

**Drax Group plc
(Symbol: DRX)**

**Preliminary Results for the year ended 31 December 2008
- Part Two -**

Introduction

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

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

An opportunity for growth

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

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

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

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

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

Investing in growth

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

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

The core business

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

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

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

During the year, we demonstrated our competence in both project execution and biomass procurement; both vital skills that are necessary as we grow the business. Our turbine upgrade project is now just over one-third complete. Following the fast-track upgrade of one high pressure turbine in 2007, we upgraded the high and low pressure turbines of two of our six generating units during the major planned outages of 2008. I am pleased to report that together these units are delivering their expected 5% efficiency improvement. Translated into carbon savings this means that, from the third quarter of 2008, two of our generating units have been operating at an overall efficiency that will save one-third of a million tonnes of carbon dioxide ("CO₂") each year.

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

Having successfully identified sources of biomass in excess of the requirements for our new 400MW direct injection facility, now we will be able to run it alongside our existing capability. This means that from mid 2010 we will have a total co-firing capacity of 500MW which will produce the equivalent output of over 600 wind turbines. The biomass co-firing facility will be the largest in the world, and will reduce Drax Power Station's emissions of CO₂ by over two and a half million tonnes a year.

Together our completed turbine upgrade and biomass co-firing projects will save over three and a half million tonnes of CO₂ emissions each year, amounting to a saving of up to 17.5% on historic levels.

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

Looking ahead

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

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

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

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

Results of operations

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

Notes:

- (1) Fuel costs comprise the fuel costs incurred in the generation process, predominantly coal and CO₂ emissions allowances, together with oil and biomass. Fuel costs also include the cost of power purchased to meet power sales commitments.
- (2) Other operating expenses excluding depreciation, amortisation, exceptional items and unrealised gains on derivative contracts principally include salaries, maintenance costs, transmission network use of system charges (“TNUoS”), balancing services use of system charges (“BSUoS”) and business rates.
- (3) EBITDA is defined as profit before interest, tax, depreciation and amortisation, exceptional items and unrealised gains on derivative contracts.

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

In addition to power sales, total revenue also includes income from the provision of ancillary services, the sale of by-products (ash and gypsum), and the sale of ROCs, LECs and SO₂ emissions allowances. In the year ended 31 December 2008, these revenues were £61 million compared to £43 million in 2007. Significantly higher ROC sales in 2008 were driven by our growing biomass burn. Lower ancillary services revenues were a result of stronger competition in the market to provide frequency response services to National Grid plc (“National Grid”).

Fuel costs in respect of generation during the year ended 31 December 2008 were £858 million, compared to £471 million in 2007. The increase was primarily due to higher generation, an increase in the price of coal and other fuels, and the impact of higher prices for and increased purchases of CO₂ emissions allowances (see Price of coal and other fuels and CO₂ emissions allowances).

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

The cost of power purchased is included within fuel costs. For the year ended 31 December 2008, the cost of purchased power increased to £212 million compared to £76 million in 2007, primarily due to higher market prices for electricity.

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

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

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

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

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

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

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

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

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

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

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

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

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

The tax charge for the year ended 31 December 2008 was £110 million, compared to £96 million in 2007. Tax for 2008 includes a one-time charge of £9 million to reflect the estimated impact on deferred tax of the withdrawal of industrial buildings allowances introduced by the Finance Act 2008. The tax charge for 2007 included a one-time credit of £18 million to reflect the impact on deferred tax of a reduction in the rate of UK corporation tax from 30% to 28% with effect from 1 April 2008.

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

Key factors affecting the business

General commodity market conditions

Commodity market conditions were generally favourable for Drax in the first half of the year. During the third quarter, trading conditions continued to improve primarily as a consequence of low capacity reserve margins in the electricity market. However, in the last quarter we saw dark green spreads narrow and significant falls in power, coal and CO₂ emissions allowances prices. These trends in forward power, coal and CO₂ emissions allowances prices are described further in the following paragraphs.

Price of electricity

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

| | Year ended 31 December 2008 | Year ended 31 December 2007 |
|---|-----------------------------------|-----------------------------------|
| Average achieved price (£/MWh) | 58.3 | 45.3 |
| | 2008 | 2007 |
| Summer baseload market close (£/MWh) | 55.8 | 23.0 |
| | 2008/2009 | 2007/2008 |
| Winter baseload market close (£/MWh) | 106.9 | 40.4 |

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

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

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

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

Price of coal and other fuels

We burnt approximately 9.5 million tonnes of coal in the year ended 31 December 2008 compared to approximately 9.8 million tonnes in 2007. This coal was purchased from a variety of domestic and international sources under either fixed or variable priced contracts with different maturities.

Spot prices for internationally traded coal delivered into North-West Europe (as reflected by the TFS API 2 index) increased dramatically over the second half of 2007, reaching US\$127 per tonne by the end of the year. Spot prices continued to increase to record levels over the first six months of 2008, reaching US\$218 per tonne by 30 June 2008. Price increases were driven by continued tight markets for both coal and freight, caused by strong demand from China, India and Japan, combined with some production and logistical issues in China, as well as South Africa and Australia. However, spot coal prices fell significantly over the final quarter, down to US\$81 per tonne by 31 December 2008, as supply constraints eased in both the coal and freight markets. The fall in coal prices was partially offset by the depreciation of sterling against the US dollar through the second half of 2008.

We also burn biomass, petcoke and fuel oil, although coal comprised around 93% of total fuel costs in the year ended 31 December 2008 (excluding CO₂ emissions allowances) compared to 95% in 2007, primarily as a result of improved fuel diversity. The average cost of fuel per MWh (excluding CO₂ emissions allowances) was £25.1 for the year ended 31 December 2008, compared to £18.5 in 2007, with high coal prices in the first nine months of 2008 relative to the levels of last year.

CO₂ emissions allowances

For Phase II of the EU ETS (2008–2012), Drax has an allocation of 9.5 million tonnes of CO₂ emissions allowances per annum under the UK NAP, compared to 14.6 million tonnes per annum for Phase I (2005–2007).

Our CO₂ emissions allowances requirement for the year ended 31 December 2008, in excess of those allocated under the UK NAP, was approximately 12.8 million tonnes compared to approximately 7.6 million tonnes in 2007, as a result of the lower UK NAP allocation and higher generation, partially offset by plant efficiency improvements and increased biomass burn.

The price for Phase I CO₂ emissions allowances began 2007 at approximately €6.6 per tonne, and as a result of oversupply, fell steadily over the first six months to €0.13 per tonne on 30 June 2007, subsequently falling away further to €0.04 per tonne by 31 December 2007.

The price for Phase II CO₂ emissions allowances began 2008 at approximately €22.4 per tonne, and in common with power and coal prices rose steadily over the first half of the year to €28.4 per tonne at 30 June 2008. However, carbon prices also fell significantly over the final quarter, down to €15.4 per tonne by 31 December 2008, as commodity prices fell back and industrial demand reduced in response to the economic climate.

As a result, the average price expended for purchased CO₂ emissions allowances during the year ended 31 December 2008 was £17.4 per tonne (equivalent to £223 million), compared to £1.5 per tonne in 2007 (equivalent to £11 million).

Outages and plant utilisation levels

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

Notes:

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

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

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

The planned outage rate achieved for the year ended 31 December 2008 was 8.9% compared to 8.1% in 2007. Our maintenance regime includes a major planned outage for each of our six units once every four years. Consequently, there is an irregular pattern to planned outages and associated expenditure, since in two of the four years two units will each undergo a major planned outage. Two major planned outages were completed in both 2007 and 2008.

The forced outage rate for the year ended 31 December 2008 was 5.8%, compared to 6.9% in 2007. The Winter forced outage rate was 6.5% for the year ended 31 December 2008, compared to 4.2% in 2007.

Health and safety

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

Liquidity and capital resources

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

Analysis of cash flows

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

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

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

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

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

Capital resources and refinancing

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

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

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

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

Seasonality of borrowing

Our business is seasonal with higher electricity prices and despatch in the Winter period and lower despatch in the Summer months, when prices are lower and plant availability is affected by planned outages.

Accordingly, cash flow during the Summer months is materially reduced due to the combined effect of lower prices and output, while maintenance expenditures are increased during this period due to major planned outages. The Group's £100 million revolving credit facility assists in managing the cash low points in the cycle where required. The revolving credit facility was undrawn at 31 December 2008 and has a final maturity date of 15 December 2010.

Capital expenditure

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

In relation to the turbine upgrade project, we expect to invest up to £100 million over the five-year period from 2007 to 2011, including approximately £70 million over the three years 2008 to 2010, to upgrade the high pressure and low pressure turbine modules on all six generating units to improve efficiency. Using proven technology we expect to achieve an overall baseload efficiency (that is, the ratio of energy out to energy in when operating at full capacity) approaching 40%. This will represent a 5% improvement on current baseload efficiency of around 38%. When complete, the project is expected to deliver annual savings of one million tonnes of CO₂ emissions allowances and approximately half a million tonnes of coal.

During the two major planned outages of 2008 we successfully completed the upgrade of the high and low pressure turbines on two of our six generating units. Together these units are now delivering the 5% efficiency improvement target. Translated into carbon savings this means that, from the third quarter of 2008, two of our generating units have been operating at an overall efficiency that will save one-third of a million tonnes of CO₂ emissions allowances each year.

With regard to extending our biomass capability, we expect to invest around £80 million to develop a 400MW direct injection co-firing biomass facility. We will extend our direct-injection capability from one generating unit to all six generating units, and install the necessary processing and handling infrastructure to enable us to handle an additional one and a half million tonnes of biomass material per annum. Delivery of the 400MW facility is expected to result in savings of over two million tonnes of CO₂ emissions allowances, the displacement of approximately one million tonnes of coal and the generation of in excess of one and a quarter million ROCs per annum.

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

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

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

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

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

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

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

Biomass growth strategy

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

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

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

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

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

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

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

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

Taxation

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

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

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

Closing cash position guidance

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

Positions under contract for 2009, 2010 and 2011

We continue to follow our stated trading strategy of making steady forward power sales with corresponding purchases of CO₂ emissions allowances and fuel purchases. Our aim is to deliver market level or better dark green spreads across all traded market periods and, as part of this strategy, we retain power to be sold into the prompt (within season) power markets.

As at 20 February 2009, the positions under contract for 2009, 2010 and 2011 were as follows:

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

Fixed price power sales include approximately 0.7TWh supplied to Centrica in the period 1 January 2009 to 20 February 2009 under the five-and-a-quarter year baseload contract with Centrica which commenced on 1 October 2007.

Fixed margin power sales include approximately 4.5TWh in 2009 and 5.3TWh in each of 2010 and 2011 in connection with the contract.

Under this contract we will supply power on terms which include Centrica paying for coal, based on international coal prices, and delivering matching CO₂ emissions allowances amounting to approximately 4.8 million tonnes per annum. The contract provides Drax with a series of fixed dark green spreads which were agreed in the first quarter of 2006.

Distributions

Distribution policy

We notified investors of a change to our distribution policy when we announced our biomass growth strategy in October 2008. With respect to 2008 and 2009, the Company will distribute all excess cash generated from operations after meeting business requirements in each year.

For 2010 and beyond, we will target a pay-out ratio of 50% of underlying earnings (being profit attributable to equity shareholders adjusted to exclude the impact of unrealised gains and losses on derivative contracts) in each year.

Dividends paid

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

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

Dividends proposed

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

Consolidated financial information

Consolidated income statements

| | Notes | Years ended 31 December | |
|---|-------|-------------------------|-----------------|
| | | 2008 £m | 2007 £m |
| Continuing operations | | | |
| Revenue | | 1,752.8 | 1,247.4 |
| Fuel costs | | (1,070.2) | (546.1) |
| | | 682.6 | 701.3 |
| Other operating expenses excluding exceptional items | 3 | (274.8) | (239.4) |
| Exceptional operating income | | – | 6.2 |
| Total other operating expenses, net | | (274.8) | (233.2) |
| Unrealised gains on derivative contracts | | 56.3 | 3.3 |
| Operating profit | | 464.1 | 471.4 |
| Interest payable and similar charges | | (28.8) | (34.3) |
| Interest receivable | | 7.2 | 11.4 |
| Profit before tax | | 442.5 | 448.5 |
| Tax charge | 4 | (109.6) | (95.5) |
| Profit for the year attributable to equity shareholders from continuing operations | | 332.9 | 353.0 |
| | | Pence per share | Pence per share |
| Earnings per share from continuing operations | | | |
| – Basic and diluted | 6 | 98 | 99 |

Consolidated statements of recognised income and expense

| | Notes | Years ended 31 December | |
|---|-------|-------------------------|----------------|
| | | 2008 £m | 2007 £m |
| Profit for the year | | 332.9 | 353.0 |
| Actuarial losses on defined benefit pension scheme | | (12.9) | (3.3) |
| Deferred tax on actuarial losses on defined benefit pension scheme | 4 | 3.6 | 0.9 |
| Impact of reduction in tax rate on deferred tax on defined benefit pension scheme | 4 | – | (0.4) |
| Fair value gains/(losses) on cash flow hedges | | 164.7 | (584.3) |
| Deferred tax on cash flow hedges | 4 | (47.4) | 171.1 |
| Impact of reduction in tax rate on deferred tax on cash flow hedges | 4 | – | 1.0 |
| Net gains/(losses) recognised in equity | | 108.0 | (415.0) |
| Total recognised income/(expense) for the year attributable to equity shareholders | | 440.9 | (62.0) |

Consolidated balance sheets

| | Notes | As at 31 December | |
|---|-------|-------------------|----------------|
| | | 2008 £m | 2007 £m |
| Assets | | | |
| Non-current assets | | | |
| Property, plant and equipment | | 1,135.7 | 1,080.4 |
| Derivative financial instruments | | 105.5 | 1.6 |
| | | 1,241.2 | 1,082.0 |
| Current assets | | | |
| Inventories | | 189.5 | 108.3 |
| Trade and other receivables | | 259.9 | 129.6 |
| Derivative financial instruments | | 286.5 | 15.0 |
| Cash and cash equivalents | | 130.2 | 59.7 |
| | | 866.1 | 312.6 |
| Liabilities | | | |
| Current liabilities | | | |
| Financial liabilities: | | | |
| – Borrowings | 7 | 14.9 | 9.9 |
| – Derivative financial instruments | | 337.1 | 145.6 |
| Trade and other payables | | 295.0 | 94.1 |
| Current tax liabilities | | 49.4 | 70.4 |
| | | 696.4 | 320.0 |
| Net current assets/(liabilities) | | 169.7 | (7.4) |
| Non-current liabilities | | | |
| Financial liabilities: | | | |
| – Borrowings | 7 | 350.0 | 387.0 |
| – Derivative financial instruments | | 70.6 | 107.7 |
| Deferred tax liabilities | | 273.8 | 201.6 |
| Retirement benefit obligations | | 20.6 | 13.5 |
| Other non-current liabilities | | — | 1.4 |
| Provisions | | 2.6 | 2.4 |
| | | 717.6 | 713.6 |
| Net assets | | 693.3 | 361.0 |
| Shareholders' equity | | | |
| Issued equity | | 39.2 | 39.2 |
| Capital redemption reserve | | 1.5 | 1.5 |
| Share premium | | 420.7 | 420.7 |
| Merger reserve | | 710.8 | 710.8 |
| Hedge reserve | | (44.0) | (161.3) |
| Retained losses | | (434.9) | (649.9) |
| Total shareholders' equity | 8 | 693.3 | 361.0 |

Consolidated cash flow statements

| | Notes | Years ended 31 December | |
|---|-------|-------------------------|------------|
| | | 2008 £m | 2007 £m |
| Cash generated from operations | 9 | 430.8 | 437.7 |
| Income taxes paid | | (102.2) | (104.7) |
| Interest paid | | (25.9) | (31.3) |
| Interest received | | 6.8 | 11.1 |
| Net cash generated from operating activities | | 309.5 | 312.8 |
| Cash flows from investing activities | | | |
| Purchase of property, plant and equipment | | (91.4) | (67.8) |
| Net cash used in investing activities | | (91.4) | (67.8) |
| Cash flows from financing activities | | | |
| Equity dividends paid | 5 | (110.0) | (171.3) |
| Purchase of own shares under share buy-back programme | | – | (83.5) |
| Repayment of borrowings | 7 | (35.0) | (82.9) |
| Purchase of own shares held by employee trust | | (2.6) | (2.4) |
| Net cash used in financing activities | | (147.6) | (340.1) |
| Net increase/(decrease) in cash and cash equivalents | | 70.5 | (95.1) |
| Cash and cash equivalents at 1 January | | 59.7 | 154.8 |
| Cash and cash equivalents at 31 December | | 130.2 | 59.7 |

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 2008 (the "financial statements").

This preliminary announcement does not constitute the full financial statements prepared in accordance with IFRSs. The financial statements were approved by the Board of directors on 2 March 2009.

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 2009 and will be available on request from the Company Secretary, Drax Group plc, Drax Power Station, Selby, North Yorkshire, YO8 8PH. The Annual General Meeting will be held at The City Presentation Centre, 4 Chiswell Street, London EC1Y 4UP at 11am on 28 April 2009. The financial statements for the year ended 31 December 2008, 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 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 certain financial assets and liabilities that have been measured at fair value.

3. Operating profit

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

4. Taxation

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

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

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

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

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

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

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

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

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

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

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

5. Dividends

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

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

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

6. Earnings per share

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

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

| | Years ended 31 December | |
|--|-------------------------|--------------|
| | 2008 £m | 2007 £m |
| Earnings attributable to equity holders of the Company for the purposes of basic and diluted earnings | 332.9 | 353.0 |

| | Years ended 31 December | |
|---|-------------------------|--------------|
| | 2008 | 2007 |
| Number of shares: | | |
| Weighted average number of ordinary shares for the purposes of basic earnings per share (millions) | 339.3 | 354.9 |
| Effect of dilutive potential ordinary shares under share options | 0.3 | 0.1 |
| Weighted average number of ordinary shares for the purposes of diluted earnings per share (millions) | 339.6 | 355.0 |
| Earnings per share – basic and diluted (pence) | 98 | 99 |

7. Borrowings

| | As at 31 December | |
|-----------------|-------------------|------------|
| | 2008 £m | 2007 £m |
| Current: | | |
| Term loans | 14.9 | 9.9 |

| | As at 31 December | |
|---------------------|-------------------|------------|
| | 2008 £m | 2007 £m |
| Non-current: | | |
| Term loans | 350.0 | 387.0 |

Maturity of borrowings

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

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

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

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

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

Analysis of borrowings

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

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

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

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

The Group's debt is guaranteed and secured directly by each of the principal subsidiary undertakings of the Company. Drax Group plc is not a guarantor of the Group's debt, but has granted a charge over the shares in its subsidiary, Drax Finance Limited.

Letter of credit facility and revolving credit facility

In addition to its borrowings, the Group has access to a letter of credit facility which provides credit support of up to £200 million to the Group's trading activities.

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

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

8. Shareholders' funds and statement of changes in shareholders' equity

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

9. Cash flow from operating activities

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

Glossary

Ancillary services

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

Availability

Average percentage of time the units were available for generation.

Average achieved price

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

Average capture price

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

Balancing Mechanism

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

Baseload

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

Bilateral contracts

Contract with counterparties and power exchange trades.

Company

Drax Group plc.

Dark green spread

The difference between the price available in the market for sales of electricity and the marginal cost of production (being the cost of coal and other fuels including CO₂ emissions allowances).

Direct-injection co-firing

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

EBITDA

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

ESIP

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

EU ETS

The EU Emissions Trading Scheme is a mechanism policy introduced across the EU to reduce emissions of CO₂; the scheme is capable of being extended to cover all greenhouse gas emissions.

Forced Outage

Any reduction in plant availability excluding planned outages.

Forced Outage Rate

The capacity which is not available due to forced outages or restrictions expressed as a percentage of the maximum theoretical capacity, less planned outage capacity.

Frequency Response Service

Services purchased by National Grid plc used to maintain system frequency.

Group

Drax Group plc and its subsidiaries.

IASs

International Accounting Standards.

IFRSs

International Financial Reporting Standards.

LECs

Levy Exemption Certificates. Evidence of Climate Change Levy exempt electricity supplies generated from qualifying renewable sources.

Load factor

Net sent out generation as a percentage of maximum sales.

Lost Time Injury Rate

The frequency rate calculated on the following basis (number of accidents * 100,000) / hours worked. Accidents are defined as occurrences where the injured party is absent from work for more than 24 hours.

Net Balancing Mechanism

Net volumes attributable to accepted bids and offers in the Balancing Mechanism.

Net merchant sales

Net volumes attributable to bilateral contracts and power exchange trades.

Net sales

The aggregate of net merchant sales and net Balancing Mechanism.

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 exchange trades

Power sales or purchases transacted on the APX UK power trading platform.

Power revenues

The aggregate of bilateral contracts and Balancing Mechanism income/expense.

ROCs

Renewables Obligation Certificates. Under the current regime, one ROC is issued to eligible generators for every MWh of electricity generated from renewable sources.

SAYE Plan

The Drax Group plc Approved Savings-Related Share Option Plan.

SIP

The Drax Group plc Approved Share Incentive Plan.

Summer

The calendar months April to September.

Summer baseload market close

Market price on the last day that the season was traded as a product.

Technical Availability

Total availability after planned and forced outages.

Through the mill co-firing

Is a process whereby biomass passes first through the pulverising mills before going to the burners situated in the boiler walls.

TXU

TXU Europe Energy Trading Limited (in administration and subject to a company voluntary arrangement).

TXU Claim

The claim issued by the Group, ultimately agreed by the Administrators of TXU at approximately £336 million (excluding VAT) in respect of unpaid power purchased by TXU and liquidated damages under the TXU Contract.

TXU Contract

A 15-year power purchase agreement with TXU.

UK NAP

UK National Allocation Plan.

Winter

The calendar months October to March.

Winter baseload market close

Market price on the last day that the season was traded as a product.