	132,907	148,049
Net Gaming Revenue	289,907	271,031

16 Principal investments in subsidiaries

Name	Country of incorporation	Percentage of equity interest 2006 %	Percentage of equity interest 2005 %	Nature of business
Intersafe Global Limited	Gibraltar	100	100	Payment processor
Cassava Enterprises Limited	Antigua	100	100	Member call centre operator
Virtual Services Limited	BVI	100	100	Advertising
Virtual Holdings Management Services (Gibraltar) Limited	Gibraltar	100	100	Operates Group headquarters
Intersafe Global (Europe) Limited	Gibraltar	100	100	Payment processor
Cassava Enterprises Services (Gibraltar) Limited	Gibraltar	100	100	Gaming website operator
Virtual Marketing Services (UK) Limited	UK	100	100	Advertising
Cassava Sports Limited	Gibraltar	100	100	Domain site owner through which a third-party operates a betting exchange
Active Media Limited	BVI	100	100	Member call centre employer
Virtual Marketing Services (Gibraltar) Limited	Gibraltar	100	100	Marketing acquisition
Dixie Operation Limited	Antigua	100	100	Member call centre operator
Random Logic Limited	Israel	100	100	Research, development and marketing
ACTeCASH Limited	Gibraltar	100	100	e-Wallet service

Consolidated Income Statement for Continuing operations
The year ended 31 December 2006

	Year ended 31 December 2006	Year ended 31 December 2005
	US\$ 000	US\$ 000
Continuing operation		
Net Gaming Revenue	157,000	122,982
Operating expenses	49,448	43,308
Research and development expenses	19,381	11,318
Selling and marketing expenses	51,037	54,920
Administrative expenses	28,653	34,208
Operating profit (loss) before share benefit charges	17,310	(3,538)
Charges in respect of shares granted to employees on IPO		15,087
Charges in respect of share and option awards	8,829	2,147
Total share benefit charges	8,829	17,234
Operating profit (loss)	8,481	(20,772)
Finance income	4,883	735
Profit (loss) before tax	13,364	(20,037)

Consolidated Income Statement for discontinuing operations
The year ended 31 December 2006

	Year ended 31 December 2006	Year ended 31 December 2005
	US\$ 000	US\$ 000
Discontinuing operation		
Net Gaming Revenue	132,907	148,049
Operating expenses	28,086	29,652
Research and development expenses		
Selling and marketing expenses	33,283	45,089
Administrative expenses	7,284	3,120
Operating profit (loss) before reorganization cost	68,287	70,188
Charges in respect of reorganization cost	4,033	
Operating profit (loss)	64,254	70,188
Finance income		
Profit (loss) before tax	64,254	70,188

Consolidated Balance Sheet for continuing operations
The year ended 31 December 2006

	31 December 2006	31 December 2005
	US\$ 000	US\$ 000
Assets		
Non-current assets		
Intangible assets		
Property, plant and equipment	13,033	8,341
Deferred taxes	546	361
	13,579	8,702
Current assets		
Cash and cash equivalents	114,356	62,202
Trade and other receivables	9,669	15,013
Amounts due from related parties		1,649
	124,025	78,864
Total assets	137,604	87,566
Equity and liabilities		
Equity attributable to equity holders of the parent		
Share capital	3,073	3,068
Share benefit reserve	9,332	2,147
Retained earnings	74,597	27,115
Total equity attributable to equity holders of the parent	87,002	32,330
Liabilities		
Current liabilities		
Trade and other payables	27,931	25,593
Member deposits	22,671	29,325
Amounts due to related parties		318
Total liabilities	50,602	55,236
Total equity and liabilities	137,604	87,566

Consolidated Balance Sheet for discontinuing operations
The year ended 31 December 2006

	31 December 2006	31 December 2005
	US\$ 000	US\$ 000
Assets		
Non-current assets		
Investment in subsidiaries	2,143	2,130
Current assets		
Cash and cash equivalents	49,300	40,466
Trade and other receivables	99,807	36,531
	149,107	76,997

Total assets	151,250	79,127
Equity and liabilities		
Equity attributable to equity holders of the parent		
Share capital	3,073	3,068
Share benefit reserve	9,332	2,147
Retained earnings	7,531	21,900
Total equity	19,936	27,115
Liabilities		
Current liabilities		
Trade and other payables	131,314	51,748
Amounts due to shareholders		264
Total liabilities	131,314	52,012
Total equity and liabilities	151,250	79,127