

Drax Group plc

Annual report and accounts 2008



2008



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## Company profile

Drax is a power generation business operating principally in the commodity markets of power, coal, biomass and carbon.









We purchase coal, biomass and carbon allowances from both UK and international suppliers.

We currently generate around 7% of the UK's electricity and trade power in the electricity wholesale market of Great Britain.

Through the effective alignment of our trading, production and investment strategies we manage our exposure to commodity price risks, operate and maintain our generating facilities and pursue economic carbon abatement, all to deliver shareholder value.

We are embarking on a growth strategy for the business, with the intention of developing 900MW of dedicated biomass-fired power generating capacity and to add to the value of the business in future years.

## Principal performance indicators and summary of operational achievements during 2008

<p><b>Total revenue</b></p> <p><b>£1,753 million</b> (2007: £1,247 million)</p> <p> <a href="#">Read more: Page 12</a></p>	<p><b>Average achieved price of electricity</b></p> <p><b>£58.3 per MWh</b> (2007: £45.3 per MWh)</p> <p> <a href="#">Read more: Page 16</a></p>
<p><b>Net sales</b></p> <p><b>25.4TWh</b> (2007: 24.9TWh)</p> <p> <a href="#">Read more: Page 12</a></p>	<p><b>Gross profit<sup>(1)</sup></b></p> <p><b>£683 million</b> (2007: £701 million)</p> <p> <a href="#">Read more: Page 12</a></p>
<p><b>EBITDA<sup>(2)</sup></b></p> <p><b>£454 million</b> (2007: £506 million)</p> <p> <a href="#">Read more: Page 13</a></p>	<p><b>Health and safety (lost time injury rate)</b></p> <p><b>0.10</b> (2007: 0.34)</p> <p> <a href="#">Read more: Page 31</a></p>
<p><b>Plant availability<sup>(3)</sup></b></p> <p><b>86%</b> (2007: 86%)</p> <p> <a href="#">Read more: Page 16</a></p>	<p><b>Load factor</b></p> <p><b>76%</b> (2007: 75%)</p> <p> <a href="#">Read more: Page 17</a></p>

Notes:

(1) Gross profit is defined as total revenues less total fuel costs of £1,070 million (2007: £546 million).

(2) EBITDA is profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains on derivative contracts.

(3) In both 2007 and 2008, two units underwent major planned outages.

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## Chairman's introduction

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This is my first full year report to you as Chairman, and I am pleased to report that it has been a solid year for Drax, despite the fact that the commodity markets in which we operate have been highly volatile. Although we are reporting lower earnings than for 2007, reflecting a decrease in the margins captured for power sales as a consequence of commodity market movements, our earnings for 2008 have been in line with expectations. We report earnings (EBITDA) of £454 million for 2008, and the Board proposes a final dividend in respect of 2008 of 38.3 pence per share, equivalent to £130 million. This takes total dividend payments for 2008 to £180 million.



Since listing the Company at the end of 2005, we have worked hard to exploit the strategic and commercial value of Drax Power Station and to deliver additional value through fuel diversification and carbon abatement. Over these years, we have delivered value for our shareholders through a combination of efficient asset management, strong engineering and commodity trading capabilities, and effective project execution.

Building on this firm foundation and taking advantage of opportunities presented by a reducing generation capacity margin and the UK's requirement for significant, low carbon, renewable generation, we are now taking the next step in the development of the Group. In October 2008, we announced our intention to build a large scale, dedicated biomass generation business.

We believe our decision to pursue this biomass business growth strategy, is not only timely, but right for our investors. Our intention to develop 900MW of dedicated biomass-fired power generating capacity with our strategic partner, Siemens Project Ventures GmbH, is expected to add to the value of the business in future years.

In October 2008, when we announced our biomass growth strategy, we also announced a change to our distribution policy which would help fund that expansion. The Company will distribute excess cash generated from operations in 2008 and 2009 and then target a pay-out ratio of 50% of underlying earnings, adjusted for non-cash accounting items (principally accounting for unrealised gains and losses on derivative contracts), from 2010 onwards to complement the expected growth potential of the Group. Any net refinancing proceeds will be used to fund Drax's equity investment in the new biomass business.

Turning our attention to the membership of the Board. We were pleased to welcome Tony Quinlan as Finance Director on 1 September 2008.

Following a review of the composition of the Board at the start of the year, we decided to recruit another independent non-executive director. I am pleased to report that, David Lindsay joined the Board on 1 December 2008. In April 2009, David will become Chairman of the Audit Committee of the Board.

I believe that both Tony's and David's knowledge and experience will complement the expertise currently held across the Board, and will be of great benefit to the Company.

Significant progress has been made during 2008 to get us to the position where we are ready to grow the business. I am confident that we have the right people in place and the right long-term plan to put us on course for a successful future.

Finally, I should like to give my thanks and praise to all our staff. Without their commitment and drive we would not have made the advances that we have. Our people are pivotal to our continued success and growth as we embark on the next phase of the Company's development.

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**Charles Berry**  
Chairman  
2 March 2009



## Biomass - our expertise in renewable fuels

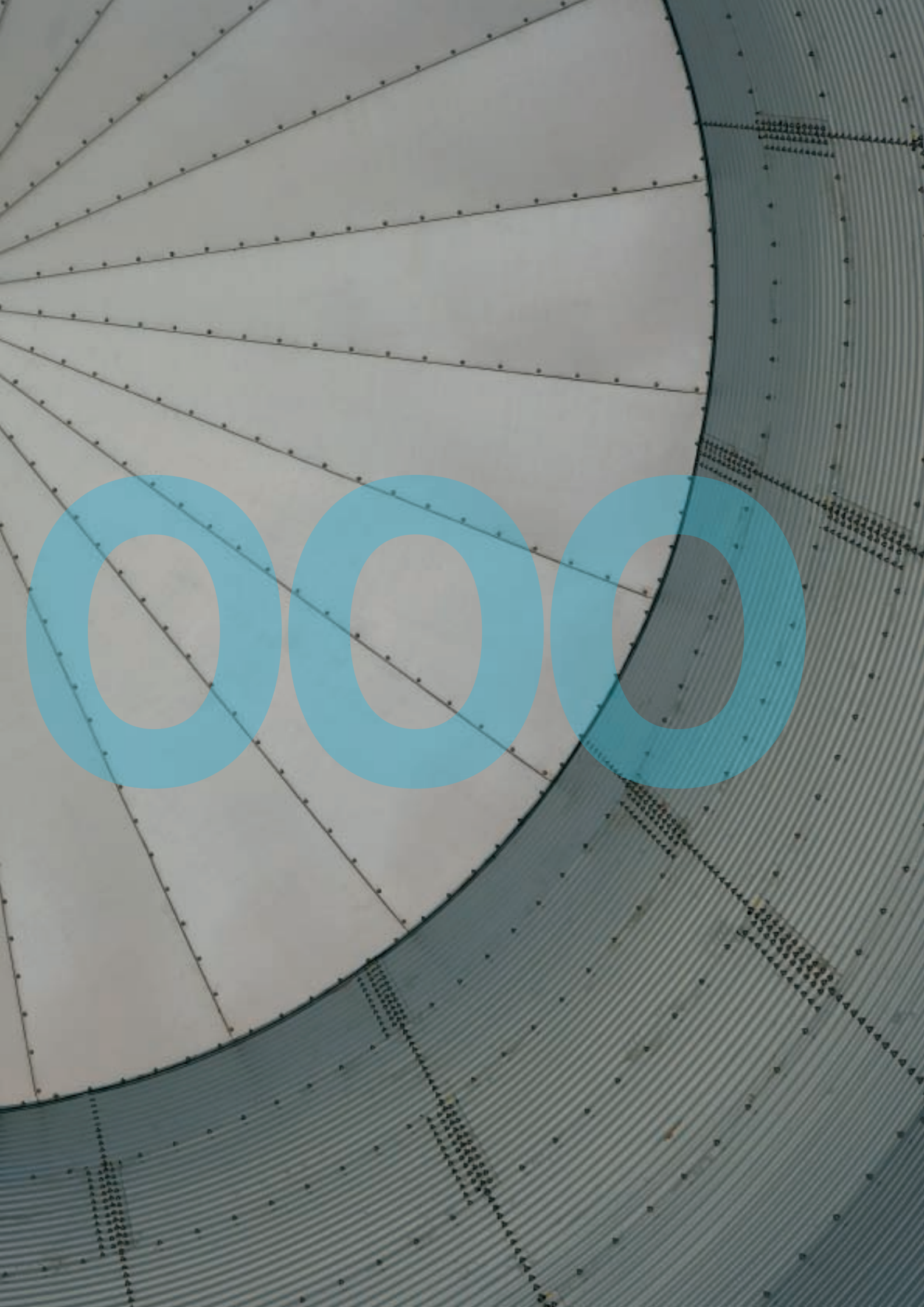
As part of our commitment to renewable biomass-fired generation, we are constructing our own state-of-the-art straw pellet plant. Due for completion in 2009, the plant will produce some 100,000 tonnes of straw pellets a year for use in our co-firing facility, which will be the largest in the world.



Read more: Pages 20 and 27

# 100,000

This image shows the inside of one of the two storage silos, each with the capacity to hold over 300 tonnes of straw pellets.



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## Business review

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### Chief Executive's statement

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The year has been characterised by extreme movements in commodity market prices, making for uncertain times. However, the market fundamentals for generators have remained strong amidst a variety of generation capacity issues, and this has allowed Drax to demonstrate the strength of its strategic role within the UK power generation sector.





## Introduction

Commodity market conditions were generally favourable for Drax in the first half of the year. During the third quarter, trading conditions continued to improve primarily as a consequence of low capacity reserve margins in the electricity market. However, in the last quarter we saw narrowing dark green spreads, as plant was returned to service and fears of a capacity shortfall were allayed, together with reduced peak electricity demand, reflecting the economic climate.

We advised shareholders in October 2008 of the significant attractive long-term opportunities from embarking on a growth strategy. The projected shortfall in UK generating capacity in the coming years and the UK's commitment to a challenging renewable energy target provide a real opportunity to exploit the core competencies of the Drax business and leverage existing business relationships to transform Drax into a multi-site, multi-fuel business that should yield value-enhancing returns for our investors.

## An opportunity for growth

For the last few years we have had a clear focus on carbon abatement, firmly believing that we have a significant part to play in the UK's transition to a low carbon economy. In pursuing carbon abatement we have always maintained that, whilst there may be new technologies on the horizon, our role is to deliver valuable carbon reductions here and now and, importantly, continue to deliver reliable and secure supplies of electricity.

Our efforts to move along this path started at Drax Power Station. We already enjoy an environmental leadership position in the coal-fired generation sector, and we are determined to strengthen that position through targeted investment. Our two key strategic investments, upgrading all our high and low pressure turbines and building a 500MW co-firing capability at the power station, have put us on the path to reducing significantly our carbon footprint, and have opened up new opportunities for the future of our business.

Our decision in 2008 to develop a 900MW dedicated biomass-fired generation business with Siemens Project Ventures GmbH ("Siemens Project Ventures") builds on the competence and focus that have been developed at Drax over recent years. In addition, through this strategic partnership, we are able to further the excellent working relationship that we already enjoy with one of the principal manufacturers in the market.

Under a Joint Development Agreement with Siemens Project Ventures, together we intend to build, own and operate three 300MW dedicated biomass-fired generation plants in the UK. Once operational, almost one-third of the generation capacity under Drax's management, some 1,400MW, would come from renewable sources. These sources will be both reliable and sustainable, and will power a generation technology that has the availability and reliability similar to that of coal. On current estimates, Drax would be responsible for around 15% of the UK's renewable electricity, equivalent to the output of some 2,000 wind turbines, and for producing around 10% of the UK's total electricity, enough to power around seven million homes.

We believe our strategy will provide a diversified and sustainable business growth path and deliver value with a clear focus on return on investment. Given the outlook for the UK power generation market and the incentives to invest in renewable generation, we firmly believe this strategy is right. We are now in the advanced feasibility stage of developing and planning, but we have been clear to our investors that we will only commit to investment once it can be plainly demonstrated that we will secure attractive returns.

## Business review

### Chief Executive's statement

#### Investing in growth

We intend to finance expansion of the business through a combination of new debt and cash generated from operations, and this required a change to our distribution policy. We notified investors of this change when we announced our growth strategy in October 2008. With respect to earnings in 2008 and 2009, the Company will distribute all excess cash generated from operations after meeting business requirements in each year. For 2010 and beyond, Drax will target a pay-out ratio of 50% of underlying earnings adjusted for non-cash accounting items (principally unrealised gains and losses on derivative contracts) in each year.

Our current debt levels are modest and our debt matures in December 2010. Any net refinancing proceeds will be used to fund Drax's equity investment in the new biomass business. We remain confident that financing will be available as we approach financial close for the first plant.

#### The core business

The Drax Power Station asset remains central to the business and we are continuing the recent trend of investing in the core business to prepare ourselves for the future. We intend to maintain our competitive edge and in so doing we are continually assessing future challenges and milestones whilst mindful of the need to deliver shareholder value.

Our long-term strategic plan for the core business develops the case for investment to 2020 and beyond. Environmental constraints represent the key challenge to the future of Drax Power Station and we are considering how best commercially to address these constraints with the options that are available to us under probable future legislation emanating from the EU.

Our successes to date make us well placed to continue to operate with high availability and reliability for many years to come. Our plant has been both well maintained and enhanced in terms of efficiency and environmental performance improvements over recent years.

During the year, we demonstrated our competence in both project execution and biomass procurement; both vital skills that are necessary as we grow the business. Our turbine upgrade project is now just over one-third complete. Following the fast-track upgrade of one high pressure turbine in 2007, we upgraded the high and low pressure turbines of two of our six generating units during the major planned outages of 2008. I am pleased to report that together these units are delivering their expected 5% efficiency improvement. Translated into carbon savings this means that, from the third quarter of 2008, two of our generating units have been operating at an overall efficiency that will save one-third of a million tonnes of carbon dioxide ("CO<sub>2</sub>") each year.

Great strides were made in advancing our biomass co-firing project. Early in 2008, planning permission was received to construct biomass handling, processing and co-firing facilities on the Drax Power Station site. During the year, contracts were awarded to Alstom Power Limited for the construction and installation of the main processing works associated with the co-firing facility, and to Doosan Babcock Energy Limited for the supply and installation of direct injection biomass co-firing systems to all six generating units.

Having successfully identified sources of biomass in excess of the requirements for our new 400MW direct injection facility, now we will be able to run it alongside our existing capability. This means that from mid-2010 we will have a total co-firing capacity of 500MW which will produce the equivalent output of over 600 wind turbines. The biomass co-firing facility will be the largest in the world, and will reduce Drax Power Station's emissions of CO<sub>2</sub> by over two and a half million tonnes a year.

Together our completed turbine upgrade and biomass co-firing projects will save over three and a half million tonnes of CO<sub>2</sub> emissions each year, amounting to a saving of up to 17.5% on historic levels.

In addition to these two strategic projects, we have successfully executed a suite of smaller projects specifically targeting efficiency and environmental performance improvements. Control instrumentation and emission reduction technologies are amongst the measures implemented, together allowing optimal and reliable operation of the plant.

## Delivering on our core competencies:

### Trading

Our trading strategy is to progressively hedge our output whilst targeting market or better dark green spreads and retaining balanced market exposure. We sell approximately one-third of our power in the near-term markets and the remaining two-thirds in the forward markets.



**Read more:** Pages 15 and 16

### Operations

Once again we delivered a strong performance in plant reliability and availability, ranking us highly amongst our sector peers. Two major planned outages were carried out in 2008, along with an increased amount of project work. As a result, we saw a significant increase in the man-hours worked, particularly by contractors. Despite this our safety record was commendable.



**Read more:** Pages 17 and 31

### Project execution

Our two major strategic carbon abatement projects made real progress during 2008. Our £100 million turbine upgrade project is now just over one-third complete and delivering to expectations. Our biomass co-firing project is taking shape and is on track to deliver significant CO<sub>2</sub> savings from mid-2010.



**Read more:** Pages 20 and 26

### Biomass procurement

During 2008, we made excellent progress in delivering our biomass procurement strategy. The identification of attractive supplies of biomass has enabled us to increase our target co-firing capacity to 500MW, equating to 12.5% of our output. A key achievement of the year was the establishment of our sustainability policy for procuring biomass.



**Read more:** Pages 20 and 27

## Looking ahead

For 2009 and beyond, we are continuing to see narrow dark green spreads compared to those in 2008, driven principally by falling forward gas prices compared to those of coal, but also by the effects of foreign currency exchange rates, with sterling depreciating against both the US dollar and the euro.

Although we have seen demand reduction in the short term, all the analysis we have conducted continues to reinforce our view that the electricity market will provide increasing returns to available capacity as the retirement of some of the older power stations on the system reduce the generation capacity margin. This should put upward pressure on spreads.

As a country we need to develop available and sustainable forms of renewable generation if we are to achieve the 2020 UK target of 15% renewable energy. Biomass has been identified as a key growth area for attaining this target and the proposed regulatory regime incentivises the uptake of this technology.

Both these aspects will be positive for the business and we firmly believe that we are in a position to take advantage of this opportunity and secure value for our shareholders.

**Dorothy Thompson**  
Chief Executive  
2 March 2009

## Project execution - our strength in making things happen

Our two major strategic carbon abatement projects are well underway. Our commitment to improving thermal efficiency is showcased by our £100 million turbine upgrade project, which is the largest steam turbine modernisation programme in UK history. Now just over one-third complete, we are already saving at least one-third of a million tonnes of CO<sub>2</sub> each year.



Read more: Pages 20 to 26

# 33% DOWN

This image shows a close up of the pipework that distributes the steam pressure exhausting from the intermediate pressure turbine module into the three new low pressure turbine modules.



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## Business review

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### Business and financial review

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The Group's principal performance indicators are highlighted on page one of this report. Solid operating performance, an improvement in our average achieved electricity price and an increase in net power sold were offset by an increase in coal prices, the cost of CO<sub>2</sub> emissions allowances and operating expenses, resulting in EBITDA of £454 million compared to £506 million in 2007. The Business and financial review includes further explanation and commentary in relation to our principal performance indicators and the results for the year.



	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
<b>Continuing operations</b>		
<b>Total revenue</b>	<b>1,752.8</b>	1,247.4
<b>Fuel costs<sup>(1)</sup></b>		
Fuel costs in respect of generation	(858.4)	(470.6)
Cost of power purchases	(211.8)	(75.5)
	(1,070.2)	(546.1)
<b>Gross profit</b>	<b>682.6</b>	701.3
Other operating expenses excluding depreciation, amortisation, exceptional items and unrealised gains on derivative contracts <sup>(2)</sup>	(228.4)	(195.7)
<b>EBITDA<sup>(3)</sup></b>	<b>454.2</b>	505.6
Depreciation, amortisation and loss on disposal of fixed assets	(46.4)	(43.7)
Exceptional operating income - final TXU Claim proceeds	-	6.2
Unrealised gains on derivative contracts	56.3	3.3
<b>Operating profit</b>	<b>464.1</b>	471.4
Interest payable and similar charges	(28.8)	(34.3)
Interest receivable	7.2	11.4
<b>Profit before tax</b>	<b>442.5</b>	448.5
Tax charge		
- Before changes in tax legislation	(100.8)	(113.4)
- Impact of industrial building allowances withdrawal on deferred tax	(8.8)	-
- Impact of reduction in tax rate on deferred tax	-	17.9
	(109.6)	(95.5)
<b>Profit for the year attributable to equity shareholders</b>	<b>332.9</b>	353.0
<b>Earnings per share</b>	<b>Pence per share</b>	<b>Pence per share</b>
- Basic and diluted	98	99

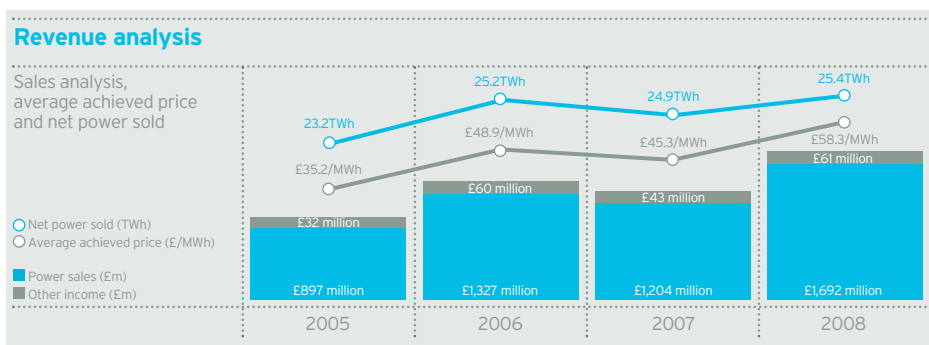
Notes:

- (1) Fuel costs comprise the fuel costs incurred in the generation process, predominantly coal and CO<sub>2</sub> 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, exceptional items and unrealised gains on derivative contracts principally include salaries, maintenance costs, transmission network 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.

## Results of operations

Total revenue for the year ended 31 December 2008 was £1,753 million compared to £1,247 million in 2007. Power sales were £1,692 million in 2008 compared to £1,204 million in 2007, reflecting a 29% improvement in our average achieved electricity price to £58.3/MWh (see Price of electricity) and an increase in net power sold to 25.4TWh, compared to 24.9TWh in 2007 (see Outages and plant utilisation levels).

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 SO<sub>2</sub> emissions allowances. In the year ended 31 December 2008, these revenues were £61 million compared to £43 million in 2007. Significantly higher ROC sales in 2008 were driven by our growing biomass burn. Lower ancillary services revenues were a result of stronger competition in the market to provide frequency response services to National Grid plc ("National Grid").



Fuel costs in respect of generation during the year ended 31 December 2008 were £858 million, compared to £471 million in 2007. The increase was primarily due to higher generation, an increase in the price of coal and other fuels, and the impact of higher prices for and increased purchases of CO<sub>2</sub> emissions allowances (see Price of coal and other fuels and CO<sub>2</sub> emissions allowances).

We purchase power in the market when the cost of power in the market is below our marginal cost of production in respect of power previously contracted for generation and delivery by us, and to cover any shortfall in generation.

The cost of power purchased is included within fuel costs. For the year ended 31 December 2008, the cost of purchased

power increased to £212 million compared to £76 million in 2007, primarily due to higher market prices for electricity.

As a result of these factors, gross profit for the year ended 31 December 2008 was £683 million compared to £701 million in 2007.

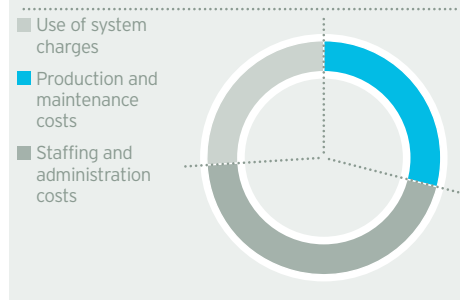
Other operating expenses were £228 million for the year ended 31 December 2008 compared to £196 million in 2007. In 2008, we experienced an increase of £11 million in use of system charges, following National Grid price uplifts in response to market conditions. Higher operating expenses in 2008 also reflect the impact of increased generation on maintenance costs.

## Business review

## Business and financial review

Operating expenses include the impact of growth in our average headcount to 712 compared to 658 in 2007. This reflects planned investments in our business, including operational support for the implementation of our large capital projects, the growth of our biomass procurement activities and investments to support the development of the biomass growth strategy.

## Operating cost analysis



EBITDA for the year ended 31 December 2008 was therefore £454 million compared to £506 million in 2007.

Depreciation and amortisation for the year ended 31 December 2008 was £46 million compared to £44 million in 2007, reflecting significant asset additions over the last two years, as well as accelerated depreciation on plant and equipment we expect to replace under our capital expenditure investment programme.

The Group recognises unrealised gains and losses on forward contracts which meet the definition of derivatives under IASs. Where possible, we take the own use exemption for derivative contracts entered into and held for our own purchase, sale or usage requirements, including forward domestic coal contracts. As such, the unrealised gains and losses recognised in the balance sheet principally relate to the mark to market of our forward contracts for power yet to be delivered. The following table describes the movements in unrealised gains and losses and where they are recorded in our financial statements.

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Net unrealised (losses)/gains in balance sheet at 1 January	(236.7)	344.3
Unrealised gains recognised in the income statement	56.3	3.3
Fair value gains/(losses) recognised in the hedge reserve (a component of equity)	164.7	(584.3)
Net unrealised losses in balance sheet at 31 December	(15.7)	(236.7)

As a consequence of increases in power prices throughout 2007, the average price relating to power which had been contracted but had yet to be delivered at 31 December 2007 was much lower than market prices at that time, resulting in the recognition of a net unrealised loss of £237 million in the balance sheet (included in captions described as derivative financial instruments). As a result of falling power prices over the last quarter of 2008, the difference narrowed considerably, resulting in a reduction in the net unrealised loss to £16 million at 31 December 2008. These trends in forward power prices, which determine the movements in our net unrealised gains/losses position, are illustrated in the chart on page 16.

The unrealised gains recognised in the income statement of £56 million for the year ended 31 December 2008 and £3 million in 2007 represent mark to market movements on a small proportion of our derivative contracts which do not qualify for hedge accounting.

Mark to market movements on most of our derivative contracts, considered to be effective hedges, have been recognised through the hedge reserve, a component of shareholders' equity in the balance sheet. Movements in unrealised gains and losses recognised in the hedge reserve are mainly the result of unwinding mark to market positions relating to power delivered during a reporting period, and the recording of mark to market positions on power yet to be delivered at the end of that period. The net unrealised gain recognised through the hedge reserve in the year ended 31 December 2008 was £165 million, compared to a net unrealised loss of £584 million in 2007, both reflecting the forward power price trends described above.





**Trading in the commodity markets**

The commodity markets in which we operate were highly volatile in 2008. We have a dedicated and experienced team in place to deliver our trading strategy of targeting market or better dark green spreads, while retaining balanced market exposure.



In considering mark to market movements, it is important to recognise that EBITDA is driven by our strategy to deliver market level or better dark green spreads, not by the absolute price of electricity at any given date.

After allowing for the unrealised gains on derivative contracts, operating profit for the year ended 31 December 2008 was £464 million compared to £471 million in 2007.

Net finance costs for the year ended 31 December 2008 were £22 million compared to £23 million in 2007, as a result of lower interest rates and debt levels.

The tax charge for the year ended 31 December 2008 was £110 million, compared to £96 million in 2007. Tax for 2008 includes a one-time charge of £9 million to reflect the estimated impact on deferred tax of the withdrawal of industrial buildings allowances introduced by the Finance Act 2008. The tax charge for 2007 included a one-time 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.

As a result of the above factors, profit attributable to equity shareholders for the year ended 31 December 2008 was £333 million compared to £353 million in 2007, and basic and diluted earnings per share were 98 pence compared to 99 pence in 2007.

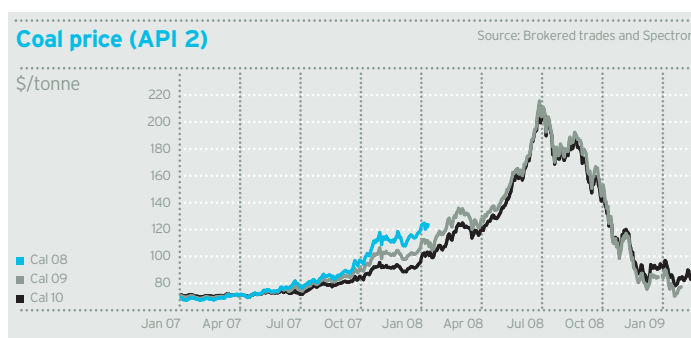
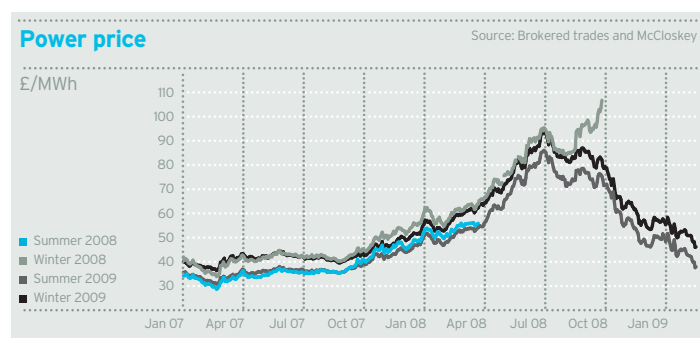
**Key factors affecting the business**

**General commodity market conditions**

Commodity market conditions were generally favourable for Drax in the first half of the year. During the third quarter, trading conditions continued to improve primarily as a consequence of low capacity reserve margins in the electricity market. However, in the last quarter we saw dark green spreads narrow and significant falls in power, coal and CO<sub>2</sub> emissions allowances prices. These trends in forward power, coal and CO<sub>2</sub> emissions allowances prices, are illustrated in the charts on pages 16 and 17, and described further in the following paragraphs.

## Business review

## Business and financial review

**Price of electricity**

The table below shows the average achieved electricity price we realised for the years ended 31 December 2008 and 31 December 2007, together with the market closing price on the last day of each season illustrated.

	Year ended 31 December 2008	Year ended 31 December 2007
Average achieved price (£/MWh)	<b>58.3</b>	45.3
Summer baseload market close (£/MWh)	<b>55.8</b>	23.0
Winter baseload market close (£/MWh)	<b>106.9</b>	40.4

Average achieved price for the year ended 31 December 2008 was £58.3 per MWh compared to £45.3 per MWh in 2007. Average capture price (being the price attained prior to Balancing Mechanism activity) for the year ended 31 December 2008 was £57.4 per MWh compared to £44.2 per MWh in 2007. The forward baseload power prices for Summer 2009 and Winter 2009/2010 were approximately £37.1 per MWh and £46.3 per MWh respectively as at 20 February 2009.

The increase in average achieved price primarily followed the impact of forward sales contracts secured in the last six months of 2007 and through the first six months of 2008, during which time power prices were generally increasing relative to the levels of late 2006 and early 2007, for power delivered in 2008.

Increasing power prices through the early part of 2008 followed strengthening oil and gas prices. High power prices were sustained through the third quarter, with fears that outages, Large Combustion Plant Directive ("LCPD") constraints and delays in Flue Gas Desulphurisation ("FGD") installations at other UK generating plant might result in a capacity shortfall.

Power price falls towards the end of the year followed weaker oil and gas prices. In addition, other plants returned to service, which allayed fears of a capacity shortfall, and peak electricity demand fell, reflecting the economic climate.

**Price of coal and other fuels**

We burnt approximately 9.5 million tonnes of coal in the year ended 31 December 2008 compared to approximately 9.8 million tonnes in 2007. 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) increased dramatically over the second half of 2007, reaching US\$127 per tonne by the end of the year. Spot prices continued to increase to record levels over the first six months of 2008, reaching US\$218 per tonne by 30 June 2008. Price increases were driven by continued tight markets for both coal and freight, caused by strong demand from China, India and Japan, combined with some production and logistical issues in China, as well as South Africa and Australia. However, spot coal prices fell significantly over the final quarter, down to US\$81 per tonne by 31 December 2008, as supply constraints eased in both the coal and freight markets. The fall in coal prices was partially offset by the depreciation of sterling against the US dollar through the second half of 2008.

We also burn biomass, petcoke and fuel oil, although coal comprised around 93% of total fuel costs in the year ended 31 December 2008 (excluding CO<sub>2</sub> emissions allowances) compared to 95% in 2007, primarily as a result of improved fuel diversity. The average cost of fuel per MWh (excluding CO<sub>2</sub> emissions allowances) was £25.1 for the year ended 31 December 2008, compared to £18.5 in 2007, with high coal prices in the first nine months of 2008 relative to the levels of last year.

**CO<sub>2</sub> emissions allowances**

For Phase II of the EU ETS (2008-2012), Drax has an allocation of 9.5 million tonnes of CO<sub>2</sub> emissions allowances per annum under the UK NAP, compared to 14.6 million tonnes per annum for Phase I (2005-2007).

Our CO<sub>2</sub> emissions allowances requirement for the year ended 31 December 2008, in excess of those allocated under the UK NAP, was approximately 12.8 million tonnes compared to approximately 7.6 million tonnes in 2007, as a result of the lower UK NAP allocation and higher generation, partially offset by plant efficiency improvements and increased biomass burn.

The price for Phase I CO<sub>2</sub> emissions allowances began 2007 at approximately €6.6 per tonne, and as a result of over-supply, fell steadily over the first six months to €0.13 per tonne on 30 June 2007, subsequently falling away further to €0.04 per tonne by 31 December 2007.

The price for Phase II CO<sub>2</sub> emissions allowances began 2008 at approximately €22.4 per tonne, and in common with power and coal prices rose steadily over the first half of the year to €28.4 per tonne at 30 June 2008. However, carbon prices also fell significantly over the final quarter, down to €15.4 per tonne by 31 December 2008, as commodity prices fell back and industrial demand reduced in response to the economic climate.

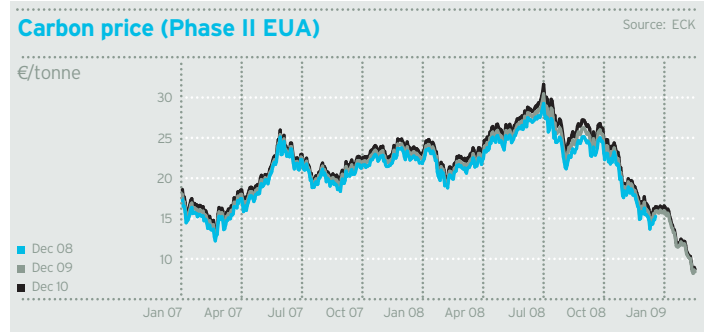
As a result, the average price expensed for purchased CO<sub>2</sub> emissions allowances during the year ended 31 December 2008 was £17.4 per tonne (equivalent to £223 million), compared to £1.5 per tonne in 2007 (equivalent to £11 million).

**Outages and plant utilisation levels**

	Year ended 31 December 2008	Year ended 31 December 2007
Electrical output (net sales) (TWh)	<b>25.4</b>	24.9
Load factor (%)	<b>76.3</b>	75.0
Availability (%)	<b>85.8</b>	85.7
Winter forced outage rate (%)	<b>6.5</b>	4.2
Forced outage rate (%)	<b>5.8</b>	6.9
Planned outage rate (%)	<b>8.9</b>	8.1
Total outage rate <sup>(1)</sup> (%)	<b>14.2</b>	14.3

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.



The load factor for the year ended 31 December 2008 was 76.3% compared to 75.0% in 2007. The improvement arises from an increase in electrical output (net sales) to 25.4TWh in 2008 compared with 24.9TWh in 2007, with higher generation in 2008 in what have historically been low margin periods. Commodity market conditions through the Summer were such that it was profitable to generate these additional volumes, albeit at moderate margins.

Plant availability was approximately 86% for both years ended 31 December 2007 and 2008.

The planned outage rate achieved for the year ended 31 December 2008 was 8.9% compared to 8.1% in 2007. Our maintenance regime includes a major planned outage for each of our six units once 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 were completed in both 2007 and 2008.

The forced outage rate for the year ended 31 December 2008 was 5.8%, compared to 6.9% in 2007.

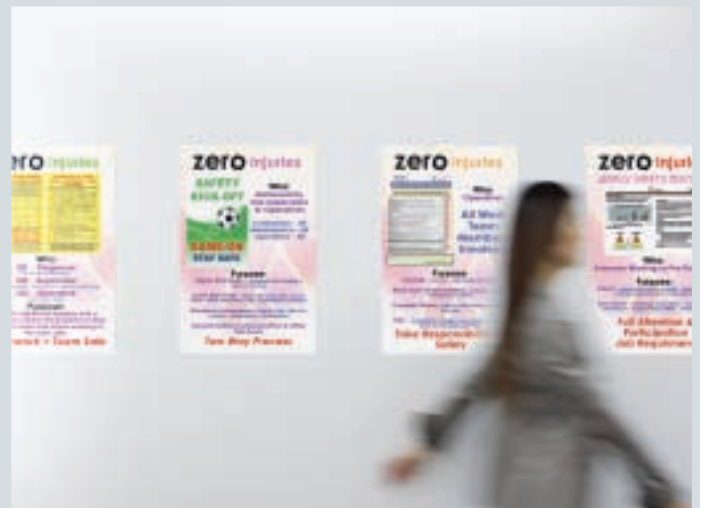
The Winter forced outage rate was 6.5% for the year ended 31 December 2008, compared to 4.2% in 2007.

**Health and safety**

Our lost time injury rate was 0.10 for the year ended 31 December 2008 compared to 0.34 in 2007. This continues to demonstrate that the safety programmes implemented in the last few years are becoming well entrenched and are delivering sound performance. Our safety record compares favourably with our sector peers and international benchmarks.

**Attaining leading performance in health and safety**

Our safety record continues to compare favourably with that of our sector peers and international benchmarks. Safety programmes are now becoming well entrenched and we are seeing the results through sound performance.



## Business review

### Business and financial review

#### Liquidity and capital resources

Net debt was £235 million as at 31 December 2008 compared to £337 million at 31 December 2007. Cash and cash equivalents were £130 million as at 31 December 2008 compared to £60 million at 31 December 2007. An analysis of cash flows for both years is set out in the following table.

##### Analysis of cash flows

	Year ended 31 December 2008 £m	Year ended 31 December 2007 £m
Net cash generated from operating activities	<b>309.5</b>	312.8
Net cash used in investing activities	<b>(91.4)</b>	(67.8)
Net cash used in financing activities	<b>(147.6)</b>	(340.1)
Net increase/(decrease) in cash and cash equivalents	<b>70.5</b>	(95.1)

Net cash generated from operating activities was £310 million in the year ended 31 December 2008 compared to £313 million in 2007. The small decrease was a result of a reduction of £51 million in EBITDA, largely offset by lower working capital utilisation in 2008.

Net cash used in investing activities, which represented payments in respect of capital expenditure in both periods, was £91 million for the year ended 31 December 2008 compared to £68 million in 2007 (see Capital expenditure).

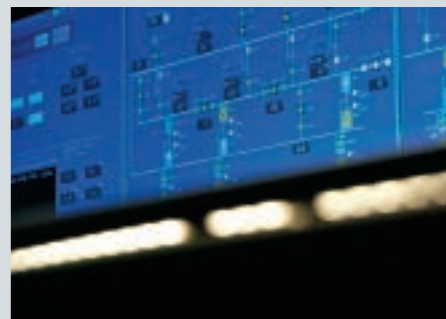
Net cash used in financing activities was £148 million in the year ended 31 December 2008 compared to £340 million in 2007. The 2008 amount includes equity dividends paid of £110 million, term loan repayments of £35 million, and purchases of our own shares to meet commitments under share-based incentive plans of £3 million. The 2007 amounts included equity dividends paid of £171 million and payments under a share buy-back programme of £84 million, together representing returns to shareholders totalling £255 million. Also included in 2007 were term loan repayments of £80 million, the final bridge loan repayment of £3 million, and purchases of our own shares to meet commitments under share-based incentive plans of £2 million.

The increase in cash and cash equivalents was therefore £71 million in the year ended 31 December 2008, compared to a decrease of £95 million in 2007. Drax's policy is to invest available cash in short-term bank, building society or other low risk deposits.



##### Investing in plant improvements

In addition to our major strategic investments, plant improvements have also been delivered through a suite of smaller projects. A focus on upgrades, process control and plant optimisation has brought efficiency, reliability and availability benefits, all strengthening the leadership position of Drax Power Station in the coal-fired generation sector.



#### Turbine upgrade project

The largest steam turbine modernisation project in the UK being undertaken at Drax Power Station is now just over one-third complete.



#### Capital resources and refinancing

Following scheduled repayments of £35 million during the year, senior secured debt was £370 million at 31 December 2008 (before deferred finance costs). Scheduled debt repayments are £65 million in each of 2009 and 2010, under an amortisation profile ending with a final repayment of £240 million on 31 December 2010.

Conditions in the debt markets have continued to be turbulent. We continue to monitor the situation, and will seek to achieve an optimal balance between refinancing risk and the cost of refinancing before maturity of the existing facilities.

We acknowledge recent guidance on going concern for companies preparing financial statements, in the light of recent volatility in financial markets which has created a general level of uncertainty. However, we have significant headroom on our existing facilities, and a reasonable expectation that these will be renewed when required. We also have a recent history of cash generation, strong covenant compliance, and good visibility in medium-term forecasts, due to our progressive hedging strategy.

We notified investors of a change in distribution policy when we announced our biomass growth strategy in October 2008 (see Distribution policy). At the same time, we also notified investors that any net refinancing proceeds will be used to fund our equity investment in the 900MW dedicated biomass-fired generation business we intend to develop with Siemens Project Ventures (see Biomass growth strategy).

#### 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 2008 and has a final maturity date of 15 December 2010.

#### Capital expenditure

In March 2008, we announced that we expected to incur total capital expenditure of approximately £250 million over the three years 2008 to 2010. Of this, around £150 million specifically related to the turbine upgrade project 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 fixed asset additions of £102 million in the year ended 31 December 2008 (£83 million in 2007), we remain on track to achieve this target. In addition, we expect to incur expenditure of around £20 million in 2009 in relation to our plans to develop the dedicated biomass-fired generation business (see Biomass growth strategy).

## Business review

### Business and financial review

In relation to the turbine upgrade project, we expect to invest up to £100 million over the five-year period from 2007 to 2011, including approximately £60 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 will represent 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 CO<sub>2</sub> emissions allowances and approximately half a million tonnes of coal.

During the two major planned outages of 2008 we successfully completed the upgrade of the high and low pressure turbines on two of our six generating units. Together these units are now delivering the 5% efficiency improvement target. Translated into carbon savings this means that, from the third quarter of 2008, two of our generating units have been operating at an overall efficiency that will save one-third of a million tonnes of CO<sub>2</sub> emissions allowances each year.

With regard to extending our biomass capability, we expect to invest around £80 million to develop a 400MW direct injection co-firing biomass facility. We will extend our direct-injection capability from one generating unit to all six generating units, and install the necessary processing and handling infrastructure to enable us to handle an additional one and a half million tonnes of biomass material per annum. Delivery of the 400MW facility is expected to result in savings of over two million tonnes of CO<sub>2</sub> emissions allowances, the displacement of approximately one million tonnes of coal and the generation of in excess of one and a quarter million ROCs per annum.

We have made good progress in advancing the project. Early in 2008, planning permission was received to construct biomass handling, processing and co-firing facilities on the Drax Power Station site. During the year, contracts were awarded to Alstom Power Limited for the construction and installation of the main processing works associated with the co-firing facility, and to Doosan Babcock Energy Limited for the supply and installation of direct injection biomass co-firing systems to all six generating units.

We anticipate commissioning phase one of the project towards the end of 2009, with achievement of the full 400MW capacity around the middle of 2010.

We have also developed our biomass procurement strategy, and identified attractive biomass supplies which greatly exceed the requirements of the new 400MW direct-injection co-firing facility. Confidence in our fuel supplies will allow us to operate the new co-firing facilities alongside our existing, through the mill delivery, co-firing capacity of 100MW. This will provide us with a total co-firing capacity of 500MW when the new 400MW direct-injection project is fully commissioned.

As part of our development of biomass supply sources, we are also in the process of constructing a pilot project for the production of pellets from locally sourced straw.

A pellet plant is being constructed in Goole, approximately three miles from the Drax site. The plant will take straw from the local area and produce around 100,000 tonnes of straw pellets annually, to be brought to Drax for combustion in the co-firing facility. If successful, similar pellet plants could be developed in other, local cereal growing regions.

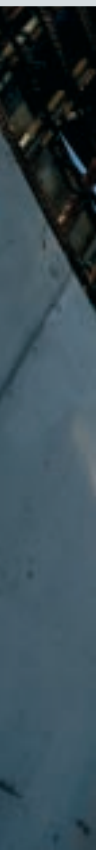
We firmly believe in procuring biomass from sustainable sources and to this end we have established a sustainable sourcing policy framework.

We will also 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.

#### Biomass growth strategy

Under a Joint Development Agreement with Siemens Project Ventures, we intend to build, own and operate three 300MW dedicated biomass-fired power plants in the UK.

We expect each plant to be funded with a debt/equity mix, and we are targeting 60% non-recourse project finance debt. Under the terms of the Joint Development Agreement, the intended ownership will be split 60% Drax and 40% Siemens Project Ventures.





#### Biomass handling and processing

Construction of the main biomass handling and processing works at Drax Power Station is now well underway. The facility will deliver processed biomass material to the direct injection co-firing systems of all six generating units.

Drax will manage and operate the biomass businesses, and will also be responsible for all biomass procurement and trading. It is proposed that the plants will use Siemens' turbine technology.

Current estimates of the total capital cost of this business are around £2 billion, including investments in ancillary biomass logistics and processing facilities. Construction of the first plant is targeted to commence in late 2010, following execution of the construction and financing contracts and agreed capital commitment, with the first plant expected to be operational in 2014.

We are now in the advanced feasibility stage of developing and planning but we will only commit to investment once it can be plainly demonstrated that we will secure attractive returns. Whilst no commitments to construction contracts or financing have been made to date, we expect to finalise these arrangements by the second half of 2010. We expect to incur expenditure of around £20 million in 2009 in developing this business.

Since we made the announcement in October 2008, we have made good progress. We now have five site options under review. We expect to accept a grid connection date shortly for the Drax site (October 2012) and have already accepted a connection date for the Immingham site (October 2014).

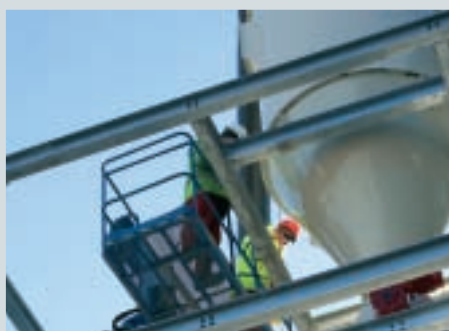
We have also moved forward on the engineering design, with our strategic partner, Siemens Project Ventures.

We believe that the long-term investment case for this business remains strong, particularly in the light of the UK's need for reliable renewable generation capacity by 2020.



#### Straw pellet plant

The straw pellet plant development at Goole, some three miles from Drax Power Station, is rapidly taking shape. With commercial operation due to commence in the first half of 2009, the plant will produce 100,000 tonnes of straw pellets a year for co-firing alongside our coal.



## Business review

### Business and financial review

#### Principal risks and uncertainties

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

##### Regulatory market risk

The UK Government and other relevant regulatory bodies have significantly changed the applicable regulatory regimes in Great Britain over the past few years, in an attempt to improve market information and transparency, enhance competition and liquidity, reduce the likelihood of market abuse and implement new EU legislation. In particular, new UK and EU legislation applicable to our sector continues to target reductions in emissions. We are exposed to further regulatory developments, which may favour other types of fuel or sources of power, and which could result in additional costs or lower output levels and reduce our profitability.

##### Plant operating risk

Extended forced outages or prolonged planned outages could have a significant adverse effect on our revenue and profitability. We may also incur additional costs in recovering from these outages, and penalties if we cannot fulfil our contractual obligations.

Forced outages may be caused by the underperformance or outright failure of our power generation plant, or other equipment and components including the information technology systems used to operate the plant or conduct trading activities. The duration of forced outages is influenced by the lead time to manufacture and procure replacement components and to carry out repairs. Although we always try to optimise our holding of spare components for use in the event of plant failure, we may not always have ready access to the relevant replacement parts.

##### Environmental and health and safety risks

The EU, UK and local environmental and health and safety laws and regulations which affect the power station are complex, frequently changing and are becoming ever more stringent. They cover many aspects of our operations, including limits on emissions of particulate, SO<sub>x</sub> and NO<sub>x</sub>, discharges to air and water, noise emissions, soil/groundwater contamination, waste and health and safety standards.

Changes in these laws and regulations may cause increased compliance costs, the need for additional capital expenditure and could affect output levels. Whilst we have robust systems in place to support and monitor compliance with these regulations, failure to do so could result in fines or penalties, civil or criminal liability, or even the limitation or suspension of operations.

##### Electricity market liquidity risk

Liquidity in the market for wholesale electricity is dependent on there being a sufficient number of counterparties willing to trade actively. Changes in the market structure or consolidation of the existing generation and supply businesses in the UK could result in a reduction in the number of active participants in the market with whom we are able to trade.

If we are not able to rely on wholesale market trading as a means of hedging our short to medium-term exposure to electricity prices, it may affect our ability to sell all of our output and/or the prices at which we sell it. As a result we could suffer reduced revenues and incur higher costs to achieve our trading objectives.

##### Refinancing risk

Recent volatility in financial markets has created a general level of uncertainty and increased refinancing risk.

Our senior secured debt matures under an amortisation profile ending on 31 December 2010. We have significant headroom under our existing facilities, and a reasonable expectation that these will be renewed when required.

##### 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 CO<sub>2</sub> emissions allowances. Price variations and market cycles have historically influenced our financial results and are expected to continue to do so.

Our policy is to make forward power sales with corresponding purchases of fuel and CO<sub>2</sub> emissions allowances when profitable to do so. We purchase coal under either fixed or variable priced contracts with different maturities from a variety of domestic and international sources. We purchase CO<sub>2</sub> 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 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 entered into to hedge substantially all of our fixed price international coal purchases in US dollars, and our CO<sub>2</sub> emissions allowances purchases in euros.



### Tax risk

Under the Group's previous financing structure, Drax Holdings Limited (a subsidiary company) was partially funded by a Eurobond payable to another group company. The whole of the coupon was previously prepaid, and an accounting based tax deduction has been claimed for the corresponding interest charged in the Drax Holdings Limited income statement each year. Were HMRC to successfully challenge the deductions claimed in respect of the Eurobond coupons for open years to 31 December 2008, it is estimated that the additional tax liability would be up to £90 million, together with interest and penalties.

In November/December 2008, HMRC issued draft legislation concerning the "Principles based approach to financial products avoidance" and the "Taxation of foreign profits of companies". These provisions updated rules on, amongst other things, the tax deductibility of interest and were generally expected to reduce the tax effectiveness of the Eurobond financing arrangements.

Following consultation with leading tax counsel and after taking professional advice, we decided to unwind the Eurobond financing arrangements. The Eurobond was formally waived by the lending group company on 30 December 2008. As a result the whole of the remaining prepaid coupon was charged in the Drax Holdings Limited income statement giving rise to potential additional interest deductions with a tax effect of around £220 million. Because of the risks related to the unwind of the Eurobond structure, no benefit will be recognised in the Group's financial statements with respect to the potential additional deductions until we are more certain they will be realised.

### Closing cash position guidance

We issued a Pre-close Trading Update on 16 December 2008 in which we reported management's expectation that the cash position as at 31 December 2008 would be in the range of £125 million to £130 million. The reported cash position as at 31 December 2008 was £130 million.

### Positions under contract for 2009, 2010 and 2011

We continue to follow our stated trading strategy of making steady forward power sales with corresponding purchases of CO<sub>2</sub> emissions allowances and fuel 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 20 February 2009, the positions under contract for 2009, 2010 and 2011 were as follows:

	2009	2010	2011
Power sales (TWh) comprising:	20.7	17.3	10.3
- Fixed price power sales (TWh) at an average achieved price (per MWh)	16.2 at £51.0	11.2 at £56.6	4.6 at £62.6
- Fixed margin and structured power sales (TWh)	4.5	6.1	5.7
CO <sub>2</sub> emissions allowances hedged, including UK NAP allocation, market purchases, structured contracts, and benefit of biomass co-firing (TWh equivalent)	20.5	17.5	18.0
Solid fuel at fixed price/hedged, including structured contracts (TWh equivalent)	22.1	15.2	9.8

Fixed price power sales include approximately 0.7TWh supplied to Centrica in the period 1 January 2009 to 20 February 2009 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 2009 and 5.3TWh in each of 2010 and 2011 in connection with the contract.

Under this contract we will supply power on terms which include Centrica paying for coal, based on international coal prices, and delivering matching CO<sub>2</sub> emissions allowances amounting to approximately 4.8 million tonnes per annum. The contract provides Drax with a series of fixed dark green spreads which were agreed in the first quarter of 2006.

### Distributions

#### Distribution policy

We notified investors of a change to our distribution policy when we announced our biomass growth strategy in October 2008. With respect to 2008 and 2009, the Company will distribute all excess cash generated from operations after meeting business requirements in each year. For 2010 and beyond, we will target a pay-out ratio of 50% of underlying earnings (being profit attributable to equity shareholders adjusted to exclude the impact of unrealised gains and losses on derivative contracts) in each year.

#### Dividends paid

On 3 March 2008, the Board resolved, subject to approval by shareholders at the Annual General Meeting on 17 April 2008, to pay a final dividend for the year ended 31 December 2007 of 9.9 pence per share (£34 million). Also on 3 March 2008, the Board resolved to pay a further interim dividend for the year ended 31 December 2007 (payable as a special dividend) of 7.8 pence per share (£27 million). The final and special dividends were subsequently paid on 7 May 2008.

On 4 August 2008, the Board resolved to pay an interim dividend for the six months ended 30 June 2008 of 5.0 pence per share (£17 million). Also on 4 August 2008, the Board resolved to pay a further interim dividend (payable as a special dividend) of 9.7 pence per share (£33 million). The interim and special dividends were subsequently paid on 8 October 2008.

#### Dividends proposed

At the forthcoming Annual General Meeting the Board will recommend to shareholders that a resolution is passed to approve payment of a final dividend for the year ended 31 December 2008 of 38.3 pence per share (£130 million) payable on or before 22 May 2009. Shares will be marked ex-dividend on 6 May 2009.

This Business and financial review was approved by the Board on 2 March 2009.

Tony Quinlan  
Finance Director  
2 March 2009



## **Operations - our key to staying on top**

Reliability, flexibility and availability are key attributes of our plant and critical to delivering shareholder value. Throughout the year we delivered an availability of 86%, ranking us highly amongst our sector peers.



**Read more:** Page 17

This image shows a close up of the flexible braided hoses of the burners that are located in the walls of the boilers, the point at which the fuel ignites to produce heat to turn water to steam.

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## Business review

### Corporate and social responsibility review

#### CSR and our business

We operate our business within a framework of increasingly stringent and challenging legislative and regulatory requirements. We are, however, mindful of the still tougher expectations held by our wider stakeholder group. For us, corporate and social responsibility is about achieving a balance between the commercial and regulatory rigours of the competitive sector within which we operate and our commitment to our stakeholders.

The Board has ultimate control of policies in respect of both the wider corporate and social responsibility and in relation to environmental and health and safety matters. The Board's policies are implemented by dedicated specialists who make sure effective processes and procedures are in place to assure compliance and to identify and to report on risks and opportunities.

As in previous years we have continued to invest, not only to comply with the environmental and health and safety requirements, but, where practicable, to go further. Throughout 2008, we maintained our presence in the FTSE4Good Index Series, which is designed to measure the performance of companies that meet globally recognised corporate responsibility standards and facilitate investment in those companies.

#### Engaging with our stakeholders

Like many businesses, our stakeholders are many and diverse, including our shareholders, employees, customers, suppliers, the local community, Government, non-governmental organisations, opinion formers, and the media. Communication with all our stakeholders is considered to be an essential part of our business and we aim to be open and transparent in all that we do. We fulfil our communication commitments through an investor relations programme and a wide-ranging external relations programme.

#### Investor relations

Drax is committed to delivering shareholder value. We communicate our results and prospects to our shareholders in an accurate and timely manner using a variety of channels. In addition to the Annual General Meeting, we communicate through our Annual Report and Accounts, Half Year Report, Interim Management Statements and Trading Updates. All of these documents are made available on our website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk). Significant matters relating to trading and the development of the business are disseminated to the market by way of announcements via a regulatory information service and those announcements appear as soon as practicable on our website.

Announcements are followed up with either conference calls or presentations to provide further detail and greater understanding. In addition, face-to-face meetings are held with our major institutional shareholders, again to assist them in their understanding of the announcements, but also to ensure that the Board is aware of their views and concerns. In 2008, a formal meeting programme was delivered in the UK after each of the Preliminary and Half Year Results announcements and in the US after the Preliminary Results announcement. To aid our communication with our private investors, during 2008 we continued to develop further the investor section of our website improving the information that is readily available.

#### External relations

As with previous years, we maintained our engagement with public affairs audiences on issues with implications for our business.

We engaged with Parliamentarians and officials both in the UK and the EU on issues including forthcoming environmental legislation, energy prices, security of supply, renewables policy and wholesale market issues.

The form of engagement was varied and included both face-to-face and written briefings, participation in public consultations, written and oral evidence to select committees and visits by Parliamentarians and officials to Drax Power Station.

Locally, we have continued to engage with parish, town, district and county councillors and officers, with the intention of keeping them up to date with our business issues and developments. Our regular communication channel with these and other local opinion formers takes the form of an annual consultative meeting, and three meetings each year with our local parish and town councillors.

No political donations were made in the UK or elsewhere during 2008, and the Company's contact with those active in the political arena has been and will continue to be aimed solely at the promotion of the Company's business interests.

#### Suppliers

As in previous years, we encouraged local and national companies to bid for contracts to supply the many goods and services required by the Company. In making purchases, we are mindful that some companies or indeed countries may have poor ethical standards or human rights issues. Covering, as we do, a varied marketplace with a number of indirect manufacturers supporting the end product, it is impossible for us to be certain that we do not indirectly trade with certain companies or countries whose standards are poor. However, we do not knowingly support or trade with such companies or countries and we remain alert to changing circumstances.

#### Caring for the environment

##### Tackling climate change

We believe we have an important part to play in managing the transition of the UK towards a low carbon economy. At Drax Power Station our focus is on co-firing and thermal efficiency improvement.

On co-firing, we aim to produce 12.5% of our output from renewable biomass materials by mid-2010, the equivalent output of around 600 wind turbines which will save over two and a half million tonnes of CO<sub>2</sub> each year.

During 2008, we co-fired 412,000 tonnes of biomass, which, due to the carbon neutral status of biomass, avoided emissions of 644,000 tonnes of CO<sub>2</sub>.

At the centre of our thermal efficiency improvement programme is the £100 million upgrade of the high and low pressure turbines of each of our six generating units. During the major planned outages of 2008 we installed one high pressure and three low pressure turbine modules to each of two units. Together with the early installation of one high pressure turbine module during 2007, this means that we are now just over one-third of the way through the upgrade project and already saving over one-third of a million tonnes of CO<sub>2</sub> emissions a year.

On completion of the upgrade in 2011 we will see an improvement in our overall baseload efficiency of 5%, taking it towards 40%, and an additional annual saving of one million tonnes of CO<sub>2</sub> emissions.

We fully recognise the challenge that we and other fossil fuel-fired power stations face in tackling carbon emissions and these two projects, when complete, will reduce our emissions of CO<sub>2</sub> by over three and a half million tonnes or 17.5% by the end of 2011.

Our focus on co-firing and in particular biomass procurement has made us well placed to pursue the development of a dedicated biomass-fired power generation business. Our plan to develop three 300MW biomass-fired power plants alongside the co-firing capability at Drax Power Station, could result in Drax becoming responsible for supplying at least 15% of the UK's renewable power, and up to 10% of total UK electricity.

At the heart of our work with biomass is our sustainability policy, which places us at the forefront of the introduction of sustainable biomass practices in the UK. Through a set of sustainability principles we aim to ensure that the biomass consumed in our generation facilities is environmentally sustainable.

As a result of our policy we will strive to reduce greenhouse gas emissions by at least 70% in comparison to coal-fired generation. Furthermore, we will engage a qualified third party to develop and implement a rigorous programme of audit and verification of biomass supply chains to ensure compliance against these principles and our policy.

In addition, we have been involved in research projects with industry partners which have the potential for considerable savings in emissions of CO<sub>2</sub>. We participated in Yorkshire Forward's initiative to examine the potential for carbon capture and storage infrastructure in the Yorkshire area which reported in the year.

Taking these initiatives forward, and others like them, is only possible within a regulatory framework which is both certain and predictable. Given the right framework, investment in clean coal technologies which will put the UK on a sure path to a low carbon future, whilst delivering reliable and secure supplies of electricity, will be incentivised.

## Sustainability principles

Our policy is designed to ensure that the biomass consumed in our generation facilities is environmentally sustainable. More specifically, our procurement process is designed to ensure that the production and delivery of our biomass will:

- Significantly reduce greenhouse gas emissions compared with coal-fired generation and give preference to biomass sources that maximise this benefit.
- Not result in a net release of carbon from the vegetation and soil of either forests or agricultural lands.
- Not endanger food supply or communities where the use of biomass is essential for subsistence (for example, heat, medicines, building materials).
- Not adversely affect protected or vulnerable biodiversity and where possible we will give preference to biomass production that strengthens biodiversity.
- Deploy good practices to protect and/or improve soil, water (both ground and surface) and air quality.
- Contribute to local prosperity in the area of supply chain management and biomass production.
- Contribute to the social wellbeing of employees and the local population in the area of the biomass production.

## Business review

## Corporate and social responsibility review

Emissions to air		
Carbon dioxide t/GWh	Sulphur dioxide g/kWh	Nitrogen oxides g/kWh
	2002 1.78	2002 2.55
	2003 1.70	2003 2.49
	2004 1.07	2004 2.36
2005 833	2005 1.01	2005 2.30
2006 844	2006 0.78	2006 2.12
2007 831	2007 0.77	2007 1.99
<b>2008 818</b>	<b>2008 0.71</b>	<b>2008 1.42</b>

## Environmental performance and compliance

We recognise our responsibilities to society and the environment and we are committed to furthering the environmental leadership position we hold in the coal-fired sector. Where practicable we work towards reducing the environmental impacts of our business, in line with our policy to regard compliance with legislation as a minimum level of achievement.

We manage our environmental compliance under an Environmental Management System ("EMS"). During the year our EMS was externally audited and we were successful in maintaining certification to the international standard ISO 14001: 2004.

We freely discuss our environmental performance and activities with our stakeholders and are sensitive to their views and concerns. Amongst our staff, business partners and contractors we promote environmental awareness, ensuring that they understand the environmental aspects of their activities, that they act responsibly and are competent to undertake their duties.

We are pleased to report that there were no breaches of our environmental consents during the year.

## Emissions to air

The principal emissions from burning coal are CO<sub>2</sub>, sulphur dioxide ("SO<sub>2</sub>"), nitrogen oxides ("NO<sub>x</sub>"), and particulates ("dust"). Our generating units have all been retrofitted with Flue Gas Desulphurisation ("FGD") equipment which removes, on average, at least 90% of SO<sub>2</sub> emissions before the flue gas is released via the chimney into the atmosphere.

We maintain investment in our emissions abatement equipment and consider this to be a high priority. Our FGD plant already complies with SO<sub>2</sub> emissions limits to 2016 and we have now completed a programme of retrofitting all units with low NO<sub>x</sub>, Boosted Over Fire Air technology in line with the NO<sub>x</sub> requirements of the Large Combustion Plant Directive ("LCPD"). All of our six units have been retrofitted and performance has been in line with expectations.

## Discharges to water

Procedures are in place to ensure that all discharges and drainage to water are monitored and treated where necessary to meet our discharge consent limits. There are a number of sources of discharge and drainage as part of the electricity generation process, including the cooling water used to cool the condensers, which as part of the steam cycle condense steam to water after it leaves the turbines and before returning to the boilers. The FGD process produces effluent water which is treated in a specially designed plant before it is discharged to the river, and there is also drainage from the main plant, coal plant and roads.

Water is abstracted mainly from the River Ouse and boiler feedwater originates from two boreholes on site. Approximately half of the water is returned to the River Ouse at a few degrees warmer than the river water.

## Disposals to land

When coal is burnt, ash is left as a residue. The finer particles of ash, pulverised fuel ash ("PFA"), are collected from the flue gas by electrostatic precipitators; the heavier ash, furnace bottom ash ("FBA") falls to the bottom of the boiler. The majority of ash is sold to the construction industry with the remainder sent for landfill at the power station's adjacent ash disposal site, which over time has been developed into farmland, woodland and wetland features providing a haven to many species of wildlife and birdlife.

Whilst our target is zero ash landfill, our ability to sell ash depends on the state of the construction industry. Hence performance in 2008 was not as good as we would have liked, reflecting contraction in the construction industry in the second half of the year, and we were forced to dispose of material to the ash disposal site. The construction of an ash rail loading facility was completed in 2008 and this will help us to improve our ash export capability through providing greater and more efficient access to construction markets around the country.

We pay landfill tax on the PFA disposed of to the ash disposal site. Through the Landfill Tax Credit Scheme, we are able to claim a tax credit against our donations to recognised Environmental Bodies. We have worked with Groundwork Selby since 2001 on projects designed to help mitigate the effects of landfill upon our local community. During 2008, we contributed approximately £71,500 towards local community-based projects designed to bring about sustainable environmental benefits and contribute to the social and economic regeneration of the area.

### Alternative fuels

To help maintain our vital role in the UK economy and safeguard cost effective power production, our fuel strategy recognises the need to sustain a ready supply of traditional quality coal and how best to incorporate alternative fuels, including different fossil fuels and renewable biomass materials. The choice of fuels has to be balanced with availability and flexibility of supply. The combustion of petcoke, a fuel derived from the petroleum industry, is an integral part of our strategy of developing and utilising alternative fuels.

A considerable amount of environmental data on the combustion of petcoke has been collected and analysed, where possible using independent specialists. In line with our policy on openness and transparency all data have been made publicly available.

Our results have provided conclusive evidence that there is no detectable impact on the environment through burning blends of coal and up to 15% petcoke compared to coal at Drax and, as a result, in early 2008 the Environment Agency accepted our case for commercial burn of coal/petcoke blends across all six units up to 600,000 tonnes per year of petcoke. The use of petcoke is now a normal part of station operation and during the year we burnt 268,000 tonnes.

### Our people

#### Lifelong learning

We are committed to improving the skill, knowledge and experience of every person in employment. Our actions are focused on enabling individuals to make the most of their personal and potential contribution at work. By its very nature, this is an endless endeavour.

In 2008, we invested over £1,000 per person, (£0.8 million), in training activities to enhance technical skills and knowledge, leadership and management knowledge and experience, and a fundamental understanding of every relevant aspect of safe working and the safety of colleagues. As a consequence, 38 of our people took on a promotion and increased responsibility.

The people at Drax are not merely the crucial asset. Through their dedication, commitment and positive culture they help to achieve outstanding results personally and collectively.



#### Laboratory analysis

The fully equipped laboratory at the power station enables comprehensive analysis of a whole range of samples ensuring close monitoring of our environmental performance.



## Business review

### Corporate and social responsibility review

#### Employment

We employed 727 people at the year end. During the year we increased employment by 40 jobs. We endeavour to recruit in our local catchment area.

Nearly four out of ten Drax people have been with the Company for 20 years or more, constituting a unique core of skill, experience and knowledge. Our employee retention rate is over 96% per annum.

Our compliance with all relevant legislation and regulations is non-negotiable.

We work to achieve high standards in the areas of employment practices, for example, through the avoidance of discriminatory practices, and the speedy and clear resolution of queries and grievances. We review each of our policies and procedures on a regular basis, normally annually, to ensure improvement of service and legal compliance.

#### Industrial partnership

We recognise and negotiate with independent Trades Unions representing a substantial number of our people. This is a long-standing and well-developed partnership. Both parties work hard to ensure that more objectives are shared than are disputed.

As a consequence, we maintain a positive industrial relations climate in which continuity of the Company's operations is acknowledged to be paramount. We are committed to be fair in the settlement of any grievances or dispute. We undertake to consult staff fully on all changes that have a material impact on their employment.

#### Quality of internal communication

We use a variety of communication techniques, one-way and two-way, formal and informal, to ensure that all our staff are kept fully informed of developments in the Company's operations.

In the last year the communication methods have included monthly team briefs to all staff, plant-wide meetings at least every six months on Company performance and major initiatives, written communications such as leaflets and newsletters, e-mails, and 360° feedback. The Company intranet is also widely used.



#### Internal communication

We strive to communicate in a clear and timely manner to all our employees. In 2008, we launched our newsletter, theGen, which covers a range of work-related and human interest topics.





### Fair pay and benefits

We operate fair and visible remuneration policies which ensure that staff are paid an appropriate salary for the work they undertake. The lowest level of salary paid at Drax is substantially higher than the national minimum wage.

Benefits, such as holidays and pension, match or exceed the best in the industry sector and the local area.

We commission independent experts to benchmark our salaries and benefits at every level against the industry sector and the market as a whole. We also participate in specialist industry meetings to exchange information and developments in employment policy.

We commit to maintain and support a range of share plans which encourage all of our staff to build a personal stake in the ownership of the business. In the case of executive directors and senior staff this includes a commitment to own shares to a significant percentage of their annual salary.

### Health and wellbeing

Health and safety is our priority. We are committed to promoting the wellbeing of all our staff and to ensure a professional response to all emergency situations that occur. We ensure that our first aid response is the best that we can make it by training our staff to the highest level we can.

Our occupational health team undertakes regular programmes to screen colleagues who are in contact with high noise-levels and sensitive respiratory conditions. Everyone working in operational areas has a three-yearly lung function test. Eye-sight tests are carried out for all on a three-year cycle, alongside the periodic medical examination. During 2008, 200 employees were tested and given specialist advice.

In 2008, the occupational health team promoted a "Stop Smoking" campaign, supported by the Hull and East Riding stop smoking service.

The average level of absence at Drax for 2008 was 2.8%, lower than the UK average for the manufacturing/industrial working environment.

### New skills for young people

Drax runs an active and developing apprenticeship programme, currently training 24 young men and women over a four-year training period. In 2008, our second year apprentices won the Apprentice Team Award, and one of its number, Oliver Dann, won Power Generation Apprentice of the Year and the Engineering Academy Apprentice of the Year Award.

### The third age

Each year we invite over 350 Drax pensioners to a celebratory event at Christmas. The Retired Employees Association organise trips and other events during the course of the year for our people who have now retired from Drax.

There are 117 Pensioners in the Drax Power Group Section of the Electricity Supply Pension Scheme ("ESPS"), 54 deferred members and 425 active contributors still working at Drax. Since 2000, new recruits have joined the Group Personal Pension Plan which now has 268 contributing members.

### Health and safety

Health and safety is at the heart of our corporate responsibility. Protecting our employees, contractors and all visitors from injury and promoting employee wellbeing is fundamental to our business philosophy. We are committed to developing and maintaining a positive health and safety culture in which statutory requirements are viewed as a minimum standard and leading performance our goal.

### Personal safety statistics

	2004	2005	2006	2007	2008
Fatality	0	0	0	1	0
Lost time accident	8	7	2	10	4
Restricted work accident	6	4	1	2	1
Medical treatment accident	5	1	1	3	7
First aid	182	140	127	267	273
RIDDOR <sup>(1)</sup> reportable	6	6	2	13	7

Notes:

(1) Reporting of Injuries, Diseases and Dangerous Occurrences Regulations.

### Attaining leading performance

The lost time injury rate and total recordable injury rate for 2008 are significantly lower than in 2007. This improvement in performance is commendable given the significant increase in contractor man-hours worked during the year, and is a clear indication that the safety programmes implemented in the last few years are now delivering sound sustainable performance. Our safety record continues to compare favourably with that of our sector peers and international benchmarks.

The Company has been successful in retaining accreditation of its Health and Safety Management System to the recently updated internationally recognised Occupational Health and Safety standard OHSAS 18001. Drax is proud to be one of a select group of large coal-fired power stations in the country to hold this standard, which is approved by Lloyd's Register Quality Assurance. In addition to this, the Company was equally delighted to be awarded the RoSPA Gold Award for the fourth year running.

### Processes underpinning performance

The Production Integrity Management Systems ("PIMS") programme launched last year continues to provide the platform the business needs to deliver continuous improvement of business critical systems which are fundamental to the safe and effective operation of the power station.

"Spotlight on Safety" is our implementation of the internationally proven DuPont™ STOP™ programme. This behavioural safety programme coupled with the Drax Task Risk Assessment ("TRA") process, the "Safety Kick-Off" start of shift safety briefings and the dynamic point of work risk assessment ("POWRA") initiatives give us the framework we need for open engagement between operatives and supervisors to develop the defensive behaviours which are a fundamental component of the robust world-class safety culture we aspire to create.

### Accident frequency rate

#### Lost time injury rate

2004	0.42
2005	0.35
2006	0.08
2007	0.34
2008	0.10

#### Total recordable injury rate

2004	0.99
2005	0.60
2006	0.17
2007	0.49
2008	0.31

Notes:

(1) Lost time injury rate = (number of time losing injuries / hours worked) x 100,000.

(2) Total recordable injury rate = ((number of time losing injuries + number of worst than first aid injuries) / hours worked) x 100,000.

## Business review

### Corporate and social responsibility review

#### Safety leadership and recognition

The Company has made a concerted effort to improve the critical safety leadership contribution required from first line supervisors. The expectations of both management and supervisors have been debated afresh and reaffirmed in a Safety Leadership Charter.

People working on the site at all levels who have demonstrated safety leadership have been given recognition awards.

#### Communicating the safety message

Our "Weekly Safety Bulletin" briefing process provides a fast track communication vehicle to reach all those working on the site. We use the process to draw attention to specific safety issues, our performance record and to recognise achievements. Active engagement in the safety briefing process is a job requirement. In addition, the safety representatives and management team members of the Health and Safety Advisory Committee continue to play a vital role in facilitating staff consultation on health and safety issues.

Our ongoing safety exchange relationships with ScottishPower's Longannet Power Station and E.ON's Ratcliffe-on-Soar Power Station continue to provide new ideas and a stimulus to drive our health and safety improvement efforts forward.

#### Caring for the community

We are committed to being a good neighbour to our local community and our "caring for the community" philosophy involves being part of local and regional communities. Our involvement takes the form of sponsoring a variety of local charities and fund raising events, promoting our own campaigns which focus on the three themes of youth sport, education and the environment, and maintaining open communication channels and good working relationships with the region's key opinion formers.

#### Sponsorship in the community

During 2008, we gave financial support of £137,012 in total across a range of charitable and non-charitable causes. Of that total, charitable donations amounted to £99,952 (2007: £73,754).

Some £24,000 of the total donations were made under the direction of our sponsorship team, across a range of activities within a 20-mile radius of the power station.

Each month the team meets to consider requests received for charitable donations and community sponsorship and makes awards against our criteria of furthering community, environmental and sporting interests.

An example of the good causes supported through the sponsorship team in 2008 is The Prince of Wales Hospice in Pontefract, West Yorkshire. Providing services to around 190,000 local people, the hospice cares for adults with progressive illnesses free of charge. Heavily dependent on donations, we are pleased to play a small part in helping to keep these services available.

Drax also operates a "£ for £" matching scheme, under which we match, £ for £, any monies raised for charity by employees. During 2008, approximately £31,300 of the total donations made were through this scheme.

For the fourth year running, we ran a scheme to encourage and reward good safety performance during the planned outage periods. Through the scheme £500 is donated for every seven days that goes by without an injury requiring more than first aid treatment. In total £8,000 was raised during the two outages. The money was divided equally between Lindsey Lodge Hospice in Scunthorpe, a charity chosen by Drax and Martin House Children's Hospice in Boston Spa, selected by our contractors, Doosan Babcock.



#### Caring for the community

Our approach to community engagement takes many forms, but adheres to the themes of environment, education and youth sport.

For the second year running we held a charity corporate golf tournament at the championship course at Fulford, York. The event raised £3,000 for The Yorkshire Air Ambulance, which provides a crucial emergency service for the region.

Other sponsorship activities included a £40,000 donation to the Selby Abbey Restoration Appeal. The donation not only ensured that the Appeal's £4.5 million target was met, but importantly that a reserve fund was set up to assist with future restoration work.

**Education in the community**

Our "Cricket in the Community" initiative launched in May 2006 has continued to prove popular with local schools. The England and Wales Cricket Board ("ECB") qualified coaches on our staff, together with England ladies' cricketer, Katherine Brunt took cricket coaching to schools in the local area as part of our support for education and to promote sports learning as part of the National Curriculum.

Strengthening our links with the game of cricket, for the second year we ran the Drax Cup, a cricket competition for teams of girls and boys under the age of nine.

A total of 270 primary schools, treble the number of last year, across Yorkshire took part in the knock-out tournament organised by The Yorkshire County Cricket Club ("Yorkshire CCC") in conjunction with The Yorkshire Cricket Board and The Yorkshire Schools' Cricket Association. The semi-finals and final were played at Headingley Carnegie Stadium, the home of Yorkshire CCC and a long-standing venue for test matches and one-day internationals. This year the winning school was High View Learning Centre, in Wombwell, near Barnsley.

Under the "Art in the Community" banner, we held our second art competition for primary and secondary schools. Double the number of entries of the previous year's competition were received and the winners and their schools shared in prize money totalling over £2,500.

We also held a two-day art camp in the Summer for seven to 13 year-olds. Under the guidance of local artist, Mark Hearld, the budding artists produced their own artistic interpretations of the Drax nature reserve and the materials handling area of the power station site. The artwork is to be pieced together to produce a large format mural which will become a permanent feature in the newly refurbished materials handling offices.

**Visitors to Drax**

Thousands of visitors are welcomed to the power station every year. The appeal of discovering more about how power is produced and the sheer scale of the site and its associated activities attracts schools and colleges as well as business organisations and associations. During 2008, we played host to some 6,550 visitors.

Visitors	
2006	5,000
2007	5,750
2008	6,550





This image shows the heart of our trading systems, updated during the year with sophisticated and dynamic analysis software personalised to our trading needs.

## Trading - our specialism in getting power to market

Throughout the year we maintained our focus on delivering added value from our 24/7 trading capability. In 2008, we continued to improve our ability to hedge our output and expand the options available to us through setting up a gas trading desk, providing a natural hedge for our power sales.



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# 24/7

## Board of directors

### Charles Berry

Chairman  
Age 56



**Appointment to the Board:**

15 December 2005 and was appointed Chairman on 17 April 2008.

**Committee Membership:**

Nominations (Chairman) and Remuneration.

**External Appointments:**

The non-executive Chairman of eaga plc and a non-executive director of Securities Trust of Scotland plc and of Impax Environmental Markets plc.

**Previous Experience:**

Charles has extensive experience within the UK power sector. He joined ScottishPower in 1991 and was appointed to the board in 1999. From 2000 to 2005, Charles was Chief Executive of the company's UK Operations, with responsibility for over 6,200MW of generating capacity as well as the trading business, energy retailing and strategic transactions, such as renewables development. Charles is also a former non-executive director and Chairman of THUS Group plc.

**Qualifications:**

BSc (Hons) in Electrical Engineering and a Masters degree in Management.

### Dorothy Thompson

Chief Executive  
Age 48



**Appointment to the Board:**

20 October 2005, having joined Drax in September 2005.

**Committee Membership:**

Executive, and Health and Safety.

**External Appointments:**

A non-executive director of Johnson Matthey plc.

**Previous Experience:**

Dorothy was previously the head of the European business of InterGen NV, the power generation subsidiary of Shell NV and Bechtel Inc., responsible for the management and operation of four gas-fired power plants, totalling some 3,160MW of capacity across the UK and the Netherlands. Prior to joining InterGen NV in 1998, Dorothy was initially in banking and subsequently was assistant group treasurer for Powergen plc.

**Qualifications:**

BSc (Hons) and MSc in Economics.

### Tony Quinlan

Finance Director  
Age 43



**Appointment to the Board:**

1 September 2008.

**Committee Membership:**

Executive.

**External Appointments:**

None.

**Previous Experience:**

Tony qualified as Chartered Accountant with Coopers & Lybrand and subsequently joined Marks & Spencer where he went on to hold a number of senior positions within Internal Audit, Corporate Finance, Investor Relations and Financial Control. From 2005, he was Director of Finance, the deputy to the Group Finance Director.

**Qualifications:**

BSc (Hons) joint degree in Chemistry and Business Studies.

### Peter Emery

Production Director  
Age 46



**Appointment to the Board:**

20 October 2005, having joined Drax in June 2004.

**Committee Membership:**

Executive, and Health and Safety.

**External Appointments:**

A director of the Association of Electricity Producers.

**Previous Experience:**

Peter joined Esso Petroleum upon leaving university and held a number of analyst and managerial roles in the UK before moving to Esso's parent, Exxon in the US to co-ordinate its downstream marketing and distribution investments outside North America and Canada. Peter returned to Esso in 1992 as plant technical services manager at Fawley Oil Refinery. He then undertook roles managing various operational areas at the refinery before moving to refinery maintenance manager in 1997. He was appointed operations manager at Fawley Oil Refinery in 2002, with full responsibility for the management and operation of the UK's largest refinery and a member of Exxon Mobil's European leadership team for refining.

**Qualifications:**

BSc (Hons) in Mining Engineering and completed the Advanced Management Programme at INSEAD in 2007.

## Tim Barker

Senior independent non-executive director  
Age 68



### Appointment to the Board:

20 October 2005, having joined Drax in June 2004, and was appointed as the senior independent director on 15 December 2005.

### Committee Membership:

Remuneration (Chairman), Audit and Nominations.

### External Appointments:

The senior independent non-executive director of Electrocomponents plc and a Member of the Professional Oversight Board of the Financial Reporting Council.

### Previous Experience:

From 1993, Tim was Vice Chairman of Kleinwort Benson Group plc and from 1998, until his retirement in 2000, he was Vice Chairman of Dresdner Kleinwort Benson. Notably, he was involved with a number of clients in the energy sector and was an adviser to the UK Government on the privatisation of the electricity sector. In the mid-1980s, Tim was Director General of the City Panel on Takeovers and Mergers. He is a former Chairman of Robert Walters plc.

### Qualifications:

MA in Economics.

## Jamie Dundas

Independent non-executive director  
Age 58



### Appointment to the Board:

15 December 2005.

### Committee Membership:

Audit (Chairman), Nominations and Remuneration.

### External Appointments:

The non-executive Chairman of Jupiter Investment Management Group, a non-executive director of Standard Chartered PLC, and Chairman of Macmillan Cancer Support.

### Previous Experience:

Jamie's career has been in merchant banking, finance and the property sector. Jamie spent 19 years with Morgan Grenfell Group, including ten years as a director of Morgan Grenfell & Co Limited. Jamie was Finance Director of the Airport Authority, Hong Kong between 1992-1996 before joining MEPC plc in 1997, initially as Finance Director and from 1999-2003 as Chief Executive. He is also a former non-executive director of J Sainsbury plc.

### Qualifications:

MA (Oxon) in Law and a Barrister (non-practising).

## Mike Grasby

Independent non-executive director  
Age 65



### Appointment to the Board:

20 October 2005, having joined Drax in December 2003.

### Committee Membership:

Audit, Health and Safety (Chairman), Nominations, and Remuneration.

### External Appointments:

A non-executive director of OPG Power Venture plc, a director of executive recruitment business, Strategic Dimensions Technical Limited and adviser to a Hong Kong based joint venture acting as an international marketing partner for the Shanghai Electric Corporation.

### Previous Experience:

Mike retired from International Power in February 2002 after 36 years in the power industry. During his career he held a number of senior positions in the UK and international power industry with the CEBG and National Power. He was manager of Drax Power Station between 1991 and 1995, and director of operations for National Power's portfolio, with responsibilities for over 16,000MW of generating capacity, until 1998. Mike was also a director of power companies in Portugal, Turkey and Pakistan. Following the demerger of National Power, he joined International Power as senior vice-president, continuing with his international directorships and leading a major consortium in the Czech Republic.

### Qualifications:

Chartered Engineer, FIET and FIMechE.

## David Lindsay

Independent non-executive director  
Age 61



### Appointment to the Board:

1 December 2008.

### Committee Membership:

Audit, Nominations, and Remuneration.

### External Appointments:

A non-executive director of Premier Oil plc, a member of the advisory board of Gartmore, deputy chairman of the Financial Reporting Review Panel and a member of the Supervisory Board of the European Financial Reporting Advisory Group.

### Previous Experience:

David was a partner at Ernst & Young for nearly 30 years. He specialised in audit and assurance services and has extensive experience across a range of industry sectors. He was a member of the Turnbull Committee and was a member of the Auditing Practices Board for a number of years.

### Qualifications:

Fellow of the Institute of Chartered Accountants in England and Wales (FCA).

## 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 2008.

### Annual General Meeting

The fourth Annual General Meeting ("AGM") of the Company will be held on 28 April 2009, 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 42 to 57.

### Business review

A review of the development and performance of the business of the Group during the year ended 31 December 2008, 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 pages 2 and 3. The Business review on pages 6 to 33 incorporates the Chief Executive's statement, 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 Business review is a constituent part of this Directors' report.

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 significant 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 61.

### Going concern

After making enquiries, the directors have formed a judgement, at the time of approving the financial statements, that there is a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason the directors continue to adopt the going concern basis in preparing the financial statements.

### 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 46 and 47 and also in the Business and financial review on pages 12 to 23.

### Dividends

Details of the dividends paid and proposed on the ordinary share capital by financial year to which these relate are shown below:

	2008 £m	2007 £m
<b>Interim and final dividends</b>		
Interim dividend paid on 8 October 2008 of 5.0 pence per share (24 October 2007: 4.7 pence per share)	17.0	16.3
Proposed final dividend to be paid on 22 May 2009 <sup>(1)</sup> of 38.3 pence per share (7 May 2007: 9.9 pence per share)	130.0	33.6
<b>Special dividends</b>		
Paid on 8 October 2008 of 9.7 pence per share (24 October 2007: nil)	32.9	-
Paid on 7 May 2008: 7.8 pence per share	-	26.5

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 2008, 339,397,000 ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each in the Company were in issue and at 31 December 2008, 339,398,968 ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each in the Company were in issue. The following details the changes to the share capital during the year.

### Share issues

During the year, a total of 1,968 ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each were issued in satisfaction of share options which were exercised in accordance with the rules of the Drax Group plc Approved Savings-Related Share Option Plan.

### Authority to purchase own shares

At the AGM of the Company held on 17 April 2008, 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 Annual General Meeting.

The Company did not purchase any of its own shares during 2008.

The Company held no Treasury shares during 2008.

Details of the share capital as at 31 December 2008, and shares issued during the year, are given in note 19 on page 80.

## Directors

The current directors are Tim Barker, Charles Berry, Jamie Dundas, Peter Emery, Mike Grasby, David Lindsell, Tony Quinlan and Dorothy Thompson. Biographical notes of the directors appear on pages 36 and 37.

Gordon Horsfield retired as a non-executive director and Chairman of the Board at the conclusion of the AGM held on 17 April 2008. He had been a director since 15 October 2005 and was succeeded as Chairman by Charles Berry.

Gordon Boyd resigned as a director and left the Company on 31 August 2008. He had been a director since 15 October 2005. Tony Quinlan was appointed Finance Director of the Company on 1 September 2008.

David Lindsell was appointed a non-executive director of the Company on 1 December 2008.

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, Charles Berry, Jamie Dundas and Dorothy Thompson will retire by rotation at the forthcoming AGM and, being eligible, offer themselves for re-election. The evaluation of the Board described on page 44 concluded that the directors offering themselves for re-election continue to demonstrate commitment to their particular role and perform effectively.

The Company's Articles of Association also require that, following appointment by the Board, directors submit themselves for election by shareholders at the first AGM following their appointment. Tony Quinlan was appointed to the Board of the Company on 1 September 2008 and David Lindsell was appointed to the Board of the Company on 1 December 2008 and, therefore, both retire and offer themselves for re-election at the AGM.

The re-election of each director is recommended by the Board. Details of the relevant terms of appointment and service agreements appear on page 54.

The rules relating to the appointment or replacement of directors are highlighted in the Corporate governance report on page 42.

## 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.

Details of directors' remuneration, service contracts and interests in the shares of the Company are set out in the Remuneration Committee report on pages 49 to 57.

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 an £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.

## Directors' report

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 20 February 2009, the following shareholders had notified the Company that their holdings exceeded the appropriate disclosure and notification thresholds:

	Number of ordinary shares directly held	Number of ordinary shares indirectly held	Total number of ordinary shares held	% of the issued ordinary share capital held
Invesco plc	-	100,966,140	100,966,140	29.74
AXA S.A.	1,641,991	19,534,443	21,176,434	6.23
Barclays Global Investors	-	11,827,092	11,827,092	3.48
<b>Total shares held by substantial shareholders</b>	<b>1,641,991</b>	<b>132,327,673</b>	<b>133,969,666</b>	<b>39.45</b>

### Employees

A commentary on employee involvement and the Group's commitment to its employees is set out within the Corporate and social responsibility review on pages 26 to 33 and details of employee involvement through share participation are contained in the Remuneration Committee report on pages 49 to 57.

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 create a common awareness on the part of all employees of the financial and economic factors affecting the performance of the Company. 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. Details of the communication methods used are provided in the "Our People" section of the report on Corporate and social responsibility on pages 29 to 31.

It is the Group's policy to give full and fair consideration to suitable applications for employment from people with disabilities having regards to their particular aptitudes and abilities. 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 policies and operations are set out on pages 26 to 33.

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 page 43 takes account of social, environmental and ethical risks.

### Charitable donations

The Group has continued to support community initiatives and charitable causes. The total charitable donations made by the Group in the year were £99,952 (2007: £73,754). More information on the charitable donations made is contained within the Corporate and social responsibility review on pages 32 and 33.

## Political donations

No political donations were made in the UK or elsewhere during the year (2007: £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 2008 represented approximately 21 days of average daily purchases through the year (2007: 22 days).

## Auditors and the disclosure of information to the auditors

So far as each person who is 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, 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 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 46 and 47.

By order of the Board.

Philip Hudson  
Company Secretary  
2 March 2009



Registered Office:  
Drax Power Station  
Selby  
North Yorkshire YO8 8PH  
Registered in England No. 5562053

## Corporate governance

### The Board of directors

As at 2 March 2009, the Board comprised the non-executive Chairman, four independent non-executive directors and three executive directors. The directors are named in the Directors' report on page 39 and their principal commitments outside the Group are described within their biographical notes on pages 36 and 37. The Board meets at least six times each year and more frequently if appropriate. In addition, the Board meets at least annually to consider Group strategy.

Charles Berry is the Chairman, having succeeded Gordon Horsfield who retired as a non-executive director and Chairman of the Board at the conclusion of the Company's Annual General Meeting on 17 April 2008. The Board considered that Charles Berry was independent on appointment as a director of the Company in December 2005.

Dorothy Thompson is the Chief Executive and is responsible for all aspects of the stewardship of the Group and its business, including developing an appropriate business strategy for Board approval and securing its timely and effective implementation. She provides leadership to the executive team and takes responsibility for the important external relationships with customers, suppliers, regulatory agencies and government bodies. The division of responsibilities between the Chairman and the Chief Executive is set out in writing, was agreed by the Board on 14 December 2005 and was reviewed and varied by the Board on 23 October 2006.

Tony Quinlan is the Finance Director, having succeeded Gordon Boyd on 1 September 2008. He is responsible for the financial management of the Group, and for relationships with the Group's bankers. He is the Chairman of the Risk Management Committee of Drax Power Limited. That committee provides reports to the Board on a monthly basis.

Peter Emery is the Production Director and is responsible for the operation, safety, repair and maintenance of the electricity generation plant at the power station and for the Drax site.

Tim Barker, Jamie Dundas and Mike Grasby have served the Group as independent non-executive directors throughout the year ended 31 December 2008. Having reviewed their position, the Board has again concluded that each of them is independent within the meaning of the Combined Code. Tim Barker is the senior independent director. David Lindsell was appointed a non-executive of the Company on 1 December 2008 and is considered by the Board to be independent.

The Company's Articles of Association provide that one-third of directors (rounded down to the nearest whole number) shall retire by rotation each year but are eligible to submit themselves for re-election by shareholders and that directors shall not serve longer than the third Annual General Meeting ("AGM") following their election without being re-elected by shareholders. Charles Berry, Jamie Dundas and Dorothy Thompson retire by rotation this year and offer themselves for re-election by shareholders at the next AGM. The Board considers it appropriate that each of them be re-elected because of their individual experience and knowledge within the electricity generation sector, wider management and industry experience. After performance evaluation, the Board has concluded that each continues to be effective and committed to their role.

The Company's Articles of Association also require that, following appointment by the Board, directors submit themselves for election by shareholders at the next AGM. Tony Quinlan was appointed to the Board of the Company on 1 September 2008 and David Lindsell was appointed to the Board of the Company on 1 December 2008 and, therefore, both will retire and offer themselves for election at the AGM. The Board considers it appropriate that each of them be re-elected because of their recent and relevant financial experience and their wider management and industry experience.

Tim Barker, Jamie Dundas and Mike Grasby have each agreed new letters of appointment during the year, by which the terms of their appointment were changed from an indefinite period to a six-year term from 15 December 2005, subject to one month's notice. David Lindsell holds a letter of appointment for a three-year term from 1 December 2008, subject to one month's notice of termination. Charles Berry's letter of appointment provides for a three-year term from 17 April 2008, subject to six months' notice on either side. It is the Board's policy that each non-executive director will be appointed for a term of three years which, subject to the Board being satisfied as to the director's performance and commitment and a resolution to re-elect at the appropriate AGM, may be renewed by mutual agreement. However, in the case of the independent non-executive directors, it is the Board's policy not to extend the aggregate period of service of any independent non-executive director beyond nine years and, as required by the Combined Code, any proposal made to extend a non-executive director's aggregate period of office beyond six years will be the subject of a rigorous review.

The Board has adopted a schedule of matters reserved for its decision and formal terms of reference for its committees which are available to view on the Group's website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk). The Board determines: the Group's strategy; the Group's appetite for risk (particularly in its trading activities); the internal control and risk management policies; the business plan and key performance indicators; acquisitions and disposals and other transactions outside delegated limits; material changes to accounting policies or practices; significant financial decisions; capital structure and dividend policy; shareholder communications; prosecution, defence or settlement of material litigation; Group remuneration policy; the terms of reference of Board committees; and the Board structure, composition and succession. Matters which are not specifically reserved to the Board and its committees under their terms of reference, or to shareholders in General Meeting, are delegated to the Chief Executive or otherwise delegated in accordance with a scheme of delegation approved by the Board.

The Board receives regular reports on performance against the business plan and periodic business reports from senior management. Directors are briefed on matters to be discussed at meetings by papers distributed in advance of Board and committee meetings.

The Board is satisfied that all the directors are able to devote sufficient time to their duties as directors.

The Board has adopted a policy whereby directors may, in the furtherance of their duties, seek independent professional advice at the Company's expense. During 2008, Charles Berry sought independent legal advice pursuant to the policy in connection with the duties under sections 175 and 177 of the Companies Act 2006 to avoid conflicts of interest, which concluded there were no issues.

Amended Articles of Association came into effect on 1 October 2008, giving the directors power to approve conflicts of interest. The Board has adopted a procedure by which situations giving rise to potential conflicts of interest are identified to the Board, considered for authorisation and recorded.

Each director has the benefit of a deed of indemnity from the Company and its subsidiaries in respect of claims made and liabilities incurred, in either case arising out of the bona fide discharge by the director of his or her duties. The Company has also arranged appropriate insurance cover in respect of legal action against directors of the Company and its subsidiaries.

## Internal control

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. A process has been established for identifying, evaluating and managing the significant risks faced by the Group and this has been in place for the year under review up to the date of approval of the Annual Report and Accounts. The process is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, not absolute, assurance against material misstatement or loss.

The Group's risk management process aims to be comprehensive, systematic and continuous. Its key features include the identification and recording of the main risks facing the Group in a risk register with clear allocation of management responsibility for risk identification, analysis and control. The Group has comprehensive and well defined control policies with clear structures, delegated authority levels and accountabilities. During the year, the Group has enhanced its procedure governing appraisal and approval of investment and development expenditure. Post completion reviews are required on significant investment and development project expenditure.

The Group has a system of planning and monitoring, which incorporates Board approval of a rolling five-year business plan and approval, towards the end of each year, of operating and capital expenditure budgets for the year ahead. Performance against the budget is subsequently monitored and reported to the Board on a monthly basis. The Board also receives monthly reports on trading risk exposure as compared to the pre-set limits and monitors overall Company performance against a corporate balanced scorecard which shows progress against a set of financial, operating, safety and other targets set at the start of the year. Performance is reported formally to shareholders through the publication of Group results. Operational management make frequent reports on performance to the executive directors.

During the year, the Board reviewed arrangements for the management of commodity trading risk. Monitoring is undertaken by a Risk Management Committee of the principal operating subsidiary, Drax Power Limited, chaired by the Finance Director. The Board receives a summary report from the Risk Management Committee each month.

Through the Audit Committee the Board has implemented and annually reviews and updates a programme of internal audit reviews of different aspects of the Group's activities designed to ensure that, over time, all facets of the business are reviewed to ensure appropriate systems of control are in place and are working effectively or, where they are not, deficiencies are rectified by timely and appropriate action. In agreeing the actions to be taken in response to each report, the aim is always to embed internal controls, including measures intended effectively to identify and manage risk, within each area of the Group's operations. In parallel with its work in relation to internal audit, the Audit Committee also satisfies itself that an action plan for dealing with points raised by the external auditors in their yearly management letters is being properly addressed by management.

With the assistance of the Audit Committee, the Board has reviewed the effectiveness of the system of internal control. It has reviewed the reports of the Audit Committee, which has considered all significant aspects of internal control including financial, operational, trading, compliance, social, environmental and ethical risks in accordance with the "Internal Control: Guidance for Directors on the Combined Code" issued in September 1999 and updated in October 2005.

Following its review the Board determined that it was not aware of any significant deficiency or material weakness in the system of internal control.

## Corporate governance

### Committees of the Board

The Board has established the following standing committees:

Committee	Membership
<b>Audit Committee</b>	Jamie Dundas (as Chairman), Tim Barker, Mike Grasby and David Lindsell.
<b>Remuneration Committee</b>	Tim Barker (as Chairman), Charles Berry, Jamie Dundas, Mike Grasby and David Lindsell.
<b>Nominations Committee</b>	Charles Berry (as Chairman), Tim Barker, Jamie Dundas, Mike Grasby and David Lindsell.
<b>Health and Safety Committee</b>	Mike Grasby (as Chairman), Dorothy Thompson, Peter Emery and the Head of Safety.

Details of the work of the Audit, Nominations and Remuneration Committees are given in the reports of those Committees on pages 46 to 57.

The Board attaches particular importance to the role of its Health and Safety Committee because of the fundamental importance of safety systems and procedures in a large and complex plant such as that of Drax Power Station. The Committee's terms of reference provide for it to review policy, monitor performance and hold management accountable for the efficacy of the Group's health and safety procedures and performance.

### Board and Board Committee attendance

The table below shows the number of meetings, and attendance at them by directors, of the Board, Audit, Nominations, Remuneration, and Health and Safety Committees of Drax Group plc during 2008.

The number in brackets represents the maximum number of meetings that each individual was entitled to and had the opportunity to attend.

	Board	Audit Committee	Nominations Committee	Remuneration Committee	Health and Safety Committee
Tim Barker	11 (11)	4 (4)	5 (5)	7 (7)	-
Charles Berry	11 (11)	1 (1)	5 (5)	7 (7)	-
Gordon Boyd	7 (7)	-	-	-	-
Jamie Dundas	11 (11)	4 (4)	4 (5)	6 (7)	-
Peter Emery	11 (11)	-	-	-	2 (2)
Mike Grasby	11 (11)	3 (3)	5 (5)	7 (7)	2 (2)
Gordon Horsfield	3 (3)	-	1 (1)	-	-
David Lindsell	1 (1)	1 (1)	-	-	-
Tony Quinlan	4 (4)	-	-	-	-
Dorothy Thompson	11 (11)	-	-	-	1 (2)

### Performance reviews and directors' development

The effectiveness of the Board is vital to the success of the Group. During the year, the Company undertook a review to assess the performance of the Board and its committees. In addition, a review of individual director's performance was facilitated by Corporate Partners, a consultancy specialising in providing assurance to listed companies on best practice in company regulation and corporate governance.

The directors and Company Secretary each completed questionnaires on the Board and committee performance and on the performance of each individual. Summarised reports were presented to the Board, and individual reports were presented to the Chairman (with a report on the Chairman presented to the senior independent director). Individual feedback sessions were later conducted by the Chairman, and by the senior independent director in relation to the Chairman. The conclusions were that the Board and its committees were effective and performance compared well with that of other companies, and that each director continued to perform effectively in their role.

As stated in its report on pages 49 to 57, in February 2009, when deciding the executive directors' bonuses for 2008, the Remuneration Committee also evaluated the performance of each of the executive directors, against both corporate targets and personal objectives. This evaluation was informed by the results of a confidential survey of senior managers' opinions, which also covered the Chairman. The results of this survey were fed back to relevant directors.

During the year, the Chairman held meetings with the non-executive directors in the absence of the executive directors as required by provision A.1.3 of the Combined Code.

The Board is committed to the development of all employees and directors and has reviewed and will periodically again review each individual director's development requirements and make appropriate arrangements to address them. All new directors receive an induction, including information about the Company and their responsibilities, meetings with key managers and visits to the Company's site. In addition, specific Board training days are arranged involving presentations on relevant topics.

## Relations with shareholders

The Board places considerable importance on communication with shareholders and is proactive in obtaining an understanding of shareholder preferences and evaluating systematically the economic, social, environmental and ethical matters that may influence or affect the interests of shareholders. A number of formal communication channels are used to account to shareholders for the performance of the Group, which include the Annual Report and Accounts, the AGM and periodic reports to the London Stock Exchange. Presentations given at appropriate intervals to representatives of the investor community are available to all shareholders to download from the Group's website. Less formal processes include contacts with institutional shareholders by the Chairman and other directors.

Major shareholders are regularly offered the opportunity to meet with the Chairman. The Board also reviews and discusses the investor feedback from post-results investor meetings conducted by the Chief Executive and the Finance Director in the UK, Europe and the USA. These took place following both the preliminary and half year results announcements in 2008. The Company has also engaged Makinson Cowell, an independent capital markets consultancy firm, to advise and assist in relation to communications with shareholders.

The Company's private registered shareholders hold approximately 1% of the issued share capital. The Board is as interested in their concerns as it is in the concerns of institutional and corporate shareholders. All shareholders are free to put questions to the Board at the AGM. Questions asked in person at the AGM will receive an oral response whenever possible. Otherwise a written response will be provided as soon as practicable after the meeting. Questions asked at other times will normally receive a written response. Shareholders attending the AGM will have an opportunity to meet informally with the directors immediately after the meeting.

All information reported to the market via a regulatory information service also appears as soon as practicable on the Group's website.

This Annual Report and Accounts together with other public announcements is designed to present a balanced and understandable view of the Group's activities and prospects. The Chairman's introduction, Chief Executive's statement, Business and financial review, and Corporate and social responsibility review provide an assessment of the Group's affairs. This Annual Report and Accounts is despatched to shareholders at least 20 working days before the AGM and the accompanying Form of Proxy provides for a shareholder to vote in favour or against, or to indicate abstention as an alternative on each separate resolution. Particulars of aggregate proxies lodged will be announced to the London Stock Exchange via a regulatory information service and placed on the Group's website as soon as practicable after the conclusion of the AGM.

## Compliance with the Combined Code

It is the Board's view that throughout the period commencing on 1 January 2008, there has been full compliance with the provisions of Section 1 of the Combined Code, with the exception that, as the former holder of an executive office, Gordon Horsfield as Chairman was not independent within the meaning of the Combined Code provision A.2.2 from the start of the year up until his retirement on 17 April 2008.

## Statement of directors' responsibilities

The directors are responsible for preparing the Annual Report and Accounts. The accounts for the Group have been prepared in accordance with International Financial Reporting Standards ("IFRSs") and for the Company in accordance with United Kingdom Generally Accepted Accounting Practice ("UK GAAP"). In the case of the IFRS Group Accounts, IAS 1 requires that Accounts present fairly for each financial year the Group's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition and measurement criteria for assets, liabilities, income and expenses set out in the IAS Board's "Framework for the Preparation and Presentation of Financial Statements". In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. A fair presentation also requires the directors to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

In the case of UK GAAP Accounts, the directors are required to prepare Accounts for each financial year, which give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for the period. In preparing these Accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Accounts.

The directors are responsible for maintaining proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group, for safeguarding the assets, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' report and Directors' Remuneration Committee report which comply with the requirements of the Companies Act 1985.

Legislation in the United Kingdom governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. During 2007, the website underwent a complete overhaul and now has much improved information content and navigation capabilities.

## Audit Committee report

### Membership and process

The Committee comprises Jamie Dundas (as Chairman), Tim Barker, Mike Grasby (appointed 17 April 2008) and David Lindsell (appointed 1 December 2008), all of whom are independent non-executive directors, appointed by the Board. Charles Berry was a member of the Committee until 17 April, when he was replaced by Mike Grasby.

The biographical notes of the members of the Committee are set out on pages 36 and 37. The Board is satisfied that the membership of the Committee meets the requirement for recent and relevant financial experience. The Company Secretary acts as Secretary to the Committee.

The Committee met on four occasions in 2008, and the members' attendance record is set out on page 44. The Chairman of the Committee reports the Committee's deliberations to the following Board meeting and, once agreed, the minutes of each meeting of the Committee are circulated to all members of the Board.

### Role

The Committee assists the Board to fulfil its oversight responsibilities. Its primary functions are to:

- monitor the integrity of the financial statements and other information provided to shareholders;
- review significant financial reporting issues and judgements contained in the financial statements;
- review the systems of internal control and risk management;
- maintain an appropriate relationship with the Group's external auditors and review the effectiveness and objectivity of the external audit process; and
- monitor and review the effectiveness of the internal audit function (which is provided by Grant Thornton UK LLP, a leading firm of accountants), review all internal audit reports and review and monitor management's responses to the findings and recommendations of the internal audit function.

The terms of reference for the Committee are reviewed annually by the Committee and then by the Board. A copy of the terms of reference is available on the Group's website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk).

### Attendance at meetings

The Chairman of the Board, the Chief Executive, the Finance Director, the Financial Controller and the internal and external auditors are normally invited by the Chairman of the Committee to attend meetings of the Committee. In undertaking its duties, the Committee has access to the services of the Finance Director and the Company Secretary and their resources, as well as access to external professional advice.

### Programme of work

During the year, the Committee undertook its duties in accordance with an agreed annual work plan of which the main features were:

- at meetings in February and July 2008, the Committee reviewed the Group's Preliminary Results Announcement and Annual Report and Accounts, and the Half Year Results Announcement and Report respectively. On each occasion, the Committee both received reports from the external auditors identifying any accounting or judgemental issues requiring its attention and also satisfied itself of the independence and objectivity of the external auditors;
- at each meeting, the Committee received reports from the internal audit function on the progress of their programme for the year, reviewed new internal audit reports and monitored progress with the implementation of internal control recommendations. In April 2008, the Committee reviewed both the arrangements for the provision of the internal audit function and the performance of the current provider, Grant Thornton UK LLP, before deciding to continue the outsourcing arrangement with that firm and then setting the internal audit programme for the coming year;
- in April 2008, the Committee undertook a detailed review of the management letter covering the external auditors' findings in respect of the prior financial year and also reviewed the performance of the external auditors;
- at meetings in April and December 2008, the Committee reviewed the Company's risk register and in December 2008 it undertook a review of the effectiveness of the system of internal controls; and
- during the year, the Committee met four times in the absence of management with the external auditors and three times with the internal auditors. No matters of concern were drawn to the Committee's attention at any of these meetings. The Committee's understanding with both the external and internal auditors is that, if they should at any time become aware of any matters occasioning them material concern, they will immediately draw it to the Committee's attention via the Chairman. Nothing was subject to this procedure in the course of the year.



The nature of the Group's activities, and the markets in which we operate, are such that from time to time there is a need to consider carefully certain complex accounting issues and make subjective judgements. During the year, the Committee reviewed the Group's accounting for unrealised gains and losses under derivative contracts, and the methodology through which we determine appropriate actuarial assumptions for our defined benefit pension scheme. The Committee also considered the subjective judgements which are made in connection with the Group's tax accounting, the methodology for calculating the weighted average cost of coal stocks, and the remaining useful economic life of the Drax Power Station.

On each occasion, the Committee concluded that the relevant accounting standards were being properly applied, and that the judgements taken were reasonable and appropriate to the circumstances.

## Independence of the audit

In July 2008, the Committee considered and adopted an enhanced Auditor Independence Policy. In accordance with the Policy, the Committee annually reviews the quality and cost effectiveness of the external audit and the independence and objectivity of the external auditor.

The provisions of the Policy include:

- seeking confirmation that the auditors are, in their professional judgement, independent of the Group and obtaining from them an account of all relationships which may affect the firm's independence and the objectivity of the audit partner and staff;
- a policy on the employment by the Group of former employees of the external auditors, the essence of which is to require a period of two years to elapse between the cessation of an individual's association with the auditors and appointment to any financial reporting oversight role within the Group; and
- a policy governing the engagement of the auditors to conduct non-audit work under which:
  - the auditors may not be engaged to provide certain categories of work, including those where they may be required to audit their own work or make management decisions, or where the auditors would act in an advocacy role for the Company;
  - there is a clear process of approval for engaging the auditors to conduct other categories of non-audit work, subject to financial limits;
  - all engagements of the auditors to conduct non-audit work are reported to the next meeting of the Committee; and
  - the balance between the fees paid to the external auditors for audit and non-audit work is monitored by the Committee.

Details of the amounts paid to the external auditors during the year for audit and other services are set out in the Notes to the consolidated financial statements on pages 65 to 89.

## Internal audit

Under an outsourcing arrangement, Grant Thornton UK LLP undertakes the Group's internal audit function. Regular reports are provided to the Audit Committee regarding the audit programme and reviews undertaken. Recommendations are made to management for process improvements as appropriate. Topics dealt with by internal audit reports reviewed by the Committee during 2008 included: information technology; financial reporting; budgeting; revenue; contract management; procurement; expenditure; human resources and payroll; and treasury. The Committee is of the opinion that, because of the nature of the Group's business, a higher quality of service is available through outsourcing the function than would be possible through the employment of internal audit staff.

## External auditors

Deloitte LLP were appointed auditors of the Company in 2005 and have been reappointed at each subsequent Annual General Meeting. They previously acted as auditors to the Drax group of companies prior to the listing of the Company in December 2005.

Having reviewed their performance during the year and satisfied itself of their continuing independence and objectivity within the context of applicable regulatory requirements and professional standards, the Committee has invited the Board to recommend the reappointment of Deloitte LLP as auditors at the forthcoming Annual General Meeting and a resolution to that effect appears in the Notice of Meeting.

The Chairman of the Committee, independent of management, maintains regular and direct contact with both the internal and external auditors.

This report was reviewed and approved by the Board on 2 March 2009.

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**Jamie Dundas**  
Chairman, Audit Committee

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## Nominations Committee report

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The Committee comprises Charles Berry (as Chairman), Tim Barker, Jamie Dundas, Mike Grasby and David Lindsell (appointed 1 December 2008). The biographical notes of the members of the Committee are set out on pages 36 and 37. The Company Secretary acts as Secretary to the Committee. Gordon Horsfield served as Chairman of the Committee until his retirement on 17 April 2008.

The principal duties of the Committee are to keep under review the structure, size and composition of the Board (including the skills, knowledge and experience required by it), to consider succession planning for the directors and other senior managers, to identify and nominate candidates to fill vacancies among the directors and to review the time required from non-executive directors. It also reviews those directors retiring by rotation in accordance with the Company's Articles of Association and makes recommendations to the Board regarding their re-election.

The terms of reference for the Committee are reviewed annually by the Committee and then by the Board. A copy of the terms of reference is available on the Group's website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk).

The Committee met on five occasions in 2008, and the members' attendance record is set out on page 44. The Chairman of the Committee reports the Committee's deliberations to the following Board meeting and, subject to redaction in the event that they include personal information, the minutes of each meeting of the Committee are circulated to all members of the Board.

During the year, the Committee considered the succession planning process for the directors and senior managers and concluded that it was appropriate for the business. The outcome of the process which it initiated for the review of the performance of the Board and individual directors is reported in the Corporate governance report within this Annual Report and Accounts.

Following Gordon Boyd's decision to resign as Finance Director, the Committee undertook the process to identify and nominate a successor. External search consultants were engaged to assist in the process. A number of potential candidates were identified and interviewed, and references were taken. The Committee recommended that Tony Quinlan be appointed as Finance Director, and he was appointed by the Board on 1 September 2008.

The Committee reviewed the structure of the Board in the light of Gordon Horsfield's retirement and the appointment of Charles Berry as Chairman. It concluded that the appointment of an additional non-executive director was desirable, and conducted a process to identify and nominate suitable candidates. External search consultants were engaged to assist in the process. A number of potential candidates were identified and interviewed, and references were taken. The Committee recommended that David Lindsell be appointed as a non-executive director, and he was appointed by the Board on 1 December 2008.

The executive directors' service contracts and non-executive directors' letters of appointment are available for inspection by prior arrangement during normal business hours at the Company's registered office. They will also be available for inspection at the venue, prior to the Annual General Meeting, details of which are contained in the Notice of Meeting.

This report was reviewed and approved by the Board on 2 March 2009.

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**Charles Berry**

Chairman, Nominations Committee



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## Remuneration Committee report

### Introduction

This Remuneration report has been prepared on behalf of the Board by the Remuneration Committee. In all its activities, the Remuneration Committee has adopted the principles of good governance as set out in the Combined Code and complies with the Listing Rules of the Financial Services Authority, the relevant schedules of the Companies Act and the Directors' Remuneration Report Regulations, 2002.

These Regulations require the Company's auditors to report on the "Audited information" in the report to state that this section has been properly prepared in accordance with the Regulations. For this reason the report is divided into audited and unaudited information.

The Remuneration report is subject to shareholder approval at the Annual General Meeting on 28 April 2009.

### Part 1 - Unaudited information

#### Remuneration Committee

During the year, the Committee comprised Tim Barker (as Chairman), Jamie Dundas, Mike Grasby and David Lindsell (appointed 1 December 2008), all of whom are independent non-executive directors. Charles Berry, Chairman of the Company is also a member of the Committee. The biographical notes of the members of the Committee are set out on pages 36 and 37.

The Committee met on seven occasions during the year and its members' attendance record is set out on page 44.

#### Advice to the Remuneration Committee

The Company Secretary, Philip Hudson, has attended meetings as Secretary to the Committee and, having taken over responsibility for Human Resources during the year, provided assistance to the Committee.

Kepler Associates LLP ("Kepler"), appointed by the Committee, have provided advice to the Committee on market practice, incentive plans and other remuneration-related topics. Kepler also advised the Board on the remuneration of non-executive directors. Kepler provided no other services to the Company during the year.

The Committee also received legal advice and other legal services from Norton Rose LLP who were appointed by the Board to act as principal legal advisers to the Group.

The Chief Executive is invited to attend meetings of the Remuneration Committee except when her own remuneration is being discussed.

#### Principal responsibilities

The Committee's principal responsibilities are:

- recommending to the Board the remuneration strategy and framework for the executive directors and senior managers;
- determining, within that framework, the individual remuneration packages for the executive directors and senior managers;
- approval of the design of annual and long-term incentive arrangements for executive directors and senior managers, including agreeing the annual targets and payments under such arrangements;
- determining and agreeing the general terms and conditions of service and the specific terms for any individual within the Committee's remit, either on recruitment or on termination;
- determining the policy for, and scope of, executive pension arrangements; and
- to oversee any major changes in employee benefit structures throughout the Group and review remuneration trends across the Group.

The terms of reference for the Committee are reviewed annually by the Committee and then by the Board. A copy of the terms of reference is available on the Group's website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk).

## Remuneration Committee report

### Remuneration policy

The remuneration policy applicable to executive directors and senior managers whose remuneration is determined by the Committee is to:

- link a significant proportion of remuneration to performance;
- manage salaries and benefits around market levels, taking into account both industry and cross-industry benchmarks;
- award annual cash bonuses which are linked to the delivery of the annual business plan targets and personal performance; and
- provide staff with long-term incentives linked to total shareholder returns.

When applying this policy to senior managers below director level, the Committee selects salary and benefit benchmarks appropriate to individual specialisms.

The objectives of the remuneration policy are to:

- motivate executive directors and staff to help ensure that Drax meets challenging performance goals;
- enable Drax to recruit and retain the expertise needed to manage and develop its business;
- strengthen teamwork at all levels; and
- ensure alignment of executive and shareholder interests.

During the year under review the remuneration package of executive directors and senior managers comprised five components, namely:

- base salary;
- annual performance bonus (a mix of cash and deferred shares);
- conditional share awards under the Executive Share Incentive Plan ("ESIP");
- pension and benefits; and
- all-employee share plans.

Variable remuneration is targeted to account for approximately 50% of the fair value of executive director remuneration.

During 2008, the Remuneration Committee, in conjunction with its independent advisers, Kepler, reviewed the Company's incentive arrangements for its executives to ensure that they are motivational and support retention, are competitive in relevant talent markets, reward growth in shareholder value and that they should not be unduly influenced by the short-term volatility of the "Dark Green Spread".

As a result of the review, the Committee decided to discontinue the "exceptional" maximum bonus opportunity (of up to 150% of salary for executive directors) and increase the "normal" target and maximum bonus opportunities available to executive directors and senior managers whose remuneration is determined by the Committee, but with a mandatory requirement to defer 25% of annual bonus into shares in the Company which will vest in three years' time subject to forfeiture if the executive is a "bad" leaver prior to vesting. The revised target and maximum bonus levels for the executive directors are set out below in the section entitled "Annual performance bonus".

In addition, it is proposed to replace the ESIP (the Company's current long-term incentive plan) in 2009 with a share-based Bonus Matching Plan ("BMP"). A proposed resolution for the adoption of the BMP is to be considered at the Annual General Meeting ("AGM") of the Company to be held on 28 April 2009. The Notice of Meeting accompanies this report and includes a description of the BMP, and the Rules of the BMP will be available for inspection at the AGM.

Under the BMP a participant would receive an annual grant of conditional shares which shall not exceed in value to 1.5 times such executive's annual bonus earned for the prior year. BMP awards will vest based on Drax's three-year Total Shareholder Return ("TSR") versus the FTSE50-150 over a three-year period. The BMP allows for 100% vesting for upper quartile performance, 15% vesting at median, and no vesting for below median performance. The Committee intends to allow partial vesting (up to 33%) based on continued employment only for BMP awards made to participants not on the Executive Committee, to support retention and in recognition that TSR is a less meaningful performance measure for that group of participants.

In addition to the performance-related awards, directors and members of the Executive Committee will be required to defer a fixed proportion of their annual bonus (currently intended to be 25%) into a conditional award of shares which will vest conditional on three years' continuing service.

BMP awards will first be made during 2009 based on the annual bonus earned for 2008. As such, BMP awards will be granted to participants conditional on shareholder approval for the BMP being obtained at the AGM.

The following paragraphs provide more detail in relation to each of the five components of remuneration for executive directors.

### Base salary

Executive directors' base salaries and benefits are reviewed each year with any changes taking effect from 1 April. The review takes into account individual performance and market competitiveness. Pensionable salary is derived from base salary only.

The Committee benchmarks executive director salaries against comparator groups of utilities, power generators and selected other industrial and commercial companies with comparable turnover, market value or staff numbers.

### Annual performance bonus

The Group operates an annual bonus scheme. Bonuses are based on Group performance and individual performance against objectives. The Committee sets Group performance measures based on the Group's business priorities for which the Board sets challenging performance targets. In 2008, Group measures included financial, trading, plant operations, safety, environmental and development objectives, and a discretionary element. In exercising its discretion the Committee has regard to management's performance in handling unforeseen events which arise during the year.

As part of its review of incentive arrangements, the Committee adjusted the target and maximum annual performance bonus opportunity for the directors and members of the Executive Committee in 2008 and introduced a requirement to defer 25% of any bonus into a conditional award of shares which will vest in three years and be forfeited if the executive leaves the Company other than as a "good leaver" before the shares vest. For annual performance bonus awards in 2008, the target bonus for the Chief Executive and other executive directors is 65% and 60% of base salary respectively. The maximum bonus is 130% and 120% respectively. 75% of any bonus award is paid in cash. Subject to shareholder approval of the BMP being obtained at the AGM, 25% of any bonus will be subject to a deferred share award.

In 2008, achievement of Group-based performance conditions provided for a bonus of up to 125% of target bonus, which was then adjusted according to individual performance by a multiplier in the range 0.67 to 1.33. The Committee reviewed 2008 actual performance against bonus targets and the amounts awarded and payable in cash are shown in the Directors' emoluments table in Part 2 of this report.

From 2008 onwards, 25% of any bonus earned will be deferred in the Company's shares for three years, and will be forfeited if the executive leaves Drax other than as a "good leaver" before the shares vest.

The target and maximum bonus for 2009 for the Chief Executive and the other executive directors are the same as in 2008, and bonus measures and targets have been set using a similar process to that used previously.

### Benefits

The Company's policy is to offer a car allowance to executive directors and to certain senior managers, according to their role. The annual allowance is currently £17,500 per annum for the Chief Executive, £12,000 per annum for executive directors and £9,000 per annum for senior managers whose remuneration is determined by the Committee. In addition, life assurance (in a sum assured of four times base salary) is provided for the directors and senior managers and private medical insurance is provided for them and their dependants. Relocation expenses are paid where appropriate.

### Pensions

Executive directors and senior managers who joined the Group after 1 January 2002 are entitled to membership of the Group's defined contribution pension plan. The employer's contribution for executive directors is 20% of base salary and for senior managers who are not members of the Electricity Supply Pension Scheme ("ESPS") it is 11.5% of base salary. For senior managers who are members of the ESPS the normal employer's contribution is 21.6% of base salary. In each case contributions were and are capped by the different statutory limits applicable before and after 6 April 2006, although there is no director or senior manager for whom contributions would mean they exceed either the lifetime or annual allowances.

Alternatively, at their option, executive directors may either have contributions of the same amounts made to their personal pension schemes or cash in lieu of pension at the stated rate and subject to normal statutory deductions. Details of pension contributions for executive directors and of payments in lieu are included in the emoluments table in Part 2 of this report.

Drax Power Limited, a trading subsidiary, is the Principal Employer of the Drax Power Group Section of the ESPS, an occupational pension scheme providing defined benefits on death, ill-health, early retirement or normal retirement to eligible members and beneficiaries based on the member's length of pensionable service, final salary and the applicable accrual rate. The defined benefit pension scheme was closed to new entrants in 2002. Although certain senior managers are members, none of the executive directors are eligible for membership.

## Remuneration Committee report

**Current annualised rates of pay**

The following table shows the current annualised rates of base salary, benefits, bonus (at target level) and pension contributions for each of the directors:

	Annual salary £000	Annual fees <sup>(1)</sup> £000	Annual bonus <sup>(2)</sup> £000	Annual benefits <sup>(3)</sup> £000	Annual cash pension <sup>(4)</sup> £000
Tim Barker	-	58	-	-	-
Charles Berry	-	200	-	-	-
Jamie Dundas	-	58	-	-	-
Peter Emery	255	-	153	12	50
Mike Grasby	-	60	-	-	-
David Lindsell	-	48	-	-	-
Tony Quinlan	300	-	180	12	60
Dorothy Thompson	450	-	293	18	90

Notes:

(1) Includes Board Committee membership fees paid as separate amounts.

(2) The annual bonus assumes an "on target" performance yielding a bonus of 65% of base salary for Dorothy Thompson and 60% of base salary for the other executive directors, of which 25% is required to be deferred into shares.

(3) Covers car allowance only. The cost of other benefits such as BUPA and additional life cover is not easily predicted because they are subject to price variation (the amount of which depends on personal circumstances at the time) during the year.

(4) Annual contribution by the Company to the directors' pension plans or cash in lieu.

The Committee has determined that the executive directors shall not receive any increase in their base salaries in the review year 2009/2010.

**Executive Share Incentive Plan ("ESIP")**

Under the ESIP, annual awards of performance shares were made to executive directors and other senior staff up to a normal maximum of 100% of salary (200% in exceptional circumstances). Shares vest based on Drax's Total Shareholder Return ("TSR") performance relative to an index over three years. The Committee considers relative TSR to be an objective, external measure of the Company's success.

For the 2008 ESIP awards, index TSR is based 50% (60% for 2006 ESIP awards and 50% for 2007 ESIP awards) on the median TSR of FTSE350 electricity sector peers, 25% (20%) on the median TSR of selected UK-listed oil and gas companies and 25% (20%) on the TSR of the FTSE100 index, as shown below:

	Electricity sector peers	Oil and gas comparators	FTSE100
Weighting	50%	25%	25%
Constituents <sup>(1)(2)</sup>	British Energy <sup>(3)</sup> International Power Scottish and Southern Energy	BG Group BP Gazprom Royal Dutch Shell	FTSE100 index, as published

Notes:

(1) Viridian Group Limited had previously been included in the electricity sector peers group, however, it was subject to takeover which took effect on 8 December 2006, and therefore it was considered appropriate to remove it as a constituent in the sector peers group for 2007.

(2) ScottishPower had previously been included in the electricity sector peers group, however, it was subject to takeover which took effect on 23 April 2007, and therefore it was considered appropriate to remove it as a constituent in the sector peers group for 2007.

(3) British Energy remained as an electricity sector peer until its takeover which took effect on 3 February 2009, following which it will be removed as a constituent.

No shares vest if the Company's TSR over the three-year period is less than the index TSR; 25% of shares vest if the Company's TSR equals that of the Index; shares vest in full if the Company's TSR outperforms that of the Index by 30% or more, and there is straight-line pro rata vesting in between.

For any award to vest, the Committee must be satisfied that there has been a demonstrable improvement in the performance of the Company in terms of (but not limited to) finance, production, trading, ancillary activities and progress in delivering the Company's strategy. The Committee has chosen these broader criteria rather than the more straightforward criterion of financial performance because of the extent to which financial performance is susceptible to the influence of movements in relevant commodity markets.

Awards under the ESIP will normally be pro rated for time and performance in circumstances where they vest for "good leavers" and on a change of control.

At the 2007 Annual General Meeting a resolution proposing that dividends accrue on ESIP shares over the vesting period to ensure alignment with shareholders' interests was approved. The dividend accrual will only relate to "ordinary" dividends and will not be allowed in respect of any special dividends which are directly linked to share consolidations (where each share consolidation has the effect of automatically maintaining the value of the award following payment of the special dividend).

The ESIP will be replaced by the proposed BMP in 2009, conditional upon shareholder approval at the 2009 AGM.

### 2008 ESIP award

ESIP awards were made in April 2008, for nil consideration. For executive directors, each award was calculated based on 100% of base salary. Performance for the 2008 ESIP awards will be measured over the three years from 1 January 2008 to 31 December 2010 with potential vesting in April 2011. The awards made in September 2006 and April 2007 are the only long-term incentives having the potential to vest before that date.

### All-employee share plans

The Committee operates a Savings-Related Share Option Plan ("SAYE") and a Share Incentive Plan ("SIP"), both of which are approved by HM Revenue & Customs and must be operated on an all-employee basis. The executive directors may participate in each plan upon the same terms as other employees.

The SAYE provides for the grant of options (which, at the Committee's discretion, may be offered at a discount of up to 20% to the market price of a share determined in accordance with the rules of the plan) linked to a savings contract which pays interest at a statutory rate. No invitations to participate in the SAYE plan were made in 2007 or 2008.

Details of the SAYE options held by the executive directors are shown in the table in Part 2 of this report.

In any one tax year, the Committee may operate the SIP for the benefit of participants using any combination of the following elements:

- award Free Shares (up to £3,000 in value);
- allow the purchase of Partnership Shares (up to £1,500 in value subject to an overriding maximum of 10% of salary);
- allocate free Matching Shares (in a maximum ratio of two Free Shares for each Partnership Share); and
- allow the investment in shares of dividends received in respect of SIP shares.

In January 2007, the Committee reviewed the use of the SIP with the aim of establishing a clearer linkage between long-term incentive rewards for all employees and collective performance and encouraging wider share ownership amongst employees. Wider employee share ownership aligns the interests of employees with those of shareholders by enabling employees to share in the benefits flowing from their contribution to the success of the Company.

As a result of the review the Committee decided to:

- award Free Shares to the value of £2,500 to each eligible employee;
- allow employees to purchase Partnership Shares up to the maximum permitted of £1,500 subject to an overriding maximum of 10% of salary; and
- make an allocation of one free Matching Share in respect of each Partnership Share purchased.

In accordance with the plan rules, shares taken up by an employee are allocated to a trustee which holds them on behalf of the employee. Under normal circumstances, the employee will receive the shares from the trustee without incurring a tax liability once the shares have been held in trust for five years. The employee is entitled to receive dividends paid in respect of the shares held in trust.

The SIP operated on the same basis in 2008 as it did in 2007. The SIP Trustee was funded by the Group to purchase the required Free and Matching Shares in order to avoid any dilution.

Details of the shares allocated to executive directors are shown in the table in Part 2 of this report.

### Provision of shares for share plans – dilution

The current estimated dilution from subsisting awards, including executive and all-employee share awards, is less than 0.5% of the shares in issue at the date of this report.

All equity-based plans are funded through the issuance of shares, or through the purchase of shares in the marketplace through a trust, subject to an overall dilution limit for all employee share plans of no more than 10% of share capital in any ten-year period and a limit of 5% of share capital in any ten-year period for the Company's discretionary share plans (e.g. ESIP).

### Share ownership guidelines

The Company has share ownership guidelines for executives participating in the ESIP. They are 100% and 50% of base salary for executive directors and other senior manager ESIP participants, respectively.

Those who receive shares by virtue of ESIP awards or who receive deferred bonus shares must retain 50% of the net (that is, after income tax and national insurance contributions) shares received until the applicable guideline is reached.

## Remuneration Committee report

### Service contracts

Executive directors' service agreements are of indefinite duration, subject to a normal retirement age of 65, terminable at any time by either party giving 12 months' prior notice except that Peter Emery's contract is terminable by him providing six months' notice to the Company.

Under each of the executive directors' service agreements other than the Chief Executive's, Drax has the right to make a payment in lieu of notice of termination, the amount of that payment being the salary and benefits that would have accrued to the executive director during the contractual notice period.

The following table shows for each person who has served as a director of the Company at any time during the year ended 31 December 2008, the commencement date and term of the service agreement or contract for services, and details of the notice periods. No service agreement now includes any operative provision for the payment of compensation upon early termination. Any compensation payable in those circumstances would need to be negotiated at the time and in the light of the circumstances.

	Contract start date	Contract term	Notice period by the Company Months	Notice period by the director Months
Tim Barker	15 December 2005	6 years	1	1
Charles Berry	17 April 2008	3 years	6	6
Jamie Dundas	15 December 2005	6 years	1	1
Peter Emery	14 June 2004	Indefinite duration	12	6
Mike Grasby	15 December 2005	6 years	1	1
David Lindsell	1 December 2008	3 years	1	1
Tony Quinlan	1 September 2008	Indefinite duration	12	12
Dorothy Thompson	26 September 2005	Indefinite duration	12	12

Directors' service agreements and contracts for services are available for inspection at the Company's registered office during normal hours of business and will be available at the place of the AGM from 10.00am until the close of the meeting.

### External appointments

The Committee recognises that executive directors may be invited to become non-executive directors of other companies and that such appointments can broaden their knowledge and experience to the benefit of the Company. The policy is that an executive director who accepts an external appointment having had the prior approval of the Board should retain the fees payable in respect of the appointment. Dorothy Thompson was appointed as a non-executive director of Johnson Matthey plc with effect from 1 September 2007, and received £45,000 in fees for that appointment during 2008.



## Non-executive directors

### Chairman's remuneration and service agreement

Charles Berry, as a non-executive director and Chairman of the Board has a contract to provide services in substantially similar terms to the contract of each of the other non-executive directors, save as to the level of remuneration and the period of notice to terminate the contract.

The Committee reviewed the Chairman's remuneration prior to his appointment using a similar approach to that used in previous years, which followed a review of remuneration data for chairmen of other listed companies of a similar market value or turnover to Drax and having regard to his expected time commitment. It decided that upon his appointment his remuneration should be at the annual rate of £200,000, which is reflected in the table of annualised rates of pay on page 52. The Committee has determined that the Chairman shall not receive any increase in his remuneration in the review year 2009/2010. His notice period is six months' on either side. Like the other non-executive directors, he does not receive a pension or other benefits, nor is he eligible for an annual cash bonus or any of the share-based reward plans.

### Other non-executive directors

The remuneration for the other non-executive directors is determined by the Chairman and the executive directors and is designed to:

- recognise prevailing market rates for non-executive directors' fees;
- reflect the responsibilities and time commitment of non-executive directors; and
- attract and retain individuals with the necessary skills and experience to contribute to the future growth of the Company.

The fees for non-executive directors were last reviewed in April 2008. The review looked at the structure of payments made in respect of Committee Chairmanship and membership and took into account the fees payable by the same comparator companies as those used for the purposes of the review of the Chairman's remuneration by the Committee and decided to increase the basic fee from £39,000 to £40,000 per annum with additional fees for each Board Committee membership being reduced from £5,040 to £2,500 per annum and the fee for being the Chairman of each of the Board's Committees being increased from £2,500 to £10,000 per annum, other than the Nominations Committee (of which the Chairman of the Board is the Chairman).

Non-executive directors' fees are neither performance-related nor pensionable. The non-executive directors do not participate in any of the Company's bonus schemes or share-based reward plans. The non-executive directors have contracts to provide services to the Company which may be terminated by either party at any time on giving one month's notice.

## Value of £100 invested

The following graph shows how the value of £100 invested in the Company on the listing of its shares on the London Stock Exchange on 15 December 2005 has changed and compares that performance with the changing value of the same amount invested at the same time in the FTSE100 and FTSE250 indices. Those indices have been chosen as suitable broad comparators against which the Company's shareholders may judge their relative returns given that, during the year under review, the Company has been a member of both the FTSE250 and FTSE100 indices. The graph reflects the total shareholder return (determined according to usual market practice) for the Company and each of the indices referred to on a cumulative basis over the period from 15 December 2005 to 31 December 2008.

### TSR performance since listing – Drax versus FTSE100 and FTSE250



## Remuneration Committee report

## Part 2 - Audited information

This section of the report (which has been subject to audit) sets out the remuneration paid to the directors during the year ended 31 December 2008.

## Directors' emoluments

The emoluments payable in respect of 2008 to directors who held office for any part of the financial year, including amounts paid to them as directors of subsidiary undertakings and compensation for loss of office, was as follows:

	Salary £000	Termination payment £000	Fees £000	Cash bonus in respect of 2008 £000	Benefits £000	Pension <sup>(1)</sup> £000	Total 2008 £000	Total 2007 £000
Tim Barker	-	-	57	-	-	-	57	56
Charles Berry (appointed as Chairman on 17 April 2008)	-	-	157	-	-	-	157	54
Gordon Boyd (resigned on 31 August 2008)	163	485 <sup>(2)</sup>	-	92	13	33	786	383
Jamie Dundas	-	-	57	-	-	-	57	56
Peter Emery	249	-	-	172	18	50	489	384
Mike Grasby	-	-	59	-	-	-	59	56
Gordon Horsfield (retired on 17 April 2008)	-	-	58	-	-	-	58	194
David Lindsay (appointed on 1 December 2008)	-	-	4	-	-	-	4	-
Tony Quinlan (appointed on 1 September 2008)	100	-	-	68	6	20	194	-
Dorothy Thompson	440	-	-	343	24	87	894	692

Notes:

(1) Annual contribution by the Company to directors' pension plans or cash in lieu.

(2) Gordon Boyd's termination comprised payment of salary and other contractual benefits for 12 months in lieu of notice, together with payment representing on target bonus for the notice period, and an additional payment of two months' salary and benefits in consideration for his agreement to remain with the Company after the agreed termination date, pending the appointment of a successor.

## Directors' interests under the ESIP

The following information shows the interests of the directors as at the end of the financial year in the Company's ESIP:

	As at 1 January 2008 Number	Awards made during the year Number	Awards vesting during the year Number	Awards lapsing during the year Number	As at 31 December 2008 Number	Market value at the date of award Pence
<b>Dorothy Thompson</b>						
2006 award <sup>(1)</sup>	60,048	-	-	-	60,048	874.3
2007 award <sup>(2)</sup>	46,104	-	-	-	46,104	797.1
2008 award <sup>(3)</sup>	-	71,057	-	-	71,057	577.0
<b>Peter Emery</b>						
2006 award <sup>(1)</sup>	30,024	-	-	-	30,024	874.3
2007 award <sup>(2)</sup>	25,718	-	-	-	25,718	797.1
2008 award <sup>(3)</sup>	-	39,861	-	-	39,861	577.0
<b>Gordon Boyd</b>						
2006 award <sup>(1)</sup>	32,597	-	-	32,597	-	874.3
2007 award <sup>(2)</sup>	27,600	-	-	27,600	-	797.1
2008 award <sup>(3)</sup>	-	42,461	-	42,461	-	577.0

Notes:

(1) The 2006 awards were made on 19 September 2006 and, subject to the performance conditions being achieved, will vest on 19 September 2009. The performance period for those awards commenced on 1 July 2006 and will end on 30 June 2009.

(2) The 2007 awards were made on 19 April 2007 and, subject to the performance conditions being achieved, will vest on 19 April 2010. The performance period for those awards commenced on 1 January 2007 and will end on 31 December 2009.

(3) The 2008 awards were made on 14 April 2008 and, subject to the performance conditions being achieved, will vest on 14 April 2011. The performance period for those awards commenced on 1 January 2008 and will end on 31 December 2010.

Details of the conditions subject to which the above awards will vest are given on page 52.

## Directors' interests under SAYE

The following information shows the interests of directors as at the end of the financial year in the Company's SAYE Plan:

	As at 1 January 2008 Number	Share options granted during the year Number	Share options exercised during the year Number	Share options lapsed during the year Number	Exercise price per share Pence	Exercise period	As at 31 December 2008 Number
Dorothy Thompson	2,531	-	-	-	636.0	From July 2011 to December 2011	2,531
Tony Quinlan	-	-	-	-	-	-	-
Peter Emery	-	-	-	-	-	-	-
Gordon Boyd	1,470	-	-	1,470	636.0	-	-

The middle market closing quotation for an ordinary share of the Company on 31 December 2008, was 561 pence and the daily middle market closing quotations during the financial year ranged from 486.75 pence to 821 pence.

## Directors' interests in Drax Group shares

The interests held by each director at the end of the financial year in the ordinary shares in the Company are shown below. All the disclosed interests are beneficial. No director had any interest at any time during the year or since in any security issued by the Company other than its ordinary shares.

	As at 31 December 2008			As at 1 January 2008		
	Ordinary shares	SIP shares <sup>(1)</sup>	SAYE option shares <sup>(2)</sup>	Ordinary shares	SIP shares <sup>(1)</sup>	SAYE option shares <sup>(2)</sup>
Tim Barker	3,462	-	-	3,462	-	-
Charles Berry	1,730	-	-	1,730	-	-
Jamie Dundas	1,730	-	-	1,730	-	-
Peter Emery	30,551	1,813	-	30,551	897	-
Mike Grasby	1,730	-	-	1,730	-	-
David Lindsell	-	-	-	-	-	-
Tony Quinlan	-	-	-	-	-	-
Dorothy Thompson	63,569	1,813	2,531	63,569	897	2,531

Notes:

(1) The SIP shares include the Free, Partnership and Matching elements of the plan.

(2) The number of SAYE option shares are those which will be available to exercise at the maturity of the savings contract.

No director had at any time during the financial year, or has had since, any beneficial interest in the shares of any subsidiaries.

No other changes to directors' share interests have taken place between 31 December 2008 and the date upon which this report was approved by the Board.

This report was reviewed and approved by the Board on 2 March 2009.

**Tim Barker**  
Chairman, Remuneration Committee



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## Directors' responsibility statement

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We confirm to the best of our knowledge:

1. the Group financial statements, prepared in accordance with IFRSs as issued by the IASB and IFRS as adopted by the EU, give a true and fair view of the assets, liabilities, financial position and profit of the Group; and
2. the Business review includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties it faces.

By order of the Board.

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**Dorothy Thompson**

Chief Executive  
2 March 2009



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**Tony Quinlan**

Finance Director  
2 March 2009



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## Group - Independent auditors' report

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### To the members of Drax Group plc

We have audited the Group financial statements of Drax Group plc for the year ended 31 December 2008 which comprise the consolidated income statements, the consolidated statements of recognised income and expense, the consolidated balance sheets, the consolidated cash flow statements, and the related notes 1 to 30. These Group financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Remuneration Committee report that is described as having been audited.

We have reported separately on the parent Company financial statements of Drax Group plc for the year ended 31 December 2008.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' Remuneration Committee report and the Group financial statements in accordance with applicable law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union are set out in the statement of directors' responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and whether the part of the Remuneration Committee report described as having been audited has been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' report is consistent with the Group financial statements. The information given in the Directors' report includes that specific information presented in the Chairman's introduction, Chief Executive's review and Business and financial review that is cross referred from the Business review and Risk identification sections of the Directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the annual report as described in the contents section and consider whether it is consistent with the audited Group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any further information outside the annual report.

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## Group - Independent auditors' report

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### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements and the part of the Remuneration Committee report to be audited. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements and the part of the Remuneration Committee report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements and the part of the Remuneration Committee report to be audited.

### Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the part of the Remuneration Committee report described as having been audited has been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the Group financial statements.

#### **Deloitte LLP**

Chartered Accountants and Registered Auditors  
London, United Kingdom  
2 March 2009

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## Consolidated income statements

	Notes	Years ended 31 December	
		2008 £m	2007 £m
<b>Continuing operations</b>			
Revenue		1,752.8	1,247.4
Fuel costs		(1,070.2)	(546.1)
		682.6	701.3
Other operating expenses excluding exceptional items	5	(274.8)	(239.4)
Exceptional operating income	4	-	6.2
Total other operating expenses, net		(274.8)	(233.2)
Unrealised gains on derivative contracts	16	56.3	3.3
<b>Operating profit</b>	5	464.1	471.4
Interest payable and similar charges	6	(28.8)	(34.3)
Interest receivable	6	7.2	11.4
<b>Profit before tax</b>		442.5	448.5
Tax charge	7	(109.6)	(95.5)
<b>Profit for the year attributable to equity shareholders from continuing operations</b>		332.9	353.0
<b>Earnings per share from continuing operations</b>			
		Pence per share	Pence per share
- Basic and diluted	9	98	99

## Consolidated statements of recognised income and expense

	Notes	Years ended 31 December	
		2008 £m	2007 £m
<b>Profit for the year</b>		<b>332.9</b>	<b>353.0</b>
Actuarial losses on defined benefit pension scheme	28	(12.9)	(3.3)
Deferred tax on actuarial losses on defined benefit pension scheme	7	3.6	0.9
Impact of reduction in tax rate on deferred tax on defined benefit pension scheme	7	-	(0.4)
Fair value gains/(losses) on cash flow hedges	23	164.7	(584.3)
Deferred tax on cash flow hedges	7	(47.4)	171.1
Impact of reduction in tax rate on deferred tax on cash flow hedges	7	-	1.0
<b>Net gains/(losses) recognised in equity</b>		<b>108.0</b>	<b>(415.0)</b>
<b>Total recognised income/(expense) for the year attributable to equity shareholders</b>		<b>440.9</b>	<b>(62.0)</b>



## Consolidated balance sheets

	Notes	As at 31 December	
		2008 £m	2007 £m
<b>Assets</b>			
<b>Non-current assets</b>			
Property, plant and equipment	10	1,135.7	1,080.4
Derivative financial instruments	16	105.5	1.6
		1,241.2	1,082.0
<b>Current assets</b>			
Inventories	11	189.5	108.3
Trade and other receivables	12	259.9	129.6
Derivative financial instruments	16	286.5	15.0
Cash and cash equivalents	13	130.2	59.7
		866.1	312.6
<b>Liabilities</b>			
<b>Current liabilities</b>			
Financial liabilities:			
- Borrowings	15	14.9	9.9
- Derivative financial instruments	16	337.1	145.6
Trade and other payables	14	295.0	94.1
Current tax liabilities		49.4	70.4
		696.4	320.0
<b>Net current assets/(liabilities)</b>		169.7	(7.4)
<b>Non-current liabilities</b>			
Financial liabilities:			
- Borrowings	15	350.0	387.0
- Derivative financial instruments	16	70.6	107.7
Deferred tax liabilities	18	273.8	201.6
Retirement benefit obligations	28	20.6	13.5
Other non-current liabilities		-	1.4
Provisions	17	2.6	2.4
		717.6	713.6
<b>Net assets</b>		693.3	361.0
<b>Shareholders' equity</b>			
Issued equity	19	39.2	39.2
Capital redemption reserve	21	1.5	1.5
Share premium	25	420.7	420.7
Merger reserve	22	710.8	710.8
Hedge reserve	23	(44.0)	(161.3)
Retained losses	24	(434.9)	(649.9)
<b>Total shareholders' equity</b>	25	693.3	361.0

These financial statements were approved by the Board of directors on 2 March 2009.

Signed on behalf of the Board of directors:

**Dorothy Thompson**  
Chief Executive  
2 March 2009



**Tony Quinlan**  
Finance Director  
2 March 2009



## Consolidated cash flow statements

	Notes	Years ended 31 December	
		2008 £m	2007 £m
<b>Cash generated from operations</b>	26	430.8	437.7
Income taxes paid		(102.2)	(104.7)
Interest paid		(25.9)	(31.3)
Interest received		6.8	11.1
<b>Net cash generated from operating activities</b>		309.5	312.8
<b>Cash flows from investing activities</b>			
Purchase of property, plant and equipment		(91.4)	(67.8)
<b>Net cash used in investing activities</b>		(91.4)	(67.8)
<b>Cash flows from financing activities</b>			
Equity dividends paid	8	(110.0)	(171.3)
Purchase of own shares under share buy-back programme	19	-	(83.5)
Repayment of borrowings	15	(35.0)	(82.9)
Purchase of own shares held by employee trust		(2.6)	(2.4)
<b>Net cash used in financing activities</b>		(147.6)	(340.1)
<b>Net increase/(decrease) in cash and cash equivalents</b>		70.5	(95.1)
Cash and cash equivalents at 1 January		59.7	154.8
<b>Cash and cash equivalents at 31 December</b>	13	130.2	59.7

## Notes to the consolidated financial statements

### 1. General information

Drax Group plc (the "Company") is a company incorporated in England and Wales under the Companies Act 1985. The Company and its subsidiaries (together the "Group") operate in the electricity generation industry within the UK. The address of the Company's registered office and principal establishment is Drax Power Station, Selby, North Yorkshire YO8 8PH, United Kingdom. The operating companies of the Group are disclosed in note 3 of the Company's separate financial statements, which follow these consolidated financial statements.

### 2. Basis of preparation

The financial statements have been prepared in accordance with "IFRSs". The financial statements have also been prepared in accordance with IFRSs adopted by the European Union and therefore the consolidated financial statements comply with Article 4 of the EU IAS Regulations.

The financial statements have been prepared on the basis of a going concern, as set out in the Directors' report on page 38 and after considering the Group's capital resources as described on page 19.

The financial statements have been prepared under the historical cost basis, except for certain financial assets and liabilities that have been measured at fair value.

#### Adoption of new and revised accounting standards

At the date of authorisation of these financial statements, the following standards and relevant interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and some of which were pending endorsement by the EU).

- IFRS 8 "Operating segments" - effective for accounting periods beginning on or after 1 January 2009
- IAS 23 "Borrowing costs" - effective for costs incurred from 1 January 2009
- IFRS 3 "Business combinations" - revision effective for accounting periods beginning on or after 1 July 2009
- IFRS 2 "Share-based payment" - revision effective for accounting periods beginning on or after 1 January 2009
- IFRIC 18 "Transfers of assets from customers" - effective for accounting periods beginning on or after 1 July 2009
- IAS 1 "Presentation of financial statements" - revision effective for accounting periods beginning on or after 1 January 2009
- IAS 27 "Consolidated and separate financial statements - cost of an investment in a subsidiary, jointly controlled entity or associate" - revision effective for accounting periods beginning on or after 1 July 2009
- IAS 39 "Financial instruments: recognition and measurement - eligible hedged items" - revision applies retrospectively for accounting periods beginning on or after 1 July 2009.

With the exception of IAS 23 "Borrowing costs", the adoption of these standards in future periods will have no material impact on the financial statements of the Group. IAS 23 is expected to impact the treatment of any borrowing costs incurred on the construction of any new plant, with such costs being capitalised as part of the construction cost.

### 3. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to both years presented, unless otherwise stated.

#### (A) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company made up to the reporting date each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

All intra-Group transactions, balances, income and expenses are eliminated on consolidation.

#### (B) Critical accounting judgements, estimates and assumptions

The preparation of financial statements in conformity with IFRSs requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's reasonable knowledge of the amount, event or actions, actual results ultimately may differ from those estimates. The critical accounting judgements, estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year 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 impairment) by assessing the present value of estimated future cash flows and net realisable value compared with net book value. The calculation of estimated future cash flows and residual values is based on the directors' reasonable estimates of future prices, output and costs, and is, therefore, subjective.

## Notes to the consolidated financial statements

### 3. Summary of significant accounting policies (continued)

**Pensions** - The Group operates an approved defined benefit scheme. The cost of providing benefits is determined using the projected unit credit method and actuarial valuations of the plan assets and liabilities are carried out as at the balance sheet date. Inherent in these valuations are key assumptions, including discount rates, expected returns on scheme assets, salary and pension increases, and mortality rates.

These actuarial assumptions are reviewed annually and modified as appropriate. The Group believes 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 the Group makes assumptions regarding the treatment of items of income and expenditure for tax purposes. The Group believes that these assumptions are reasonable based on prior experience and consultation with advisers.

Full provision is made for deferred taxation 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** - Derivative financial instruments are stated 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 the Group's estimates of the prices at which a buyer or seller could contract today for delivery or settlement of a commodity at future dates. The Group generally bases forward price curves upon readily obtainable market price quotations, as the Group's 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.

#### (C) Revenue recognition

Revenue represents amounts receivable for goods or services provided in the normal course of business, net of trade discounts, VAT and other sales-related taxes, and excluding transactions with or between subsidiaries.

Revenues from the sale of electricity are recorded based upon output delivered at rates specified under contract terms or prevailing market rates as applicable.

Revenues from sales of Renewables Obligation Certificates ("ROCs") are recorded at the invoiced value, net of VAT. Revenue is recognised when the risks and rewards of ownership have been transferred to a third party.

Where goods or services are exchanged for goods or services of a similar nature and value, the exchange is not treated as giving rise to revenue. Where goods or services are exchanged for goods or services of a dissimilar nature, the exchange is treated as giving rise to revenue. The revenue is measured at the fair value of goods or services received, adjusted by the amount of any cash or cash equivalents received or paid. If the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents received or paid.

#### (D) Segmental reporting

Turnover comprises primarily sales of electricity generated by the Group to the electricity wholesale market in Great Britain. As such, the Group has only one business segment and one geographical segment.

#### (E) Property, plant and equipment

Property, plant and equipment are initially measured at cost. Cost comprises the purchase price (after deducting trade discounts and rebates), any directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management, and the estimate of the present value of the costs of dismantling and removing the item and restoring the site. Property, plant and equipment are stated at cost less accumulated depreciation and any provision for impairment in value. Freehold land and assets in the course of construction are not depreciated.

Depreciation is provided on a straight-line basis to write-down assets to their residual value evenly over the estimated useful lives of the assets from the date of acquisition (limited to the expected decommissioning date of the power station). The estimated useful lives, beginning in 2004 when they were reset, are currently:

	Years
Main generating plant and freehold buildings	35
Other plant and machinery	4-20
Decommissioning asset	35
Plant spare parts	35

Estimated useful lives and residual values are reviewed annually, taking into account commercial and technological obsolescence as well as normal wear and tear, and any provision for impairment. Residual values are based on prices prevailing at each balance sheet date.

Costs relating to major inspections, overhauls and upgrades to the power station are included in the asset's carrying amount or recognised as a separate asset, as appropriate, if the recognition criteria are met; namely, when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance costs are expensed as incurred.

**(F) Impairment of property, plant and equipment**

At each balance sheet date the Group reviews its property, plant and equipment to determine whether there is any indication that these assets may have suffered an impairment loss. If such an indication exists, the recoverable amount is assessed by reference to the net present value of expected future cash flows of the asset (value-in-use). If an asset is impaired, a provision is made to reduce its carrying amount to the estimated recoverable amount. The discount rate applied is a pre-tax rate based upon the Group's weighted average cost of capital and reflects the current market assessment of the time value of money and the risks specific to the business.

**(G) Decommissioning costs**

Provision is made for the estimated decommissioning costs at the end of the useful economic life of the Group's generating assets, when a legal or constructive obligation arises, on a discounted basis. The amount provided represents the present value of the expected costs. An amount equivalent to the discounted provision is capitalised within tangible fixed assets and is depreciated over the useful lives of the related assets. The unwinding of the discount is included in interest payable and similar charges.

**(H) Inventories**

Inventories primarily comprise coal stocks, together with other fuels and consumables. Coal stocks are valued at the lower of the weighted average cost of coal and net realisable value. Other stocks of fuel and consumables are valued at the lower of average cost and net realisable value.

The Group is able to claim ROCs from the Office of Gas and Electricity Markets ("OFGEM") as a result of burning renewable fuels. A market exists for sale of ROCs and the Group recognises income in the income statement at the point where the risks and rewards of ownership have been transferred to a third party. The attributable incremental cost of generating ROCs above that of burning coal is included within inventory in respect of ROCs earned but not yet sold. The inventory value is stated at the lower of cost and net realisable value.

**(I) CO<sub>2</sub> emissions allowances**

The Group recognises its free emissions allowances received under the National Allocation Plan at nil cost. Any additional allowances purchased in the market are recorded at cost. The Group also recognises a liability in respect of its obligations to deliver emissions allowances. The charge to the income statement within fuel costs and the related liability is measured based on an estimate of the amounts that will be required to satisfy the net obligation, taking into account generation, free allowances allocated under the National Allocation Plan, market purchases, sales and forward contracts already in place, and the market price at the year end.

**(J) Taxation**

Current tax is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax payable or recoverable on the difference between the carrying amounts of assets and liabilities in the balance sheet and the corresponding tax bases used in the computation of taxable profits. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is considered more likely than not that taxable profit will be available against which deductible temporary differences can be utilised.

Deferred tax is calculated at the tax rates that are expected to apply in the period in which the liability is settled or the asset is realised, and is charged or credited in the income statement, except where it relates to items charged or credited to equity via the statement of recognised income and expense, in which case the deferred tax is also dealt with in equity and is shown in the statement of recognised income and expense.

**(K) Pension and other post-retirement benefits**

The Group provides pensions through an approved industry defined benefit scheme and a defined contribution scheme. The cost of providing benefits under the defined benefit scheme is determined using the projected unit credit method, and actuarial valuations of the plan assets and liabilities are carried out as at the balance sheet date. Actuarial gains and losses are taken to the statement of recognised income and expense as incurred.

The current service cost and finance cost of the pension charge are deducted in arriving at operating profit. The excess of the present value of the defined benefit obligation over the fair value of the plan assets is recognised as a liability in the balance sheet.

For the defined contribution scheme, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due to be paid.

**(L) Share-based payments**

Share-based payments are measured at fair value at the date of grant and expensed on a straight-line basis over the relevant vesting period, based on an estimate of the shares that will ultimately vest.

**(M) Foreign currencies**

The Group's consolidated financial statements are presented in sterling, which is the functional and presentational currency of the Company and its principal subsidiaries. Transactions in foreign currencies are translated into sterling at the exchange rate ruling at the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at the exchange rate ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies, are recognised in the income statement.

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## Notes to the consolidated financial statements

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### 3. Summary of significant accounting policies (continued)

#### (N) Financial instruments

##### Debt instruments

The Group measures all debt instruments, whether financial assets or financial liabilities, initially at the fair value of the consideration paid or received. Subsequent to initial measurement, debt instruments are measured at amortised cost using the effective interest method. Transaction costs (any such costs incremental and directly attributable to the issue of the financial instrument) are included in the calculation of the effective interest rate and are, in effect, amortised through the income statement over the life of the instrument.

##### Commodity contracts and treasury derivatives

Where possible, the Group takes the own use exemption for commodity contracts entered into and held for the purpose of the Group's own purchase, sale or usage requirements. Commodity contracts which do not qualify for the own use exemption are dealt with as derivatives and are recorded at fair value in the balance sheet with changes in fair value reflected through the hedge reserve to the extent that contracts are considered to be effective hedges, or the income statement to the extent the contracts are not effective as hedges.

The Group uses a number of treasury-related derivatives to manage exposure to interest rate and currency fluctuations. Treasury-related derivatives are recorded at fair value in the balance sheet with changes in fair value reflected through the hedge reserve to the extent that contracts are considered to be effective hedges, or the income statement to the extent the contracts are not effective as hedges. Income statement movements under interest rate hedges are accounted for as adjustments to finance cost/income for the period.

The Group designates certain hedging instruments used to address commodity price risk, foreign currency risk and interest rate risk as cash flow hedges. At the inception of the hedge, the relationship between the hedging instrument and hedged item is documented, along with its risk management objectives. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instruments used in hedging transactions are highly effective in offsetting changes in cash flows of hedged items.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in equity. The gain or loss relating to any ineffective portion is recognised immediately in profit or loss. Amounts deferred in equity are released in the periods when the hedged item is recognised in profit or loss.

The fair value of hedging derivatives is classified as a non-current asset or non-current liability if the remaining maturity of the hedge relationship is more than 12 months, and as a current asset or liability if the remaining maturity of the hedge relationship is less than 12 months. Derivatives not designated into an effective hedge relationship are classified as a current asset or current liability.

##### Other financial instruments

Share capital - Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. The share premium account records the difference between the nominal value of shares issued and the fair value of the consideration received.

Cash and cash equivalents - Cash and cash equivalents includes cash in hand, deposits held at call with banks, other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

Trade receivables - Trade receivables are recognised initially at fair value. A provision for impairment of trade receivables is established subsequently where there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivable.

## 4. Exceptional operating income

	Years ended 31 December	
	2008 £m	2007 £m
Distributions under the TXU Claim	-	6.2

The Group received £6.2 million under the TXU Claim in April 2007, bringing the total received to £336 million, representing full recovery of the claim. This amount is net of VAT and costs, and all proceeds were used to prepay debt secured against the claim, which was repaid in full.

## 5. Operating profit

	Years ended 31 December	
	2008 £m	2007 £m
<b>The following charges have been included in arriving at operating profit:</b>		
Staff costs (note 27)	51.1	42.9
Depreciation of property, plant and equipment (all owned assets)	46.2	43.7
Repairs and maintenance expenditure on property, plant and equipment	56.3	50.4
Other operating expenses	121.2	102.4
<b>Total other operating expenses excluding exceptional items</b>	<b>274.8</b>	<b>239.4</b>

### Auditors' remuneration

During the year the Group obtained the following services from its auditors, Deloitte LLP, at costs as detailed below:

	Years ended 31 December	
	2008 £000	2007 £000
<b>Audit fees:</b>		
Fees payable for the audit of the Group's consolidated financial statements	261	272
Fees payable for the audit of the Company's subsidiaries pursuant to legislation	10	10
	<b>271</b>	<b>282</b>
<b>Other services:</b>		
Pursuant to legislation - interim review	59	55
<b>Total audit related fees</b>	<b>330</b>	<b>337</b>
Taxation services	-	195
Other services	8	66
<b>Total non-audit fees</b>	<b>8</b>	<b>261</b>
<b>Total auditors' remuneration</b>	<b>338</b>	<b>598</b>

In addition to the amounts set out above, the Drax Power Group of the Electricity Supply Pension Scheme paid fees of £190,000 (2007: £150,000) to Deloitte LLP in respect of pension advisory services.

## Notes to the consolidated financial statements

## 6. Finance costs

	Years ended 31 December	
	2008 £m	2007 £m
<b>Interest payable and similar charges:</b>		
Interest payable on bank borrowings	(25.8)	(30.7)
Amortisation of deferred finance costs	(3.0)	(3.6)
<b>Total interest payable and similar charges</b>	<b>(28.8)</b>	<b>(34.3)</b>
<b>Interest receivable:</b>		
Interest income on bank deposits	7.2	11.4
<b>Total interest receivable</b>	<b>7.2</b>	<b>11.4</b>

## 7. Taxation

The income tax expense reflects the estimated effective tax rate on profit before taxation for the Group for the year ended 31 December 2008 and the movement in the deferred tax balance in the year, so far as it relates to items recognised in the income statement.

The Finance Act 2007 introduced a reduction in the rate of UK corporation tax from 30% to 28% with effect from 1 April 2008, and accordingly the tax charge for the year ended 31 December 2007 included a credit of approximately £18 million to reflect the impact on deferred tax.

The Finance Act 2008 introduced the withdrawal of industrial buildings allowances, and accordingly tax for 2008 includes an additional deferred tax charge of £9 million to reflect the estimated impact of loss of tax base in April 2011.

	Years ended 31 December	
	2008 £m	2007 £m
<b>Tax charge comprises:</b>		
Current tax	81.2	112.2
Deferred tax:		
- Before impact of changes in tax legislation	19.6	1.2
- Impact of withdrawal of industrial buildings allowances	8.8	-
- Impact of reduction in tax rate	-	(17.9)
<b>Tax charge</b>	<b>109.6</b>	<b>95.5</b>

	Years ended 31 December	
	2008 £m	2007 £m
<b>Tax on items charged/(credited) to equity:</b>		
Deferred tax on actuarial losses on defined benefit pension scheme	(3.6)	(0.9)
Impact of reduction in tax rate on deferred tax on defined benefit pension scheme	-	0.4
Deferred tax on cash flow hedges	47.4	(171.1)
Impact of reduction in tax rate on deferred tax on cash flow hedges	-	(1.0)
	<b>43.8</b>	<b>(172.6)</b>



The tax differs from the standard rate of corporation tax in the UK of 28.5% (2007: 30%). The differences are explained below:

	Years ended 31 December	
	2008 £m	2007 £m
<b>Profit before tax</b>	<b>442.5</b>	<b>448.5</b>
Profit before tax multiplied by rate of corporation tax in the UK of 28.5% (2007: 30%)	126.1	134.6
<b>Effects of:</b>		
Adjustments in respect of prior periods	(2.6)	(0.4)
Expenses not deductible for tax purposes	1.4	1.5
Tax effect of funding arrangements	(24.0)	(22.9)
Other	(0.1)	0.6
Change in UK tax rate	-	(17.9)
Change to industrial buildings allowances	8.8	-
<b>Total tax charge</b>	<b>109.6</b>	<b>95.5</b>

Under the Group's previous financing structure, Drax Holdings Limited (a subsidiary company) was partially funded by a Eurobond payable to another group company. The whole of the coupon was previously prepaid, and an accounting based tax deduction has been claimed for the corresponding interest charged in the Drax Holdings Limited income statement each year. Were HMRC to successfully challenge the deductions claimed in respect of the Eurobond coupons for open years to 31 December 2008, it is estimated that the additional tax liability would be up to £90 million, together with interest and penalties.

In November/December 2008 HMRC issued draft legislation concerning the "Principles based approach to financial products avoidance" and the "Taxation of foreign profits of companies". These provisions updated rules on, amongst other things, the tax deductibility of interest and were generally expected to reduce the tax effectiveness of the Eurobond financing arrangements.

The Eurobond was formally waived by the lending group company on 30 December 2008. As a result, the whole of the remaining prepaid coupon was charged in the Drax Holdings Limited income statement, giving rise to potential additional interest deductions with a tax effect of around £220 million. Because of the risks related to the unwind of the Eurobond structure, no benefit will be recognised in the Group's financial statements with respect to the potential additional deductions until the Group is more certain they will be realised.

Further details of the Group's previous financing structure, and related contingent tax liability described above, are included on pages 78 and 79 of the listing particulars issued on 28 October 2005 in respect of the introduction of Drax Group plc to the Official List of the UK Listing Authority.

## 8. Dividends

	Years ended 31 December	
	2008 £m	2007 £m
<b>Amounts recognised as distributions to equity holders in the year (based on the number of shares in issue at the record date):</b>		
Final dividend for the year ended 31 December 2007 of 9.9 pence per share paid on 7 May 2008 (2007: 9.1 pence per share paid on 16 May 2007)	33.6	33.6
Special interim dividend for the year ended 31 December 2007 of 7.8 pence per share paid 7 May 2008 (2007: 32.9 pence per share paid on 16 May 2007)	26.5	121.4
Interim dividend for the year ended 31 December 2008 of 5.0 pence per share paid on 8 October 2008 (2007: 4.7 pence per share paid on 24 October 2007)	17.0	16.3
Special interim dividend for the year ended 31 December 2008 of 9.7 pence per share paid on 8 October 2008 (2007: £nil)	32.9	-
	<b>110.0</b>	<b>171.3</b>

The Company undertook a share consolidation in connection with the special interim dividend paid on 16 May 2007 (note 19).

At the forthcoming Annual General Meeting the Board will recommend to shareholders that a resolution is passed to approve payment of a final dividend for the year ended 31 December 2008 of 38.3 pence per share (equivalent to approximately £130 million) payable on or before 22 May 2009. The final dividend has not been included as a liability as at 31 December 2008.

## Notes to the consolidated financial statements

## 9. Earnings per share

Basic earnings per share is calculated by dividing the earnings attributable to ordinary shareholders by the weighted average number of ordinary shares outstanding during the year. In calculating diluted earnings per share the weighted average number of ordinary shares outstanding during the year is adjusted to take account of outstanding share options in relation to the Group's Savings-Related Share Option Plan ("SAYE Plan") and contingently issuable shares under the Group's Executive Share Incentive Plan ("ESIP").

Reconciliations of the earnings and weighted average number of shares used in the calculation are set out below.

	Years ended 31 December	
	2008 £m	2007 £m
<b>Earnings attributable to equity holders of the Company for the purposes of basic and diluted earnings</b>	<b>332.9</b>	353.0
<b>Number of shares:</b>		
	2008	2007
<b>Weighted average number of ordinary shares for the purposes of basic earnings per share (millions)</b>	<b>339.3</b>	354.9
Effect of dilutive potential ordinary shares under share options	0.3	0.1
<b>Weighted average number of ordinary shares for the purposes of diluted earnings per share (millions)</b>	<b>339.6</b>	355.0
<b>Earnings per share - basic and diluted (pence)</b>	<b>98</b>	99

## 10. Property, plant and equipment

	Freehold land and buildings £m	Plant and equipment £m	Plant spare parts £m	Total £m
<b>Cost:</b>				
<b>At 1 January 2007</b>	134.5	1,139.4	30.6	1,304.5
Additions at cost	0.3	78.6	3.7	82.6
Disposals	-	(4.3)	-	(4.3)
Issues	-	-	(0.7)	(0.7)
<b>At 1 January 2008</b>	134.8	1,213.7	33.6	1,382.1
Additions at cost	18.7	80.2	2.8	101.7
Disposals	-	(13.5)	-	(13.5)
<b>At 31 December 2008</b>	<b>153.5</b>	<b>1,280.4</b>	<b>36.4</b>	<b>1,470.3</b>
<b>Accumulated depreciation:</b>				
<b>At 1 January 2007</b>	25.9	232.5	3.9	262.3
Charge for the year	3.5	39.6	0.6	43.7
Disposals	-	(4.3)	-	(4.3)
<b>At 1 January 2008</b>	29.4	267.8	4.5	301.7
Charge for the year	3.5	42.0	0.7	46.2
Disposals	-	(13.3)	-	(13.3)
<b>At 31 December 2008</b>	<b>32.9</b>	<b>296.5</b>	<b>5.2</b>	<b>334.6</b>
<b>Net book amount at 31 December 2007</b>	105.4	945.9	29.1	1,080.4
<b>Net book amount at 31 December 2008</b>	<b>120.6</b>	<b>983.9</b>	<b>31.2</b>	<b>1,135.7</b>

Assets in the course of construction amounted to £81.0 million at 31 December 2008 (2007: £61.4 million).

During the year ended 31 December 2008 depreciation was accelerated for plant and machinery which the Group expects to replace under its capital expenditure investment programme, resulting in an increase in depreciation for the year of approximately £4.0 million (2007: £7.0 million).

## 11. Inventories

	As at 31 December	
	2008 £m	2007 £m
Coal	142.3	86.0
Other fuels and consumables	25.1	12.6
Renewables Obligation Certificates (ROCs)	22.1	9.7
	189.5	108.3

## 12. Trade and other receivables

	As at 31 December	
	2008 £m	2007 £m
<b>Amounts falling due within one year:</b>		
Trade debtors	228.3	124.8
Prepayments and other debtors	31.6	4.8
	259.9	129.6

Prepayments and other debtors at 31 December 2008 include £26.4 million (2007: £nil) in relation to market purchases of CO<sub>2</sub> emissions allowances acquired in advance to satisfy part of the Group's 2009 obligation.

Trade debtors generally represent sales of electricity to a number of counterparties. At 31 December 2008, the Group had amounts receivable from six (2007: five) significant counterparties, and a number of smaller counterparties, representing 86% (2007: 96%) of trade debtors, all of which paid within 15 days of receipt of invoice in line with agreed terms. Counterparty risk is discussed in note 16.

Management do not consider there to be a significant concentration of credit risk and as a result, do not believe that a further credit risk provision is required in excess of the normal provision for doubtful debts of £0.1 million (2007: £0.1 million). This allowance has been determined by reference to past default experience.

## 13. Cash and cash equivalents

	As at 31 December	
	2008 £m	2007 £m
Cash and cash equivalents	130.2	59.7

The Group's policy is to invest available cash in short-term bank, building society or other low risk deposits.

## 14. Trade and other payables

	As at 31 December	
	2008 £m	2007 £m
<b>Amounts falling due within one year:</b>		
Trade payables	21.0	16.7
Other creditors	13.5	5.1
Accruals	259.6	71.5
Other tax and social security payable	0.9	0.8
	295.0	94.1

Accruals at 31 December 2008 include £158.3 million (2007: £15.9 million) with respect to the Group's estimated net liability to deliver CO<sub>2</sub> emissions allowances. Amounts due to trade creditors at 31 December 2008 represented approximately 21 days of average daily purchases through the year (2007: 22 days).

## Notes to the consolidated financial statements

## 15. Borrowings

	As at 31 December	
	2008 £m	2007 £m
<b>Current:</b>		
Term loans	14.9	9.9

	As at 31 December	
	2008 £m	2007 £m
<b>Non-current:</b>		
Term loans	350.0	387.0

**Maturity of borrowings**

The following table details the remaining contractual maturity, including interest payments, for the Group's borrowings at the balance sheet dates:

	As at 31 December	
	2008 £m	2007 £m
In less than one year	28.8	33.0
In more than one year but not more than two years	363.2	28.5
In more than two years but not more than five years	-	393.8
<b>Total contractual maturity</b>	<b>392.0</b>	<b>455.3</b>
Less interest payments	(27.1)	(58.4)
<b>Carrying amount of borrowings</b>	<b>364.9</b>	<b>396.9</b>

The term loans are subject to a fixed amortisation profile ending with full repayment on 31 December 2010 and debt service payments are made semi-annually on 30 June and 31 December. Payment profiles for repayment of debt set out above are based on the fixed minimum repayment profile. Repayments above the fixed minimum repayment profile are permitted subject to the amount of cash available for debt service.

Interest payments are calculated based on forward interest rates estimated at the balance sheet date based on publicly available information. The interest rates payable at the balance sheet dates were as follows:

	As at 31 December	
	2008 %	2007 %
Term loans	4.09	6.01

**Analysis of borrowings**

Borrowings at 31 December 2008 and 31 December 2007 consisted of bank loans held by the Company's subsidiary Drax Finance Limited as follows:

	As at 31 December 2008		
	Borrowings before deferred finance costs £m	Deferred finance costs £m	Net borrowings £m
Term loans	370.0	(5.1)	364.9
<b>Total borrowings</b>	<b>370.0</b>	<b>(5.1)</b>	<b>364.9</b>
Less current portion of debt	(15.0)	0.1	(14.9)
<b>Non-current borrowings</b>	<b>355.0</b>	<b>(5.0)</b>	<b>350.0</b>

	As at 31 December 2007		
	Borrowings before deferred finance costs £m	Deferred finance costs £m	Net borrowings £m
Term loans	405.0	(8.1)	396.9
<b>Total borrowings</b>	<b>405.0</b>	<b>(8.1)</b>	<b>396.9</b>
Less current portion of debt	(10.0)	0.1	(9.9)
<b>Non-current borrowings</b>	<b>395.0</b>	<b>(8.0)</b>	<b>387.0</b>

Term loan repayments of £17.5 million were made on each of 30 June 2008 and 31 December 2008. Previously, repayments of £40.0 million were made on each of 29 June 2007 and 31 December 2007. All repayments have been made in line with the target repayment profile as a result of the levels of cash available for debt service.

The Group's debt is guaranteed and secured directly by each of the principal subsidiary undertakings of the Company, as set out in note 3 to the Company's separate financial statements. Drax Group plc is not a guarantor of the Group's debt, but has granted a charge over the shares in its subsidiary, Drax Finance Limited.

#### Letter of credit facility and revolving credit facility

In addition to its borrowings, the Group has access to a letter of credit facility which provides credit support of up to £200 million to the Group's trading activities. The letter of credit facility, which has a final maturity date of 15 December 2012, provides a mechanism whereby it may be extended for a further 12 months at any time up to one year before the final maturity date. The Group guarantees the obligations of a number of banks in respect of the letters of credit issued by those banks to counterparties of the Group. As at 31 December 2008 the Group's contingent liability in respect of these guarantees amounted to £160.2 million (2007: £133.3 million).

In addition, the Group has access to an undrawn £100 million revolving credit facility, which may be used to issue letters of credit or for working capital, with a final maturity date of 15 December 2010.

## 16. Financial instruments

The Group issues or holds financial instruments for two purposes: financial instruments relating to the financing and risks of the Group's operations; and financial instruments relating to the financing and risks of the Group's debt portfolio.

The Group's financial instruments comprise borrowings, cash and liquid resources, items that arise directly from its operations and derivative contracts. The Group enters into short-term and medium-term forward contracts for the sale of electricity and the purchase of coal and CO<sub>2</sub> emissions allowances. The Group also enters into interest rate swap agreements and forward foreign currency exchange contracts.

#### Fair value

Cash and cash equivalents, trade and other receivables, and trade and other payables generally have short times to maturity. For this reason, their carrying values approximate their fair value. The Group's borrowings relate to term loans, the carrying amounts of which approximate their fair values by virtue of being floating rate instruments.

The fair values of the Group's derivative financial instruments which are marked to market and recorded in the balance sheet at 31 December 2008 and 31 December 2007 were as follows:

	As at 31 December 2008		As at 31 December 2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
<b>Commodity contracts:</b>				
In less than one year	172.9	(267.5)	10.4	(144.3)
In more than one year but not more than two years	63.9	(51.2)	0.7	(87.0)
In more than two years	41.6	(17.9)	0.2	(20.7)
<b>Interest rate swaps:</b>				
In less than one year	-	(5.8)	1.6	(0.3)
In more than one year but not more than two years	-	(1.5)	0.4	-
In more than two years	-	-	0.3	-
<b>Forward foreign currency exchange contracts:</b>				
In less than one year	113.6	(63.8)	3.0	(1.0)
<b>Total</b>	<b>392.0</b>	<b>(407.7)</b>	<b>16.6</b>	<b>(253.3)</b>
<b>Less: non-current portion</b>				
Commodity contracts	(105.5)	69.1	(0.9)	107.7
Interest rate swaps	-	1.5	(0.7)	-
<b>Total non-current portion</b>	<b>(105.5)</b>	<b>70.6</b>	<b>(1.6)</b>	<b>107.7</b>
<b>Current portion</b>	<b>286.5</b>	<b>(337.1)</b>	<b>15.0</b>	<b>(145.6)</b>

## Notes to the consolidated financial statements

## 16. Financial instruments (continued)

The amounts recorded in the income statement in respect of derivatives which are marked to market were as follows:

	As at 31 December	
	2008 £m	2007 £m
Unrealised gains on derivative contracts recognised in arriving at operating profit	56.3	3.3

The net unrealised gains on derivative contracts recorded in the income statement in 2008 primarily represent mark to market movements on CO<sub>2</sub> emissions allowances contracts, foreign currency exchange contracts and financial coal derivatives.

**Commodity contracts fair value**

Due to the nature of commodity contracts and the way they are managed, the own use exemption has been applied to a limited number of them, including the five-and-a-quarter year baseload contract with Centrica which commenced on 1 October 2007.

The fair value of commodity contracts qualifying as derivative financial instruments is calculated by reference to forward market prices which are available at the balance sheet date. As contracts are generally short term, forward market price curves are available for the duration of the contracts. The quoted market price used for financial assets held by the Group is the current bid price; the quoted price for financial liabilities is the current ask price.

- **Interest rate swaps fair value** - The fair value of interest rate swap contracts is determined by discounting the future cash flows using forward interest rate curves at the balance sheet date.
- **Forward foreign currency exchange contracts fair value** - The fair value of forward foreign currency exchange contracts is determined using forward currency exchange market rates at the balance sheet date.
- **Embedded derivatives fair value** - The Group has also reviewed all contracts for the presence of embedded derivatives. Where contracts were found to contain embedded derivatives, they were considered to be closely related to the economic characteristics and risks of the host contract, and therefore do not require separate valuation from their host contracts.

**Risk**

The Group's activities expose it to a variety of financial risks including commodity price risk, counterparty risk, interest rate risk and foreign currency risk. The Group's overall risk management programme focuses on the unpredictability of commodity and financial markets and seeks to manage potential adverse effects on the Group's financial performance.

The Group uses derivative financial instruments to hedge certain risk exposures. Risk management is carried out by a management committee and treasury function which identify, evaluate and hedge financial risks in close co-operation with the Group's trading function under policies approved by the Board of directors.

**Commodity price risk**

The Group is 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 CO<sub>2</sub> emissions allowances. Price variations and market cycles have historically influenced the financial results of the Group and are expected to continue to do so.

The Group has a policy of making forward power sales with corresponding purchases of fuel and CO<sub>2</sub> emissions allowances when profitable to do so. All commitments to sell power under fixed price contracts are designated as cash flow hedges in order to reduce the Group's cash flow exposure resulting from fluctuations in the price of electricity.

The Group purchases coal under either fixed or variable priced contracts with different maturities from a variety of domestic and international sources. All physical coal purchase contracts transacted at a fixed price and financial coal contracts exchanging floating price coal for fixed price amounts are designated as cash flow hedges in order to reduce the Group's cash flow exposure resulting from fluctuations in the price of coal.

The Group purchases CO<sub>2</sub> emissions allowances under fixed price contracts with different maturity dates from a range of domestic and international sources. All commitments to purchase CO<sub>2</sub> emissions allowances under fixed price contracts are designated as cash flow hedges in order to reduce the Group's cash flow exposure resulting from fluctuations in the price of CO<sub>2</sub> emissions allowances.

**Commodity price sensitivity**

The sensitivity analysis below has been determined based on the exposure to commodity prices for outstanding monetary items at the balance sheet date. The analysis is based on the Group's commodity financial instruments held at each balance sheet date.

If commodity prices had been 5% higher/lower and all other variables were held constant, the Group's:

- profit after tax for the year ended 31 December 2008 would decrease/increase by £3.2 million (2007: decrease/increase by £2.1 million). This is mainly attributable to the Group's exposure to financial coal derivatives; and
- other equity reserves would decrease/increase by £64.2 million (2007: decrease/increase by £57.2 million) mainly as a result of the changes in the fair value of commitments to sell power.

**Interest rate risk**

The Group is exposed to interest rate risk principally in relation to its outstanding bank debt. In particular, it is exposed to changes in the LIBOR interest rate of sterling denominated debt, as all of its debt is both denominated in sterling and has a variable LIBOR rate. The Group mitigates this risk with interest rate hedges on a proportion of its debt facilities. Information about the Group's instruments that are exposed to interest rate risk and their repayment schedules is included in note 15.

All interest rate swap contracts exchanging floating rate interest amounts for fixed rate interest amounts are designated as cash flow hedges in order to reduce the Group's cash flow exposure resulting from variable interest rates on borrowings. The interest rate swap payments and the interest payments on the loan occur simultaneously and the amount deferred in equity is recognised in profit or loss over the loan period.

**Interest rate sensitivity**

The sensitivity analysis below has been determined based on the exposure to interest rates for both derivatives and non-derivative instruments at the balance sheet date. For floating rate liabilities, the analysis is prepared assuming the amount of liability outstanding at the balance sheet date was outstanding for the whole year.

If interest rates had been 1% higher/lower and all other variables were held constant, the Group's:

- profit after tax for the year ended 31 December 2008 would decrease/increase by £1.7 million (2007: decrease/increase by £1.8 million). This is mainly attributable to the Group's exposure to interest rates on its variable rate borrowings; and
- other equity reserves would decrease/increase by £2.0 million (2007: decrease/increase by £2.7 million) mainly as a result of the changes in the fair value of interest rate swaps.

**Foreign currency risk**

Foreign currency exchange contracts are entered into to hedge substantially all of the Group's fixed price international coal purchases in US dollars and CO<sub>2</sub> emissions allowances purchases in euros. Exchange rate exposures are managed within approved policy parameters utilising foreign currency exchange contracts.

**Foreign currency sensitivity**

If sterling exchange rates had been 5% stronger/weaker against other currencies, and all other variables were held constant, the Group's profit after tax and net assets for the year ended 31 December 2008 would increase/decrease by £10.7 million (2007: increase/decrease by £1.6 million).

**Liquidity risk**

The treasury function is responsible for liquidity, funding and settlement management under policies approved by the Board of directors. Liquidity needs are monitored using regular forecasting of operational cash flows and financing commitments. The Group maintains a mixture of cash and cash equivalents, long-term debt and committed facilities in order to ensure sufficient funding for business requirements. Note 15 includes details of undrawn facilities that the Group has at its disposal.

The following table sets out details of the expected maturity of derivative financial instruments which are marked to market based on the undiscounted net cash inflows/(outflows). Where the amount payable or receivable is not fixed, the amount disclosed has been determined by reference to projected commodity prices, interest rates, or foreign currency exchange rates, as illustrated by the yield or other forward curves existing at the reporting date.

	As at 31 December 2008			
	Within 1 year £m	1-2 years £m	>2 years £m	Total £m
Commodity contracts, net	456.7	563.2	291.0	1,310.9
Interest rate swaps	(5.8)	(1.5)	-	(7.3)
Forward foreign currency exchange contracts, net	(201.5)	1.6	(63.8)	(263.7)
	249.4	563.3	227.2	1,039.9

## Notes to the consolidated financial statements

## 16. Financial instruments (continued)

	As at 31 December 2007			Total £m
	Within 1 year £m	1-2 years £m	>2 years £m	
Commodity contracts, net	481.4	282.7	179.9	944.0
Interest rate swaps	1.3	0.4	0.3	2.0
Forward foreign currency exchange contracts, net	(52.3)	2.8	4.1	(45.4)
	430.4	285.9	184.3	900.6

Details of the contractual maturity of the Group's borrowings are included in note 15.

**Counterparty risk**

As the Group relies on third party suppliers for the delivery of coal and other goods and services, it is exposed to the risk of non-performance by these third party suppliers.

The Group purchases a significant portion of its 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.

The Group enters 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 the Group financial distress or increase the risk profile of the Group.

**Credit risk**

The Group's exposure to credit risk is limited to the carrying amount of financial assets recognised at the balance sheet date, as summarised below:

	As at 31 December	
	2008 £m	2007 £m
<b>Financial assets</b>		
Cash and cash equivalents	130.2	59.7
Trade and other receivables	259.9	129.6
Derivative financial instruments	392.0	16.6
	782.1	205.9

Credit exposure is controlled by counterparty limits that are reviewed and approved by a management committee. Counterparties without an investment grade rating are normally required to provide credit support in the form of a parent company guarantee, letter of credit, deed of charge, or cash collateral. Where deemed appropriate the Group has purchased credit default swaps.

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

**Capital risk management**

The Group manages its capital to ensure it is able to continue as a going concern while maximising the return to stakeholders through the optimisation of the debt and equity balance. The capital structure of the Group consists of the borrowings disclosed in note 15, cash and cash equivalents in note 13, and equity attributable to the equity holders of the parent, comprising issued capital, reserves and retained earnings in note 25.

The capital structure of the Group is as follows:

	As at 31 December	
	2008 £m	2007 £m
Borrowings	(364.9)	(396.9)
Cash and cash equivalents	130.2	59.7
<b>Net debt</b>	<b>(234.7)</b>	<b>(337.2)</b>
<b>Total shareholders' equity</b>	<b>693.3</b>	<b>361.0</b>



## 17. Provisions

	Re-instatement £m
<b>At 1 January 2007</b>	2.2
Unwinding of discount	0.2
<b>At 1 January 2008</b>	2.4
Unwinding of discount	0.2
<b>At 31 December 2008</b>	2.6

The provision for re-instatement represents the estimated decommissioning, demolition and site remediation costs at the end of the useful economic life of the Group's generating assets, on a discounted basis. The amount provided represents the present value of the expected costs. An amount equivalent to the initial provision is capitalised within tangible fixed assets and is being depreciated over the useful lives of the related assets. The unwinding of the discount is included in interest payable and similar charges.

The provision is estimated using the assumption that the re-instatement will take place between 2039 and 2045. The provision has been estimated using existing technology at current prices. The discount rate applied is the pre-tax rate based upon the Group's weighted average cost of capital and reflects the current market assessment of the time value of money and the risks specific to the business.

## 18. Deferred tax

The movement on the deferred tax account is as shown below:

	Year ended 31 December	
	2008 £m	2007 £m
<b>Deferred tax liability at 1 January</b>	201.6	390.9
Charged/(credited) to income statement	28.4	(16.7)
Deferred tax on actuarial losses on defined benefit pension scheme	(3.6)	(0.5)
Deferred tax on cash flow hedges	47.4	(172.1)
<b>Deferred tax liability at 31 December</b>	273.8	201.6

The movements in deferred tax assets and liabilities during each year are shown below. Deferred tax assets and liabilities are offset where there is a legally enforceable right of offset and there is an intention to settle the balances net.

### Deferred tax liabilities/(assets):

	Financial instruments £m	Accelerated capital allowances £m	Other liabilities £m	Other assets £m	Total £m
<b>At 1 January 2007</b>	103.3	282.8	15.8	(11.0)	390.9
Charged/(credited) to income statement	1.5	(21.6)	1.8	1.6	(16.7)
Credited to equity	(172.1)	-	-	(0.5)	(172.6)
<b>At 1 January 2008</b>	(67.3)	261.2	17.6	(9.9)	201.6
Charged to income statement	15.5	8.8	-	4.1	28.4
Charged/(credited) to equity	47.4	-	-	(3.6)	43.8
<b>At 31 December 2008</b>	(4.4)	270.0	17.6	(9.4)	273.8

Deferred tax assets are recognised to the extent that the realisation of the related tax benefit through future associated taxable profits is probable.

As described in note 7, no deferred tax asset has been recognised with respect to the unwind of the Eurobond financing structure.

## Notes to the consolidated financial statements

## 19. Called-up share capital

	As at 31 December	
	2008 £m	2007 £m
<b>Authorised</b>		
865,238,823 ordinary shares of £0.11 <sup>16</sup> / <sub>29</sub> each	100.0	100.0
<b>Issued and fully paid</b>		
2007 - 339,397,000 ordinary shares of £0.11 <sup>16</sup> / <sub>29</sub> each	-	39.2
2008 - 339,398,968 ordinary shares of £0.11 <sup>16</sup> / <sub>29</sub> each	39.2	-
	39.2	39.2

The movement in allotted and fully paid share capital of the Company during each year was as follows:

	Years ended 31 December	
	2008 Number	2007 Number
<b>At 1 January</b>	339,397,000	368,921,151
Effect of share consolidations	-	(16,518,847)
Cancelled under share buy-back programme	-	(13,005,304)
Issued under employee share schemes	1,968	-
<b>At 31 December</b>	339,398,968	339,397,000

**Effect of share consolidations**

The Company undertook a share consolidation in connection with the interim special dividend paid on 16 May 2007 (note 8). Following approval at the Annual General Meeting held on 26 April 2007, the share consolidation under which shareholders received 64 new ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each for every 67 existing ordinary shares of 11<sup>1</sup>/<sub>29</sub> pence each, became effective on 30 April 2007.

**Share buy-back programme**

Under a share buy-back programme completed between 7 September 2007 and 13 December 2007, the Company purchased 13,005,304 ordinary shares for an aggregate consideration (inclusive of all transaction costs) of £83.5 million. Transaction costs of share purchases under the programme amounted to £0.5 million. All shares purchased through the share buy-back programme were cancelled.

**Issued under employee share schemes**

During the year, a total of 1,968 ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each were issued in satisfaction of share options which were exercised in accordance with the rules of the SAYE Plan.

The Company has only one class of ordinary shares, which carry no right to fixed income. No shareholders have waived their rights to dividends.

## 20. Share-based payments

Costs recognised in the income statement in relation to share-based payments are as follows:

	Years ended 31 December	
	2008 £m	2007 £m
SIP	2.4	2.2
ESIP	1.3	0.8
SAYE	0.1	0.1
	3.8	3.1

### Share Incentive Plan ("SIP")

Under the 2008 SIP Free share award, the Company's employee benefit trust purchased a total of 295,776 shares (2007: 195,810 shares issued) in April 2008 to be held on behalf of qualifying employees, equating to 416 shares (2007: 305 shares) with a cash value of approximately £2,500 (2007: £2,500) per employee based on the Company's share price at the time of the award. The fair value of the 2008 Free share award (determined at the award date based on the price paid) of £1.8 million was charged in the income statement in full in the year ended 31 December 2008, 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 2007 Free share award of £1.6 million was charged to the income statement in full in the year ended 31 December 2007.

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, in a ratio of one-to-one, with the cost of Matching shares borne by the Group. As at 31 December 2008, a total of 230,790 Matching shares had been purchased and were held in trust on behalf of qualifying employees (2007: 104,367). The fair value of Matching shares awarded in the year to 31 December 2008 (determined at the award dates based on the price paid) of £0.6 million is being charged in the income statement on a straight-line basis over a one-year vesting period. Similarly, the fair value of the 2007 Matching shares award of £0.8 million was charged to the income statement on a straight-line basis over a one-year vesting period now ended.

Shares in the Company held under trust and under the Company's control as a result of the SIP (i.e. the Matching shares) were as follows:

	Year ended 31 December 2008						
	Shares held at 1 January 2008 Number	Shares acquired during year Number	Shares transferred during year Number	Shares held at 31 December 2008 Number	Cost at 31 December 2008 £000	Nominal value at 31 December 2008 £000	Market value at 31 December 2008 £000
SIP	104,367	130,681	(4,258)	230,790	1,583	27	1,295

### Executive Share Incentive Plan ("ESIP")

Under the ESIP, annual awards of performance shares are made at nil consideration to executive directors and other senior staff up to a normal maximum of 100% of salary (200% in exceptional circumstances). Shares vest according to whether Drax's TSR matches or outperforms an index (determined in accordance with the scheme rules) over three years.

ESIP awards over 604,753 shares (2007: 361,582 shares) were granted to executive directors and other senior staff in 2008, with performance measured over the three years to December 2010 and potential vesting in April 2011. The fair value of the 2008 ESIP awards (determined at the grant date using a Monte Carlo simulation model, which takes into account the estimated probability of different levels of vesting) of £1.2 million, is being charged to the income statement on a straight-line basis over the three-year vesting period to April 2011. Similarly, the fair value of the 2006 and 2007 ESIP awards of £1.9 million and £0.9 million are being charged to the income statement on a straight-line basis over the three-year vesting period to September 2009 and April 2010 respectively.

## Notes to the consolidated financial statements

## 20. Share-based payments (continued)

**Savings-Related Share Option Plan ("SAYE Plan")**

In July 2006, participation in the SAYE Plan was offered to all qualifying employees. Options were granted for employees to acquire shares at a price of £6.36 (representing a discount of 20% to the prevailing market price determined in accordance with the scheme rules), exercisable at the end of the three and five year savings contracts. The fair value of the 899,396 options granted in connection with the SAYE Plan of £0.5 million is being charged to the income statement over the life of the respective contracts. There have been no further offers under the SAYE Plan since that made in July 2006.

During the year, a total of 1,968 ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each were issued in satisfaction of share options which were exercised in accordance with the rules of the SAYE Plan. No other shares have been issued or repurchased to date with respect to the SAYE Plan or ESIP. Given that these share-based incentive plans have commenced only recently, the level of forfeitures is not significant. Additional information in relation to the Group's share-based incentive plans is included in the Remuneration Committee report.

## 21. Capital redemption reserve

	Years ended 31 December	
	2008 £m	2007 £m
<b>At 1 January</b>	1.5	-
Redemption of ordinary shares under share buy-back programme	-	1.5
<b>At 31 December</b>	1.5	1.5

## 22. Merger reserve

	Years ended 31 December	
	2008 £m	2007 £m
<b>At 1 January and 31 December</b>	710.8	710.8

The merger reserve arose on the financial restructuring of the Group which took place in 2005.

## 23. Hedge reserve

	Years ended 31 December	
	2008 £m	2007 £m
<b>At 1 January</b>	(161.3)	250.9
Gains/(losses) recognised:		
- Commodity contracts	49.0	(317.7)
- Interest rate swaps	(5.9)	(0.8)
Released from equity:		
- Commodity contracts	123.2	(264.1)
- Interest rate swaps	(1.6)	(1.7)
Related deferred tax, net	(47.4)	172.1
<b>At 31 December</b>	<b>(44.0)</b>	<b>(161.3)</b>

The Group's cash flow hedges relate to commodity contracts, principally commitments to sell power and interest rate swaps. Amounts are recognised in the hedge reserve as the designated contracts are marked to market at each period end for the effective portion of the hedge, which is generally 100% of the relevant contract. Amounts held within the hedge reserve are then released as the related contract matures and the hedged transaction impacts profit or loss. For power sales contracts, this is when the underlying power is delivered. Further information in relation to the Group's accounting for financial instruments is included in notes 3 and 16.

The expected release profile from equity of post-tax hedging gains and losses is as follows:

	As at 31 December 2008			
	Within 1 year £m	1-2 years £m	>2 years £m	Total £m
Commodity contracts	(67.4)	9.1	18.0	(40.3)
Interest rate swaps	(2.7)	(1.0)	-	(3.7)
	(70.1)	8.1	18.0	(44.0)

	As at 31 December 2007			
	Within 1 year £m	1-2 years £m	>2 years £m	Total £m
Commodity contracts	(86.3)	(62.1)	(14.5)	(162.9)
Interest rate swaps	1.2	0.3	0.1	1.6
	(85.1)	(61.8)	(14.4)	(161.3)

## 24. Retained losses

	Years ended 31 December	
	2008 £m	2007 £m
<b>At 1 January</b>	<b>(649.9)</b>	<b>(746.0)</b>
Profit for the year	332.9	353.0
Equity dividends paid (note 8)	(110.0)	(171.3)
Purchase of own shares under share buy-back programme (note 19)	-	(83.5)
Actuarial losses on defined benefit pension scheme (note 28)	(12.9)	(3.3)
Deferred tax on actuarial losses on defined benefit pension scheme	3.6	0.9
Impact of reduction in tax rate on deferred tax on defined benefit pension scheme	-	(0.4)
Net movements in equity associated with share-based payments	1.4	0.7
<b>At 31 December</b>	<b>(434.9)</b>	<b>(649.9)</b>

## Notes to the consolidated financial statements

## 25. Shareholders' funds and statement of changes in shareholders' equity

	Share capital £m	Capital redemption reserve £m	Share premium £m	Merger reserve £m	Hedge reserve £m	Retained losses £m	Total £m
<b>At 1 January 2007</b>	40.7	-	420.7	710.8	250.9	(746.0)	677.1
Profit for the year	-	-	-	-	-	353.0	353.0
Equity dividends paid	-	-	-	-	-	(171.3)	(171.3)
Purchase and redemption of own shares under share buy-back programme	(1.5)	1.5	-	-	-	(83.5)	(83.5)
Actuarial losses on defined benefit pension scheme	-	-	-	-	-	(3.3)	(3.3)
Deferred tax on actuarial losses on defined benefit pension scheme	-	-	-	-	-	0.9	0.9
Impact of reduction in tax rate on deferred tax on defined benefit pension scheme	-	-	-	-	-	(0.4)	(0.4)
Fair value losses on cash flow hedges	-	-	-	-	(584.3)	-	(584.3)
Deferred tax on cash flow hedges	-	-	-	-	171.1	-	171.1
Impact of reduction in tax rate on deferred tax on cash flow hedges	-	-	-	-	1.0	-	1.0
Movement in equity associated with share-based payments	-	-	-	-	-	3.1	3.1
Own shares held by employee trust	-	-	-	-	-	(0.8)	(0.8)
Own shares purchased and vested with employees	-	-	-	-	-	(1.6)	(1.6)
<b>At 1 January 2008</b>	39.2	1.5	420.7	710.8	(161.3)	(649.9)	361.0
Profit for the year	-	-	-	-	-	332.9	332.9
Equity dividends paid	-	-	-	-	-	(110.0)	(110.0)
Actuarial losses on defined benefit pension scheme	-	-	-	-	-	(12.9)	(12.9)
Deferred tax on actuarial losses on defined benefit pension scheme	-	-	-	-	-	3.6	3.6
Fair value gains on cash flow hedges	-	-	-	-	164.7	-	164.7
Deferred tax on cash flow hedges	-	-	-	-	(47.4)	-	(47.4)
Movement in equity associated with share-based payments	-	-	-	-	-	3.8	3.8
Own shares held by employee trust	-	-	-	-	-	(0.6)	(0.6)
Own shares purchased and vested with employees	-	-	-	-	-	(1.8)	(1.8)
<b>At 31 December 2008</b>	39.2	1.5	420.7	710.8	(44.0)	(434.9)	693.3

## 26. Cash flow from operating activities

	Years ended 31 December	
	2008 £m	2007 £m
<b>Profit for the year</b>	<b>332.9</b>	<b>353.0</b>
Adjustments for:		
Interest payable and similar charges	28.8	34.3
Interest receivable	(7.2)	(11.4)
Tax charge	109.6	95.5
Depreciation	46.2	43.7
Unrealised gains on derivative contracts	(56.3)	(3.3)
Defined benefit pension scheme charge	4.1	2.3
Non-cash charge for share-based payments	3.8	3.1
<b>Operating cash flows before movement in working capital</b>	<b>461.9</b>	<b>517.2</b>
Changes in working capital:		
Increase in inventories	(81.2)	(31.4)
(Increase)/decrease in receivables	(130.3)	43.8
Increase/(decrease) in payables	190.1	(87.5)
Defined benefit pension scheme contributions	(9.9)	(4.6)
Increase in provisions	0.2	0.2
<b>Cash generated from operations</b>	<b>430.8</b>	<b>437.7</b>

## 27. Employees and directors

### Staff costs (including executive directors)

	Years ended 31 December	
	2008 £m	2007 £m
<b>Included in other operating expenses excluding exceptional items (note 5):</b>		
Wages and salaries	39.0	33.5
Social security costs	3.1	3.2
Other pension costs (note 28)	5.2	3.1
Share-based payments (note 20)	3.8	3.1
	<b>51.1</b>	<b>42.9</b>

### Average monthly number of people employed (including executive directors)

	Years ended 31 December	
	2008 Number	2007 Number
Operations	566	520
Business services	146	138
	<b>712</b>	<b>658</b>

## Notes to the consolidated financial statements

## 28. Pensions

The Group operates an approved defined benefit scheme on behalf of the Drax Power Group of the Electricity Supply Pension Scheme ("DPG ESPS"). This scheme was closed to new members as from 1 January 2002 unless they qualify through being existing members of another part of the ESPS. The Group also operates a defined contribution scheme.

**Defined benefit scheme**

The most recent actuarial valuation of the DPG ESPS was 31 March 2007. This has been updated as at 31 December 2008 to reflect relevant changes in assumptions. The principal assumptions were as follows:

	Years ended 31 December	
	2008 % p.a.	2007 % p.a.
Discount rate	6.1	5.8
Inflation	3.0	3.4
Rate of increase in pensions in payment and deferred pensions	3.0	3.4
Rate of increase in pensionable salaries	4.5	4.9
Expected return on plan assets	5.4	6.5

The mortality assumptions are based on standard mortality tables which incorporate an adjustment to allow for future mortality improvements. The assumptions are that a member who retired in 2008 at age 60 will live on average for a further 25 years (2007: 25 years) after retirement if they are male, and for a further 27 years (2007: 27 years) after retirement if they are female. Similarly life expectancy at age 60 for male and female non-pensioners (currently aged 45) is assumed to be 27 years and 28 years respectively (2007: 27 years and 28 years respectively).

The amounts recognised in the balance sheet are determined as follows:

	As at 31 December	
	2008 £m	2007 £m
Present value of funded obligations	114.4	118.6
Fair value of plan assets	(93.8)	(105.1)
Net liability recognised in the balance sheet	20.6	13.5

The amounts recognised in the income statement, entirely within other operating expenses, are as follows:

	Years ended 31 December	
	2008 £m	2007 £m
Current service cost	3.7	3.3
Past service cost	0.3	-
Interest cost	7.0	5.6
Expected return on plan assets	(6.9)	(6.6)
Total included in staff costs (note 27)	4.1	2.3

The actual return on plan assets was a loss of £19.2 million (2007: gain of £4.4 million).

The amounts recognised in the statement of recognised income and expense are as follows:

	Years ended 31 December	
	2008 £m	2007 £m
Cumulative actuarial losses on defined benefit pension scheme at 1 January	(25.7)	(22.4)
Actuarial losses on defined benefit pension scheme recognised in the year	(12.9)	(3.3)
Cumulative losses recognised in the statement of recognised income and expense at 31 December	(38.6)	(25.7)



Changes in the present value of the defined benefit obligation are as follows:

	Years ended 31 December	
	2008 £m	2007 £m
Defined benefit obligation at 1 January	118.6	109.4
Service cost	3.7	3.3
Past service cost	0.3	-
Employee contributions	1.0	1.0
Interest cost	7.0	5.6
Actuarial (gains)/losses	(13.2)	1.1
Benefits paid	(3.0)	(1.8)
Defined benefit obligation at 31 December	114.4	118.6

Changes in the fair value of plan assets are as follows:

	Years ended 31 December	
	2008 £m	2007 £m
Fair value of plan assets at 1 January	105.1	96.9
Expected return	6.9	6.6
Actuarial losses	(26.1)	(2.2)
Employer contributions	9.9	4.6
Employee contributions	1.0	1.0
Benefits paid	(3.0)	(1.8)
Fair value of plan assets at 31 December	93.8	105.1

Employer contributions included a special payment to reduce the actuarial deficit of £3.5 million in June 2008. This payment was subsequently invested in fixed interest bonds.

The major categories of plan assets as a percentage of total plan assets were as follows:

	As at 31 December	
	2008 %	2007 %
Equities	48.4	65.2
Fixed interest bonds	47.9	34.8
Cash	3.7	-

The pension plan assets do not include any ordinary shares issued by Drax Group plc or any property occupied by the Group.

The Group employs a building block approach in determining the long-term rate of return on pension plan assets. Historical markets are studied and assets with higher volatility are assumed to generate higher returns consistent with widely accepted capital market principles. The overall expected rate of return on assets is then derived by aggregating the expected return for each asset class over the actual asset allocation for the scheme.

The net liability recognised in the balance sheet is particularly sensitive to the discount rate assumption, which is determined by reference to market yields at the balance sheet date on high quality corporate bonds, allowing for the duration of the scheme's liabilities. Recent volatility in financial markets has caused the range of yields on corporate bonds to widen significantly. It is estimated that a change of +/-0.5% in the discount rate would have the effect of decreasing/increasing the net liability recognised in the balance sheet by approximately £11 million.

## Notes to the consolidated financial statements

## 28. Pensions (continued)

The history of experience adjustments is as follows:

	Years ended 31 December				
	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Defined benefit obligation	(114.4)	(118.6)	(109.4)	(107.0)	(85.0)
Fair value of plan assets	93.8	105.1	96.9	62.3	48.5
Deficit	(20.6)	(13.5)	(12.5)	(44.7)	(36.5)
Experience adjustments on plan liabilities	13.2	(1.1)	5.3	(15.1)	(7.6)
Experience adjustments on plan assets	(26.1)	(2.2)	3.3	6.9	1.5

## Defined contribution plans

Pension costs for the defined contribution scheme are as follows:

	Years ended 31 December	
	2008 £m	2007 £m
Total included in staff costs (note 27)	1.1	0.8

The Group expects to contribute £9 million to its pension plans during the 12 months ended 31 December 2009.

## 29. Capital and other financial commitments

	As at 31 December	
	2008 £m	2007 £m
Contracts placed for future capital expenditure not provided in the financial statements	110.9	94.8
Future support contracts not provided in the financial statements	65.2	45.6
Future commitments to purchase fuel under fixed and variable priced contracts	1,211.3	996.5
Future commitments to sell power under fixed and variable priced contracts	2,873.1	2,558.2

## 30. Related party transactions

### Subsidiary companies

The Company's subsidiary undertakings including the name, country of incorporation and proportion of ownership interest for each are disclosed in note 3 to the Company's separate financial statements which follow these consolidated financial statements. Transactions between subsidiaries and between the Company and its subsidiaries are eliminated on consolidation.

### Remuneration of key management personnel

The remuneration of the directors, who are considered to be the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 "Related party disclosures". Further information about the remuneration of individual directors, together with the directors' interests in the share capital of Drax Group plc, is provided in the audited part of the Remuneration Committee report on pages 56 and 57.

	Years ended 31 December	
	2008 £m	2007 £m
Salaries and short-term benefits	2,080	1,702
Termination payment	485	-
Aggregate amounts receivable under share-based incentive schemes	343	247
Company contributions to money purchase pension schemes	190	173
	3,098	2,122

Amounts receivable under long-term incentive schemes represents the expenses arising from share-based payments included in the income statement, determined based on the fair value of the related awards at the date of grant (note 20).

There were no other transactions with directors for the periods covered by these consolidated financial statements.

## Company - Independent auditors' report

### To the members of Drax Group plc

We have audited the parent Company financial statements of Drax Group plc for the year ended 31 December 2008 which comprise the balance sheet and the related notes 1 to 7. These parent Company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the Group financial statements of Drax Group plc for the year ended 31 December 2008 and on the information in the Remuneration Committee report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the parent Company financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the statement of directors' responsibilities.

Our responsibility is to audit the parent Company financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent Company financial statements give a true and fair view and whether the parent Company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the Directors' report is consistent with the parent Company financial statements. The information given in the Directors' report includes that specific information presented in the Chairman's introduction, Chief Executive's review and Business and financial review that is cross referred from the Business review and Risk identification sections of the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report as described in the contents section and consider whether it is consistent with the audited parent Company financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent Company financial statements. Our responsibilities do not extend to any further information outside the Annual Report.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent Company financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the parent Company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent Company financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent Company financial statements.

### Opinion

In our opinion:

- the parent Company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2008;
- the parent Company financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the parent Company financial statements.

#### Deloitte LLP

Chartered accountants and registered auditors  
London, United Kingdom  
2 March 2009

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## Company balance sheets

	Notes	As at 31 December	
		2008 £000	2007 £000
<b>Fixed assets</b>			
Investment in subsidiaries	3	461,373	461,368
<b>Current assets</b>			
Other debtors		11	37
Cash at bank and in hand	4	3,370	3,637
		3,381	3,674
<b>Current liabilities</b>			
Amounts due to other Group companies		(3,198)	(1,086)
<b>Net current assets</b>		183	2,588
<b>Net assets</b>		461,556	463,956
<b>Capital and reserves</b>			
Called-up share capital	5	39,207	39,207
Capital redemption reserve	6	1,502	1,502
Share premium account	6	420,688	420,675
Profit and loss account	6	159	2,572
<b>Total equity shareholders' funds</b>	6	461,556	463,956

These financial statements were approved by the Board of directors on 2 March 2009.

Signed on behalf of the Board of directors:

**Dorothy Thompson**  
Chief Executive  
2 March 2009



**Tony Quinian**  
Finance Director  
2 March 2009



## Notes to the Company balance sheets

### 1. Significant accounting policies

The separate financial statements of the Company are presented as required by the Companies Act 1985. They have been prepared under the historical cost convention and in accordance with applicable United Kingdom Accounting Standards and law.

The principal accounting policies are summarised below, and have been consistently applied to both years presented.

#### Cash flow statement

The cash flows of the Group are included in the consolidated cash flow statements of Drax Group plc, whose accounts are publicly available. Accordingly, the Company has taken advantage of the exemption under FRS 1 "Cash flow statements" not to publish a cash flow statement.

#### Related party transactions

The Company has taken advantage of the exemption granted by paragraph 3(b) of FRS 8 "Related party disclosures" not to disclose transactions with other Group companies.

#### Fixed asset investments

Fixed asset investments in subsidiaries are stated at cost less, where appropriate, provision for impairment.

### 2. Profit and loss account

As permitted by Section 230 of the Companies Act 1985, the Company has elected not to present its own profit and loss account for the year. The Company's profit and loss account was approved by the Board on 2 March 2009. Drax Group plc reported a profit for the year ended 31 December 2008 of £110.1 million (£0.1 million before dividends received from other Group companies) (2007: £123.9 million, or £2.4 million before dividends received from other Group companies).

The Company has no employees other than the directors, whose remuneration was borne by a subsidiary undertaking and recharged to the Company. The amount recharged during the year was £599,000 (2007: £599,000).

The auditors' remuneration for audit services to the Company, totalling £20,000 (2007: £20,000), was borne by a subsidiary undertaking and recharged to the Company during the year.

### 3. Fixed asset investments

Cost	Subsidiary undertakings £000
<b>At 1 January 2008</b>	461,368
Additions in year (see below)	5
<b>At 31 December 2008</b>	<b>461,373</b>

#### Subsidiary undertakings

Name and nature of business	Country of incorporation and registration	Type of share	Group effective shareholding
Drax Finance Limited (holding company)	England and Wales	Ordinary	100%
Drax GCo Limited (non-trading company) <sup>(1)</sup>	England and Wales	- <sup>(3)</sup>	100%
Drax Group Limited (holding company) <sup>(1)</sup>	Cayman Islands	Ordinary	100%
Drax Intermediate Holdings Limited (holding company) <sup>(1)</sup>	Cayman Islands	Ordinary	100%
Drax Holdings Limited (holding company) <sup>(1)(2)</sup>	Cayman Islands	Ordinary	100%
Drax Electric Limited (in members' voluntary liquidation) (holding company) <sup>(1)</sup>	Cayman Islands	Ordinary	100%
Drax Limited (holding company) <sup>(1)</sup>	Cayman Islands	Ordinary	100%
Drax Power Limited (power generation) <sup>(1)</sup>	England and Wales	Ordinary	100%
Drax Ouse (dormant company) <sup>(1)</sup>	England and Wales	Ordinary	100%
Drax Investments Limited (investment company) <sup>(1)</sup>	England and Wales	Ordinary	100%
Biomass Developments Limited (holding company)*	England and Wales	Ordinary	100%
Emergefource Limited (non-trading company)* <sup>(1)</sup>	England and Wales	Ordinary	100%
Emergestyle Limited (non-trading company)* <sup>(1)</sup>	England and Wales	Ordinary	100%
Mid Suffolk Power Limited (non-trading company)* <sup>(1)</sup>	England and Wales	Ordinary	100%
BondPower Limited (investment company)*	Jersey	Ordinary	100%

All subsidiary undertakings operate in their country of incorporation. All subsidiary undertakings have 31 December year ends, except as indicated below.

Notes:

(1) Held by an intermediate subsidiary undertaking.

(2) 30 December year end.

(3) Limited by guarantee.

\* Additions in year.

InPower Limited, InPower 2 Limited and NoteCo Limited are all incorporated in Jersey. Although not subsidiaries of Drax Group plc, they have been included in the consolidated financial statements (prepared under IFRSs) in accordance with SIC 12 "Consolidation - special purpose entities" on the basis that their sole purpose was to hold the debt of the Group prior to the Refinancing and listing on 15 December 2005.

## 4. Cash at bank and in hand

	As at 31 December	
	2008 £000	2007 £000
Cash at bank and in hand	3,370	3,637

## 5. Called-up share capital

	As at 31 December	
	2008 £000	2007 £000
<b>Authorised</b>		
865,238,823 ordinary shares of £0.11 <sup>16</sup> / <sub>29</sub> each	99,950	99,950
<b>Issued and fully paid</b>		
2007 - 339,397,000 ordinary shares of £0.11 <sup>16</sup> / <sub>29</sub> each	-	39,207
2008 - 339,398,968 ordinary shares of £0.11 <sup>16</sup> / <sub>29</sub> each	39,207	-
	39,207	39,207

The movement in allotted and fully paid share capital of the Company during each year was as follows:

	Years ended 31 December	
	2008 Number	2007 Number
<b>At 1 January</b>	339,397,000	368,921,151
Effect of share consolidations	-	(16,518,847)
Cancelled under share buy-back programme	-	(13,005,304)
Issued under employee share schemes	1,968	-
<b>At 31 December</b>	<b>339,398,968</b>	<b>339,397,000</b>

### Effect of share consolidations

The Company undertook a share consolidation in connection with the interim special dividend paid on 16 May 2007 (note 7). Following approval at the Annual General Meeting held on 26 April 2007, the share consolidation under which shareholders received 64 new ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each for every 67 existing ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each, became effective on 30 April 2007.

### Share buy-back programme

Under a share buy-back programme completed between 7 September 2007 and 13 December 2007, the Company purchased 13,005,304 ordinary shares for an aggregate consideration (inclusive of all transaction costs) of £83.5 million. Transaction costs of share purchases under the programme amounted to approximately £0.5 million. All shares purchased through the share buy-back programme were cancelled.

### Issued under employee share schemes

During the year, a total of 1,968 ordinary shares of 11<sup>16</sup>/<sub>29</sub> pence each were issued in satisfaction of share options which were exercised in accordance with the rules of the SAYE Plan.

The Company has only one class of ordinary shares, which carry no right to fixed income. No shareholders have waived their rights to dividends.

## Notes to the Company balance sheets

## 6. Analysis of movements in equity shareholders' funds

	Share capital £000	Capital redemption reserve £000	Share premium £000	Profit and loss account £000	Total £000
<b>At 1 January 2007</b>	40,709	-	420,675	133,506	594,890
Retained profit for the year	-	-	-	123,852	123,852
Purchase and redemption of own shares under share buy-back programme (note 5)	(1,502)	1,502	-	(83,510)	(83,510)
Equity dividends paid (note 7)	-	-	-	(171,276)	(171,276)
<b>At 1 January 2008</b>	39,207	1,502	420,675	2,572	463,956
Share capital issued (note 5)	-	-	13	-	13
Retained profit for the year	-	-	-	110,147	110,147
Charge to equity for share-based payments	-	-	-	(2,595)	(2,595)
Equity dividends paid (note 7)	-	-	-	(109,965)	(109,965)
<b>At 31 December 2008</b>	<b>39,207</b>	<b>1,502</b>	<b>420,688</b>	<b>159</b>	<b>461,556</b>

## 7. Dividends

	Years ended 31 December	
	2008 £000	2007 £000
<b>Amounts recognised as distributions to equity holders in the year (based on the number of shares in issue at the record date):</b>		
Final dividend for the year ended 31 December 2007 of 9.9 pence per share paid on 7 May 2008 (2007: 9.1 pence per share paid on 16 May 2007)	33,600	33,572
Special interim dividend for the year ended 31 December 2007 of 7.8 pence per share paid 7 May 2008 (2007: 32.9 pence per share paid on 16 May 2007)	26,473	121,375
Interim dividend for the year ended 31 December 2008 of 5.0 pence per share paid on 8 October 2008 (2007: 4.7 pence per share paid on 24 October 2007)	16,970	16,329
Special interim dividend for the year ended 31 December 2008 of 9.7 pence per share paid on 8 October 2008 (2007: nil)	32,922	-
	<b>109,965</b>	<b>171,276</b>

The Company undertook a share consolidation in connection with the special interim dividend paid on 16 May 2007 (note 5).

At the forthcoming Annual General Meeting, the Board will recommend to shareholders that a resolution is passed to approve payment of a final dividend for the year ended 31 December 2008 of 38.3 pence per share (equivalent to approximately £130 million) payable on or before 22 May 2009. The final dividend has not been included as a liability as at 31 December 2008.



## Shareholder information

### Key dates for 2009

At the date of publication of this document, the following are the proposed key dates in the 2009 financial calendar:

Annual General Meeting	Interim Management Statement	Ordinary shares marked ex-dividend	Record Date for entitlement to the final dividend	Payment of final dividend <sup>(1)</sup>
28	28	6	8	22
April	April	May	May	May
Pre-close Trading Update and financial half year end	Announcement of half year results	Interim Management Statement	Pre-close Trading Update	Financial year end
30	4	Mid	16	31
June	August	October	December	December

Notes:

(1) Payment of the final dividend is subject to shareholder approval at the forthcoming Annual General Meeting.

Other significant dates, or amendments to the proposed dates above, will be posted on the Company's website as and when they become available.

### Results announcements

Results announcements are issued to the London Stock Exchange and are available on its news service. Shortly afterwards, they are available on the Company's website.

### Financial reports

Copies of all financial reports we publish are available from the date of publication on our website. Printed copies of reports can be requested by writing to the Company Secretary at the registered office, by clicking on "Contact Us" on our website, or direct by e-mail to enquiries@draxpower.com.

## Shareholder information

### Share price

Shareholders can access the current share price of Drax Group plc ordinary shares on our website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk). During Stock Exchange trading hours the price shown on the website is subject to a delay of approximately 15 minutes and outside trading hours it is the last available price.

The table below provides an indication of fluctuations in the Drax Group plc share price during the course of 2008, and the graph provides an indication of the trend of the share price throughout the year.

Closing price on 31 December 2007	605 pence
High during the year (19 September 2008)	821 pence
Low during the year (23 January 2008)	486.75 pence
Closing price on 31 December 2008	561 pence



Notes:

(1) The share prices given are the middle market closing prices as derived from the London Stock Exchange Daily Official List and no adjustment has been made to try to reflect the effects of the share consolidation.

### Market capitalisation

The market capitalisation, based on shares in issue and closing middle market price at 31 December 2008, was approximately £1.9 billion.

### Company share registrars and transfer office

Shareholders who have a query regarding their shareholding should contact the Company's share registrars at Equiniti Limited, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA or by telephone on 0871 384 2030 from within the UK (calls to 0871 Helpline numbers are charged at 8 pence per minute from a BT landline. Other telephony provider costs may vary) or +44 121 415 7047 from outside the UK. When contacting the registrar it is advisable to have the shareholder reference to hand and quote Drax Group plc, as well as the name and address in which the shares are held.

### Electronic communication

Registering for online communication gives shareholders more control of their shareholding. The registration process is via our registrars' secure website [www.shareview.com](http://www.shareview.com).

Once registered shareholders are able to:

- elect how we communicate with them;
- amend their details;
- amend the way dividends are received; and
- buy or sell shares online.

This doesn't mean shareholders can no longer receive paper copies of documents. We are able to offer a range of services and tailor communication to meet our shareholders' needs.

### Beneficial owners of shares with "information rights"

Beneficial owners of shares who have been nominated by the registered holder of those shares to receive information rights under Section 146 of the Companies Act 2006 are required to direct all communications to the registered holder of their shares and not to the Company or Equiniti Limited.

## Shareholder profile

The categories of ordinary shareholders and the ranges and size of shareholdings are set out below:

Analysis of shareholders	As at 31 December 2008			
	Number of shareholders	%	Number of shares <sup>(1)</sup>	%
Private shareholders	720	33.71	1,761,510	0.52
Institutional and corporate holders	1,416	66.29	337,637,458	99.48
<b>Total</b>	<b>2,136</b>	<b>100.00</b>	<b>339,398,968</b>	<b>100.00</b>

Range	As at 31 December 2008			
	Number of shareholders	%	Number of shares <sup>(1)</sup>	%
1-100	124	5.81	6,679	0.00
101-200	139	6.51	21,546	0.01
201-500	347	16.25	122,801	0.04
501-1,000	405	18.96	308,814	0.09
1,001-5,000	461	21.58	1,005,725	0.30
5,001-10,000	92	4.31	658,418	0.19
10,001-100,000	327	15.30	12,868,173	3.79
100,001-500,000	159	7.44	37,651,301	11.09
500,001-5,000,000	70	3.28	102,386,199	30.17
5,000,001 and above	12	0.56	184,369,312	54.32
<b>Total</b>	<b>2,136</b>	<b>100.00</b>	<b>339,398,968</b>	<b>100.00</b>

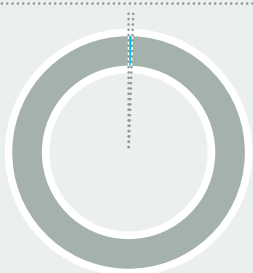
Notes:

(1) Ordinary shares of 11 $\frac{1}{2}$ pence each.

### Shareholders by percentage ownership

as at 31 December 2008

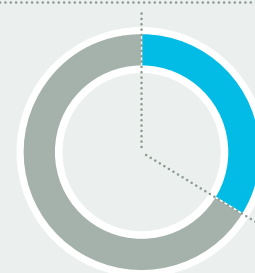
- Private shareholders: 0.52%
- Institutional and corporate holders: 99.48%



### Shareholders by number

as at 31 December 2008

- Private shareholders: 720
- Institutional and corporate holders: 1,416



## Shareholder information

## Want to find out more?

Information about the Group in addition to that outlined in this report is available on the Company's website at [www.draxgroup.plc.uk](http://www.draxgroup.plc.uk). Information made available on the website does not constitute part of this Annual Report.



## Company information, professional advisers and service providers

### Drax Group plc

#### Registered office and trading address

Drax Power Station  
Selby  
North Yorkshire YO8 8PH  
Telephone +44 (0)1757 618381  
Fax +44 (0)1757 612192

#### Registration details

Registered in England and Wales  
Company Number: 5562053

#### Company website

[www.draxgroup.plc.uk](http://www.draxgroup.plc.uk)

#### Company Secretary

Philip Hudson

#### Enquiry e-mail address

[enquiries@draxpower.com](mailto:enquiries@draxpower.com)

### Professional advisers and service providers

#### Auditors

Deloitte LLP  
2 New Street Square  
London EC4A 3BZ

#### Bankers

Barclays Bank PLC  
1 Churchill Place  
Canary Wharf  
London E14 5HP

#### Brokers

Deutsche Bank AG  
Winchester House  
1 Great Winchester Street  
London EC2N 2DB

#### Financial PR

Brunswick Group LLP  
16 Lincoln's Inn Fields  
London WC2A 3ED

#### Registrars

Equiniti Limited  
Aspect House  
Spencer Road  
Lancing  
West Sussex BN99 6DA

#### Remuneration

Kepler Associates LLP  
60 Trafalgar Square  
London WC2N 5DS

#### Solicitors

Norton Rose LLP  
3 More London Riverside  
London SE1 2AQ

## Glossary

### Ancillary services

Services provided by National Grid plc used for balancing supply and demand or maintaining secure electricity supplies within acceptable limits. They are described in Connection Condition 8 of the Grid Code.

### Availability

Average percentage of time the units were available for generation.

### Average achieved price

Power revenues divided by volume of net sales (includes imbalance charges).

### Average capture price

Revenue derived from bilateral contracts divided by volume of net merchant sales.

### Balancing Mechanism

The period during which the System Operator can call upon additional generation/consumption or reduce generation/consumption, through market participants' bids and offers, in order to balance the system minute by minute.

### Baseload

Running 24 hours per day, seven days per week remaining permanently synchronised to the system.

### Bilateral contracts

Contracts with counterparties and power exchange trades.

### Company

Drax Group plc.

### Dark green spread

The difference between the price available in the market for sales of electricity and the marginal cost of production (being the cost of coal and other fuels including CO<sub>2</sub> emissions allowances).

### Direct-injection co-firing

Is a process whereby biomass is fed directly (that is, avoiding the pulverising mills) to the burners situated in the boiler walls.

### EBITDA

Profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains/(losses) on derivative contracts.

### ESIP

The Drax Group plc Restricted Share Plan, also known as the Drax Group plc Executive Share Incentive Plan.

### EU ETS

The EU Emissions Trading System is a mechanism introduced across the EU to reduce emissions of CO<sub>2</sub>; the scheme is capable of being extended to cover all greenhouse gas emissions.

### Forced Outage

Any reduction in plant availability excluding planned outages.

### Forced Outage Rate

The capacity which is not available due to forced outages or restrictions expressed as a percentage of the maximum theoretical capacity, less planned outage capacity.

### Frequency Response Service

Services purchased by National Grid plc used to maintain system frequency.

### Group

Drax Group plc and its subsidiaries.

### IASs

International Accounting Standards.

### IFRSs

International Financial Reporting Standards.

### LECs

Levy Exemption Certificates. Evidence of Climate Change Levy exempt electricity supplies generated from qualifying renewable sources.

### Load factor

Net sent out generation as a percentage of maximum sales.

### Lost Time Injury Rate

The frequency rate calculated on the following basis (number of accidents x 100,000)/hours worked. Accidents are defined as occurrences when the injured party is absent from work for more than 24 hours.

### Net Balancing Mechanism

Net volumes attributable to accepted bids and offers in the Balancing Mechanism.

### Net merchant sales

Net volumes attributable to bilateral contracts and power exchange trades.

### Net sales

The aggregate of net merchant sales and net Balancing Mechanism.

### Occupational health and safety assessment series (OHSAS)

The OHSAS specification gives requirements for an occupational health and safety management system, to enable an organisation to control its occupational health and safety risks and improve its performance.

### Planned Outage

A period during which scheduled maintenance is executed according to the plan set at the outset of the year.

### Planned Outage Rate

The capacity not available due to planned outages expressed as a percentage of the maximum theoretical capacity.

### Power exchange trades

Power sales or purchases transacted on the APX UK power trading platform.

### Power revenues

The aggregate of bilateral contracts and Balancing Mechanism income/expense.

### ROCs

Renewables Obligation Certificates. Under the current regime, one ROC is issued to eligible generators for every MWh of electricity generated from renewable sources.

### SAYE Plan

The Drax Group plc Approved Savings-Related Share Option Plan.

### SIP

The Drax Group plc Approved Share Incentive Plan.

### Summer

The calendar months April to September.

### Summer baseload market close

Market price on the last day that the season was traded as a product.

### Technical Availability

Total availability after planned and forced outages.

### Through the mill co-firing

Is a process whereby biomass passes first through the pulverising mills before going to the burners situated in the boiler walls.

### TXU

TXU Europe Energy Trading Limited (in administration and subject to a company voluntary arrangement).

### TXU Claim

The claim issued by the Group, ultimately agreed by the Administrators of TXU at approximately £336.0 million (excluding VAT) in respect of unpaid power purchased by TXU and liquidated damages under the TXU Contract.

### TXU Contract

A 15-year power purchase agreement with TXU.

### UK NAP

UK National Allocation Plan.

### Winter

The calendar months October to March.

### Winter baseload market close

Market price on the last day that the season was traded as a product.



**Design and production:**  
Radley Yeldar (London) | [www.ry.com](http://www.ry.com)

**Photography:**  
Marcus Ginns and Lloyd Sturdy

**Print:**  
Granite

think<sup>4</sup> bright is produced with 100% ECF (Elemental Chlorine Free) pulp that is sourced from carefully managed and renewed commercial forests, certified in accordance with the FSC (Forest Stewardship Council). The range is fully recyclable and manufactured within a mill which is registered under the British quality standard of BS EN ISO 9001:2000 and the environmental standard of ISO 14001.



**Mixed Sources**

Product group from well-managed  
forests, controlled sources and  
recycled wood or fiber  
[www.fsc.org](http://www.fsc.org) Cert no. TT-COC-2238  
© 1996 Forest Stewardship Council

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**Drax Group plc**

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Drax Power Station  
Selby  
North Yorkshire YO8 8PH

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Telephone: +44 (0)1757 618381

Fax: +44 (0)1757 612192

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[www.draxgroup.plc.uk](http://www.draxgroup.plc.uk)

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