

Directors' report

The directors present their report for Drax Group plc, together with the Consolidated accounts of the Drax group of companies, for the year ended 31 December 2007.

Annual General Meeting

The third Annual General Meeting ("AGM") of the Company will be held on 17 April 2008, at The City Presentation Centre, 4 Chiswell Street, London EC1Y 4UP at 11.00am. A separate document accompanying this report contains the notice convening the AGM and a description of the business to be conducted thereat.

Corporate governance

The Group is committed to high standards of corporate governance, details of which are given in this Directors' report and the Corporate governance, Audit Committee, Nominations Committee and Remuneration Committee reports set out on pages 38 to 53.

Business review

A review of the development and performance of the business of the Group during the year ended 31 December 2007, including the financial performance during the year, an analysis of the position of the Group at the end of the financial year, key performance indicators, a description of the principal risks and uncertainties facing the Group and forward looking statements can be found in the Chairman's introduction on page 2; the Business review on pages 4 to 31 which incorporates the Chief Executive's review, the Business and financial review and the Corporate and social responsibility review and the reports under the broad heading of Corporate governance as referred to above.

The purpose of this Annual Report is to provide information to members of the Company. It contains certain forward looking statements relating to the operations, performance and financial condition of the Group. By their nature these statements involve uncertainty since future events and circumstances can differ from those anticipated. Nothing in this Annual Report should be construed as a profit forecast.

Principal activities

Drax Group plc is the holding Company of the Drax group of companies. The principal activities of the Group are the generation and sale of electricity at the Drax Power Station, Selby, North Yorkshire and the sale of by-products of the electricity generation process. No acquisitions or disposals have been made by the Group during the year.

Results

The Group results for the year are shown in the Consolidated income statements on page 56.

Going concern

After making enquiries, the directors have a reasonable expectation that the Company and the Group as a whole will continue in operation for the foreseeable future. The directors are therefore content to adopt the going concern basis in preparing the accounts.

Risk identification, assessment and management

A summary of the Group's position regarding risk identification, assessment and management and use of financial instruments is contained in the Audit Committee report on pages 42 to 44 and also in the Business and financial review on pages 14 to 23.

Dividends

Details of the dividends paid and proposed on the ordinary share capital are shown below:

	2007 £m	2006 £m
Interim and final dividends		
Interim dividend paid on 24 October 2007 of 4.7 pence per share (25 October 2006: 4.0 pence per share)	16.3	16.3
Proposed final dividend to be paid on 7 May 2008 ⁽¹⁾ of 9.9 pence per share (16 May 2007: 9.1 pence per share)	33.6	33.6
Special dividends		
To be paid on 7 May 2008 of 7.8 pence per share (16 May 2007: 32.9 pence per share)	26.5	121.4
Paid on 25 October 2006 of 80.0 pence per share	-	325.7

Notes:

(1) Subject to approval by shareholders at the forthcoming AGM.

Share capital

The Company has only one class of equity shares, which are ordinary shares. There are no known restrictions on the voting rights of the ordinary shares.

At 1 January 2007, 368,921,151 ordinary shares of 11 ¹⁶/₂₉ pence each in the Company were in issue and at 31 December 2007, 339,397,000 ordinary shares of 11 ¹⁶/₂₉ pence each in the Company were in issue. The following details the changes to the share capital during the year.

Share consolidation

A circular to shareholders dated 20 March 2007, set out the details of a proposed share consolidation to replace every 67 existing ordinary shares of 11 ¹⁶/₂₉ pence each with 64 new ordinary shares of 11 ¹⁶/₂₉ pence each. The share consolidation was approved by shareholders at the AGM held on 26 April 2007.

On 17 April 2007, 11 ordinary shares of 11 ¹⁶/₂₉ pence each were issued in advance of the share consolidation in order to make the number of ordinary shares in issue divisible by 67 and thus make the share consolidation calculation exact.

On 30 April 2007, upon the share consolidation taking effect as described above, there were 352,402,304 ordinary shares of 11 ¹⁶/₂₉ pence each in issue.

Purchase and cancellation of shares

During the period 7 September 2007 to 13 December 2007, a total of 13,005,304 ordinary shares of 11 ¹⁶/₂₉ pence each, having a nominal value of £1.5 million were repurchased, representing 3.69% of the Company's issued capital as at 6 September 2007 (immediately prior to the share buy-back programme commencing). The aggregate consideration (inclusive of all expenses) paid for the shares was £83.5 million. All shares repurchased were cancelled.

Authority to purchase own shares

At the AGM of the Company held on 26 April 2007, shareholders resolved to authorise the Company to make market purchases of up to 10% of the issued ordinary share capital. At the forthcoming AGM, shareholders will be asked to renew this authority. Details are contained in the Notice of Meeting.

At the end of the period under review the authority granted at the AGM on 26 April 2007, remained valid in respect of 22,194,696 ordinary shares.

The Company held no Treasury shares during the year.

Details of the share capital as at 31 December 2007, and shares issued during the year, are given in note 20 on page 77.

Directors

The current directors, who were also directors throughout 2007, are Tim Barker, Charles Berry, Gordon Boyd, Jamie Dundas, Peter Emery, Mike Grasby, Gordon Horsfield and Dorothy Thompson. Biographical notes of the directors appear on pages 32 and 33. No other person served as a director or as an alternate director at any time during the year.

In accordance with the Company's Articles of Association, Tim Barker, Gordon Boyd and Peter Emery will retire by rotation at the forthcoming AGM and, being eligible, offer themselves for re-election. The evaluation of the Board described on page 40 concluded that each director offering himself for re-election continues to demonstrate commitment to their particular role and perform effectively. The re-election of each director is recommended by the Board. Details of the relevant terms of appointment and service agreements appear on page 50.

On 18 December 2007, the Company announced that Gordon Horsfield will retire as a non-executive director and Chairman of the Board at the conclusion of the AGM to be held on 17 April 2008. He will be succeeded as Chairman by Charles Berry, who is currently a non-executive director of the Company.

The rules relating to the appointment or replacement of directors are highlighted in the Corporate governance report on page 38.

Directors' report (continued)

Directors' interests, indemnity arrangements and other significant agreements

Other than a deed of indemnity between each director, the Company and each of its subsidiaries in respect of claims made and personal liability incurred as a result of the bona fide discharge of the director's responsibilities and a service contract between the executive directors and a Group company, or as noted in the Remuneration Committee report, no director had a material interest at any time during the year in any contract of significance with the Company or any of its subsidiary undertakings.

Mike Grasby is a director of Strategic Dimensions, an executive recruitment business which placed two senior managers with a Group company during the year. The total fees paid by the Group to the recruitment business for the services was £9,987. The interest was disclosed to the Board and was not considered to be material or to affect Mr Grasby's independence.

Details of directors' remuneration, service contracts and interests in the shares of the Company are set out in the Remuneration Committee report on pages 46 to 53.

There are no agreements between the Group and its directors or employees providing for compensation for loss of office or employment that occurs because of a takeover bid.

Under a £800 million credit facility agreement dated 27 October 2005 between, amongst others, Drax Finance Limited, Drax Power Limited and Barclays Bank PLC (as facility agent), on a change of control, if any lender requires, it may, by giving notice to Drax Finance Limited and the facility agent within 30 days of receiving notice from Drax Finance Limited that a change of control has occurred, cancel its commitments and require payment of its share of any outstanding amounts within three business days of such cancellation notice being given.

Under a £100 million credit facility dated 11 May 2006 between, amongst others, Drax Finance Limited and Lloyds TSB plc (as facility agent), on a change of control, if any lender so requires, it may, by giving notice to Drax Finance Limited and the facility agent within 30 days of receiving notice from Drax Finance Limited that a change of control has occurred, cancel its commitments and require payment of its share of any outstanding amounts within three business days of such cancellation notice being given.

Under the terms of both credit facility agreements, a "change of control" occurs if any person or group of persons acting in concert gains control of the Group.

There are no other significant agreements to which the Group is a party that take effect, alter or terminate upon a change of control of the Group following a takeover bid providing that the Group's credit rating is maintained.

Substantial shareholdings

As at 22 February 2008, the following shareholders had notified the Company that their holdings exceeded the appropriate disclosure thresholds:

	Number of ordinary shares held	% of the issued ordinary share capital held
Invesco plc	98,601,427	29.05
Morgan Stanley Investment Management Limited	23,593,818	6.95
Barclays plc	21,659,733	6.38
Ameriprise Financial Inc.	18,435,535	5.43
Legal & General Group plc	15,336,523	4.51
LloydsTSB Group Plc	13,547,668	3.99
Total shares held by substantial shareholders	191,174,704	56.31

Employees

The Group's statement on its employees is set out in the Corporate and social responsibility review on pages 24 to 31 and details of employee involvement through share participation are contained in the Remuneration Committee report on pages 46 to 53.

Shares awarded under the Group's Share Incentive Plan are registered in the name of the Trustee. Voting rights attached to those shares are at the direction of individual employee participants.

Drax uses a wide variety of communication methods in order to keep employees as informed as possible. For example, team briefings are held once a month where wide-ranging information is communicated throughout the organisation. In addition, plant-wide meetings are held on a regular basis and cover, inter alia, the financial and market factors affecting the performance of the Group.

It is the Group's policy to give full consideration to suitable applications for employment from people with disabilities. In the event of a member of staff becoming disabled every effort is made to ensure that their employment with the Group continues and that appropriate training and rehabilitation is provided. It is the policy of the Group that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of other employees.

The Group is committed to a policy of equal opportunities and ensures that country of origin, colour, gender, religious belief, sexual orientation, age or disability, are not barriers to working at Drax.

The Group provides a wide range of development opportunities to help employees develop the necessary skills, knowledge and experience to realise their performance potential.

Corporate and social responsibility

Details of the Group's corporate and social responsibility policy and operations are set out on pages 24 to 31. There are Group policies for environment, health and safety and human resources as well as a code of business ethics. The internal control processes described on pages 39, 43 and 44 take account of social, environmental and ethical risks.

Charitable donations

Drax Group has continued to support community initiatives and charitable causes. The total charitable donations made by the Group in the year were £73,754 (2006: £45,872). More information on the charitable donations made is contained within the Corporate and social responsibility review on page 30.

Political donations

No political donations were made in the UK or elsewhere during the year (2006: £nil). It is the Board's policy not to make donations to political organisations or for political causes.

The Corporate and social responsibility review explains that the Group's activities in the political sphere are aimed only at the promotion of its business interests. However, the definitions of EU political expenditure are broad and there is widespread doubt about the extent to which normal business activities, which might not be thought to be political expenditure in the usual sense, could be considered to be political expenditure within the meaning of the legislation. The Board wishes to avoid any inadvertent infringement of the legislation and is therefore seeking the authority of shareholders to incur expenditure, for the Company and its subsidiaries, for such purposes of £100,000 during the next 12 months. A resolution to that effect is contained within the Notice of Meeting for the AGM. The Board does not believe that the Group has incurred any political expenditure in the past year.

Creditor payment policy and practice

Terms of payment are agreed with suppliers when negotiating each transaction and the policy is to abide by those terms and pay creditors when sums owing fall due for payment, provided that the suppliers also comply with all relevant terms and conditions. Drax Group plc, the holding Company of the Group, has no trade creditors. In respect of Group activities, the amounts due to trade creditors at 31 December 2007, represented approximately 22 days of average daily purchases through the year (2006: 26 days).

Auditors and the disclosure of information to the auditors

So far as each person who was a director at the date of approving this report is aware, there is no relevant audit information, being information needed by the auditors in connection with preparing the report, of which the auditors are unaware. Having made enquiries of fellow directors and the Company's auditors, each director has taken all the steps that he/she is obliged to take as a director in order to make himself/herself aware of any relevant audit information and to establish that the auditors are aware of that information. This information is given and should be interpreted in accordance with the provisions of Section 234ZA of the Companies Act 1985.

In accordance with Section 385 of the Companies Act 1985, a resolution is to be proposed at the AGM for the reappointment of Deloitte & Touche LLP as auditors of the Company. A resolution will also be proposed authorising the directors to determine the auditors' remuneration. The Audit Committee reviews the appointment of the auditors, the auditors' effectiveness and relationship with the Group, including the level of audit and non-audit fees paid to the auditors. Further details on the work of the auditors and the Audit Committee are set out in the Audit Committee report on pages 42 to 44.

By order of the Board.

Philip Hudson
Company Secretary
3 March 2008



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Registered in England No. 5562053