

The Group's principal performance indicators are highlighted on the inside front cover of this document. EBITDA was £506 million for the year ended 31 December 2007 compared to £583 million in 2006. The business and financial review includes further explanation and commentary in relation to our principal performance indicators and the results for the year.

Results of operations

Total revenue for the year ended 31 December 2007 was £1,247 million compared to £1,387 million in 2006. Power sales were £1,204 million for the year ended 31 December 2007 compared to £1,327 million in 2006, reflecting a fall in our average achieved electricity price (see Price of electricity) and a reduction in net power sold to 24.9TWh, compared to 25.2TWh in 2006.

In addition to power sales, total revenue also includes income from the provision of ancillary services, the sale of by-products (ash and gypsum), and the sale of ROCs, LECs and sulphur dioxide ("SO₂") emissions allowances. In the year ended 31 December 2007, these revenues were £43 million compared to £60 million in 2006, reflecting the timing of ROC sales, partially offset by higher ancillary services income. Although we burnt more biomass in 2007 compared to 2006, a proportion of the associated ROC sales will not be made until 2008, which has resulted in a reduction in ROC revenues in 2007 when compared to 2006.

Fuel costs in respect of generation during the year ended 31 December 2007 were £471 million, compared to £548 million in 2006. The decrease was primarily due to the impact of lower prices for CO₂ emissions allowances and lower generation, partially offset by an increase in the cost of coal and other fuels (see Price of coal and other fuels and CO₂ emissions allowances).

We purchase power in the market when the cost of power in the market is below our marginal costs of production in respect of power previously contracted for generation and delivery by us, and to cover any shortfall in generation. The costs of power purchased are treated as fuel costs. For the year ended 31 December 2007, the cost of purchased power decreased to £76 million compared to £94 million in 2006, primarily due to lower market prices for electricity.

Gross profit for the year ended 31 December 2007 was therefore £701 million compared to £746 million in 2006.

Other operating expenses excluding depreciation, amortisation, unrealised gains on derivative contracts and exceptional items were £196 million for the year ended 31 December 2007 compared to £163 million in 2006. The increase of £33 million includes significantly higher maintenance costs, with two units undergoing a major planned outage in 2007 compared to just one unit in 2006. We also experienced an increase in business interruption insurance costs due to higher margins in 2006 and the first six months of 2007, and we have significantly increased our expenditure on site security following the Camp for Climate Action in August 2006. We also incurred higher grid connection and use of system charges ("TNUoS").



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Results of operations

	Year ended 31 December 2007 £m	Year ended 31 December 2006 £m
Continuing operations		
Total revenue	1,247.4	1,387.0
Fuel costs⁽¹⁾		
Fuel costs in respect of generation	(470.6)	(547.5)
Costs of power purchases	(75.5)	(93.8)
	(546.1)	(641.3)
Gross profit	701.3	745.7
Other operating expenses excluding depreciation, amortisation, unrealised gains on derivative contracts and exceptional items ⁽²⁾	(195.7)	(162.7)
EBITDA⁽³⁾	505.6	583.0
Depreciation and amortisation	(43.7)	(34.9)
Other operating income - exceptional credit	6.2	19.0
Unrealised gains on derivative contracts	3.3	90.8
Operating profit	471.4	657.9
Interest payable and similar charges	(34.3)	(37.1)
Interest receivable	11.4	13.4
Profit before tax	448.5	634.2
Tax charge		
- Before impact of reduction in tax rate on deferred tax	(113.4)	(170.7)
- Impact of reduction in tax rate on deferred tax	17.9	-
	(95.5)	(170.7)
Profit for the year attributable to equity shareholders	353.0	463.5
Earnings per share⁽⁴⁾	Pence per share	Pence per share
- Basic and diluted	99	116

Notes:

- (1) Fuel costs comprise the fuel costs incurred in the generation process, predominantly coal and CO₂ emissions allowances, together with oil and biomass. Fuel costs also include the cost of power purchased to meet power sales commitments.
- (2) Other operating expenses excluding depreciation, amortisation, unrealised gains on derivative contracts and exceptional items principally include salaries, maintenance costs, grid connection and use of system charges ("TNUoS"), balancing services use of system charges ("BSUoS") and business rates.
- (3) EBITDA is defined as profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains on derivative contracts.
- (4) During the year the Group has amended the calculation of earnings per share to reflect share consolidations associated with special dividends from the date of the consolidation only. Comparatives have been amended accordingly (see note 9 to the consolidated financial statements).

Increased operating expenses also includes a one-time payment of £3 million made in April 2007 (equating to £5,000 per eligible employee) in order to secure a two-year pay agreement with trades unions, following expiry of the previous two-year pay agreement. The pay award recognised the importance of retaining a skilled workforce at a time of competition for those skills locally and in the workplace at large, and recognised that in a number of areas Drax had fallen behind market rates. In addition, our average monthly headcount increased to 658 in 2007 compared to 619 in 2006, primarily as a result of planned investments in the business.

EBITDA (defined as profit before interest, tax, depreciation, amortisation, exceptional items and unrealised gains on derivative contracts) for the year ended 31 December 2007 was accordingly £506 million compared to £583 million in 2006.

Depreciation and amortisation for the year ended 31 December 2007 was £44 million compared to £35 million in 2006. The increase primarily reflected accelerated depreciation of plant and equipment we expect to replace under our capital expenditure investment programme.

Exceptional operating income of £6 million for the year ended 31 December 2007 related to our final distribution under the TXU Claim received in April 2007, bringing the total received to date to £336 million, representing full recovery of the claim. Income recognised under the claim in the year ended 31 December 2006 amounted to £19 million. All amounts are net of VAT and costs, with proceeds used to prepay debt secured against the claim, which has now been repaid in full.

The Group recognises unrealised gains and losses on forward contracts which meet the definition of derivatives under IAS 32, IAS 39 and IFRS 7, the International Accounting Standards in respect of derivatives and financial instruments. The unrealised gains and losses principally relate to the mark-to-market of our forward contracts for power yet to be delivered.

Unrealised gains on derivative contracts recorded in the income statements were £3 million for the year ended 31 December 2007 compared to £91 million in 2006. The unrealised gains primarily represent the unwinding of unrealised losses originally reflected in the income statement in 2005, prior to the Group implementing hedge accounting under IAS 39, as power was delivered in accordance with underlying derivative contracts.

Mark-to-market movements on a large proportion of our commodity contracts, considered to be effective hedges under IAS 39, have been recognised through the hedge reserve, a component of shareholders' equity in the balance sheet. The unrealised losses recognised through the hedge reserve in the year ended 31 December 2007 were £584 million compared to unrealised gains of £468 million in 2006.

Gross profit £m	
2004	239
2005	389
2006	746
2007	701

EBITDA £m	
2004	90
2005	239
2006	583
2007	506

£506 million

EBITDA reflects lower gross margin and increased operating expenses. Operating expenses reflect higher outage costs, as a result of a double outage year, increased insurance costs, significant expenditure on site security, higher transmission system charges and a payment to employees to secure a two-year pay agreement in recognition of the value of retaining a skilled workforce.

Movements between the balance sheet position reported at 31 December 2007 and 31 December 2006 are mainly the result of unwinding mark-to-market movements relating to power delivered during 2007, and recording mark-to-market movements on power yet to be delivered. As a consequence of the decline in power prices over the last six months of 2006, the average price relating to power which had been contracted but had yet to be delivered at 31 December 2006 was significantly higher than market prices at that time, resulting in the recognition of a net unrealised gain of £344 million in the balance sheet. By comparison, following increases in power prices over the last quarter of 2007, the average price relating to power which had been contracted but had yet to be delivered at 31 December 2007 was lower than market prices at that time, resulting in the recognition of a net unrealised loss of £237 million in the balance sheet.

Operating profit for the year ended 31 December 2007 was £471 million compared to £658 million in 2006.

Interest payable and similar charges for the year ended 31 December 2007 were £34 million compared to £37 million in 2006, as a result of lower debt levels partially offset by the impact of higher interest rates.

The tax charge for the year ended 31 December 2007 was £96 million, compared to £171 million in 2006. The tax charge for 2007 includes a one-off credit of £18 million to reflect the impact on deferred tax of a reduction in the rate of UK corporation tax from 30% to 28% with effect from 1 April 2008.

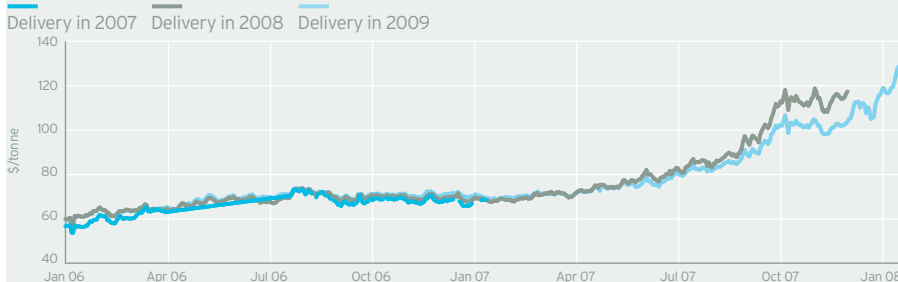
Reflecting the above factors, profit attributable to equity shareholders for the year ended 31 December 2007 was £353 million compared to £464 million in 2006, and basic and diluted earnings per share was 99 pence compared to 116 pence in 2006, as calculated in accordance with note 9 to the consolidated financial statements.

Forward power price



Source: Brokered Trades, Prebon, Spectron, ICAP, GFI

Forward coal price (API2)



Source: McCloskey

Key factors affecting the business

Price of electricity

The table below shows the average achieved electricity price realised for the years ended 31 December 2006 and 31 December 2007, together with the market closing price on the last day each season illustrated was traded as a product.

	Year ended 31 December 2007	Year ended 31 December 2006
Average achieved price (£/MWh)	45.3	48.9
	2007	2006
Summer baseload market close (£/MWh)	23.0	45.5
	2007/2008	2006/2007
Winter baseload market close (£/MWh)	40.4	51.7

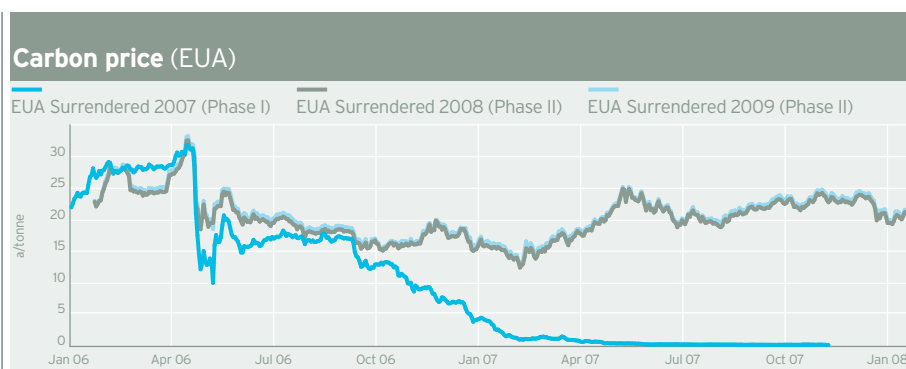
Average achieved price for the year ended 31 December 2007 was £45.3 per MWh compared to £48.9 per MWh in 2006. Average capture price (being the price attained prior to Balancing Mechanism activity) for the year ended 31 December 2007 was £44.2 per MWh compared to £47.7 per MWh in 2006. The forward baseload power prices for Summer 2008 and Winter 2008/2009 were approximately £54.2 per MWh and £61.2 per MWh respectively as at 22 February 2008.

The fall in average achieved price primarily reflected the impact from forward sales contracts secured in the last six months of 2006 and early in 2007, during which time power prices were generally falling relative to the levels of late 2005 and early 2006, for power now delivered in 2007.

Price of coal and other fuels

We burnt approximately 9.8 million tonnes of coal in the year ended 31 December 2007 compared to approximately 10.2 million tonnes in 2006. This coal was purchased from a variety of domestic and international sources under either fixed or variable priced contracts with different maturities.

Spot prices for internationally traded coal delivered into North West Europe (as reflected by the TFS API 2 index) rose steadily from US\$68 per tonne on 31 December 2006 to US\$79 per tonne by 30 June 2007, but then increased dramatically over the last six months of the year reaching US\$127 per tonne on 31 December 2007. This reflected tight markets for both coal and freight, especially in the Pacific Basin, caused by strong demand from China and India, combined with some production and logistical issues in Indonesia and Australia.



Source: Bloomberg

We also burn biomass, petcoke and fuel oil, although coal comprised around 95% of total fuel costs in 2007 (excluding CO₂ emissions allowances) compared to 93% in 2006, primarily reflecting higher coal prices in 2007. The average cost of fuel per MWh (excluding CO₂ emissions allowances) for the year ended 31 December 2007 was £18.5 compared to £17.1 in 2006, with coal prices continuing to rise throughout the year.

CO₂ emissions allowances

Our CO₂ emissions allowances requirement for the year ended 31 December 2007, in excess of those allocated under the UK NAP, was approximately 7.6 million tonnes compared to approximately 8.2 million tonnes in 2006, with the reduction largely due to lower generation.

The price for Phase I (2005-2007) CO₂ emissions allowances began the year at approximately €6.6 per tonne, and as a result of oversupply, fell steadily over the first six months of the year to €0.13 per tonne on 30 June 2007, subsequently falling away further to €0.04 per tonne by 31 December 2007. The average price expended for CO₂ emissions allowances during the year ended 31 December 2007 was £1.5 per tonne compared to £14.3 per tonne in 2006.

Outages and plant utilisation levels

	Year ended 31 December 2007	Year ended 31 December 2006
Winter forced outage rate (%)	4.2	4.7
Forced outage rate (%)	6.9	5.8
Planned outage rate (%)	8.1	4.8
Total outage rate ⁽¹⁾ (%)	14.3	10.4
Availability (%)	85.7	89.6
Electrical output (net sales) (TWh)	24.9	25.2
Load factor (%)	75.0	75.9

Notes:

(1) The forced outage rate is expressed as a percentage of planned capacity available (that is, it includes a reduction for planned losses). The planned outage rate is expressed as a percentage of registered capacity. Accordingly, the aggregation of the forced outage rate and planned outage rate will not equate to the total outage rate.

Plant availability in the year ended 31 December 2007 was 86% compared to 90% in 2006, primarily as a result of an increase in the planned outage rate with two major planned outages taking place in 2007 compared to one in 2006.

Our maintenance regime includes a major planned outage for each unit every four years. Consequently, there is an irregular pattern to planned outages and associated expenditure, since in two of the four years; two units will each undergo a major planned outage. Two major planned outages (units 2 and 3) were completed during 2007, whereas one major planned outage (unit 4) took place during 2006. The planned outage rate achieved for the year ended 31 December 2007 was 8.1% compared to 4.8% in 2006. Two units will each undergo a major planned outage in 2008.

The Winter forced outage rate in 2007 was 4.2% (4.7% in 2006). The forced outage rate for the full year was 6.9% (5.8% in 2006), of which approximately 0.8% was due to a decision to undertake a number of elective forced outages during low margin periods to inspect boiler tubes following a tube failure at an older UK coal-fired power station.

These outages also allowed additional plant inspections and repair work to be undertaken which have provided us with a high degree of confidence in maintaining plant integrity.

We have targeted improvements in forced outage rates by focusing on preventing minor predictable failures and seeking to avoid major failures by using historical Drax operating data together with original equipment manufacturer and industry experience. We believe further progress can be made in both areas and will continue the programmes to improve performance, with the objective of achieving a sustainable average Winter forced outage rate of 4.5%.

Health and safety

The lost time injury rate was 0.34 for the year ended 31 December 2007 compared to 0.08 in 2006. Although this represents a deterioration, we maintained the much improved performance levels achieved in 2005, despite a 53% increase in hours worked by our production teams and contractors in 2007 compared to 2005. This demonstrates that the safety programmes implemented in the last few years are becoming well entrenched and are delivering sound performance, and our safety record compares favourably to our sector peers and international benchmarks.

Liquidity and capital resources

Net debt was £337 million as at 31 December 2007 compared to £321 million at 31 December 2006.

Cash and cash equivalents were £60 million as at 31 December 2007 compared to £155 million at 31 December 2006. The changes in cash and cash equivalents are analysed in the following table.

Analysis of cash flows

	Year ended 31 December 2007	Year ended 31 December 2006
Net cash generated from operating activities	312.8	525.1
Net cash used in investing activities	(67.8)	(27.0)
Net cash used in financing activities	(340.1)	(431.1)
Net (decrease)/increase in cash and cash equivalents	(95.1)	67.0

Net cash generated from operating activities was £313 million in the year ended 31 December 2007 compared to £525 million in 2006. The decrease reflected a reduction of £77 million in EBITDA in 2007, lower cash received under the TXU Claim (£6 million cash received under the claim in the year ended 31 December 2007 compared to £74 million in 2006), an increase of £55 million in income taxes paid and increased working capital utilisation in 2007, including a higher coal stock build and a significantly lower liability with respect to CO₂ emissions allowances.

Net cash used in investing activities, which represented payments in respect of capital expenditure in both periods, was £68 million for the year ended 31 December 2007 compared to £27 million in 2006 (see Capital expenditure).

Net cash used in financing activities was £340 million in the year ended 31 December 2007 compared to £431 million in 2006. The 2007 amounts included equity dividends paid of £171 million and payments under the share buy-back programme of £84 million (inclusive of all expenses), together representing returns to shareholders totalling £255 million. Also included were term loan repayments of £40 million in June 2007 and £40 million in December 2007, the final bridge loan prepayment of £3 million, and purchases of our own shares to meet commitments under share-based incentive plans of £2 million. The 2006 amounts included new debt raised of £100 million, offset by equity dividends paid of £342 million, term loan repayments of £58 million in June 2006 and £58 million in December 2006 and bridge loan prepayments of £55 million and £19 million in January and July 2006 respectively.

The decrease in cash and cash equivalents was therefore £95 million in the year ended 31 December 2007, compared to an increase of £67 million in 2006. Drax's policy is to invest available cash in short-term bank, building society or other low risk deposits.

Capital resources and refinancing

Since listing in December 2005, senior secured debt has fallen from £500 million to £405 million at 31 December 2007 (both before deferred financing costs), through a combination of scheduled debt repayments and the raising of additional secured debt. Scheduled debt repayments for 2008 are £35 million.

The Board continues to monitor developments in the debt markets and is committed to maintaining balance sheet efficiency. In September 2007, the Board announced its intention to undertake a refinancing of the Group's current debt facilities (subject to market conditions). As a result of continuing turbulence in the debt markets the Board decided to postpone the refinancing until such time as it judges market conditions have improved and the Group will be able to secure more attractive terms.

Seasonality of borrowing

Our business is seasonal with higher electricity prices and despatch in the Winter period and lower despatch in the Summer months, when prices are lower and plant availability is affected by planned outages. Accordingly, cash flow during the Summer months is materially reduced due to the combined effect of lower prices and output, while maintenance expenditures are increased during this period due to major planned outages. The Group's £100 million revolving credit facility assists in managing the cash low points in the cycle where required. The revolving credit facility was undrawn at 31 December 2007.

Contractual commitments

The following table illustrates our contractual obligations, excluding interest, as they fall due as at 31 December 2007.

	Total £m	Payments due by period			
		2008 £m	2009 £m	2010 £m	2011-2014 £m
Debt	405.0	10.0	15.0	380.0	-
Fuel purchases	996.5	461.7	293.6	124.3	116.9
Contracted capital expenditure	94.8	33.3	26.6	20.3	14.6
Support contract payments	45.6	29.6	9.1	4.5	2.4
Total	1,541.9	534.6	344.3	529.1	133.9

Capital expenditure

At the turn of the year we announced that we expected to incur total capital expenditure of approximately £260 million over the three years 2007 to 2009. Of this, around £150 million specifically related to the turbines upgrade project, condenser and feed system plant improvements and investments in extending our biomass capability. The remainder comprised smaller value enhancing investments and other expected capital expenditure in support of current operations. Following capital expenditure of £83 million in 2007, we remain on track to achieve this target.

We now expect to incur capital expenditure of approximately £250 million over the three years 2008 to 2010, of which around £150 million specifically relates to the turbines upgrade project and investments in extending our biomass capability. We plan to fund this capital expenditure investment programme from a combination of operational cash flows and debt.

In relation to the turbines upgrade project, we expect to invest up to £100 million over a five year period, including approximately £70 million over the three years 2008 to 2010, to upgrade the high pressure and low pressure turbine modules on all six generating units to improve efficiency. Using proven technology we expect to achieve an overall baseload efficiency (that is, the ratio of energy out to energy in when operating at full capacity) approaching 40%. This represents a 5% improvement on current baseload efficiency of around 38%. When complete, the project is expected to deliver annual savings of one million tonnes of CO₂ emissions allowances and approximately half a million tonnes of coal.

Installation, which is being undertaken during the planned outage programme, commenced in the third quarter of 2007, when we were able to fast track the upgrade of a high pressure turbine module on one of our units. The early start to the programme enabled valuable engineering experience to be gained, along with some modest efficiency gains, ahead of the upgrade of two high pressure and six low pressure turbines during the major outages on two of our generating units planned for 2008.

With regard to extending our biomass capability, we expect to invest around £80 million to meet our target to produce 10% of our output from burning biomass by the end of 2009. The largest single investment included in the £80 million programme relates to extending our direct injection capability from one generating unit to all six generating units, and to install the necessary processing and handling infrastructure to ensure we are able to handle up to one and a half million tonnes of biomass material per annum. In addition, we expect to make investments in off site processing facilities.

Achievement of the 10% target is expected to result in savings of over two million tonnes of CO₂ emissions allowances, the displacement of approximately one million tonnes of coal and the generation of in excess of two and a half million ROCs per annum. Our dedicated renewables co-firing project team have made good progress in finalising the design of the new biomass handling and direct injection facilities required to meet our 10% co-firing objective.

In February 2008, we were granted planning approval by Selby District Council for the new facilities. Following a competitive tender process, we are on schedule to execute Engineering, Procurement and Construction contracts for the co-firing facilities in the second quarter of 2008, with building works commencing in the second half of 2008. The facilities will come on line during the course of 2009 with full completion being at the end of 2009 in line with our target.

In addition, we will continue to evaluate other investment opportunities which may result in additional capital expenditure. Further investment will be required beyond 2009 and prior to 2016 to meet the requirements of the LCPD.

Share-based incentive plans

Costs charged in the income statement in relation to share-based payments were £3.1 million in the year ended 31 December 2007, compared to £1.7 million in 2006.

Under the 2007 SIP Free share award, the Company purchased a total of 195,810 shares in April 2007 to be held in trust on behalf of qualifying employees, equating to 305 shares with a cash value of approximately £2,500 per employee based on the Company's share price at the time of the award. The fair value of the 2007 Free share award (determined at the award date) of £1.6 million was charged to the income statement in full in the year ended 31 December 2007, on the basis that employees were granted specific rights in relation to shares held in trust on their behalf. Similarly, the fair value of the 2006 Free share award of £1.3 million was charged to the income statement in full in the year ended 31 December 2006.

In March 2007, the SIP was extended by introducing two further elements: Partnership shares and Matching shares. Qualifying employees can buy up to £1,500 worth (subject to an overriding maximum of 10% of salary) of Partnership shares (out of pre-tax pay) in any one tax year. Matching shares are awarded to employees to match any Partnership shares they buy. Under the Drax SIP the ratio is one to one for the 2007/2008 tax year, with the cost of Matching shares borne by the Group. As at 31 December 2007, a total of 104,367 Matching shares had been purchased and were held in trust on behalf of qualifying employees. The fair value of Matching shares awarded up to 31 December 2007 (determined at the award dates) of £0.8 million is being charged to the income statement on a straight-line basis over a one-year vesting period (Matching shares are forfeited if an employee leaves Drax within one year of the award).

Share-based incentive plans



Two further elements were introduced to the SIP enabling employees to buy Partnership shares which are matched by the Group.

ESIP awards over 361,582 shares were granted to executive directors and other senior staff in 2007, with performance measured over the three years to 31 December 2009 and potential vesting in April 2010. The fair value of the 2007 ESIP awards (determined at the grant date) of £0.9 million, which takes into account the estimated probability of different levels of vesting, is being charged to the income statement on a straight-line basis over the three-year vesting period to 19 April 2010. Similarly, the fair value of the 2006 ESIP award of £1.9 million is being charged to the income statement on a straight-line basis over the three-year vesting period to 19 September 2009.

There have been no further offers under the SAYE Plan since that made in July 2006. No shares have been issued or purchased to date with respect to the SAYE or ESIP.

Taxation

In December 2007, HM Revenue & Customs issued a consultation document entitled "Principles based approach to financial products avoidance: a consultation document" which is expected to lead to the introduction of new legislation concerning "disguised interest" from 1 April 2008.

It is thought likely that the new rules, if introduced in the form currently envisaged, could adversely impact the future tax efficiency of the Group's existing financing structure. Until the consultation process is completed and the legislation drafted, however, it is not possible to predict with any certainty how the proposed legislation, if and when enacted, might affect the Group tax rate, and the Group is therefore keeping the situation under review.

Critical accounting policies

Note 3(B) to note 3(N) to the Group's consolidated financial statements on pages 60 to 63 include a summary of the significant accounting principles and policies used in the preparation of our financial statements.

The preparation of financial statements, in conformity with generally accepted IFRS accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the financial statements and notes to the financial statements. Actual results may differ from these estimates.

Certain accounting policies have been identified as the most critical accounting policies by considering which policies involve particularly complex or subjective decisions or assessments and these are discussed below.

Fixed assets and depreciation

Estimated useful lives and residual values are reviewed annually, taking into account prices prevailing at each balance sheet date. The carrying values of fixed assets are also reviewed for impairment where there has been a trigger event (that is, an event which may have resulted in an impairment) by assessing the present value of estimated future cash flows and net realisable value compared to net book value. The calculation of estimated future cash flows and residual values is based on our reasonable estimates of future prices, output and costs, and is, therefore, subjective.

Pensions

The Group operates an approved defined benefit scheme. We account for this scheme in accordance with IAS 19 "Employee benefits" with the cost of providing benefits determined using the projected unit credit method, and actuarial valuations being carried out at each balance sheet date. Inherent in these valuations are key assumptions, including discount rates, expected returns on plan assets, salary and pension increases and mortality rates. These actuarial assumptions are reviewed annually and modified as appropriate. We believe that the assumptions utilised in recording obligations under the scheme are reasonable based on prior experience, market conditions and the advice of scheme actuaries. However, actual results may differ from such assumptions.

Taxation

In accounting for taxation we make assumptions regarding the treatment of items of income and expenditure for tax purposes. We believe that these assumptions are reasonable based on prior experience and consultation with our advisers.

Full provision is made for deferred taxation, as required under IAS 12 "Income taxes", at the rates of tax prevailing at the period end dates unless future rates have been substantively enacted. Deferred tax assets are recognised where it is considered more likely than not that they will be recovered.

Derivatives

The Group applies IFRS 7 "Financial instruments: disclosure", IAS 32 "Financial instruments: disclosure and presentation" and IAS 39 "Financial instruments: recognition and measurement". IAS 39 requires derivative financial instruments to be recorded in the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in earnings unless specific hedge accounting criteria are met.

The fair values of derivative instruments for commodities are determined using forward price curves. Forward price curves represent our estimates of the prices at which a buyer or seller could contract today for delivery or settlement of a commodity at future dates. We generally base forward price curves upon readily obtainable market price quotations, as our commodity contracts do not generally extend beyond the actively traded portion of these curves. However, the forward price curves used are only an estimate of how future prices will move and are, therefore, subjective.

Market risks and treasury policies

We manage the commercial risks faced by the Group in accordance with policies approved by the Board.

Commodity risk

We are exposed to the effect of fluctuations in commodity prices, particularly the price of electricity, the price of coal (and other fuels) and the price of CO₂ emissions allowances.

Price variations and market cycles have historically influenced our financial results and are expected to continue to do so.

We have a policy of making forward sales of power when profitable compared to marginal costs of fuel and CO₂ emissions allowances.

We purchase coal under either fixed or variable priced contracts with different maturities from a variety of domestic and international sources. We purchase CO₂ emissions allowances under fixed price contracts with different maturity dates from a variety of domestic and international sources.

Counterparty risk

As we rely on third party suppliers for the delivery of coal and other goods and services, we are exposed to the risk of non-performance by these third party suppliers.

We purchase a significant portion of our coal requirement under contracts with a number of UK suppliers. There is a risk that if a large supplier falls into financial difficulty and/or fails to deliver against the contracts, there would be additional costs associated with securing coal from other suppliers.

We enter into fixed price and fixed margin contracts for the sale of electricity to a number of counterparties. The failure of one or more of these counterparties to perform their contractual obligations may cause us financial distress or increase our risk profile.

The investment of surplus cash is undertaken to maximise the return within Board approved policies. These policies set out minimum rating requirements, maximum investment with any one counterparty and the maturity profile.

Interest rate risk

We are exposed to interest rate risk principally in relation to our outstanding bank debt. In particular, we are exposed to changes in the LIBOR interest rate of sterling denominated debt, as substantially all of our debt is both denominated in sterling and has a variable LIBOR rate. We mitigate this risk with interest rate hedges on a proportion of our debt facilities.

Foreign currency risk

Foreign currency exchange contracts are principally entered into to hedge substantially all of our fixed price international coal purchases in US dollars, and our CO₂ emissions allowances purchases in euros.

EBITDA forecast for the year ended 31 December 2007 and closing cash position guidance

We issued a Trading Update on 18 December 2007 which reported our contracted position for 2007, 2008 and 2009 in respect of power, coal and CO₂ emissions allowances. In addition, we reported management's expectation that EBITDA for the year ended 31 December 2007 would be around £500 million and that the cash position as at 31 December 2007 would be in the range £55 million to £60 million (together the "Forecast"). EBITDA was defined as profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains on derivative contracts.

In arriving at the Forecast, we took account of market prices as of 11 December 2007 for the uncontracted portion of power sales, and coal and CO₂ emissions allowances purchases for the period to 31 December 2007. The Forecast also assumed that there would be no significant unplanned outages for the period to 31 December 2007.

Reported EBITDA of £506 million includes the impact on gross margin of a small improvement in dark green spreads between 11 December 2007 and 31 December 2007. The reported cash position as at 31 December 2007 was £60 million.

Contracted position for 2008, 2009 and 2010

Since issuing the Trading Update on 18 December 2007, we have continued to trade in line with expectations and to follow our stated trading strategy of making steady forward power sales with corresponding purchases of CO₂ emissions allowances and coal purchases. Our aim is to deliver market level or better dark green spreads across all traded market periods and, as part of this strategy, we retain power to be sold into the prompt (within season) power markets.

As at 22 February 2008, the contracted position for 2008, 2009 and 2010 was as follows:

	2008	2009	2010
Power sales (TWh) comprising:	20.5	15.4	10.4
- Fixed price power sales (TWh) at an average achieved price (per MWh)	16.0 at £47.9	10.1 at £43.0	5.1 at £45.3
- Fixed margin power sales (TWh)	4.5	5.3	5.3
CO ₂ emissions allowances hedged, including UK NAP allocation, market purchases, structured contracts, and benefit of biomass co-firing (TWh equivalent)	20.5	15.1	18.0
Solid fuel at fixed price/hedged, including structured contracts (TWh equivalent)	22.2	16.6	12.1

Fixed price power sales include approximately 0.8TWh supplied to Centrica in the period 1 January 2008 to 22 February 2008 under the five-and-a-quarter year baseload contract with Centrica which commenced on 1 October 2007.

Fixed margin power sales include approximately 4.5TWh in 2008 and 5.3TWh in each of 2009 and 2010 in connection with the contract. Under this contract the Group will supply power on terms which include Centrica paying for coal, based on international coal prices, and delivering matching CO₂ emissions allowances amounting to approximately 4.8 million tonnes per annum. The contract provides the Group with a series of fixed dark green spreads which were agreed in the first quarter of 2006.

We will provide the next update on our contracted position in our Interim Management Statement which is expected to be issued on 19 May 2008.

Distributions

Distribution policy

The Board has previously stated that the Group will pay a stable amount (£50 million) by way of ordinary dividends each year (the base dividend) subject to availability of cash and appropriate reserves. In addition to the base dividend, the Board has also previously stated that substantially all of any remaining cash flow, subject to the availability of reserves and after making provision for debt payments, debt service requirements (if any), capital expenditure and other expected business requirements, will be distributed to shareholders.

Dividends paid

On 7 March 2007, the Board resolved to pay a final dividend for the year ended 31 December 2006 of 9.1 pence per share (equivalent to £34 million). Also on 7 March 2007, the Board resolved, subject to the approval by shareholders of a resolution to effect a share consolidation considered at the Annual General Meeting on 26 April 2007, to pay a further interim dividend as a special dividend of 32.9 pence per share (equivalent to £121 million). The share consolidation, under which shareholders received 64 new ordinary shares of 11 ¹⁶/₂₉ pence each for every 67 existing ordinary shares of 11 ¹⁶/₂₉ pence, became effective on 30 April 2007. These final and special dividends were subsequently paid on 16 May 2007.

On 5 September 2007, the Board resolved to pay an interim dividend for the six months ended 30 June 2007 of 4.7 pence per share (equivalent to approximately £16 million). This interim dividend was subsequently paid on 24 October 2007.

Special distribution - share buy-back programme (completed)

On 5 September 2007, the Board resolved to make a special distribution of approximately £83 million to be undertaken through the introduction of a share buy-back programme. The buy-back programme represented approximately 3.5% of the Company's issued capital as of 6 September 2007. The programme was completed between 7 September 2007 and 13 December 2007, and resulted in the repurchase and cancellation of 13,005,304 ordinary shares for an aggregate consideration (inclusive of all expenses) of £83.5 million.

Dividends proposed

At the forthcoming Annual General Meeting the Board is recommending to shareholders that a resolution is passed to approve payment of a final dividend for the year ended 31 December 2007 of 9.9 pence per share (equivalent to £33.6 million) payable on or before 7 May 2008. Shares will be marked ex-final dividend on 16 April 2008.

The Board has declared a further interim dividend (payable as a special dividend) of 7.8 pence per share (equivalent to £26.5 million), also payable on or before 7 May 2008. Shares will be marked ex-special dividend on 16 April 2008.

This review was approved by the Board on 3 March 2008.

Gordon Boyd
Finance Director
3 March 2008

