

DRAX GROUP PLC
(Symbol: DRX)

PRELIMINARY RESULTS FOR THE YEAR ENDED 31 DECEMBER 2006 – PART ONE

(London – 8 March 2007) Drax Group plc (“Drax” or the “Company”), the UK power generator, announces its preliminary results for the year ended 31 December 2006 and reports on key developments to date.

Highlights

- Underlying business performing well with strong operating and trading performance increasing EBITDA⁽¹⁾ by 144% to £583 million.
- EBITDA enhancements substantially achieved 12 months ahead of target. Estimated £45 million of EBITDA enhancements realised in the year ended 31 December 2006.
- Proposed final ordinary dividend of 9.1 pence per share; proposed second special dividend of 32.9 pence per share; making total dividend payments for the year of £497 million (equivalent to 134.7 pence per share⁽³⁾).
- High plant availability placed Drax as the UK’s industry leader for the reliable operation of coal-fired plant by a clear margin.
- Continued management focus on safety delivered record improvements and a leading performance.
- Turbine upgrade announced in December will boost efficiency of the plant to 40% and save one million tonnes of CO₂ each year.
- Formalised our target to produce 10% of output from biomass by 2009 which is expected to deliver an annual saving of two million tonnes of CO₂.

Year ended 31 December 2006 compared to year ended 31 December 2005

	Year ended 31 December	
	2006	2005
	£ million	£ million
Total revenue	1,387	929
Gross profit	746	389
EBITDA ⁽¹⁾	583	239
Operating profit ⁽²⁾	658	355
Profit before tax	634	264
	Pence per share	Pence per share
Basic and diluted earnings per share	126	108
Proposed final ordinary dividend ⁽³⁾	9.1	-
Proposed special dividend ⁽³⁾	32.9	-

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

(2) Operating profit includes exceptional items and IAS 39 mark-to-market adjustments totalling £110 million in 2006 compared to £147 million in 2005.

(3) Based on the number of shares in issue as at 31 December 2006.

Commenting on the results, Dorothy Thompson, Chief Executive of Drax, said:

“These results and our achievements in 2006 reflect the benefit from our strategy of delivering excellence in plant operations and trading performance; enhancing and diversifying the business, with a focus on fuel optionality and carbon abatement; and ensuring we have the appropriate financial and human resources. This strategy will continue in 2007.

“We firmly believe that we have an important part to play in the UK’s transition towards a low carbon economy whilst, at the same time, delivering reliable supplies of electricity. We continue to work on projects to reduce our carbon emissions and are pleased to announce investments of up to £67 million to increase

our capability to produce 10% of our output from renewable fuels by 2009. This is in addition to the £100 million turbine enhancement project which we are now implementing. We expect these investments together to save over three million tonnes of CO₂ emissions each year, equalling the output of around 700 wind turbines.”

Forward Looking Statements

This announcement may contain certain statements, statistics and projections that are or may be forward-looking. The accuracy and completeness of all such statements, including, without limitation, statements regarding the future financial position, strategy, projected costs, plans and objectives for the management of future operations of Drax Group plc (“Drax”) and its subsidiaries (the “Group”) are not warranted or guaranteed. By their nature, forward-looking statements involve risk and uncertainty because they relate to events and depend on circumstances that may occur in the future. Although Drax believes that the expectations reflected in such statements are reasonable, no assurance can be given that such expectations will prove to be correct. There are a number of factors, many of which are beyond the control of the Group, which could cause actual results and developments to differ materially from those expressed or implied by such forward-looking statements. These factors include, but are not limited to, factors such as: future revenues being lower than expected; increasing competitive pressures in the industry; and/or general economic conditions or conditions affecting the relevant industry, both domestically and internationally, being less favourable than expected. We do not intend to publicly update or revise these projections or other forward-looking statements to reflect events or circumstances after the date hereof, and we do not assume any responsibility for doing so.

Management Presentation and Conference Call

Management will host a presentation for analysts and investors at 9:00am (UK Time) today, Thursday 8 March 2007, at the City Presentation Centre, 4 Chiswell Street, Finsbury Square, London, EC1Y 4UP.

The meeting can also be accessed remotely via a conference call or alternatively via a live webcast, as detailed below. After the meeting, a video webcast and recordings of the call will be made available and access details for these recordings are also set out below.

A copy of the presentation will be made available from 7:00am (UK time) on Thursday 8 March for download at www.draxgroup.plc.uk (>>Financial Results 2006).

Event Title:	Drax Group plc: Full Year Results
Event Date:	Thursday 8 March 2007
Event Time:	9:00am (UK time)

UK Call In Number:	020 7162 0125
International Call In Number:	+44 7162 0125
US Call In Number:	+1 334 323 6203

Webcast details	
Live Event Link:	http://events.webeventservices.com/Drax/2007/03/08/

UK Instant Replay	
Start Date:	8 March 2007
Delete Date:	7 April 2007
Dial In Number:	020 7031 4064
Freephone number (UK only):	0800 358 1860
Passcode:	737384

US Instant Replay	
Start Date:	8 March 2007
Delete Date:	7 April 2007
Dial In Number:	+1 954 334 0342
Freephone number:	+1 888 365 0240
Passcode:	737384

Video Webcast

Start Date:

8 March 2007

Delete Date:

9 June 2007

Archive Link:

<http://events.webeventsolutions.com/Drax/2007/03/08/>

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Website:

www.draxgroup.plc.uk

~~~ PART TWO TO FOLLOW ~~~

**DRAX GROUP PLC**  
**(Symbol: DRX)**

**PRELIMINARY RESULTS FOR THE YEAR ENDED 31 DECEMBER 2006 – PART TWO**

**Chief Executive's review**

**Introduction**

We entered 2006 as a newly refinanced and listed company with the credit strength to implement a forward-looking strategy for the business founded on the effective alignment of production, trading and investment strategies. Our achievements in 2006 are borne out by our strong financial results and demonstrate well the value of having a sound capital base. They also reflect the benefit derived from our strategy of: delivering excellence in plant operations and trading performance; enhancing and diversifying the business, with a focus on fuel optionality and carbon abatement; and ensuring we have the appropriate financial and human resources.

We are a power generation business operating in commodity markets. Against a backdrop of volatile power prices, increasing fuel costs and erratic prices for carbon dioxide ("CO<sub>2</sub>") emissions allowances we have delivered strong and improved revenue and earnings compared with 2005. Key to the delivery of these results is the seamless interaction between our production and trading functions which work together to exploit opportunities as they arise. The resulting strong cash flow has allowed us to make significant distributions to our shareholders, fully in line with the commitments we made at Listing.

**Production strategy**

Above all, the principal foundation for our operating philosophy is that we must ensure safe, high integrity operations before we consider anything else. Improvements in our safety record have taken us to leading performance levels helping us to collect, for the second year running, the Royal Society for the Prevention of Accidents' Gold Award.

We continue to operate our "Spotlight on Safety" ("SOS") behaviour-based safety programme for employees and contractors and we have strengthened the safety communication and feedback process.

Our production strategy for the year focused on two key areas: securing the targeted improvements in the fundamentals of plant operation, a programme that was initiated in 2004; and developing and executing projects that will improve the operating efficiency and environmental performance of the Drax plant and equipment.

Our Forced Outage Rate ("FOR") performance has improved for the second year running, both for the full year and during the critical Winter quarters, when reliability of the plant is an essential contributor to the security of supply of the UK electricity system.

This improved operating performance has led to the high availability of all six units at the Drax Power Station and places us as the industry leader for coal-fired plant by a clear margin – we achieved 90% compared to an average of 71% for the remainder of the sector – confirming the competitiveness and reliability of our operations.

We pride ourselves on our environmental leadership position within the sector and are pleased to report that, through focused effort on our operations, 2006 was the third consecutive year in which we recorded zero environmental breaches of our operating licence as issued by the Environment Agency.

**Trading strategy**

Our credit rating and strong market presence have enabled us to deliver our progressive hedging strategy targeting market or better dark green spreads through making full use of the good liquidity available to us in the forward power markets.

During 2006, value was significantly enhanced through a substantial growth in our forward sales portfolio, which more than doubled. In April, we were particularly pleased to announce our contract with Centrica, through which we were able to secure power sales into the term market for the five-and-a-quarter year period to December 2012. In addition, we have continued to contract power through smaller structured deals and the liquid traded market, which now extends through to Winter 2010.

During the course of 2006, we diversified our coal procurement strategy to increase our fuel flexibility and choice. We expanded our access to port capacity and we also worked with our rail freight suppliers to improve logistics between Drax and the ports and the mines from which our coal is delivered.

Our revenue during the year was enhanced through the sale of by-products, National Grid support, or ancillary services and other products. We moved closer to our target of “zero ash landfill” through selling some 80% of our ash to the construction industry. We are working on reducing further this figure through an agreement with Lafarge Cement, under which we will construct an ash rail loading facility to improve our ash export capability and allow greater and more efficient access to construction markets, particularly in the South East of England. In addition, during the year we signed a new gypsum supply contract with British Gypsum to continue to sell all of the gypsum we produce, as a by-product of our flue gas desulphurisation process, to the plasterboard and related products market.

### **Investment strategy**

Through continuing investment, Drax has maintained its position as the most efficient coal-fired generator in the UK with the lowest amount of CO<sub>2</sub> emissions per unit of output. However, we are not complacent and economic carbon abatement is a key driver for our forward investment programme.

In December, we announced our decision to proceed with a major, £100 million turbine upgrade – the largest steam turbine modernisation in UK history. Once complete, it will improve the overall efficiency of the plant taking it close to 40%, and strengthen further our position as the UK’s most efficient coal-fired generator. The efficiency improvement feeds through to environmental improvement and will result in a saving of one million tonnes of CO<sub>2</sub> each year.

The 2006 Energy Review and the expected changes in the co-firing regime have resulted in us formalising our target to produce 10% of our output from burning biomass by 2009. Achievement of this target will result in a saving of over two million tonnes of CO<sub>2</sub> each year. During 2006, our biomass co-firing activities were constrained by the regulatory regime. However, towards the end of the year and in the light of encouraging regulatory developments, we started work on the growth of our biomass handling and co-firing facilities and plan to invest up to £47 million in an expansion project commencing in 2007.

Biomass material can be purchased in various forms, from untreated to pre-processed. We are considering supplementing our existing and already sizeable biomass programme, through which we have entered into energy crop supply contracts with local farmers, with an on-site rape seed crushing plant, at a cost of up to £20 million, which will deliver processed biomass material. Where appropriate we will consider further investments depending on the “make-or-buy” economics.

Final implementation of these projects is reliant on the Government delivering against its proposals for regulatory change to the co-firing regime through the Energy Review.

### **Environmental and regulatory landscape**

The major challenge facing Drax, and the coal-fired generation sector, is environmental and carbon is the single biggest constraint. We firmly believe that we have an important part to play in the UK’s transition towards a low carbon economy, whilst, at the same time, delivering reliable supplies of electricity. It is for this reason that our primary environmental goal is to reduce our emissions of CO<sub>2</sub>.

The year started with the launch of a timely Energy Review by the Government. Today, the UK is served well by a diverse and well proportioned energy mix; a circumstance that is widely recognised as making a valuable contribution to security of supply. Environmental legislation, in particular the Large Combustion Plant Directive (“LCPD”), is hastening the closure of some fossil-fuelled power stations, that combined with decommissioning of nuclear plant will, over the next ten to 15 years, have a dramatic effect on the energy mix, the capacity margin and, without early and significant new build, security of supply. A certain and predictable energy policy framework is essential to encouraging the level of investment needed to ensure long-term, reliable electricity supplies.

Coal-fired generation generally meets around one-third of the electricity needs of the UK, but, during the Winter of 2005/06 it met around half of the demand; a timely reminder of its importance in the UK energy mix.

Through the Energy Review we were able to make our voice heard on the continuing role for coal-fired generation and the prospects for clean coal technology. Existing coal-fired power stations have considerable scope to make a real difference to their environmental performance through significant reductions in emissions of CO<sub>2</sub>. We have long advocated the role of co-firing renewable biomass materials with coal in the fight against global warming. At Drax, we have pioneered co-firing technology and it has emerged as a cost effective and credible renewable technology with huge potential.

We were delighted when the Government's report on the Energy Review, published in July, reported their findings of "a broad consensus that co-firing should be encouraged to play a long-term role in reducing CO<sub>2</sub> emissions". The report went on to present proposals that, once implemented, will enable us to develop fully the co-firing potential of Drax. We stand ready to invest in this technology and to deliver considerable savings in our CO<sub>2</sub> emissions.

Through the Energy Review the Government identified the need for, and has now convened, the Coal Forum. Working together, Government, coal-fired generators, coal producers and suppliers, power plant suppliers, infrastructure owners and operators, trade unions and other parties are aiming to secure the long-term contribution of coal-fired power generation and optimise the use of economic coal reserves in the UK. Drax is wholly supportive of this approach and is participating fully in the process.

We are, however, constantly reminded that regulatory change in the UK is increasingly being driven by EU legislation. During 2006, there were several developments with implications for the UK electricity industry. The key ones involved further clarification on the future control of emissions of pollutants such as sulphur dioxide ("SO<sub>2</sub>"), oxides of nitrogen ("NO<sub>x</sub>"), and CO<sub>2</sub>.

The UK Government made its final decisions on the implementation of the LCPD. At Drax, we have decided to implement the Directive through the National Emission Reduction Plan ("NERP") option, which involves compliance with annual limits for SO<sub>2</sub>, NO<sub>x</sub> and particulates. We anticipate that these limits will be incorporated within the site's Pollution Prevention and Control ("PPC") permit, which will replace the existing Integrated Pollution Control ("IPC") authorisations in 2007.

In addition, the UK Government determined, and the European Commission approved, the level of CO<sub>2</sub> emissions allowances for the National Allocation Plan ("NAP") for Phase II (2008 to 2012) of the EU Emissions Trading Scheme ("EU ETS"). Under the new "benchmarked" methodology, it is anticipated that Drax will be allocated around 9.5 million tonnes of allowances each year over the Phase II period. This allocation will be supplemented by allowances already purchased for Phase II as part of our forward hedging strategy, including the 4.7 million tonnes to be delivered each year through the Centrica contract.

Going forward, the EU ETS is pivotal to providing the much needed certainty to instil investor confidence. We saw a precipitous fall in the price of CO<sub>2</sub> emissions allowances for Phase I when it became apparent, from 2005 emissions data, that EU Member State governments had allocated more allowances to participants than they needed to cover their actual emissions. However, we were pleased to see the European Commission ("EC") taking a much firmer stance on allocations for Phase II.

### **Market outlook**

Throughout most of 2006, gas-fired power stations were the price-setting plant in the power market, with marginal costs of production above the equivalent cost for coal-fired generation and nuclear generation. As a result, power prices were principally driven by gas prices and CO<sub>2</sub> emissions allowances prices – the two key input costs of gas-fired power generation.

It is expected that in the coming years power prices will continue to be strongly influenced by gas prices and CO<sub>2</sub> emissions allowances prices, but, it is also to be expected that power plant capacity issues will become an increasingly important driver due to the emerging capacity gap. Addressing regulatory uncertainty is key to creating the investor confidence to bridge this gap.

### **Looking ahead**

In 2007, our overriding aim will be to continue to create added value and to deliver on our promises to shareholders. We fully expect that we will continue to have good access across relevant commodity markets as a result of our credit strength.

We expect the markets in which we trade to continue to display high levels of volatility. We are fortunate in that our capital structure takes account of this volatility and fully recognise the desirability of maintaining an investment grade rating in support of our operational and trading strategies. However, we will continue to keep our capital structure under active review and, when appropriate, we will consider raising additional debt to ensure we maintain an efficient structure which is compatible with our trading needs. We plan to continue with our progressive hedging strategy targeting market or better dark green spreads and to expand the areas in which our trading function adds value to the business.

Given current trading expectations and the continued development of our hedge position coupled with effective cash management, we expect to continue to deliver on our commitment to return substantial excess

cash to our shareholders. As always, we will remain alert to sector opportunities and be consistent in our drive to build shareholder value through good operational strategies and judicious investment.

During 2007, as well as commencing the major turbine upgrade project, we will continue to identify projects to enhance the value of the plant through improved performance in reliability, fuel optionality and efficiency. We believe that it is important to identify economic routes to reduce the CO<sub>2</sub> emissions from our operations at Drax. We are confident that the turbine upgrade project will deliver significant CO<sub>2</sub> savings and we are equally confident that the Government will implement changes to the regulatory framework for renewables that will enable the economic co-firing of biomass at Drax. With this in mind, we will work towards developing and implementing projects to deliver our target of 10% of renewable energy through Drax by the end of 2009.

We will continue to be active in the regulatory debate – we strongly believe coal-fired generation is critical to the UK energy mix going forward if the Government is to achieve its objectives of delivering security of supply, affordability and tackling climate change, where co-firing biomass with coal has much to contribute.

Excellence in safety and operations performance will continue to be an important driver for the business and, in particular, the two major outages planned for this year. Much management focus will be devoted to delivering solid results across the production function through operational improvements to consolidate our recent advances in reliability and availability.

### **Our people**

Last, but, by no means least, a mention of the real asset of our business – our people. The employees of Drax are the backbone of our business and their drive and enthusiasm are fundamental to delivering against our strategy and delivering value to shareholders. Throughout 2006, we continued to recruit specialists to populate our workforce with the experience, skills and foresight to take our business forward. During the year, around 50 people were recruited to Drax across all disciplines from training, through trading to craftsmen and engineers. In September, for the fourth year running, we welcomed engineering apprentices and saw our 2003 intake enter into their final year.

Throughout 2007, we intend to place particular emphasis on the development of the staff at Drax with implementation of a new approach to training and development. We will also place additional emphasis on building the engineering capability within Drax, both to deliver the projects already identified and to inform our strategic options going forward. We will continue to invest in trading, recognising the importance of improving and growing our trading capability across all the commodities we trade, and of particular note is the growth in our biomass trading function to support the corporate strategy.

## Results of operations

|                                                                                                                                                       | Year ended<br>31 December<br>2006<br>£m | Year ended<br>31 December<br>2005<br>£m |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------|-----------------------------------------|
| <b>Total revenue</b>                                                                                                                                  | <b>1,387.0</b>                          | 928.6                                   |
| <b>Fuel costs<sup>(1)</sup></b>                                                                                                                       |                                         |                                         |
| Fuel costs in respect of generation                                                                                                                   | <b>(547.5)</b>                          | (459.7)                                 |
| Costs of power purchases                                                                                                                              | <b>(93.8)</b>                           | (79.8)                                  |
|                                                                                                                                                       | <b>(641.3)</b>                          | (539.5)                                 |
| <b>Gross profit</b>                                                                                                                                   | <b>745.7</b>                            | 389.1                                   |
| Other operating expenses excluding depreciation, amortisation, unrealised gains/(losses) on derivative contracts and exceptional items <sup>(2)</sup> | <b>(162.7)</b>                          | (149.7)                                 |
| <b>EBITDA<sup>(3)</sup></b>                                                                                                                           | <b>583.0</b>                            | 239.4                                   |
| Depreciation and amortisation                                                                                                                         | <b>(34.9)</b>                           | (31.2)                                  |
| Other operating income – net exceptional credit                                                                                                       | <b>19.0</b>                             | 263.3                                   |
| Unrealised gains/(losses) on derivative contracts                                                                                                     | <b>90.8</b>                             | (117.0)                                 |
| <b>Operating profit</b>                                                                                                                               | <b>657.9</b>                            | 354.5                                   |
| Interest payable and similar charges                                                                                                                  | <b>(37.1)</b>                           | (114.4)                                 |
| Interest receivable                                                                                                                                   | <b>13.4</b>                             | 23.5                                    |
| <b>Profit before tax</b>                                                                                                                              | <b>634.2</b>                            | 263.6                                   |
| Tax (charge)/credit                                                                                                                                   | <b>(170.7)</b>                          | 18.8                                    |
| <b>Profit for the year attributable to equity shareholders from continuing operations</b>                                                             | <b>463.5</b>                            | 282.4                                   |
|                                                                                                                                                       | <b>pence</b>                            | pence                                   |
| <b>Earnings per share from continuing operations</b>                                                                                                  | <b>per share</b>                        | <b>per share</b>                        |
| – Basic and diluted                                                                                                                                   | <b>126</b>                              | 108                                     |

### 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, unrealised gains/(losses) on derivative contracts and exceptional items principally include salaries, maintenance costs, grid connection and use of system charges (TNUoS), balancing services use of system charges (BSUoS) and business rates.
- (3) EBITDA is defined as profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains/(losses) on derivative contracts.

EBITDA for the year ended 31 December 2006 was £583 million compared to £239 million in 2005 and operating profit was £658 million (£548 million excluding exceptional items and unrealised gains on derivative contracts), compared to £355 million in 2005 (£208 million excluding exceptional items and unrealised losses on derivative contracts).

Total revenue for the year ended 31 December 2006 was £1,387 million compared to £929 million in 2005. The increase reflected an improvement in our average achieved electricity price (see Price of electricity below) and an increase in net power sold to 25.2TWh, compared to 23.2TWh in 2005. Included within total revenue is income from the sale of by-products (ash and gypsum), the provision of ancillary services, and the sale of ROCs, LECs and SO<sub>2</sub> emissions allowances. In the year ended 31 December 2006, these revenues increased to £60 million compared to £32 million in 2005, reflecting higher ancillary services and ROC sales.

Fuel costs in respect of generation during the year ended 31 December 2006 were £548 million, compared to £460 million in 2005, an increase of £88 million. The difference was primarily due to increased generation, the impact of higher prices for CO<sub>2</sub> emissions allowances, and an increase in the cost of coal and other fuels (see Price of coal and other fuels and CO<sub>2</sub> emissions allowances below).

We purchase power in the market when the cost of power in the market is below our marginal costs of production in respect of power previously contracted for generation and delivery by us, and to cover any shortfall in generation. The costs of power purchased are treated as fuel costs. For the year ended 31 December 2006, the cost of purchased power increased to £94 million compared to £80 million in 2005, primarily due to higher market prices.

Reflecting the above factors, gross profit for the year ended 31 December 2006 was £746 million compared to £389 million in 2005.

Other operating expenses excluding depreciation, amortisation, unrealised gains/(losses) on derivative contracts and exceptional items were £163 million for the year ended 31 December 2006 compared to £150 million in 2005, an increase of £13 million. The increase reflected planned investments in people and systems which commenced in 2005 (most notably in trading) and which continued during 2006, and higher balancing services use of systems costs (BSUoS), which were effectively offset by income earned from ancillary services provided to the National Grid and which is reported within total revenue.

EBITDA (defined as profit before interest, tax, depreciation, amortisation, exceptional items and unrealised gains/(losses) on derivative contracts) for the year ended 31 December 2006 was £583 million compared to £239 million in 2005.

Exceptional operating income of £19 million for the year ended 31 December 2006 related to a further distribution received under the TXU Claim in July 2006. Exceptional operating income for the year ended 31 December 2005 of £263 million included £311 million received under the TXU Claim and a credit of £19 million due to the reversal of provisions relating to impairment of tangible fixed assets. Exceptional operating income in 2005 was partially offset by a charge under the LTIP of £38 million, as well as costs incurred with respect to the Refinancing and Listing of £29 million. Additional information relating to these exceptional items is included in the Notes to the consolidated financial statements.

IAS 32 and IAS 39, the International Accounting Standards in respect of derivatives and financial instruments, were applicable to the Group for the period from 1 January 2005. As a result of applying these standards, unrealised gains of £351 million and unrealised losses of £7 million on derivative contracts were recognised within assets and liabilities respectively at 31 December 2006, as compared to unrealised gains of £8 million and unrealised losses of £223 million at 31 December 2005. The unrealised gains and losses principally relate to the mark-to-market of our forward contracts for power yet to be delivered, which meet the definition of derivatives under IAS 39.

Movements between the balance sheet position reported at 31 December 2006 and 31 December 2005 are mainly the result of unwinding mark-to-market movements relating to power delivered during 2006, and recording mark-to-market movements on power yet to be delivered. As a consequence of the recent decline in power prices, the average price relating to power which had been contracted but had yet to be delivered at 31 December 2006 was higher than current market prices, resulting in the recognition of a net unrealised gain in the balance sheet at 31 December 2006. Conversely, increases in power prices during 2005 led to the average price relating to power which had been contracted but had yet to be delivered at 31 December 2005 being lower than market prices at that time, resulting in the recognition of a net unrealised loss in the balance sheet at 31 December 2005.

For the period from 1 January 2005 to 30 June 2005, mark-to-market movements on derivative contracts were reflected directly in the income statement, as appropriate hedge accounting documentation was not in place. This resulted in a charge of £117 million relating to unrealised losses on derivative contracts being recognised in the income statement for the year ended 31 December 2005. Subsequently, a credit of £91 million was recognised in the income statement for the year ended 31 December 2006, primarily representing the unwinding of the December 2005 position, as power was delivered in accordance with the underlying derivative contracts for which mark-to-market movements were originally reflected in the 2005 income statement. From 1 July 2005, we put in place appropriate documentation to permit hedge accounting for a large proportion of our commodity contracts. As a result, from 1 July 2005 mark-to-market movements on contracts considered to be effective hedges have been recognised through the hedge reserve.

Operating profit for the year ended 31 December 2006 was £658 million compared to £355 million in 2005.

Interest payable and similar charges in the year ended 31 December 2006 were £37 million compared to £114 million in 2005. The decrease principally reflected a reduction in interest payable on borrowings as a result of lower debt and interest rates following the Refinancing and Listing.

The tax charge for the year ended 31 December 2006 was £171 million, compared to a tax credit of £19 million in 2005. The tax credit in 2005 resulted from the utilisation of previously unrecognised tax losses brought forward from earlier years, which more than offset the taxable profit for the year. All recognised trading losses brought forward from earlier years have now been utilised.

Reflecting the above factors, profit attributable to equity shareholders for the year ended 31 December 2006 was £464 million compared to £282 million in 2005, and basic earnings per share was 126 pence compared to 108 pence in 2005.

## Key factors affecting the business

### Price of electricity

The table below shows the average achieved price realised for the years ended 31 December 2005 and 31 December 2006, together with the market closing price on the last day each season illustrated was traded as a product.

|                                      | Year ended<br>31 December<br>2006 | Year ended 31<br>December<br>2005 |
|--------------------------------------|-----------------------------------|-----------------------------------|
| Average achieved price (£/MWh)       | 48.9                              | 35.2                              |
| Summer baseload market close (£/MWh) | 45.5                              | 29.0                              |
| Winter baseload market close (£/MWh) | 51.7                              | 49.2                              |

Average achieved price for the year ended 31 December 2006 was £48.9 per MWh compared to £35.2 per MWh in 2005. Average capture price (being the price attained prior to Balancing Mechanism activity) for the year ended 31 December 2006 was £47.7 per MWh compared to £33.9 per MWh in 2005. The forward baseload power prices for Summer 2007 and Winter 2007/2008 were approximately £24.1 per MWh and £40.0 per MWh respectively as at 1 March 2007.

### Price of coal and other fuels

We burnt approximately 10.2 million tonnes of coal in the year ended 31 December 2006 compared to approximately 9.3 million tonnes in 2005. 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) continue to be volatile. For example, prices per tonne fell from US\$60 at the end of June 2005 to US\$54 at the end of December 2005, but then increased to US\$68 at the end of December 2006.

We also burn biomass, petroleum coke ("petcoke") and fuel oil, although coal comprises more than 90% of total fuel costs (excluding CO<sub>2</sub> emissions allowances). The average cost of fuel per MWh (excluding CO<sub>2</sub> emissions allowances) for the year ended 31 December 2006 was £17.1 compared to £16.0 in 2005.

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

Our CO<sub>2</sub> emissions allowances requirement for the year ended 31 December 2006, in excess of those allocated under the UK NAP, was approximately 8.2 million tonnes compared to approximately 6.3 million tonnes in 2005, with the increase largely due to higher generation.

During 2006, the price for CO<sub>2</sub> emissions allowances was volatile, beginning the year at approximately €22 per tonne and rising to a high of €31 per tonne in April. Towards the end of April and early May the price fell dramatically, reaching a low of €8 per tonne. After recovering to approximately €20 per tonne by mid-May, the price fell steadily over the remainder of the year, closing at €6.6 per tonne on 31 December 2006.

The average price expended for CO<sub>2</sub> emissions allowances during the year ended 31 December 2006 was £14.3 per tonne compared to £13.8 per tonne in 2005.

### Outages and plant utilisation levels

|                                      | Year ended<br>31 December<br>2006 | Year ended<br>31 December<br>2005 |
|--------------------------------------|-----------------------------------|-----------------------------------|
| Forced outage rate (%)               | 5.8                               | 6.1                               |
| Planned outage rate (%)              | 4.8                               | 7.1                               |
| Total outage rate <sup>(1)</sup> (%) | 10.4                              | 12.8                              |
| Availability (%)                     | 89.6                              | 87.2                              |
| Electrical output (net sales) (TWh)  | 25.2                              | 23.2                              |
| Load factor (%)                      | 75.9                              | 70.1                              |

#### 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.

Lost generation capacity in the year ended 31 December 2006 from forced outages was 1.8TWh compared to 1.9TWh in 2005, resulting in a forced outage rate of 5.8% (2005: 6.1%). We have targeted improvements in forced outage rates by focusing on preventing minor predictable failures and seeking to avoid major failures by using historical Drax operating data together with original equipment manufacturer and industry experience. We believe further progress can be made in both areas and will continue the programmes to improve performance, with the objective of achieving a sustainable average forced outage rate of 4.5% by the end of 2007.

Our maintenance regime includes a major planned outage for each unit every four years. Consequently, there is an irregular pattern of planned outages and associated expenditure, since in two of the four years, two units will undergo a major outage. A major planned outage (unit 4) was completed mostly in the second quarter of 2006, whereas a major planned outage (unit 6) took place largely in the third quarter of 2005. The planned outage rate achieved for the year ended 31 December 2006 was 4.8% compared to 7.1% in 2005. Two units are scheduled to undergo a major planned outage in 2007.

#### *TXU claim*

We received £19 million under the TXU Claim in July 2006 bringing the total received to date to £330 million. All amounts are net of VAT and costs, and all proceeds have been used to prepay debt secured against the claim.

At the time of approving the financial statements we had approximately £5 million (excluding VAT) outstanding under the TXU Claim.

The directors have reasonable expectations that the Group will receive repayment of this amount broadly in full in 2007. However, due to the contingent nature of insolvency proceedings, there remains uncertainty over the timing and amount of further distributions to be determined by the TXU Supervisors, and consequently these further amounts have not been recognised in the financial statements at 31 December 2006.

### **Business enhancements**

#### *EBITDA enhancement projects*

We advised investors in March 2005 that we had identified a range of projects which had the potential to improve EBITDA by £30 million to £50 million per annum by the end of 2007. The projects were focused on the following areas: trading; operations (planned and forced outages); alternative fuels (petcoke); by-product sales; procurement savings; and exploiting the Drax site. We are pleased to report that good progress has been made with an estimated £45 million of EBITDA realised in the year ended 31 December 2006 attributable to the enhancement projects (including an estimated £5 million resulting from changes in commodity prices).

Greatest progress has been made in trading, where we have invested in both people and systems and have been able to take advantage of the increasing reliability of the plant. Management initiated a series of programmes at the end of 2004 aimed at reducing forced outage, with a target of achieving a sustainable average forced outage rate of 4.5% by the end of 2007. We established an interim target of 5.7% for 2006 with the actual forced outage outturning at 5.8%.

The results from the test burning of a blend of coal and petcoke on one unit have been positive, with emissions within the permitted range, and we are confident of the environmental case submitted to the Environment Agency. The characteristics of petcoke vary depending on the source, and we are extending the trial to June 2007 to enable us to widen the range of petcoke and hence to provide maximum operational flexibility. Although the price differential between petcoke and coal has narrowed since the trial commenced (and, if sustained, will reduce the benefits from extending burning petcoke to the other five units, assuming consent is given by the Environment Agency), we believe that there remains significant benefit in burning this fuel. To date this narrowing of the price differential has been more than offset by higher than planned benefits achieved elsewhere (particularly in trading and plant availability). Good progress has been made in securing procurement savings from contract renewals, by reducing the number of contracts and by concentrating our expenditure with a smaller number of suppliers. Plans to exploit the Drax site and to secure additional revenues from by-product sales continue to progress.

The benefits derived from the EBITDA enhancement projects are now substantially included within business as usual and with the targeted contribution to EBITDA largely attained 12 months earlier than originally anticipated, progress against the programme identified in 2005 will not be separately reported in future.

### *Other enhancements and investments*

In addition to the EBITDA enhancement projects advised to investors in March 2005, we continue to evaluate other value enhancing opportunities, some of which may involve significant investment in excess of the £100 million of core capital expenditure previously announced for the period 2006 to 2008. For example, during 2006 we committed £17 million to condenser and feed system plant improvements to enhance efficiency and reliability. The work will be undertaken during planned outages in 2007 and 2008 with an expected payback of four to five years.

In December 2006, we announced that we had decided to proceed with a £100 million investment project to upgrade the high pressure and low pressure turbine modules on all six generating units to improve efficiency. Using proven technology we expect to achieve an overall baseload efficiency (that is, the ratio of energy out to energy in when operating at full capacity) approaching 40%. This represents a 5% improvement on current baseload efficiency of 38%. Installation, which will be undertaken during the planned outage programme, is expected to take place between 2008 and 2011 (although some work may be undertaken in 2007). Total costs of £100 million are expected to be incurred on this project over the next five years. 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.

The 2006 Energy Review and the expected changes in the co-firing regime have allowed us to formalise our target to produce 10% of our output from burning biomass by the end of 2009. Achievement of this target 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 two and a half million ROCs per annum. To achieve the target will require additional investment in people and infrastructure. Specifically the Board has recently approved the investment of up to £47 million over the next three years to extend our direct injection capability from one generating unit to all six generating units and to install the necessary processing and handling infrastructure to ensure we are able to handle up to 1.5 million tonnes of biomass material per annum.

Biomass material can be provided in various forms, from untreated to pre-processed. Drax will evaluate the "make-or-buy" economics of alternative sources and forms of biomass material and where appropriate will consider additional investment where this produces added value. For example, the Board has recently approved in principle an investment of up to £20 million to build a rape seed crusher plant to produce rape meal and rape oil and which will also provide a valuable insight into rape seed market dynamics.

### **Liquidity and capital resources**

Net debt was £321 million as at 31 December 2006 compared to £462 million at 31 December 2005, a reduction of £141 million.

Cash and cash equivalents were £155 million as at 31 December 2006 compared to £88 million at 31 December 2005, an increase of £67 million. The increase in cash and cash equivalents is analysed in the following table.

### *Analysis of cash flows*

|                                                                | Year ended<br>31 December<br>2006 | Year ended 31<br>December<br>2005 |
|----------------------------------------------------------------|-----------------------------------|-----------------------------------|
| Net cash generated from operating activities                   | 525.1                             | 348.5                             |
| Net cash used in investing activities                          | (27.0)                            | (25.0)                            |
| Net cash used in financing activities                          | (431.1)                           | (273.2)                           |
| <b>Net increase in cash and cash equivalents<sup>(1)</sup></b> | <b>67.0</b>                       | <b>50.3</b>                       |

#### Notes:

(1) For the purposes of the cash flow statements, cash and cash equivalents excludes amounts held in escrow and debt service reserve accounts. The movements in these accounts are included as a component of net cash generated from operating activities.

Net cash generated from operating activities was £525 million in the year ended 31 December 2006 compared to £349 million in 2005, an increase of £176 million. The increase reflected the impact of improved business performance, EBITDA having increased by £344 million in 2006, and a reduction of £108 million in interest payments following the Refinancing and Listing. These amounts were partially offset by a reduction in cash received under the TXU Claim (£74 million cash received under the claim in the year ended 31 December 2006 compared to £256 million in 2005), an increase of £47 million in income taxes paid and a payment of £23 million into the employee pension scheme to reduce the actuarial deficit.

Net cash used in investing activities, which represented capital expenditure in both periods, was £27 million for the year ended 31 December 2006 compared to £25 million in 2005.

Net cash used in financing activities was £431 million in the year ended 31 December 2006 compared to £273 million in 2005. The 2006 amounts included new debt raised of £100 million, offset by equity dividends paid of £342 million (see Distribution policy below), Bridge loan prepayments of £55 million and £19 million in January and July 2006 respectively, and Term loan repayments of £57.5 million in June 2006 and £57.5 million in December 2006. The 2005 amounts included repayment of borrowings under the Group's previous debt facilities prior to the Refinancing and Listing of £268 million, being primarily a repayment of B Debt of £256 million funded out of distributions under the TXU Claim. Also included in 2005 is repayment of borrowings on Refinancing and Listing of £583 million, largely offset by new debt issued on Refinancing and Listing of £577 million.

The increase in cash and cash equivalents was £67 million in the year ended 31 December 2006, compared to £50 million in 2005. Drax's policy is to invest available cash in short-term bank and building society deposits.

#### *Capital resources*

On 15 December 2005, the Group's then existing debt was replaced by new debt facilities comprising a £500 million five year amortising Term loan facility, a £200 million Letter of Credit facility, a £100 million Revolving Credit facility, and a £77 million Bridge loan facility. The Term loan facility is secured on a pari passu basis with the Letter of Credit facility and the Revolving Credit facility and any other permitted secured indebtedness. The Group's debt is guaranteed and secured directly by each of the principal subsidiaries within the Group. 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. Standard & Poor's Ratings Group ("S&P") has assigned a BBB senior secured debt rating with a recovery rating of "1" to the Term loan facility, the Letter of Credit facility and the Revolving Credit facility. We are required to fund a debt service reserve account if we do not meet the specified historic annual debt service cover ratio on any of the six-monthly calculation dates, with the first calculation date being on 31 December 2006. No such requirement exists at this present time.

The Letter of Credit facility can be used to provide letters of credit to counterparties or exchanges in relation to our trading business. The final maturity date of the Letter of Credit facility is 15 December 2012. 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 2006, the Group's contingent liability in respect of these guarantees amounted to £154 million compared to £77 million in 2005.

The Revolving Credit facility can be used to finance working capital requirements. It may also be used to provide letters of credit up to a maximum of £100 million or provide cash collateral, to the extent that counterparties do not accept letters of credit, up to a maximum of £20 million. The final maturity date is 15 December 2010.

The Bridge loan facility must be repaid in full by 31 December 2008. Proceeds under the TXU Claim must be applied to repay the Bridge loan facility. Following distributions under the TXU Claim of £55 million and £19 million in January and July 2006 respectively, £74 million of the Bridge loan has been repaid, leaving a balance of £3 million outstanding.

Under our debt facilities, we can enter into additional finance leases up to an aggregate value of £10 million, and subject to certain other restrictions, incur overdraft and other short-term borrowings not to exceed £15 million. The new debt facilities may be prepaid without penalty.

As permitted under our debt facilities, on 11 May 2006 the Group entered into a new credit facility agreement providing a further £100 million Term loan facility on similar terms and with a similar repayment profile to the existing term borrowings. The facility was drawn down in full on 3 July 2006 and partially utilised to make the payment of £23 million into the employee pension scheme to reduce the actuarial deficit. The remainder of the facility was utilised to partially fund the interim and special dividends paid on 25 October 2006 (see Distribution policy below). S&P has assigned a BBB senior secured debt rating with a recovery rating of "1" to the new Term loan facility. The S&P credit and recovery ratings in relation to the existing Term loan facility, Letter of Credit facility and Revolving Credit facility remain unchanged.

Following repayments of £115 million in 2006, £473 million (net of deferred financing costs) remains outstanding under the Term loans at 31 December 2006.

### *Seasonality of borrowing*

Our business is seasonal with higher economic despatch in the Winter period and lower economic despatch in the Summer months. 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 2006.

### *Contractual commitments*

The following table illustrates our contractual obligations, excluding interest, as they fall due as at 31 December 2006:

|                                | Total<br>£m    | Payments due by period |              |              |               |
|--------------------------------|----------------|------------------------|--------------|--------------|---------------|
|                                |                | 2007<br>£m             | 2008<br>£m   | 2009<br>£m   | 2010–16<br>£m |
| Debt                           | 487.9          | 20.0                   | 12.9         | 75.0         | 380.0         |
| Coal purchases                 | 906.8          | 337.8                  | 217.0        | 165.5        | 186.5         |
| Contracted capital expenditure | 19.7           | 10.9                   | 7.4          | 0.8          | 0.6           |
| Support contract payments      | 72.6           | 32.7                   | 25.4         | 8.0          | 6.5           |
| <b>Total</b>                   | <b>1,487.0</b> | <b>401.4</b>           | <b>262.7</b> | <b>249.3</b> | <b>573.6</b>  |

Subsequent to 31 December 2006, the Group entered into contractual commitments with an estimated value of £100 million with respect to the major turbine upgrade (see Business enhancements above).

### *Capital expenditure*

We previously announced that we expected to incur capital expenditure in support of current operations of approximately £100 million over the period 2006 to 2008. Capital expenditure was £27 million in the year ended 31 December 2006 (compared to £25 million in 2005) leaving a balance of £63 million for the remaining two years 2007 and 2008. At the time of the announcement we also stated that we intended to evaluate other investment opportunities to enhance value which may result in additional expenditure.

We have identified a number of value enhancing investments (see Business enhancements above) and total capital expenditure is currently estimated at around £260 million over the three years 2007 to 2009. Of this around £150 million specifically relates to the turbine upgrade project and condenser and feed system plant improvements (both previously announced) and investments in extending our biomass capability, with the remainder comprising smaller value enhancing investments, the balance of the original £100 million programme and expected expenditure for 2009 in support of current operations. We plan to fund these investments from a combination of operational cash flows and debt. We continue to evaluate other opportunities which may result in additional expenditure. In addition, investment will also be required beyond 2009 and prior to 2016 to meet the requirements of the Large Combustion Plant Directive.

### *Share-based incentive plans*

During 2006, we introduced two all-employee share plans, the Share Incentive Plan ("SIP") and the Savings-Related Share Option Plan ("SAYE") and an Executive Share Incentive Plan ("ESIP"), to provide long-term incentives for executive directors, senior managers and all other employees.

Under the SIP, the Company issued a total of 157,734 ordinary shares to a trust on behalf of qualifying employees, equating to 254 shares with a cash value of approximately £2,000 per employee based on our share price at the time of the awards in May 2006. The fair value of the SIP awards (determined at the grant date) of £1.3 million was charged to the income statement in full in 2006, on the basis that employees obtained certain rights in relation to shares issued to the trust on their behalf.

In July 2006, participation in the SAYE 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 that are expected to be issued in connection with the SAYE of £0.5 million is being charged to the income statement over the life of the respective plans.

Under the ESIP, annual awards of performance shares are made 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. The first conditional ESIP awards over 390,213 ordinary shares were granted in September 2006, with performance measured over the three years to 30 June 2009 and potential

vesting in September 2009. The fair value of the ESIP awards (determined at the grant date) of £1.9 million, which takes into account the estimated probability of different levels of vesting, is being charged to the income statement on a straight-line basis over the three year vesting period.

No shares have been issued or repurchased to date with respect to the SAYE or ESIP.

### **EBITDA forecast for the year ended 31 December 2006 and closing cash position guidance**

We issued a Trading Update on 13 December 2006 which reported our contracted position for 2006, 2007 and 2008 in respect of power, coal and CO<sub>2</sub> emissions allowances. In addition, we reported management's expectation that EBITDA for the year ended 31 December 2006 would be in the range £578 million to £585 million and that the cash position as at 31 December 2006 would be in the range £150 million to £155 million (together the "Forecast"). EBITDA was defined as profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains/(losses) on derivative contracts.

In arriving at the Forecast, we took account of market prices as of 6 December 2006 for the uncontracted portion of power sales, and coal and CO<sub>2</sub> emissions allowances purchases for the period to 31 December 2006. The Forecast also assumed that there would be no significant unplanned outages for the period to 31 December 2006.

Reported EBITDA of £583 million includes the impact on gross margin of a decline in market prices between 6 December 2006 and 31 December 2006. The reported cash position as at 31 December 2006 was £155 million.

### **Contracted position for 2007 and 2008**

Since issuing the Trading Update on 13 December 2006, we have continued to trade in line with expectations and to follow our stated trading strategy of making steady forward power sales with corresponding CO<sub>2</sub> emissions allowances and coal purchases. Our aim is to deliver market level or better dark green spreads across all traded market periods and, as part of this strategy, we retain power to be sold into the prompt (within season) power markets.

As at 1 March 2007, the contracted power sales for 2007, and 2008 were as follows:

|                                                                                                                                                | <b>2007</b>         | <b>2008</b>         |
|------------------------------------------------------------------------------------------------------------------------------------------------|---------------------|---------------------|
| Output – expected annual production hedged                                                                                                     | <b>80%</b>          | <b>61%</b>          |
| Comprising:                                                                                                                                    |                     |                     |
| – Fixed price power sales at an average achieved price per MWh                                                                                 | <b>75% at £47.6</b> | <b>40% at £46.8</b> |
| – Fixed margin power sales                                                                                                                     | <b>5%</b>           | <b>21%</b>          |
| CO <sub>2</sub> emissions allowances – expected annual requirement<br>(including UK NAP allocation, market purchases and structured contracts) | <b>84%</b>          | <b>66%</b>          |
| Coal – expected annual requirement hedged                                                                                                      | <b>81%</b>          | <b>66%</b>          |

Fixed margin power sales include approximately 1.3TWh in 2007 and 5.3TWh in 2008 under the five-and-a-quarter year baseload contract with Centrica which commences on 1 October 2007. Under this contract Drax 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. The contract provides us with a series of fixed dark green spreads.

We expect to issue a further Trading Update on or around 29 June 2007.

### **Distribution policy**

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

On 11 September 2006, the Board resolved to pay an interim dividend for the six months ended 30 June 2006 of 4 pence per share (equivalent to £16 million). Also on 11 September 2006, the Board resolved, subject to the approval by shareholders of a resolution to effect a share consolidation considered at an Extraordinary General Meeting on 6 October 2006, to pay a further interim dividend as a special dividend of 80 pence per share (equivalent to £326 million). The interim and special dividends were subsequently paid on 25 October 2006.

Following approval at the Extraordinary General Meeting on 6 October 2006, the share consolidation under which shareholders received 29 new ordinary shares of 11  $\frac{1}{29}$  pence each for every 32 existing ordinary shares of 10 pence, became effective on 9 October 2006.

At the forthcoming Annual General Meeting the Board is recommending to shareholders that a resolution is passed to approve payment of a final dividend for the year ended 31 December 2006 of 9.1 pence per share (equivalent to £34 million) payable on or before 16 May 2007. Shares will be marked ex-final dividend on 25 April 2007.

The Board is also proposing, subject to the approval by shareholders of a resolution to effect a share consolidation to be considered at the Annual General Meeting on 26 April 2007, to pay a further interim dividend (payable as a special dividend) of 32.9 pence per share (equivalent to £121 million), also payable on or before 16 May 2007. Shares will be marked ex-special dividend on 30 April 2007.

The Board intends to keep under review the most appropriate method of returning any further surplus cash.

## Consolidated income statements

|                                                                                           | Notes | Years ended 31 December |                  |
|-------------------------------------------------------------------------------------------|-------|-------------------------|------------------|
|                                                                                           |       | 2006<br>£m              | 2005<br>£m       |
| <b>Continuing operations</b>                                                              |       |                         |                  |
| Revenue                                                                                   |       | <b>1,387.0</b>          | 928.6            |
| Fuel costs                                                                                |       | <b>(641.3)</b>          | (539.5)          |
| Other operating expenses excluding exceptional items                                      | 4     | <b>(197.6)</b>          | (180.9)          |
| Other exceptional operating income                                                        | 3     | <b>19.0</b>             | 329.9            |
| Other exceptional operating expenses                                                      | 3     | <b>–</b>                | (66.6)           |
| Total other operating (expenses)/income                                                   |       | <b>(178.6)</b>          | 82.4             |
| Unrealised gains/(losses) on derivative contracts                                         |       | <b>90.8</b>             | (117.0)          |
| <b>Operating profit</b>                                                                   | 4     | <b>657.9</b>            | 354.5            |
| Interest payable and similar charges                                                      |       | <b>(37.1)</b>           | (114.4)          |
| Interest receivable                                                                       |       | <b>13.4</b>             | 23.5             |
| <b>Profit before tax</b>                                                                  |       | <b>634.2</b>            | 263.6            |
| Tax (charge)/credit                                                                       | 5     | <b>(170.7)</b>          | 18.8             |
| <b>Profit for the year attributable to equity shareholders from continuing operations</b> |       | <b>463.5</b>            | 282.4            |
|                                                                                           |       | <b>pence</b>            | <b>pence</b>     |
| <b>Earnings per share from continuing operations</b>                                      |       | <b>per share</b>        | <b>per share</b> |
| – Basic and diluted                                                                       | 7     | <b>126</b>              | 108              |

## Consolidated statements of recognised income and expense

|                                                                                      | Notes | Years ended 31 December |            |
|--------------------------------------------------------------------------------------|-------|-------------------------|------------|
|                                                                                      |       | 2006<br>£m              | 2005<br>£m |
| <b>Profit for the year</b>                                                           |       | <b>463.5</b>            | 282.4      |
| Actuarial gains/(losses) on defined benefit pension schemes                          |       | <b>8.6</b>              | (8.2)      |
| Deferred tax on actuarial gains/losses on defined benefit pension schemes            | 5     | <b>(2.6)</b>            | 2.5        |
| Initial recognition of net mark-to-market liability on adoption of IAS 32 and IAS 39 |       | <b>–</b>                | (5.6)      |
| Deferred tax recognised on adoption of IAS 32 and IAS 39                             | 5     | <b>–</b>                | 1.7        |
| Fair value gains/(losses) on cash flow hedges                                        |       | <b>468.2</b>            | (109.7)    |
| Deferred tax recognised on fair value gains/losses on cash flow hedges               | 5     | <b>(140.5)</b>          | 32.9       |
| <b>Net gains/(losses) not recognised in income statement</b>                         |       | <b>333.7</b>            | (86.4)     |
| <b>Total recognised income for the year attributable to equity shareholders</b>      |       | <b>797.2</b>            | 196.0      |

## Consolidated balance sheets

|                                         | Notes | At 31 December |                |
|-----------------------------------------|-------|----------------|----------------|
|                                         |       | 2006<br>£m     | 2005<br>£m     |
| <b>Assets</b>                           |       |                |                |
| <b>Non-current assets</b>               |       |                |                |
| Property, plant and equipment           |       | 1,042.2        | 1,050.5        |
| Derivative financial instruments        |       | 93.9           | 0.3            |
|                                         |       | <b>1,136.1</b> | <b>1,050.8</b> |
| <b>Current assets</b>                   |       |                |                |
| Inventories                             |       | 76.9           | 67.8           |
| Trade and other receivables             |       | 171.4          | 192.9          |
| Derivative financial instruments        |       | 257.2          | 7.7            |
| Cash at bank and in hand                | 8     | 154.8          | 99.1           |
|                                         |       | <b>660.3</b>   | <b>367.5</b>   |
| <b>Liabilities</b>                      |       |                |                |
| <b>Current liabilities</b>              |       |                |                |
| Financial liabilities:                  |       |                |                |
| – Borrowings                            | 9     | 19.8           | 101.4          |
| – Derivative financial instruments      |       | 6.8            | 173.0          |
| Trade and other payables                |       | 166.8          | 176.1          |
| Current tax liabilities                 |       | 63.2           | 5.2            |
|                                         |       | <b>256.6</b>   | <b>455.7</b>   |
| <b>Net current assets/(liabilities)</b> |       | <b>403.7</b>   | <b>(88.2)</b>  |
| <b>Non-current liabilities</b>          |       |                |                |
| Financial liabilities:                  |       |                |                |
| – Borrowings                            | 9     | 456.4          | 460.1          |
| – Derivative financial instruments      |       | –              | 49.6           |
| Deferred tax liabilities                |       | 390.9          | 185.3          |
| Retirement benefit obligations          |       | 12.5           | 44.7           |
| Other non-current liabilities           |       | 0.7            | 0.7            |
| Provisions                              |       | 2.2            | 2.0            |
|                                         |       | <b>862.7</b>   | <b>742.4</b>   |
| <b>Net assets</b>                       |       | <b>677.1</b>   | <b>220.2</b>   |
| <b>Shareholders' equity</b>             |       |                |                |
| Issued equity                           |       | 40.7           | 40.7           |
| Share premium                           |       | 420.7          | 420.7          |
| Merger reserve                          |       | 710.8          | 710.8          |
| Hedge reserve                           |       | 250.9          | (76.8)         |
| Retained losses                         |       | (746.0)        | (875.2)        |
| <b>Total shareholders' equity</b>       | 10    | <b>677.1</b>   | <b>220.2</b>   |

## Consolidated cash flow statements

|                                                                      | Notes | Years ended 31 December |            |
|----------------------------------------------------------------------|-------|-------------------------|------------|
|                                                                      |       | 2006<br>£m              | 2005<br>£m |
| <b>Cash generated from operations</b>                                | 11    | <b>586.5</b>            | 462.3      |
| Income taxes paid                                                    |       | (50.0)                  | (2.8)      |
| Decrease in restricted cash                                          |       | 11.2                    | 26.9       |
| Interest paid in 2005 prior to the Refinancing and Listing           |       | –                       | (57.5)     |
| Interest paid in 2005 on the Refinancing and Listing                 | 9     | –                       | (86.2)     |
| Interest paid in 2006                                                |       | (36.1)                  | –          |
| Interest received                                                    |       | 13.5                    | 5.8        |
| <b>Net cash generated from operating activities</b>                  |       | <b>525.1</b>            | 348.5      |
| <b>Cash flows from investing activities</b>                          |       |                         |            |
| Purchase of property, plant and equipment                            |       | (27.0)                  | (25.0)     |
| <b>Net cash used in investing activities</b>                         |       | <b>(27.0)</b>           | (25.0)     |
| <b>Cash flows from financing activities</b>                          |       |                         |            |
| Equity dividends paid                                                | 6     | (342.0)                 | –          |
| Repayment of borrowings in 2005 prior to the Refinancing and Listing |       | –                       | (267.6)    |
| Repayment of borrowings in 2005 on the Refinancing and Listing       | 9     | –                       | (582.6)    |
| Debt issued as a result of the Refinancing and Listing               | 9     | –                       | 577.0      |
| Repayment of borrowings in 2006                                      | 9     | (189.1)                 | –          |
| Debt issued in 2006                                                  | 9     | 100.0                   | –          |
| <b>Net cash used in financing activities</b>                         |       | <b>(431.1)</b>          | (273.2)    |
| <b>Net increase in cash and cash equivalents</b>                     |       | <b>67.0</b>             | 50.3       |
| Cash and cash equivalents at 1 January                               |       | 87.8                    | 37.5       |
| <b>Cash and cash equivalents at 31 December</b>                      | 8     | <b>154.8</b>            | 87.8       |

## Notes to the consolidated financial information

### 1. General information

The consolidated financial information for Drax Group plc (the "Company") and its subsidiaries (together "the Group") set out in this preliminary announcement has been derived from the audited consolidated financial statements of the Group for the year ended 31 December 2006 (the "financial statements"). This preliminary announcement does not constitute the financial statements. The financial statements were approved by the Board of directors on 7 March 2007. The report of the auditors on the financial statements was unqualified and did not contain a statement under Section 237 (2) or (3) of the Companies Act 1985.

The Annual Report will be posted to shareholders by the end of March 2007 and will be available on request from the Company Secretary, Drax Group plc, Drax Power Station, PO Box 3, Selby, North Yorkshire, YO8 8PQ. The Annual General Meeting will be held at The City Presentation Centre, 4 Chiswell Street, London EC1Y 4UP at 11am on 26 April 2007. The financial statements will be delivered to the Registrar of Companies following the Annual General Meeting.

### 2. Basis of preparation

The financial statements have been prepared in accordance with the prior year accounting policies and International Financial Reporting Standards ("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 under the historical cost basis, except for the revaluation of financial assets and liabilities under IAS 39 "Financial Instruments: Recognition and measurement".

### 3. Other exceptional operating income and expenses

|                                                            | Years ended 31 December |               |
|------------------------------------------------------------|-------------------------|---------------|
|                                                            | 2006                    | 2005          |
|                                                            | £m                      | £m            |
| <b>Other exceptional operating income:</b>                 |                         |               |
| Distributions under the TXU Claim                          | 19.0                    | 310.9         |
| Reversal of impairment of tangible fixed assets            | –                       | 19.0          |
| <b>Total other exceptional operating income</b>            | <b>19.0</b>             | <b>329.9</b>  |
| <b>Other exceptional operating expenses:</b>               |                         |               |
| LTIP expenses arising on cash and share-based transactions | –                       | (37.6)        |
| Refinancing and Listing fees and expenses                  | –                       | (29.0)        |
| <b>Total other exceptional operating expenses</b>          | <b>–</b>                | <b>(66.6)</b> |

#### *Distributions under the TXU Claim*

The Group received £19.0 million under the TXU Claim in July 2006, bringing the total received to date to £329.9 million. All amounts are net of VAT and costs and all proceeds have been used to prepay debt secured against the claim.

At the time of approving the financial statements the Group had approximately £5 million (excluding VAT) outstanding under the TXU Claim. The directors have reasonable expectations that the Group will receive repayment of this amount broadly in full during 2007. However, due to the contingent nature of insolvency proceedings, there remains uncertainty over the timing and amount of further distributions to be determined by the TXU Supervisors, and consequently these further amounts have not been recognised in the financial statements at 31 December 2006.

#### *Reversal of impairment of tangible fixed assets*

In accordance with IAS 36 "Impairment of Assets", the Group assessed at each reporting date whether there was any indication that impairment losses recognised following the loss of the TXU Contract and its related income streams in 2002 should be reversed. As a result of an assessment performed during the year ended 31 December 2005, the Group recorded a reversal of a tangible fixed asset impairment of £19.0 million (£13.3 million net of tax). This represented a reversal of the total impairment loss recognised in respect of tangible fixed assets at 31 December 2002 after adjusting for depreciation.

#### *Refinancing and Listing fees and expenses*

The total costs of the Refinancing and Listing amounted to £44.7 million. Of these costs, £29.0 million (£20.3 million net of tax) were included within other exceptional operating expenses in the income statement for the year ended 31 December 2005. The remaining £15.7 million were deducted from debt and are being amortised to interest payable over the duration of the Group's new debt facilities.

#### 4. Operating profit

|                                                                                                                       | Years ended 31 December |              |
|-----------------------------------------------------------------------------------------------------------------------|-------------------------|--------------|
|                                                                                                                       | 2006<br>£m              | 2005<br>£m   |
| <b>The following charges have been included in arriving at operating profit:</b>                                      |                         |              |
| Staff costs                                                                                                           | 34.6                    | 29.1         |
| Depreciation of property, plant and equipment (all owned assets)                                                      | 34.9                    | 31.0         |
| Loss on the disposal of property, plant and equipment                                                                 | –                       | 0.2          |
| Repairs and maintenance expenditure on property, plant and equipment                                                  | 34.1                    | 32.0         |
| Other operating expenses                                                                                              | 94.0                    | 88.6         |
| <b>Total other operating expenses excluding exceptional items and unrealised gains/losses on derivative contracts</b> | <b>197.6</b>            | <b>180.9</b> |

#### 5. Taxation

|                                          | Years ended 31 December |             |
|------------------------------------------|-------------------------|-------------|
|                                          | 2006<br>£m              | 2005<br>£m  |
| <b>Tax (charged)/credited comprises:</b> |                         |             |
| Current tax                              | (108.2)                 | (5.5)       |
| Deferred tax                             | (62.5)                  | 24.3        |
|                                          | <b>(170.7)</b>          | <b>18.8</b> |

|                                                                                      | Years ended 31 December |             |
|--------------------------------------------------------------------------------------|-------------------------|-------------|
|                                                                                      | 2006<br>£m              | 2005<br>£m  |
| <b>Tax on items (charged)/credited to equity:</b>                                    |                         |             |
| Deferred tax recognised on actuarial gains/losses on defined benefit pension schemes | (2.6)                   | 2.5         |
| Deferred tax recognised on adoption of IAS 32 and IAS 39                             | –                       | 1.7         |
| Deferred tax recognised on fair value gains/losses on cash flow hedges               | (140.5)                 | 32.9        |
|                                                                                      | <b>(143.1)</b>          | <b>37.1</b> |

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

|                                                                                        | Years ended 31 December |               |
|----------------------------------------------------------------------------------------|-------------------------|---------------|
|                                                                                        | 2006<br>£m              | 2005<br>£m    |
| <b>Profit before tax</b>                                                               | <b>634.2</b>            | <b>263.6</b>  |
| Profit before tax multiplied by rate of corporation tax in the UK (30% for both years) | 190.3                   | 79.1          |
| <b>Effects of:</b>                                                                     |                         |               |
| Adjustments in respect of prior periods                                                | 1.2                     | (6.2)         |
| LTIP tax deduction                                                                     | –                       | (9.4)         |
| Expenses not deductible for tax purposes                                               | 0.5                     | 2.9           |
| Tax effect of funding arrangements                                                     | (20.9)                  | (0.8)         |
| Other                                                                                  | (0.4)                   | (0.1)         |
| Tax losses utilised                                                                    | –                       | (84.3)        |
| <b>Total taxation (continuing operations)</b>                                          | <b>170.7</b>            | <b>(18.8)</b> |

Under the current financing structure, Drax Holdings Limited (“Holdings”), a wholly-owned subsidiary undertaking of the Company, is partially funded by a Eurobond payable to another group company, with a tax deduction being claimed for all of the corresponding interest charged in the Holdings income statement. Were HM Revenue & Customs to successfully challenge the deductions claimed in respect of the Eurobond coupons for open years to 31 December 2006, it is estimated that the additional tax liability would be up to £40 million, together with interest and penalties.

## 6. Dividends

|                                                                                                                                       | Years ended 31 December |            |
|---------------------------------------------------------------------------------------------------------------------------------------|-------------------------|------------|
|                                                                                                                                       | 2006<br>£m              | 2005<br>£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> |                         |            |
| Interim dividend for the year ended 31 December 2006 of 4 pence (2005: nil) per share                                                 | 16.3                    | –          |
| Special interim dividend for the year ended 31 December 2006 of 80 pence (2005: nil) per share                                        | 325.7                   | –          |
|                                                                                                                                       | <b>342.0</b>            | –          |

|                                                                                                           | Years ended 31 December |            |
|-----------------------------------------------------------------------------------------------------------|-------------------------|------------|
|                                                                                                           | 2006<br>£m              | 2005<br>£m |
| <b>Amounts not recognised as distributions to equity holders in the year:</b>                             |                         |            |
| Proposed final dividend for the year ended 31 December 2006 of 9.1 pence (2005: nil) per share            | 33.6                    | –          |
| Proposed special interim dividend for the year ended 31 December 2006 of 32.9 pence (2005: nil) per share | 121.4                   | –          |
|                                                                                                           | <b>155.0</b>            | –          |

At the forthcoming Annual General Meeting, the Board is recommending to shareholders that a resolution is passed to approve payment of a final dividend for the year ended 31 December 2006 of 9.1 pence per share (equivalent to £33.6 million) payable on or before 16 May 2007. The Board is also proposing, subject to the approval by shareholders of a resolution to effect a share consolidation to be considered at the Annual General Meeting on 26 April 2007, to pay a further interim dividend (payable as a special dividend) of 32.9 pence per share (equivalent to £121.4 million), also payable on or before 16 May 2007.

The final dividend of 9.1 pence per share and the special dividend of 32.9 pence per share have not been included as liabilities as at 31 December 2006.

## 7. 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") and contingently issuable shares under the Group's Executive Share Incentive Plan ("ESIP"). Both the SAYE and the ESIP commenced in 2006.

The calculation of weighted average number of ordinary shares outstanding assumes that the ordinary shares in Drax Group plc issued to the existing shareholders of Drax Group Limited (the previous holding company) on Refinancing and Listing were in issue either at 1 January 2005 (to the extent that the related Drax Group Limited shares were in issue at 1 January 2005), or from the date of issue of Drax Group Limited shares (to the extent that the related Drax Group Limited shares were issued after 1 January 2005). In accordance with IAS 33 "Earnings per Share", calculation of the weighted average number of ordinary shares outstanding also assumes that the share consolidation which became effective on 9 October 2006 had taken place on 1 January 2005.

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

|                                                                                                       | Years ended 31 December |            |
|-------------------------------------------------------------------------------------------------------|-------------------------|------------|
|                                                                                                       | 2006<br>£m              | 2005<br>£m |
| Earnings attributable to equity holders of the Company for the purposes of basic and diluted earnings | 463.5                   | 282.4      |

|                                                                                                             | Years ended 31 December |            |
|-------------------------------------------------------------------------------------------------------------|-------------------------|------------|
|                                                                                                             | 2006<br>£m              | 2005<br>£m |
| <b>Number of shares:</b>                                                                                    |                         |            |
| Weighted average number of ordinary shares for the purposes of basic earnings per share (millions)          | <b>368.9</b>            | 261.2      |
| Effect of dilutive potential ordinary shares under share options                                            | <b>0.1</b>              | –          |
| Effect of dilutive contingently issuable shares                                                             | –                       | –          |
| <b>Weighted average number of ordinary shares for the purposes of diluted earnings per share (millions)</b> | <b>369.0</b>            | 261.2      |

## 8. Cash at bank and in hand

|                                       | As at 31 December |            |
|---------------------------------------|-------------------|------------|
|                                       | 2006<br>£m        | 2005<br>£m |
| <b>Cash at bank and in hand:</b>      |                   |            |
| Unrestricted cash at bank and in hand | <b>154.8</b>      | 87.8       |
| Escrow account                        | –                 | 11.3       |
|                                       | <b>154.8</b>      | 99.1       |

The escrow account represented cash paid into escrow prior to 31 December 2005 with respect to certain fees and expenses related to the Refinancing and Listing.

Cash and cash equivalents includes the following for the purposes of the cash flow statement:

|                                    | As at 31 December |            |
|------------------------------------|-------------------|------------|
|                                    | 2006<br>£m        | 2005<br>£m |
| <b>Cash and cash equivalents:</b>  |                   |            |
| Cash at bank and in hand per above | <b>154.8</b>      | 99.1       |
| Less: escrow account               | –                 | (11.3)     |
|                                    | <b>154.8</b>      | 87.8       |

## 9. Financial liabilities – borrowings

|                     | As at 31 December |            |
|---------------------|-------------------|------------|
|                     | 2006<br>£m        | 2005<br>£m |
| <b>Current:</b>     |                   |            |
| Term loans          | <b>19.8</b>       | 46.3       |
| Bridge loan         | –                 | 55.1       |
|                     | <b>19.8</b>       | 101.4      |
| <b>Non-current:</b> |                   |            |
| Term loans          | <b>453.5</b>      | 438.2      |
| Bridge loan         | <b>2.9</b>        | 21.9       |
|                     | <b>456.4</b>      | 460.1      |

### *Maturity of borrowings*

The maturity profile of the carrying amount of the Group's non-current borrowings at the balance sheet dates were as follows:

|                                                     | As at 31 December |            |
|-----------------------------------------------------|-------------------|------------|
|                                                     | 2006<br>£m        | 2005<br>£m |
| <b>Non-current:</b>                                 |                   |            |
| In more than one year but not more than two years   | <b>12.8</b>       | 31.6       |
| In more than two years but not more than five years | <b>443.6</b>      | 428.5      |
|                                                     | <b>456.4</b>      | 460.1      |

### Refinancing and Listing

Pursuant to the schemes of arrangement under which the Refinancing and Listing was implemented, the Group's debt was restructured on 15 December 2005. The particular elements of the restructuring relating to the Group's debt are illustrated below:

|                                        | As at 15 December 2005 |                |
|----------------------------------------|------------------------|----------------|
|                                        | Principal<br>£m        | Interest<br>£m |
| <b>Previous debt facilities:</b>       |                        |                |
| A1 Debt prepayment                     | 388.2                  | 12.8           |
| B Debt prepayment                      | 82.4                   | 28.1           |
| A2 Debt cash consideration             | 112.0                  | –              |
| A2/A3 Debt interest payment            | –                      | 22.2           |
| Interest rate swap termination payment | –                      | 23.1           |
|                                        | <b>582.6</b>           | <b>86.2</b>    |
| <b>New debt facilities:</b>            |                        |                |
| Term loan                              | 500.0                  | –              |
| Bridge loan                            | 77.0                   | –              |
|                                        | <b>577.0</b>           | <b>–</b>       |

Outstanding principal and interest in relation to A1 and B Debt was repaid in full. In addition, interest rate swap contracts with a notional value of £400 million, principally related to A1 Debt, were terminated.

A2/A3 Debt holders contributed their A2/A3 Debt in exchange for cash and ordinary shares of 10 pence each in Drax Group plc. In total, A2 Debt holders received cash consideration of £112.0 million and A2/A3 Debt holders received 124,164,221 ordinary shares of 10 pence each in Drax Group plc. Outstanding interest on A2/A3 Debt was repaid in full.

The total cash outflows related to the Refinancing and Listing were partially funded by a new Term loan of £500.0 million and a Bridge loan of £77.0 million as described below.

On 11 May 2006, the Group entered into a new credit facility agreement providing a further £100.0 million Term loan on similar terms and with a similar repayment profile to the existing term borrowings. The facility was drawn down in full on 3 July 2006 and partially used to make a payment of £22.5 million into the employee pension scheme to reduce the actuarial deficit.

### Analysis of borrowings

Borrowings at 31 December 2006 and 31 December 2005 consisted of bank loans held by the Company's subsidiary Drax Finance Limited as follows:

|                               | As at 31 December 2006                                  |                                 |                         |
|-------------------------------|---------------------------------------------------------|---------------------------------|-------------------------|
|                               | Borrowings<br>before<br>deferred<br>finance costs<br>£m | Deferred<br>finance costs<br>£m | Net<br>borrowings<br>£m |
| Term loans                    | 485.0                                                   | (11.7)                          | 473.3                   |
| Bridge loan                   | 2.9                                                     | –                               | 2.9                     |
| <b>Total borrowings</b>       | <b>487.9</b>                                            | <b>(11.7)</b>                   | <b>476.2</b>            |
| Less current portion of debt  | (20.0)                                                  | 0.2                             | (19.8)                  |
| <b>Non-current borrowings</b> | <b>467.9</b>                                            | <b>(11.5)</b>                   | <b>456.4</b>            |

  

|                               | As at 31 December 2005                                  |                                 |                         |
|-------------------------------|---------------------------------------------------------|---------------------------------|-------------------------|
|                               | Borrowings<br>before<br>deferred<br>finance costs<br>£m | Deferred<br>finance costs<br>£m | Net<br>borrowings<br>£m |
| Term loan                     | 500.0                                                   | (15.5)                          | 484.5                   |
| Bridge loan                   | 77.0                                                    | –                               | 77.0                    |
| <b>Total borrowings</b>       | <b>577.0</b>                                            | <b>(15.5)</b>                   | <b>561.5</b>            |
| Less current portion of debt  | (105.1)                                                 | 3.7                             | (101.4)                 |
| <b>Non-current borrowings</b> | <b>471.9</b>                                            | <b>(11.8)</b>                   | <b>460.1</b>            |

The Term loans are subject to a fixed amortisation profile ending 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. £57.5 million of the Term loan was repaid on 30 June 2006 and £57.5 million of the Term loan was repaid on 29 December 2006, in line with the target repayment profile as a result of the levels of cash available for debt service.

The Bridge loan has a first priority over the TXU Claim and the proceeds thereof, which are its primary source of repayment. The Bridge loan has no fixed amortisation profile, with the timing of repayments determined by receipts under the TXU Claim. Following distributions under the TXU Claim in January and July 2006, £55.1 million of the Bridge loan was repaid on 23 January 2006 and a further £19.0 million was repaid on 25 July 2006. Any outstanding principal balance falls due for payment on 31 December 2008.

Ultimately, the Group's ability to make repayments of the Term loan is entirely dependent on the successful operation of the business. The ability of the Group to make repayments of the Bridge loan is dependent on: i) the timing and quantum of recoveries under the TXU Claim; and ii) the extent that such recoveries are insufficient to pay amounts under the Bridge loan when due, the successful operation of the business.

The Group's debt is guaranteed and secured directly by each of the principal subsidiary undertakings of the Company. 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.

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

|                                                                                      | Share capital<br>£m | Share premium<br>£m | Merger reserve<br>£m | Capital reserve<br>£m | Hedge reserve<br>£m | Retained losses<br>£m | Total<br>£m  |
|--------------------------------------------------------------------------------------|---------------------|---------------------|----------------------|-----------------------|---------------------|-----------------------|--------------|
| <b>At 1 January 2005</b>                                                             | –                   | 0.5                 | 445.1                | 293.5                 | –                   | (1,173.2)             | (434.1)      |
| Profit for the year                                                                  | –                   | –                   | –                    | –                     | –                   | 282.4                 | 282.4        |
| Actuarial losses on defined benefit pension schemes                                  | –                   | –                   | –                    | –                     | –                   | (8.2)                 | (8.2)        |
| Deferred tax on actuarial losses on defined benefit pension schemes                  | –                   | –                   | –                    | –                     | –                   | 2.5                   | 2.5          |
| Initial recognition of net mark-to-market liability on adoption of IAS 32 and IAS 39 | –                   | –                   | –                    | –                     | –                   | (5.6)                 | (5.6)        |
| Deferred tax recognised on adoption of IAS 32 and IAS 39                             | –                   | –                   | –                    | –                     | –                   | 1.7                   | 1.7          |
| Fair value losses on cash flow hedges                                                | –                   | –                   | –                    | –                     | (109.7)             | –                     | (109.7)      |
| Deferred tax recognised on fair value losses on cash flow hedges                     | –                   | –                   | –                    | –                     | 32.9                | –                     | 32.9         |
| Share capital issued on Refinancing and Listing                                      | 40.7                | –                   | –                    | –                     | –                   | –                     | 40.7         |
| Share premium arising on Refinancing and Listing                                     | –                   | 420.7               | –                    | –                     | –                   | –                     | 420.7        |
| Reverse acquisition adjustments:                                                     |                     |                     |                      |                       |                     |                       |              |
| – Share for share exchange                                                           | –                   | (0.5)               | (27.8)               | –                     | –                   | –                     | (28.3)       |
| – Transfer of capital reserve                                                        | –                   | –                   | 293.5                | (293.5)               | –                   | –                     | –            |
| LTIP – credit to equity for share-based payments                                     | –                   | –                   | –                    | –                     | –                   | 25.2                  | 25.2         |
| <b>At 31 December 2005</b>                                                           | <b>40.7</b>         | <b>420.7</b>        | <b>710.8</b>         | <b>–</b>              | <b>(76.8)</b>       | <b>(875.2)</b>        | <b>220.2</b> |
| Profit for the year                                                                  | –                   | –                   | –                    | –                     | –                   | 463.5                 | 463.5        |
| Equity dividends paid                                                                | –                   | –                   | –                    | –                     | –                   | (342.0)               | (342.0)      |
| Actuarial gains on defined benefit pension schemes                                   | –                   | –                   | –                    | –                     | –                   | 8.6                   | 8.6          |
| Deferred tax on actuarial gains on defined benefit pension schemes                   | –                   | –                   | –                    | –                     | –                   | (2.6)                 | (2.6)        |
| Fair value gains on cash flow hedges                                                 | –                   | –                   | –                    | –                     | 468.2               | –                     | 468.2        |
| Deferred tax recognised on fair value gains on cash flow hedges                      | –                   | –                   | –                    | –                     | (140.5)             | –                     | (140.5)      |
| Credit to equity for share-based payments                                            | –                   | –                   | –                    | –                     | –                   | 1.7                   | 1.7          |
| <b>At 31 December 2006</b>                                                           | <b>40.7</b>         | <b>420.7</b>        | <b>710.8</b>         | <b>–</b>              | <b>250.9</b>        | <b>(746.0)</b>        | <b>677.1</b> |

## 11. Cash flow from operating activities

|                                                                | Years ended 31 December |            |
|----------------------------------------------------------------|-------------------------|------------|
|                                                                | 2006<br>£m              | 2005<br>£m |
| <b>Profit for the year</b>                                     | <b>463.5</b>            | 282.4      |
| Adjustments for:                                               |                         |            |
| Interest payable and similar charges                           | <b>37.1</b>             | 114.4      |
| Interest receivable                                            | <b>(13.4)</b>           | (23.5)     |
| Tax charge/(credit)                                            | <b>170.7</b>            | (18.8)     |
| Depreciation                                                   | <b>34.9</b>             | 31.0       |
| Reversal of impairment of tangible fixed assets                | –                       | (19.0)     |
| Loss on disposal of property, plant and equipment              | –                       | 0.2        |
| Unrealised (gains)/losses on derivative contracts              | <b>(90.8)</b>           | 117.0      |
| LTIP – credit to equity for share-based payments               | –                       | 25.2       |
| Credit to equity for share-based payments                      | <b>1.7</b>              | –          |
| <b>Operating cash flows before movement in working capital</b> | <b>603.7</b>            | 508.9      |
| Changes in working capital:                                    |                         |            |
| Increase in inventories                                        | <b>(9.1)</b>            | (22.6)     |
| Decrease/(increase) in receivables                             | <b>19.7</b>             | (123.4)    |
| (Decrease)/increase in payables                                | <b>(4.4)</b>            | 99.8       |
| Decrease in pensions                                           | <b>(23.6)</b>           | –          |
| Increase/(decrease) in provisions                              | <b>0.2</b>              | (0.4)      |
| <b>Cash generated from operations</b>                          | <b>586.5</b>            | 462.3      |

## Glossary

**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.

**Bilateral contracts** - Contract with counterparties and power exchange trades.

**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.

**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).

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

**EBITDA enhancements** - EBITDA enhancement projects advised to investors in March 2005.

**EU ETS** - The EU Emissions Trading Scheme is a policy introduced across Europe to reduce emissions of carbon dioxide ("CO<sub>2</sub>"); the scheme is capable of being extended to cover all greenhouse gas emissions.

**ESIP** - The Drax Group plc Restricted Share Plan, also known as the Drax Group plc Executive Share Incentive Plan.

**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.

**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** - Percentage of actual net sales to potential maximum net generation.

**LTIP** - The Drax Group Limited Long-Term Incentive Plan.

**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.

**Planned Outage** - A period during which scheduled maintenance is executed according to the budget 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 revenues** - The aggregate of bilateral contracts and Balancing Mechanism income/expense.

**Refinancing and Listing** - The financial restructuring of the Group effective on 15 December 2005 resulting in the creation of a new holding company, Drax Group plc. Pursuant to the schemes of arrangement under which the Refinancing and Listing was implemented, the existing debt of the Group was settled partially through the issue of new debt and partially through the issue of ordinary shares in Drax Group plc. Also on 15 December 2005, Drax Group plc was introduced to the Official List of the UK Listing Authority and its ordinary shares commenced trading on the London Stock Exchange.

**ROCs** - Renewables Obligation Certificates. 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.

**The Company** - Drax Group plc.

**The Group** - Drax Group plc and its subsidiaries.

**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 £348 million (including 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.

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