International Power annual report 2006

Contents

Our core business values

- Financial discipline
- Integrity of communication
- Respect for the individual
- Safe behaviour
- Team first culture

2006 highlights

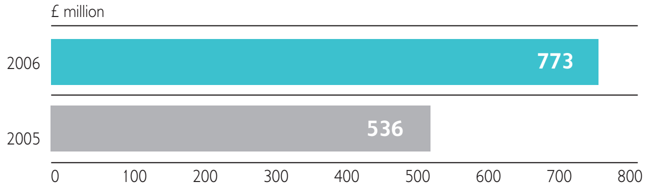
In 2006 our profit from operations* increased significantly from £536 million in 2005 to £773 million and earnings per share* increased from 14.6p to 22.4p, an improvement of 53%.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Excluding exceptional items and specific IAS 39 mark to market movements		
Revenue (including joint ventures and associates)	**3,645**	2,980
Profit from operations	**773**	536
Profit before tax	**525**	334
Earnings per share in pence (basic)	**22.4p**	14.6p
Including exceptional items and specific IAS 39 mark to market movements		
Revenue (including joint ventures and associates)	**3,783**	2,936
Profit from operations	**898**	611
Profit before tax	**624**	419
Earnings per share in pence (basic)	**27.6p**	19.4p
Dividend per share in pence	**7.9p**	4.5p
Cash generated from operations	**769**	512
Free cash flow – see page 39	**456**	285
Capital expenditure		
Maintenance	**128**	72
Growth	**142**	188
Major acquisition expenditure		
Coleto Creek	**621**	–
Levanto	**129**	–
Saltend	–	495

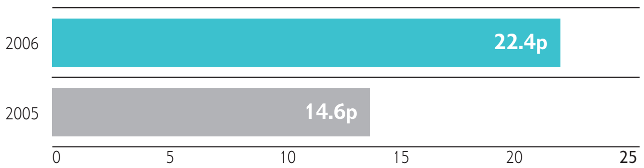
* Excluding exceptional items and specific IAS 39 mark to market movements

	As at 31 December 2006 £m	As at 31 December 2005 £m
Net assets	**2,740**	2,375
Net debt	**(3,485)**	(2,979)
Gearing	**127%**	125%
Debt capitalisation	**56%**	56%

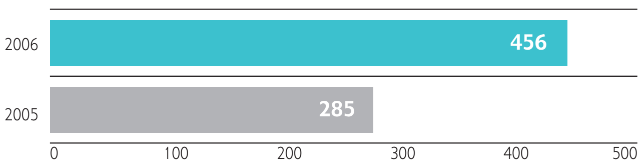
Profit from operations*



Earnings per share* (basic)



Free cash flow



Uthmaniyah, Tihama, Saudi Arabia

Chairman's statement

2006 was another successful year for the Company in terms of both strong growth in earnings and cash flow, and expansion by acquisitions and greenfield developments. The business is well placed for further growth in 2007.

Last year I said we expected 2006 to be a year of further growth and I am glad to report that it was. In 2006 our profit from operations* increased significantly from £536 million in 2005 to £773 million, an improvement of 44% and earnings per share* (EPS) increased from 14.6p to 22.4p, an improvement of 53%. In addition, free cash flow increased by 60% from £285 million in 2005 to £456 million in 2006.

In 2004, when we announced our first dividend payment, we stated that our dividend policy was to commence paying a dividend representing a pay-out ratio of 30% of pre-exceptional EPS progressing towards a pay out of 40% in the medium-term. This year the Board is proposing a dividend of 7.9p per share which reflects a pay-out ratio of 35%*, and an increase of 75% on last year's payment.

The financial results reflect the good operational performance of our assets, the improvement in the UK and US merchant markets and the continued growth of the business. In 2006 we completed the acquisition of a 40% interest in the 910 MW and 30 MIGD (gross) Hidd power and water plant in Bahrain, the coal fired 632 MW Coleto Creek power station in Texas, the 140 MW Indian Queens oil fired peaking plant in Cornwall, UK and the 436 MW Levanto wind farm portfolio, which has wind farms that are currently operating or under construction in Germany and France plus further potential growth from a pipeline of development opportunities. These acquisitions all met our financial criteria whilst fitting in with our strategic aims. The Hidd acquisition continued our growth in the Middle East in a new market for us – Bahrain. Coleto Creek increased our presence in Texas and added good fuel diversification. The Indian Queens peaking plant increased our ability to provide system support. Levanto represented our first major renewables business in Europe and, in addition to providing fuel diversification, gives the business immediate scale and credibility in this increasingly important area of electricity generation.

- Profit from operations* of £773 million (2005: £536 million) – up 44%
- EPS* of 22.4p (2005: 14.6p) – up 53%
- Free cash flow of £456 million (2005: £285 million) – up 60%
- Dividend per share of 7.9p proposed – up 75% from 4.5p in 2005

* Excluding exceptional items and specific IAS 39 mark to market movements.

The successful growth that has taken place in the last few years is testament to the strong leadership of the Chief Executive Officer, Phil Cox, and his executive team and the professionalism and efforts of all the Group's employees. On your behalf I would like to thank them all for their contribution to the continued success of the Company. Whenever I visit our assets (and in 2006 I visited plants in Australia and the Middle East), I have been very impressed by the enthusiasm demonstrated by the employees for our business and the obvious pride they all take in their work.

We take our commitment to safety very seriously. One of our core values is to instil safe behaviour in everything we do. We therefore decided to ask DuPont, an acknowledged world authority in this field, to carry out a safety review at a selection of our assets around the globe to ensure that our commitment to excellent health and safety standards, across our portfolio, is checked and challenged and that best practice is shared by all our plants. Health and safety is of vital importance in our business and therefore the accident frequency rate is one of the non-financial key performance indicators we use in managing our business.

Once again, I would like to express my thanks to our Non-Executive Directors, whose guidance, challenge and support continues to be invaluable. During the year there were changes at Board level. Following the retirement of Jack Taylor, as a Non-Executive Director, at last year's Annual General Meeting, John Roberts, formerly Chief Executive of United Utilities plc, has been appointed as a Non-Executive Director. John brings related power industry and international experience to the Board and has already made a positive contribution to the business.

Our broadly based international portfolio has been strengthened by the successful integration of acquired assets and the addition of new greenfield projects commissioned in 2006, and provides a solid platform for our business. This, coupled with a largely forward contracted position for our merchant capacity, gives us confidence that 2007 will be a year of further growth. We will continue with our disciplined approach to pursuing value enhancing growth opportunities in our core regions, alongside our commitment to increase our dividend pay-out ratio over the medium-term.

Sir Neville Simms
Chairman

Chief Executive Officer's statement

Dear Shareholder,

2006 was a strong year, with very good operational and financial performance reflected in a significant increase in our share price. The key commercial drivers were the continued recovery of the US and UK merchant markets, together with contributions from selected acquisitions and greenfield growth projects. However, none of this would have been possible without the continued enthusiasm, commitment and drive from our dedicated teams of professionals across the entire Group, and I thank every individual for this.

This performance needs to be viewed in the wider context of our industry. Power generation, and the energy sector as a whole, is right at the centre of a number of key international debates, including security of supply, high and volatile fuel prices, the environmental impact of emissions, and carbon dioxide in particular, technology advances, and government energy policies. It is critically important that we actively keep all these key themes under continual review to ensure we understand their impact and therefore best position International Power in all of the markets in which we operate.

Clear strategy to create value

Our results are based on a clear strategy to create value from power generation and very closely related activities, such as desalination and district heating. A key strength comes from our international portfolio approach, which provides a breadth of geography, market structure, fuel, and technology. This portfolio approach not only provides excellent risk mitigation, but also outstanding access to growth opportunities across all of our markets. Growth continues to be an important part of our business model, and our combination of in-depth regional market knowledge with a rigorous capital allocation process is designed to ensure only the best projects are selected. We will continue to focus on both carefully researched liberalised merchant markets, where we take full price risk for the power that we generate, and regulated markets where we have long-term offtake arrangements for our power with contractually agreed pricing.

Our overarching criterion, irrespective of the market structure in which we operate, is that our investments make money for our shareholders over the long-term. To deliver strong performance over the long-term, we must have strong values that all International Power employees ascribe to and live by. It is our values and behaviour that drive our performance, and it is worth a short reminder of our five core values, listed below.

These values, running through the heart of our core competencies – greenfield development, acquisitions, financing, asset and project management, trading, and plant operations – will continue to be our foundation.

A successful year – strong operational and financial performance

In terms of performance in 2006, it was a very good year across the portfolio with all regions contributing well, but with especially strong performances in the UK and in the US. Environmental upgrades and initiatives are a common theme across our portfolio, and you will see reference to a number of these in this review.

North America In the US, our two key merchant markets of Texas and New England continued their recovery. Oversupply continues to be reduced through consistent demand growth, enabling our plants in both Texas and New England to run at higher load factors and at higher margins than in 2005. In July 2006, we acquired Coleto Creek, a 632 MW coal fired plant in Texas, and this asset has been quickly and successfully integrated into our US portfolio. Coleto Creek provides good fuel diversity, and its access to low cost, low sulphur Powder River Basin coal from Wyoming represents a long-term cost advantage. We are now investing to improve the environmental performance of Coleto Creek by upgrading its dust emission control equipment. Coleto Creek also comes with expansion potential at site, and we are keeping this growth opportunity under close review. In New England, December 2006 saw the introduction of an enhanced Forward Capacity Market – this is a very welcome development, as it rewards capacity for being available.

Europe In Europe, the main driver for the increase in profits was the UK. As in the US, the reserve margin – the difference between installed capacity and peak demand – continues to reduce. This, when coupled with a high oil and gas price that generally sets the price of power in the UK, resulted in a much improved year for Rugeley, our 1,050 MW coal fired plant. We are investing some £145 million in environmental improvements at Rugeley to reduce sulphur and other emissions, providing this plant with a long-term role within UK generation. Price volatility, and the continual need for power at very short notice to ensure security of supply, combined to make 2006 a very good year for First Hydro, the largest fast-response pumped storage peaking unit in

Our core values:

- **Financial discipline** – we assess opportunities and risks carefully, we won't overpay for assets, and we look after shareholders' investment
- **Integrity** – honesty, openness, and fairness underpin all our business dealings, internally and externally
- **Respect** – for the individual, for opinions, for nationalities, genders, religions and ethnic backgrounds
- **Safety** – safe behaviour and attitude in everything we do – all day, every day
- **Team culture** – success in a complex business means bringing people of many different disciplines together into co-ordinated teams

the UK. For gas fired generation, the high price of gas generally meant that margins remained depressed – however, this was not the case for Saltend, our 1,200 MW gas fired plant, as this plant benefited from an attractively priced gas contract in 2006.

The balance of our European portfolio is largely contracted, and delivered an excellent performance, characterised by high plant availability. As in the UK, we are also installing improved emission control equipment at Pego, our Portuguese coal fired plant. We were also very pleased to announce two acquisitions during the year – Indian Queens, a 140 MW peaking plant in the UK, and Levanto, a 436 MW portfolio of wind farms in operation or under construction in Germany and France. Levanto represents our first significant move into renewables in Europe, and we plan to use this as a platform for further growth in renewables, using the acquired expertise and the inherent development opportunities.

Middle East Our performance in the Middle East in 2006 reflects additional capacity coming on line, our four plants in Saudi Arabia progressively reached full commercial operation during the year, in Qatar, our power and desalination plant commenced partial commercial operation and we also acquired the Hidd power and desalination plant in Bahrain in early 2006. By the end of 2006, we had 2,033 MW (net) of power plant, and 75 MIGD (net) of desalination plant in operation in the Middle East, with a further 355 MW (net) and 42 MIGD (net) due to come into operation from existing projects. Our existing plants continue to perform well under their long-term contracts, and we continue to target this region as a source of long-term growth through leveraging our operational and development skills, alongside our excellent market relationships.

Australia In Australia, our headline profit is down, due to lower achieved prices which were anticipated in this merchant market. Our forward contracting policy has significantly insulated the business from weaker market prices over the last few years, but 2006 margins reflect more recent, and hence lower, prices. However, the market background is now more encouraging, with forward prices showing an improvement. As we are largely contracted for 2007, we should see most of the benefit from this improvement from 2008 onwards. We are also investigating means of reducing carbon dioxide emissions from brown coal generation at our Hazelwood plant in Victoria, working with both federal and state governments, and with selected technology specialists. This is a medium to long-term project, and we are pleased to be at the forefront of addressing such an important issue for Australian power generation.

Asia In Asia, all of our assets operate under long-term offtake contracts, and all have performed well, with high availability the main driver. Profit is a little down year-on-year, primarily because the tax free status of one of our assets in Pakistan (KAPCO) has time expired, as originally planned. We continue to target growth opportunities in Asia, including both greenfield and acquisition opportunities, and accordingly we have strengthened our development resources in the region.

Focus on growth opportunities

Our strong operational performance has been matched by a very significant improvement in free cash flow. This ensures that our balance sheet remains robust, with gearing and debt capitalisation at levels very similar to last year, despite the acquisitions made during 2006. Our corporate liquidity also remains good, providing us with great flexibility to pursue growth opportunities, alongside our commitment to progressively increase our dividend pay-out ratio.

The foundation of our business is stronger, and we are focused on growth opportunities through greenfield development and acquisitions across our core regions. Recovering power markets are resulting in generally higher asset prices, but we will use our key strengths of regional market knowledge and financial discipline to ensure that we do not overpay, and that long-term shareholder value remains at the very top of our agenda.

Philip Cox
Chief Executive Officer

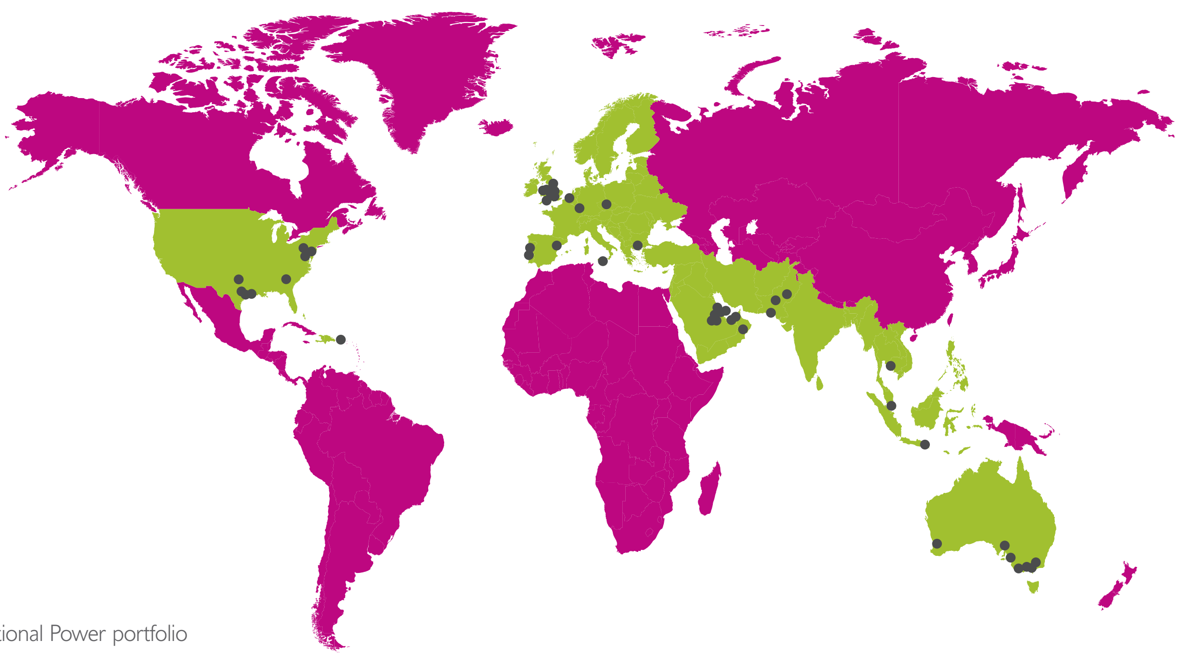
Asset portfolio

The tables below and opposite set out details in relation to our operating plants and assets under construction as at 5 March 2007.

As at 5 March 2007	Fuel/type	Gross capacity power MW	IPR ownership %	Net capacity power MW	Gross capacity heat (MWth) desal (MIGD) steam (million lbs/hr)	IPR net capacity heat (MWth) desal (MIGD) steam (million lbs/hr)
Assets in operation						
North America						
Hartwell, Georgia	Gas (OCGT)	310	50	155		
Bellingham, Massachusetts [1]	Gas (CCGT)	570	100	570		
Blackstone, Massachusetts [1]	Gas (CCGT)	570	100	570		
Milford, Massachusetts	Gas (CCGT)	160	100	160		
EcoEléctrica, Puerto Rico	LNG (CCGT)	524	35	183		
Coleto Creek, Texas	Coal	632	100	632		
Hays, Texas [1]	Gas (CCGT)	1,100	100	1,100		
Midlothian, Texas [1]	Gas (CCGT)	1,650	100	1,650		
Oyster Creek, Texas	Gas (Cogen/CCGT)	425	50	213	100 MWth	50 MWth
North America total in operation		**5,941**		**5,233**		
Europe						
International Power Opatovice, Czech Republic [2]	Coal/gas (Cogen)	585	100	585	2,040 MWth	2,040 MWth
Levanto, Europe	Wind	361	100	361		
ISAB, Italy	Gas (IGCC)	528	34	181		
Tejo Energia (Pego), Portugal	Coal	600	50	300		
Turbogás, Portugal	Gas (CCGT)	990	60	594		
Spanish Hydro, Spain	Hydro	84	67	57		
Uni-Mar (Marmara), Turkey	Gas (CCGT)	480	33	160		
Deeside, UK	Gas (CCGT)	500	100	500		
Derwent, UK	Gas (CCGT)	214	23	50		
Indian Queens, UK	Oil (OCGT)	140	100	140		
First Hydro, UK	Pumped storage	2,088	70	1,462		
Rugeley, UK	Coal/50 MW of OCGT	1,050	100	1,050		
Saltend, UK	Gas (CCGT/Cogen)	1,200	70	840	0.30m lbs/hr	0.21m lbs/hr
Europe total in operation		**8,820**		**6,280**		
Middle East						
Hidd, Bahrain	Gas (CCGT)/desalination	910	40	364	30 MIGD	12 MIGD
Al Kamil, Oman	Gas (OCGT)	285	65	185		
Ras Laffan B, Qatar	Gas (CCGT)/desalination	600	40	240	15 MIGD	6 MIGD
Tihama, Saudi Arabia	Gas (Cogen)	1,074	60	645	4.5m lbs/hr	2.7m lbs/hr
Shuweihat S1, UAE	Gas (CCGT)/desalination	1,500	20	300	100 MIGD	20 MIGD
Umm Al Nar, UAE	Gas (CCGT)/desalination	1,495	20	299	185 MIGD	37 MIGD
Middle East total in operation		**5,864**		**2,033**		
Australia						
Canunda, South Australia	Wind	46	100	46		
Pelican Point, South Australia	Gas (CCGT)	485	100	485		
Synergen, South Australia	Gas/distillate	360	100	360		
Hazelwood, Victoria	Coal	1,635	92	1,500		
Loy Yang B, Victoria	Coal	1,010	70	707		
Kwinana, Western Australia	Gas (CCGT)	118	49	58		
Australia total in operation		**3,654**		**3,156**		

	Fuel/type	Gross capacity power MW	IPR ownership %	Net capacity power MW	Gross capacity heat (MWth) desal (MIGD) steam (million lbs/hr)	IPR net capacity heat (MWth) desal (MIGD) steam (million lbs/hr)
Assets in operation continued...						
Asia						
Paiton, Indonesia	Coal	1,230	31	385		
Malakoff, Malaysia[5]	Gas (OCGT/CCGT)	3,760	18	677		
HUBCO, Pakistan	Oil	1,290	17	219		
KAPCO, Pakistan	Gas/oil (CCGT)	1,600	36	575		
Uch, Pakistan	Gas (CCGT)	586	40	234		
TNP (Pluak Daeng), Thailand	Gas (Cogen)	143	100	143	7.7 MWth[4]	7.7 MWth[4]
Asia total in operation		**8,609**		**2,233**		
TOTAL in operation around the world		**32,888**		**18,935**		
Assets under construction						
Levanto, Europe	Wind	75	100	75		
Hidd, Bahrain	Desalination	–	40	–	60 MIGD	24 MIGD
Ras Laffan B, Qatar	Gas (CCGT)/desalination	425	40	170	45 MIGD	18 MIGD
Umm Al Nar Expansion, UAE	Gas (CCGT)/desalination	925	20	185		
TOTAL under construction around the world		**1,425**		**430**		
Other investments						
BioX, Netherlands	Renewable energy company		10			
Opus Energy, UK	Independent supplier of electricity to small and medium-size businesses		30			
EnergyAustralia, Victoria and South Australia[3]	Electricity and gas retailer		50			
SEA Gas pipeline, Victoria and South Australia	687km gas pipeline from Victoria to South Australia		33			

(1) Capacity shown for these assets is the nameplate capacity.
(2) Gross capacity amount shown for International Power Opatovice represents the actual net interest owned directly or indirectly by International Power Opatovice.
(3) EnergyAustralia services circa 415,000 electricity and gas retail accounts in Victoria and South Australia.
(4) District cooling system capacity.
(5) Gross capacity amount shown for Malakoff represents the actual net interest owned directly or indirectly by Malakoff. International Power's investment in Malakoff is classified on its Group balance sheet as an asset held for sale following Malakoff's shareholder approval to divest its business to MMC, another Malaysian corporate.



● International Power portfolio

Group overview

International Power plc is a leading independent electricity generating company with interests in over 32,000 MW (gross) of power generating capacity, located in 20 countries. We add value and manage risk through a portfolio management approach, which involves maintaining a balance in the portfolio in terms of geographical spread, fuel diversity and contract type. This portfolio approach gives us access to multiple opportunities to create value whilst mitigating the risks associated with over exposure to any particular market, fuel or contract type.

Our strategy

We aim to maximise value to our shareholders over time through:

- a portfolio approach;
- maximising the value of our existing portfolio;
- growing the portfolio.

Our portfolio approach

Our balanced geographical presence gives us access to growth opportunities with attractive risk reward profiles whilst protecting the overall business from a downturn in any particular market.

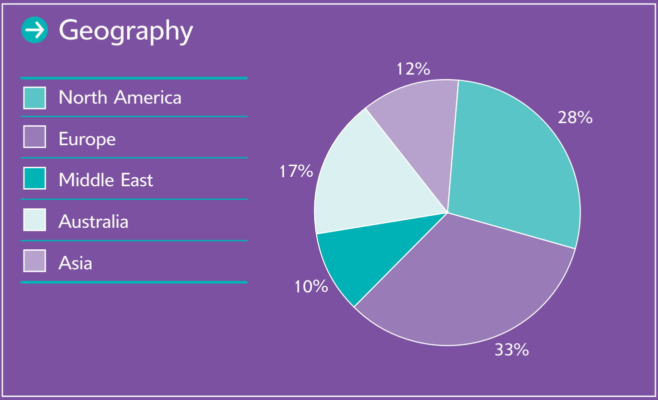
The portfolio approach also extends through to our operational capabilities. We are able to operate a range of power plant technologies, namely thermal, hydro, pumped storage and wind. These technologies produce electricity using different fuel types that include gas, oil, coal and renewable sources such as wind and water. This operational experience allows us to capture opportunities that are most economic and best suited to the market in question.

As electricity is a critical service for any economy, governments carefully decide whether or not they wish to liberalise this key sector. Several governments have retained full control of the sector and others have fully liberalised both the production and supply of electricity. The skills required for operating in liberalised (merchant) or non-liberalised (contracted) markets are very different – and we have both.

The government controlled markets offer opportunities to sell power to government bodies via long-term contracts that offer stable and regulated returns. Assets in the liberalised or merchant markets are subject to the forces of supply and demand, and these markets are generally cyclical and more volatile. Both these markets offer attractive risk/reward environments for investments. International Power maintains a balanced presence in both types of markets, providing the business with a stable platform of contracted earnings and cash flow overlaid by merchant generation which offers greater potential when markets are favourable.

The Business and financial review is based on the guidelines for Operating and Financial Reviews published by the Accounting Standards Board. To assist shareholders with their understanding of our business we look at issues affecting the Group as a whole on pages 8 to 25 followed by reviews of our five regions on pages 26 to 37. We cover our financial position and resources on pages 38 to 43.

IPR portfolio



All charts are presented based on net operating MW

Maximising the value of our existing portfolio

Our specific strategies for value enhancement in each country and for each individual asset are tailored to local requirements, but generally we seek to achieve the following:

- Optimise the operations of our power plants We optimise the operation of our power plants through several means, including managing all of our assets to high standards of safety and operating performance; managing our assets on a portfolio basis, particularly with regard to contingency and strategic spare parts planning, so as to minimise the loss of generation during planned and forced outages; closely co-ordinating plant operation with trading activity to maximise the value of our uncontracted output; standardising management reporting for all investments; and utilising our management experience to prepare successfully, certain of our plants, for the introduction of competition in some of the energy markets in which we operate.
- Leverage our existing assets We leverage our investments to enhance earnings in several ways, including financing at a variety of corporate, project and intermediate corporate levels; capturing operational, trading, and administrative economies of scale in asset aggregation; capitalising on market knowledge derived through asset ownership and leveraging off the skills, expertise and ideas of the people we and our associates employ.
- Trade assets to maximise value We expect to increase the size of our portfolio over time. However, as part of our strategy to maximise the value of our investments, we will sell an asset if this generates a higher return, or if we can obtain a comparable return with lower risk elsewhere.
- Seek effective routes to market We seek to improve our access and routes to the market in those geographical areas where it is appropriate. In July 2005, for example, we formed a partnership with EnergyAustralia to supply power and gas to retail customers, predominately in South Australia and Victoria.

Our growth

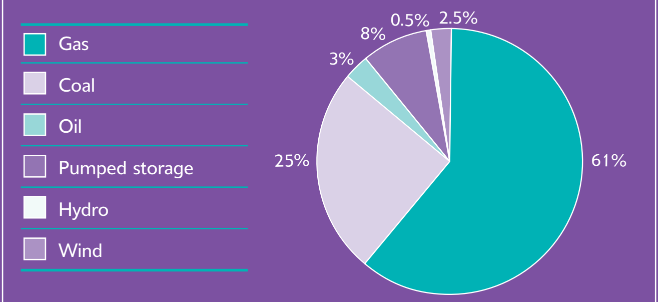
Following the establishment of the business in October 2000, on the demerger of National Power PLC, the Group has grown significantly, more than doubling our operational capacity through successful acquisitions and greenfield developments in our core markets.

Growth continues to be an important part of our business model, and when we look at opportunities we have very clear investment criteria. In merchant markets, we focus on the following key factors:

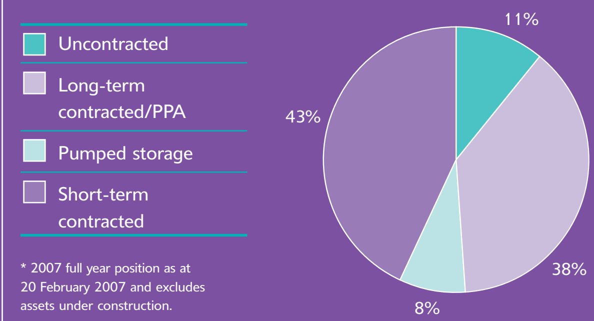
- the balance of supply and demand for power, both current and future – to ensure that conditions for a wholesale power generator are attractive;
- the regulatory framework – to ensure the market structure encourages open competition, and that the playing field is level;
- ensuring that our assets will deliver reliable power at margins that will support our investment.

Although we do not take any significant price risk in our long-term contracted markets, we do look for many of the same key factors. Essentially, we want to ensure that we generate power that is affordable to the local economy, that we are in countries that have high growth in demand and encourage inward foreign investment, and that our plants are well situated close to the major centres of demand. We do, of course, require all the necessary legal and contractual safeguards in our offtake contracts, but our best guarantee of long-term contractual security is the economic viability of the power plant in the local economy in which it operates.

Fuel type



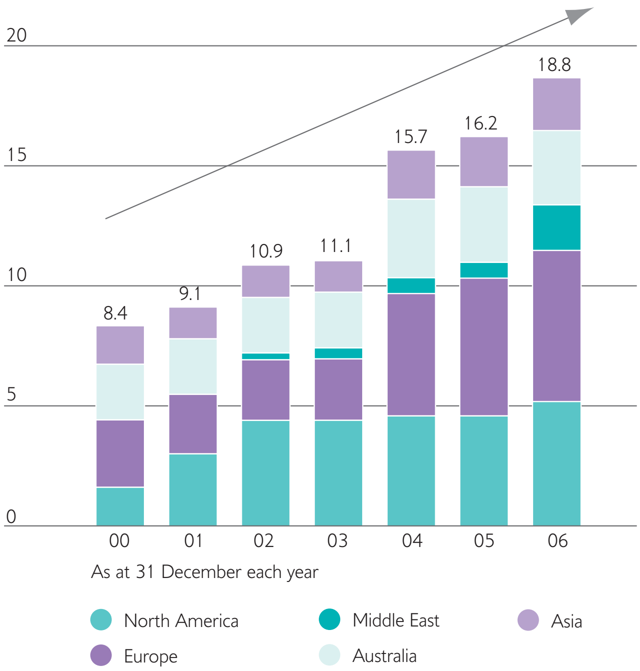
Contract type*



* 2007 full year position as at 20 February 2007 and excludes assets under construction.

We review very carefully market fundamentals before making any investment in new markets. We consider entering into alliances with other companies through partnerships, if we believe such alliances will enable us to implement our strategy, in relation to particular markets or more generally. We ensure that all acquisitions and greenfield projects are quickly and efficiently integrated into our regional business structures. The expected returns from the acquisitions are built into regional business performance targets and we measure delivery against these targets at a regional and Group level through growth in profit from operations, earnings per share (EPS) and free cash flow.

International Power's net generation capacity (GW)



Our overarching criterion, irrespective of the market structure in which we operate, is that our investments make money for our shareholders over the long-term. We subject new investment opportunities to rigorous evaluation criteria, with a focus on the following elements:

- **Financial return** New investments must meet stringent financial return criteria. We use a range of financial criteria in our project evaluations including assessing the effect of the transaction on our financial key performance indicators (KPIs); profit from operations, EPS and free cash flow, but the fundamental principle is that we must reasonably believe any prospective capital investment will yield, on an after-tax cash flow basis, a return (adjusted for risk) in excess of our estimated cost of capital. As part of this evaluation, we test investment projections to ensure that they are both reasonable over the life of the investment and balanced in terms of timing of cash flow, based on realistic assumptions.
- **Market suitability** We intend to invest in countries that have a track record of respecting foreign direct investment, that offer a significant opportunity for future investment and growth, have strong market fundamentals in terms of demand/supply balance and that complement our portfolio of assets.
- **Degree of control** We focus our investments where we have a controlling share or are otherwise able to contribute directly to the realisation of projected return on investment. Generally we do not intend to make passive investments. In some cases we have agreed to share management control of our investments where we have partners that have complementary or similar commercial, technical and operating expertise.

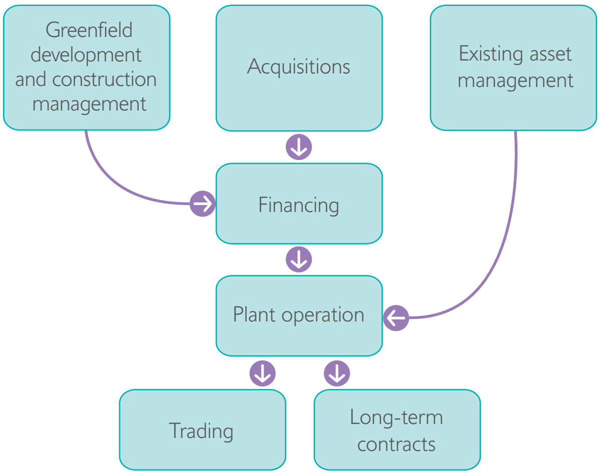
With non-recourse project debt as a fundamental building block, our capital structure is prudently balanced to provide us with the flexibility to carry out growth initiatives without overstretching our financial resources. We have access to multiple financial resources – including strong cash generation from our portfolio, our borrowing facilities and capacity, and our partnering capabilities – to execute selected opportunities which meet our stringent investment criteria.

In addition to pursuing the development and acquisition of single assets, we will also seek to acquire portfolios of generation assets if they become available on attractive terms.

In conjunction with our focus on value enhancing growth opportunities, we also remain committed to delivering free cash flow needed to fund that growth and, of course, our dividend policy.

Our capabilities

Our core capabilities for implementing our strategy can be categorised into the following seven areas:



International Power's high quality asset portfolio, together with the capabilities of our teams around the world, forms a strong combination for revenue optimisation, effective risk management and future growth in earnings and cash flow.

International Power has in-depth experience in plant operations and engineering. This not only ensures smooth plant operations, but also ensures that we understand all operational and technical issues relating to the potential acquisition or development of new power plants. Today, the Group has skills to execute power projects right from inception through to the delivery of power in the most advanced and complex traded markets of the world.

Greenfield development and construction management We have excellent experience of developing large capital intensive infrastructure projects – from selecting the appropriate site to securing multiple government/stakeholder approvals and project managing the entire construction programme right through to successful commercial operation. International Power's successful growth in the Middle East is the most graphic example of our greenfield development expertise, where, in the six years from 2000 to 2006 the Company has developed and has an interest in six major projects with a total enterprise value of approximately £4 billion.

Acquisitions We have demonstrated our ability to execute acquisitions at the right time and at the right value, together with the capability to integrate quickly and seamlessly newly acquired assets into the portfolio. An excellent example of International Power's acquisition capabilities is the successful purchase of the EME international asset portfolio, in association with Mitsui, which was completed in late 2004. The portfolio has since met or exceeded financial and operational performance targets. Other examples are the acquisitions of Saltend (UK) in 2005, and Coleto Creek (Texas) in 2006.

Financing Given the very capital intensive nature of our business, the ability to fund projects is vital for success. International Power has consistently proven its financing capabilities through the execution of numerous greenfield and acquisition financings, together with refinancings of existing assets. We have completed this in different parts of the world, under different circumstances and through the combined use of local and international capital. As examples, Shuweihat S1 and Umm Al Nar, two power and water projects in the Middle East, were both financed in a challenging geopolitical environment, and Saltend, when acquired in 2005, was the first merchant plant in the UK to be project financed with non-recourse debt in over five years. In 2006 we refinanced Rugeley power station in the UK and successfully put in place project finance for the acquisition of Coleto Creek in Texas. Non-recourse project finance is at the core of International Power's financing strategy and capital structure – this provides the most appropriate level of debt for each asset and also excellent risk mitigation for the Group.

Plant operations We have comprehensive power station operational experience and skills. Through-life engineering and maintenance plans, meticulously implemented, ensure maximum availability and are key for delivering value in both our merchant and long-term contracted markets. Effective plant operations are enhanced by ensuring information is shared around the portfolio and key operational staff are rotated to different assets on a regular basis. Safe behaviour is a cornerstone of International Power's operations, and we share best practices across the portfolio to ensure all of our assets operate to the highest possible safety standards.

Umm Al Nar, UAE

Long-term contract expertise We have strong commercial skills to structure and negotiate long-term power and water contracts in regulated markets such as Asia and the Middle East. Under these contracts, key cost risks such as fuel and turbine maintenance are mitigated through long-term hedging and supply arrangements. Overall, the contracts provide visibility and stability of earnings and cash generation over the long-term.

Trading We operate in a number of merchant markets. We have developed the skills necessary to maximise our returns in these markets, with a practical focus on co-ordinating trading and operations to ensure we optimise our returns by having our plant available whenever our trading teams see value. For us, trading predominately means selling the physical output generated by our plants. Our traders operate within strict guidelines and risk policies to ensure our traded position is carefully monitored and managed. This includes matching fuel purchases with power sales and carrying out only a very limited amount of non-asset backed trading. Where possible we will forward sell output if we consider the return is favourable, which provides some certainty for near-term earnings and cash flow. We also ensure that lessons learnt in any particular market – for example experience of the environmental legislation in Europe relating to CO_2 allocations – are shared across the business.

Existing asset management All our investments have to deliver performance targets on a standalone basis first, and then as part of the regional and global portfolio. Through regular and robust technical, commercial and financial reviews, the corporate headquarters and regional offices together monitor the performance of each asset in the portfolio. We work to ensure that we maximise fleet efficiencies where we operate plants with similar technologies, for example through global spare parts supply agreements or by bringing certain engineering services in-house. In addition, we have a Health, Safety and Environment Committee which co-ordinates the Group's activities and enables best practices to be adopted at all plants. This co-ordinated approach helps us manage operational risk and extract the full portfolio benefits.

Guiding philosophy

Our capabilities are underpinned by our core values which form the guiding philosophy for everyone within International Power. Our corporate values are set, reviewed and refreshed by representatives from assets and regional offices around the world. They are:

Financial discipline

Integrity of communication

Respect for the individual

Safe behaviour

Team first culture

Spanish Hydro, Spain

Coleto Creek, Texas

Our approach to risk and risk management

International Power's principal activities are the development, acquisition and operation of power generation plants together with closely related activities, such as desalination and district heating. These principal activities are supported by a number of local, regional and corporate offices which carry out activities such as trading and treasury operations. All of these activities have inherent risks.

Our general approach to risk management and risk governance is set out below. This is followed by a description of the principal risks faced by the business.

Risk management framework

Our risk management philosophy is designed to deal with the diverse nature of our asset base. International Power owns, or has equity stakes in, over 40 plants and businesses located in 20 countries on four continents. Our portfolio contains all major technologies and fuel types with the exception of nuclear power. In terms of age, our plants range from those which entered service in the 1950s through to those still under construction. Overall, the majority of the portfolio entered service less than 15 years ago. Politically and economically the portfolio is similarly diverse, having a presence in developed and developing countries, with a variety of cultural, political and legal systems.

To reflect the profile of our business we have developed a system that contains both bottom up and top down elements to identify and manage risks.

Corporate level	Policy, delegations and exposure limits are set at the corporate level, with the Board of Directors taking ultimate responsibility. Acceptable business practices and health, safety and environmental standards are set centrally.
Regional business	Market and trading risks are managed regionally within the framework set at corporate level. Political risks are also managed regionally with support from the corporate centre.
Business units	Risk assessments and action plans are mainly business unit based. Health, safety and environment compliance activities are also managed at asset level, albeit within a central policy framework. Business managers are accountable for managing the risks within their areas of responsibility. This principle also applies to managers of corporate functions.

Hub, Pakistan

There is a continuous process for identifying, evaluating and managing the key risks faced by the Group. Activities are co-ordinated by the Risk Committee, which is chaired by the Chief Financial Officer (CFO) and comprises Executive Directors, other regional directors and senior managers. The Risk Committee has responsibility, on behalf of the Board, for ensuring:

- the adequacy of systems for identifying and assessing significant risks;
- that appropriate control systems and other mitigating actions are in place;
- that residual exposures are consistent with the Company's strategy and objectives.

During the business planning process, each business unit and functional group identifies and assesses the key risks associated with achievement of its principal objectives and assesses their impact. These assessments are conducted by all material entities. During the year, significant changes in the risk profile are highlighted through the business performance reporting process.

The centrepiece of our risk management activities is an annual, Group-wide, risk review. This is based on the outcome of the business planning exercise, updated as necessary to take account of 'post business plan' events. The assessments are synthesised into a Risk Report that identifies all the principal risks and which is reviewed by the Risk Committee. Where risks are considered to exceed the Company's risk appetite, the Risk Committee directs which actions are to be taken. The Risk Report is reviewed by the full Board and the Audit Committee. Schematically the annual Risk Report system functions as follows:

In order to compare risks across the Group on a systematic basis we segment our activities as shown below. In reality, certain exposures interact and other exposures apply to more than one 'risk area' (for example regulatory risk applies to all of our activities). Such cross-segment risks are assessed in each of the areas in which they occur.

- Financial risks
- Market and trading risks
- Fuel supply risks
- Country and political risks
- Construction and operational risks
- Health, safety and environmental risks
- Staffing and HR risks

Principal risks and exposures

Financial risks

Our business can be subject to financial volatility. This can originate from a number of sources, including project company and counterparty related events. One example is the insolvency of TXU Europe in 2002 which resulted in the termination of the Rugeley Tolling Agreement (a long-term agreement to purchase coal and sell power), which caused a shortfall in revenues for that asset. Our capital structure is designed to address these risks.

At the corporate level we have a number of loan facilities which provide us with a prudent level of financial headroom (cash plus outstanding credit lines, less known obligations) which can be applied to any aspect of our business should the need arise. These facilities will meet the short to medium-term funding requirements envisaged by the business. Longer-term funding requirements or funding for a particularly large transaction (e.g. the acquisition of the EME international asset portfolio in 2004) may be sourced from a combination of these facilities and suitable long-term instruments, such as bonds or by raising additional equity. The actual choice of funding instrument(s) will depend on market conditions at that time.

In merchant markets we are sometimes required to provide trading credit support for our trading operations. Fuel and electricity markets periodically experience sharp price movements. When price movements occur this has an immediate knock-on effect on our trading credit

- We own or have equity stakes in over 40 plants and businesses in 20 countries on four continents
- Overall, the majority of our portfolio entered service less than 15 years ago
- There is a continuous process for identifying, evaluating and managing key risks faced by the Group
- The centrepiece of our risk management activities is an annual, Group-wide risk review

support requirements, which can be volatile as a consequence. The maintenance of financial headroom offers protection against escalating margin calls (payments we are required to make when power prices increase above the contract price).

Project development can, on occasions, require credit support. This support can take the form of parent company guarantees or credit support instruments issued by banks. In the unlikely event that credit support facilities are unavailable to support the growth developments that we are planning, this could require us to reduce our development activities. We consider it highly unlikely that we will have to forego opportunities as a result of this constraint due to the prudent level of financial headroom that we maintain and the availability of additional bilateral facilities with banks.

At the individual business level we finance our projects with non-recourse debt. We use non-recourse finance as this insulates the Group from adverse events occurring at the project level, limiting our balance sheet exposure to a given project to the loss of the equity in that project. Other financial exposures and their mitigants are set out below.

Counterparty risk

We manage our credit exposure to trading and financial counterparties by establishing clearly defined limits, policies and procedures. Energy trading activities are strictly monitored and controlled through delegated authorities and procedures, which include specific criteria for the management of credit exposures in each of our key regions. With respect to our treasury activities, the financial counterparty credit exposure is limited to arrangements with relationship banks and to commercial paper that has an investment grade credit rating.

Counterparty exposures arising from sale and purchase agreements with our customers are monitored and managed locally with assistance from Group treasury. In addition, Group treasury manages the consolidated (Group-wide) counterparty credit positions, with the active involvement of the global risk manager.

Currency and interest rate exposures

Project company borrowings are normally made in the project company's functional currency. Hence exchange rate fluctuations do not affect the financial stability of our assets. In countries with historically weak currencies we aim to have power purchase agreement (PPA) tariffs denominated in a major international currency. This protects future returns against large and rapid devaluations.

Variability in interest payments can introduce further volatility into project returns. We mainly mitigate this risk by fixing borrowing rates, principally by using interest rate swaps. A limited number of our PPAs also have interest rate pass through mechanisms. Overall, 77% of our borrowings were protected from interest rate fluctuations in these ways, at the end of 2006.

In order to hedge the net assets of non-UK operations, borrowings are generally in the same currency as the underlying investment. The Group aims to hedge a reasonable proportion of its non-sterling assets in this way. It is not our policy, however, to hedge currency translation exposures through foreign exchange contracts or currency swaps. This exposes our sterling profits and our balance sheet assets and liabilities to fluctuations that are not related to underlying business performance.

For 2006 and 2005 average and year-end sterling rates for major currencies, which are significant to the Group, were:

	Average		At 31 December	
	2006	2005	**2006**	2005
US dollar	**1.85**	1.82	**1.96**	1.72
Australian dollar	**2.44**	2.39	**2.48**	2.34
Euro	**1.47**	1.46	**1.48**	1.46
Czech koruna	**41.51**	43.56	**40.85**	42.27

When one of our projects makes sales and purchases in a currency other than its functional currency this gives rise to a currency transaction exposure. Transaction exposures also arise when dividends or other funds are remitted from our overseas companies. We match transaction exposures in advance where possible, and hedge any unmatched transactions as soon as they are committed. We use foreign currency contracts and similar instruments for this purpose.

Investment structures and contingent liabilities

Going forward, the complexity of the Group and its investment structures, together with the rapidly growing body of tax legislation, will make tax planning and forecasting an increasingly complex and uncertain process. We closely monitor actual and potential changes in tax legislation in order to assess the continued effectiveness of our corporate structures and financial planning assumptions. We are supported by a major global specialist firm in making these assessments.

International Power has a number of contingent liabilities. These arise from certain tax planning assumptions that are not yet confirmed by the relevant fiscal authorities and from ongoing legal actions, one of which dates back more than a decade. We have fully provided for all sums that we believe will become due.

Funding of pensions obligations

The Group operates a number of defined benefit pension schemes. These schemes guarantee their members that they will receive pensions related to their final salary at retirement, which gives rise to a risk that our pension funds will not be sufficient to meet these obligations. This risk crystallised during the first part of the decade as share prices fell worldwide and more onerous actuarial valuation assumptions were mandated by government. The Group's defined benefit pension funds recorded a deficit of £15 million when they were last reviewed, and actuarial assumptions updated, in December 2006. Whilst this is not large compared to a number of other UK groups, the adequacy of our pension funds will remain an area of focus for some time.

In order to address this we have increased the level of contributions. Furthermore, the comparatively small number of staff within our defined benefit pension schemes (approximately 1,400 as at 31 December 2006) significantly reduces the level of our potential exposure relative to many other FTSE 100 companies.

Financial processes

We consider that we have an appropriate and robust internal control system. During the past year our systems of financial control have been subject to a comprehensive review to meet the requirements of Section 404 of the US Sarbanes-Oxley Act. We anticipate that the systems will meet the standards of this Act and the rules that have been developed during its implementation.

In order to identify variances to our forecasts in a timely manner and provide an early warning of changing circumstances, we monitor a number of performance indicators. The principal financial KPIs are profit from operations (PFO), EPS, and free cash flow, details of which are set out on pages 20 to 22.

Insurance risk management

Our risk management processes assist us in the identification of events that can be partly or entirely mitigated through use of insurance, or which we can self-insure. Risks that we insure include business interruption, Directors' and officers' liability and property damage. Insurance providers recognise the robust nature of our processes and this is reflected in the cost of our policies.

Market and trading risks

A significant number of the projects in which we have an interest operate without PPAs and are, therefore, vulnerable to market forces, which determine the price and amounts of power sold and fuel purchased. In particular, the majority of our plants in the UK, North America and Australia operate on a merchant basis. In order to limit our exposure to market movements, we hedge a proportion of our anticipated output by forward selling power and buying forward related commodities including fuel, transmission rights, capacity and emission credits. The key risks facing our market and trading activities and their mitigants are set out below.

Hedging activities

Unhedged output is subject to price and volume volatility. To reduce this uncertainty, we operate a 'rolling hedge' programme under which we increase the proportion of output that is sold forward as the production date approaches. As at 20 February 2007 around 90% of expected output at Rugeley and Saltend was contracted for 2007 and approximately 80% for 2008. In Texas 60% of our expected output at Midlothian and Hays, and 95% at Coleto Creek, has been forward contracted for 2007 and for our Blackstone and Bellingham, New England plants, 55% has been forward contracted. In Australia, both Loy Yang B and Hazelwood are highly contracted for 2007, with 85% and 75% of output sold forward respectively. Due to market liquidity considerations the majority of our hedging activity is for a maximum period of two years ahead.

It is not always possible to achieve an exact match between power sales and purchases, and the purchases and sales of related commodities. Mismatched positions have the potential to result in substantial losses. This potential exposure is addressed in our trading policies, which do not allow us to take significant unmatched positions.

In addition to asset-backed trading we carry out some proprietary trading (trading not linked to the expected output of our power plants). Our proprietary trading activities are limited in scope and any exposures are correspondingly small.

Framework for trading activities

Our trading activities operate within a robust framework of policies and oversight functions. Trading and forward contracting strategies are continually reviewed by regional and corporate trading and risk management professionals, to ensure they are best suited to both local market conditions and corporate risk guidelines. Company-wide oversight of our trading operations is provided by a global commodities risk committee (GCRC) which includes the Chief Executive Officer (CEO), the CFO, and the global trading and risk managers. The GCRC acts under the authority of the Board, and delegates limits and authorities to local risk committees, which have been established in each of our trading operations to oversee the management of the market, operational and credit risks arising from our marketing and trading activities. The local risk committees include the trading manager, global and local risk managers, Directors and senior managers.

Energy market risks and counterparty exposures on our asset and proprietary portfolios are measured and managed using various statistical techniques.

Midlothian, Texas

Investments in new projects

When we invest in assets that operate, or will operate, on a merchant basis we make assumptions regarding long-term spreads. There is a large degree of uncertainty in these forecasts, which include assumptions concerning:

- supply and demand characteristics;
- new entrant economics used to forecast power prices from the date at which new capacity is required;
- market and environmental regulation, particularly the cost of carbon dioxide (CO_2) allowances and limits on other emissions;
- correlations between power prices and fuel prices.

We carry out detailed investigations and develop sophisticated market models prior to investing in new merchant plants.

Fuel supply risks

Fuel supply security is fundamental to our business. Most of our markets have robust supply infrastructures, and other measures that further enhance our position. These include: mines local to the power plant, fuel storage, dual-fuel capability and sourcing from a number of reputable suppliers. Consequently, we have experienced very few supply interruptions that have had an impact on operations, and none that have had material adverse effects on financial performance.

We procure fuel under a variety of contractual arrangements ranging from long-term fuel supply agreements (FSAs) to on-the-day merchant gas purchases. The principal determinant of our fuel supply activity is the need to match purchases to power sales, both in terms of volume and price. Hence, we operate long-term FSAs at assets where we have long-term PPAs and predominantly merchant supply arrangements in our merchant power markets.

It is not always possible to achieve an exact balance between fuel purchases and power production. This is particularly an issue for our projects with PPAs, where the associated FSAs often have minimum fuel purchase obligations. By structuring the purchases flexibly and incorporating appropriate force majeure protection, we are able to mitigate this risk to ensure as far as possible that the price and volume obligations in the PPA and FSA mirror one another.

Country and political risks

Most of our projects with PPAs are in countries with some degree of country risk. In the past, some PPA tariffs have been reopened by our offtakers and renegotiated. We do not currently foresee the prospect of further renegotiations but this remains a possibility.

We address country risk exposures in several ways. Country risk assessment is an important element of our due diligence prior to participating in a project and we favour projects where international arbitration is available for resolving disputes. Once projects are operational, International Power always strives to be a 'good neighbour', supporting the local, regional and national communities wherever possible. We also attempt to maintain good relationships with political institutions and our customers.

The size of our portfolio dilutes the effect of a dispute, at any given asset, on the Group as a whole. Furthermore, non-recourse debt arrangements limit our financial exposure to the loss of our equity investment and the future cash flows from the project. Thus, whilst the loss or impairment of a project would affect the financial performance of the Group, other operating companies would remain unaffected.

Construction and operational risks

Costs of new power plants are significant, and the build phase has programme (delayed completion) and technical performance risk. It is our policy, wherever possible, to award major projects on an engineering, procurement and construction (EPC) basis to suitably qualified contractors. EPC contracts transfer the majority of the design and construction risks to the contractor, and provide substantial protection through liquidated damages, in the event of failure on the part of the contractor to meet contractual completion or plant performance targets. We supplement this contractual protection with insurances.

As with many other industrial sectors, the power plant sector has consolidated over the past two decades. Whilst there is currently a competitive market, further consolidation could change this situation, increasing prices and reducing our ability to secure commercial protection within EPC contracts. We would also be exposed to concentration risk, becoming dependent on a very small number of suppliers for replacement parts, overhaul and maintenance contracts. Currently we have long-term relationships with a number of original equipment manufacturers across our fleet, including Alstom, General Electric, Mitsubishi and Siemens.

Power plants are characterised by extremely high temperatures, pressures, rotational velocities and voltages. Providing a safe environment for people on our sites and in surrounding areas is a major priority. We achieve this by a combination of engineering and operational procedures and standards, provision of training, performance monitoring and by employing experienced staff.

ISAB, Italy

We are a minority partner in a number of projects and do not set operational standards in all cases. In such circumstances we provide support where appropriate and attempt to use our influence to achieve standards that are equivalent to our own. However, our ability to influence partners varies.

During the build period we closely monitor the progress of four major factors: construction programme, cost, quality and safety. Once a plant is in operation we monitor performance by reference to a number of performance indicators, including the technical availability KPI, which is a measure of reliability.

Health, safety and environmental (HS&E) risks

Poor health, safety and environmental performance has the potential to adversely affect our business. Risks range from enforced plant closures and substantial fines to damage to the well-being of our staff and to our reputation in the wider community.

HS&E compliance activities

At plant level, HS&E requirements are set by local and national standards and regulations, and individual plants operate within site specific environmental licensing limits. We have an ongoing HS&E audit programme to provide assurance in this area and we closely monitor accident frequency rate (AFR) statistics and breaches of environmental permits. AFR and reportable environmental incidents are amongst our KPIs.

Plant operating and monitoring procedures are effective in ensuring that we comply with the conditions of our environmental licenses and consents. Whilst we have experienced occasional breaches of our environmental operating limits, there have been no recent incidents that have posed a significant threat to the environment or to our ability to run our plants.

Sites are required to adhere to a set of corporate health and safety standards and to local regulations. Health and safety performance is the responsibility of our plant managers, who are supported by local health and safety specialists. Our global health and safety manager is responsible for ensuring that our corporate standards remain current and are understood by all of our sites.

Global warming and development of environmental regulation

Environmental legislation is one of the key drivers of the long-term development of the electricity industry. Initiatives to reduce greenhouse gas emissions are expected to increasingly restrict our ability to emit CO_2, and hence our ability to use fossil fuels to generate power without the use of carbon capture and storage. The impact of carbon reduction measures is currently most apparent at our European plants, where we are required to ensure that we have sufficient carbon credits to support our expected levels of generation. Certain of our projects have change of law protection, which enables us to pass on any carbon costs to the offtaker. In such cases carbon risk is removed.

In the US and Australia there are active discussions at both the state and federal level that could lead to CO_2 limitations being introduced some time in the future. The absence of single, centrally sponsored, debates increases the unpredictability of final outcomes. At the global level there is uncertainty over what, if anything, will replace the Kyoto convention on climate change when it expires at the end of 2012.

Most governments in developed countries have introduced legislation to incentivise renewable generation to the point where growth in renewable generation may have a material impact on our fossil fuelled plants. In response, we made a major investment in renewable energy during 2006 and we are implementing clean coal and carbon capture technology at Hazelwood.

We have also dedicated resources to reviewing technology trends in order to ensure that we are well positioned to participate in the drive towards a lower carbon environment.

Staffing and HR risks

The power industry has a history of long-term employment at plant and corporate level and staffing is not generally a day-to-day risk issue.

Our industry is highly competitive and we have to balance resources against the need to contain costs. We utilise our extensive experience to make these judgements and have the ability to mobilise people at short notice to mitigate the risk of loss of key staff. To date we have not experienced any disruption of note as a result of unexpected staff unavailability.

We anticipate that terrorism will remain a threat to our staff and assets for the foreseeable future. In order to reduce this threat we liaise with local law enforcement organisations on security issues and our corporate security specialist assists vulnerable sites to assess and reduce their exposures. We also utilise the services of a global security consultancy to ensure that our risk assessments and physical security measures fully reflect local conditions. The consultancy additionally has the capacity to provide personal security services if required.

Certain of our sites are highly unionised. We have not been affected by industrial action for several years but this remains a risk. We maintain active dialogues with staff unions to ensure that we are aware of any potential issues in good time to mitigate our risks.

Key performance indicators and financial highlights

Key performance indicators (KPIs)

We use a range of performance indicators, both financial and non-financial, to measure both the delivery of the Company's strategic objectives and to manage the business. The most important of these measures are considered KPIs and their targets are determined annually during the business planning process. The KPIs are used by management to compare actual performance during the year, and the latest monthly forecasts, against the annual budgeted targets. Our KPIs, both financial and non-financial, are set out below.

Financial KPIs	Non-financial KPIs
Our financial key performance indicators address two key aspects of the business, its profitability and its cash generation:	Our non-financial key performance indicators address other aspects of the business: safety, environmental and operational performance:
Profit from operations (PFO)*	Accident frequency rate (AFR)
Earnings per share (EPS)*	Reportable environmental incidents
Free cash flow	Technical availability

* Financial KPIs are presented excluding exceptional items and specific IAS 39 mark to market movements

The explanations of our KPIs are as follows:

Profit from operations (PFO)

PFO is a measure of the operating profitability of the Group. It excludes the impact of all non-operating costs from subsidiaries, including financing costs and income tax expense, and therefore provides a comprehensive measure of operational and financial performance. We consider PFO excluding exceptional items and specific IAS 39 mark to market movements to be an appropriate indicator of performance, as this measure: excludes significant items which, by virtue of their size or incidence, could potentially distort year-on-year comparisons; allows a better understanding of the financial information presented, and specifically the Group's underlying business performance by excluding fair value movements on economic hedges; and assists shareholders and analysts who have expressed a preference for the reporting of results without the inclusion of the effects of exceptional items and specific IAS 39 mark to market movements. Presenting the Group's segment and total PFO excluding exceptional items and specific IAS 39 mark to market movements is consistent with the way management measures the Group's performance in its budgets, forecasts and management accounts on a day-to-day basis. PFO excluding exceptional items and specific IAS 39 mark to market movements is presented in the consolidated income statement on page 79. The results of this KPI for 2005 and 2006 and the objective for 2007 are set out on page 22.

Earnings per share (EPS)

EPS is a measure of the overall profitability of the Group and shareholder returns. It is defined as the profit in pence attributable to each Ordinary Share in the Company, based on the consolidated profit for the year, after deducting tax, minority interests, and when applicable, preference share dividends. The calculation is shown in note 11 to the financial statements. Growth in EPS over time is indicative of the ability of the Group to add value. We consider EPS excluding exceptional items and specific IAS 39 mark to market movements as an appropriate indicator of performance as it: excludes significant items which, by virtue of their size or incidence, could potentially distort the year-on-year comparison; allows a better understanding of the financial information presented, and specifically the Group's underlying business performance by excluding fair value movements on economic hedges; and assists shareholders and analysts who have expressed a preference for the reporting of results without the inclusion of the effects of exceptional items and specific IAS 39 mark to market movements. This is consistent with the way management measures the Group's performance in its budgets, forecasts and management accounts on a day-to-day basis. The results of this KPI for 2005 and 2006 and the objective for 2007 are set out on page 22.

In 2005 we reported this KPI as EPS before exceptional items. We have changed the basis of measurement in 2006 to reflect how we now measure underlying business performance before both exceptional items and specific IAS 39 mark to market movements.

Financial KPIs

- Profit from operations*
- Earnings per share*
- Free cash flow

Non-financial KPIs

- Accident frequency rate
- Reportable environmental incidents
- Technical availability

* Financial KPIs are presented excluding exceptional items and specific IAS 39 mark to market movements

Free cash flow

Power generation is a capital intensive business and hence it requires the assets within the Group to generate sufficient cash to repay the initial investment in the assets, to provide returns for shareholders and to provide funds for future investment opportunities. We define free cash flow as net cash flow from operating activities excluding exceptional cash flows associated with items recorded as exceptional in the income statement, and capital expenditure for growth projects (which enhances the economic benefits of the Group). Free cash flow includes capital expenditure to maintain the operating capability of the Group (by replacing or restoring individual assets or components), interest, and tax.

We consider this measure of cash flow to be a key indicator of business performance as it measures the cash generated from underlying business performance from continuing operating activities. This is consistent with the way management measures the Group's performance in its budgets, forecasts and management accounts on a day-to-day basis. The derivation of free cash flow and the results of this KPI for 2005 and 2006 are set out on page 22.

Accident frequency rate (AFR)

Health and safety is of vital importance in our business. Not only is it important to provide employees with a safe place to work, any accident is disruptive to the running of the business. AFR is the normal reporting standard and is defined as the number of lost time accidents (LTAs) divided by the number of hours worked, multiplied by 100,000. A LTA is an accident where an individual is away from work for more than one day and is an auditable indicator across a number of industries.

In 2005 the AFR for employees and contractors combined was 0.23. In 2006 there was a very strong improvement to 0.12. International Power intends to consolidate this by establishing a target of 0.12 for 2007. This does not mean we tolerate unsafe behaviour; we seek to have zero LTAs but targets need to be realistic and challenging. The data underlying these calculations is submitted by individual plants directly into the corporate reporting system.

Reportable environmental incidents

The environment and how we care for it is central to the business of International Power and we have always had a policy commitment to comply with all applicable environmental regulations. One measure of our compliance with this policy is compliance with environmental licences for our power plants, issued by the relevant statutory authorities. Environmental licences require that any environmental incident is reported. The underlying data is submitted by individual plants directly into the corporate reporting system. The results of this KPI for 2005 and 2006, and the objective for 2007 are set out on page 22.

Technical availability

Technical availability measures when a plant is available for dispatch. Each of our plants will generally be unavailable during some periods in the year due to a combination of planned outages for maintenance and unplanned outages due to plant breakdowns or operational problems.

An important part of our business is ensuring that our trading and power purchase agreements are closely aligned to our operational activities and availability planning is a key factor in this regard. The year-to-year variance in the profile of planned outages influences both the achieved and targeted availability. Technical availability is calculated by first determining the potential maximum amounts of electricity that could be generated in the year if all the plants were operated at full output for the entire year. We then deduct from this the electricity that could not be produced due to planned and unplanned outages that occurred at the plants throughout the year. This number is then expressed as a percentage of the potential maximum electricity that could be generated, where all these quantities are calculated in terms of electrical energy (GWh). This calculation is carried out using data submitted by the individual plants directly into the corporate reporting system. The results of this KPI for 2005 and 2006, and the objective for 2007 are set out on page 22.

Pelican Point, South Australia

Key performance indicators	2005 Result	2006 Result	2007 Objectives
Financial KPIs			
Profit from operations* (PFO)	£536 million	£773 million	To increase on prior year
Earnings per share* (EPS)	14.6p	22.4p	To increase on prior year
Free cash flow	£285 million	£456 million	To increase on prior year
Non-financial KPIs			
Accident frequency rate (AFR)	0.23	0.12	0.12
Reportable environmental incidents	16	16	10
Technical availability	90.1%	89.6%	90.0%

* Excluding exceptional items and specific IAS 39 mark to market movements

Financial highlights

The financial information included in the consolidated financial statements has been prepared on the basis of all applicable IFRSs as adopted by the EU. A discussion of the policies we believe to be most critical in considering the impact of estimates and judgements on the Group's financial position and results of operations are set out on pages 42 and 43.

In order to allow a full understanding of the financial information presented within the consolidated financial statements, and specifically the Group's underlying business performance, the Group presents its income statement such that it separately identifies:

- the results excluding exceptional items and specific IAS 39 mark to market movements;
- the effect of the exceptional items and specific IAS 39 mark to market movements;
- the total result.

The basis of preparation is outlined more fully in note 1 to the consolidated financial statements. However, in summary, those items that the Group separately presents as exceptional are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order to obtain a proper understanding of the financial information. Those items that the Group separately discloses as specific IAS 39 mark to market movements are those mark to market movements recorded in the income statement which relate to: derivative contracts into which the Group has entered in order to economically hedge certain of its physical and financial exposures; and fair value gains and losses on equity conversion features embedded within convertible bonds, so as to separately identify a non-cash movement which, if the conversion option is exercised, will ultimately be extinguished by the issue of equity.

A summary of the Group's financial performance during the year is as follows:

Income statement

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Excluding exceptional items and specific IAS 39 mark to market movements		
Revenue (including joint ventures and associates)	**3,645**	2,980
Profit from operations		
- from subsidiaries	**565**	345
- from joint ventures and associates	**208**	191
Profit from operations	**773**	536
Interest	**248**	202
Profit before tax	**525**	334
Tax	**122**	68
Profit for the year	**403**	266
Minority interests	**71**	52
Profit attributable to equity holders of the parent	**332**	214
Earnings per share (basic)	**22.4p**	14.6p
Including exceptional items and specific IAS 39 mark to market movements		
Profit from operations	**898**	611
Profit for the year	**477**	330
Profit attributable to equity holders of the parent	**410**	285
Earnings per share (basic)	**27.6p**	19.4p

Cash flow

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit for the year	**477**	330
Depreciation, amortisation and other movements [1]	**322**	183
Dividends received from joint ventures and associates	**113**	92
Capital expenditure – maintenance	**(128)**	(72)
Movements in working capital	**(15)**	(21)
Net tax and interest paid	**(313)**	(227)
Free cash flow	**456**	285

[1] Depreciation, amortisation and other movements include income statement charges for interest, tax, depreciation, the share of profit of joint ventures and associates, the exceptional profit on the TXU settlement, and the exceptional profit on compensation for breach of contract.

Balance sheet

	As at 31 December 2006 £m	As at 31 December 2005 £m
Net assets	**2,740**	2,375
Net debt	**(3,485)**	(2,979)
Gearing	**127%**	125%
Debt capitalisation	**56%**	56%

Milford, Massachusetts

Profit from operations (PFO)

2006 PFO (excluding exceptional items and specific IAS 39 mark to market movements) at £773 million is 44% ahead of 2005. This principally reflects improved spreads and load factors in New England and Texas, strong contributions from First Hydro, Rugeley, Saltend and our Czech businesses, and first time contributions from assets in the Middle East. PFO (excluding exceptional items and specific IAS 39 mark to market movements) is discussed in more detail in the Regional review sections which follow.

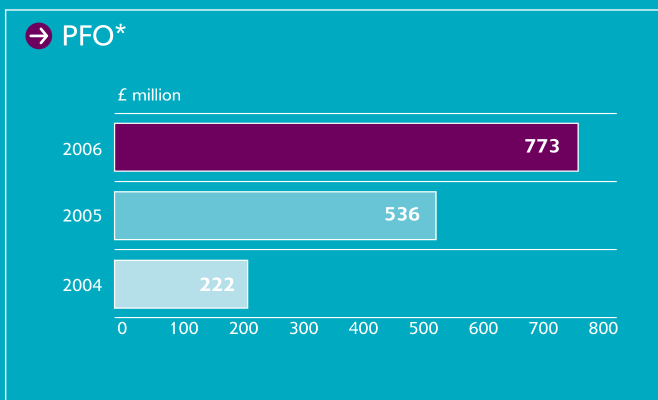
	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Reconciliation from PFO to PFO (excluding exceptional items and specific IAS 39 mark to market movements)		
Profit from operations	**898**	611
Deduct exceptional items (profits)	**(55)**	(110)
(Deduct gains)/add losses on specific IAS 39 mark to market movements	**(70)**	35
PFO (excluding exceptional items and specific IAS 39 mark to market movements)	**773**	536

Segmental results

	Subsidiaries	**Share of joint ventures and associates**	**Total**	Subsidiaries	Share of joint ventures and associates	Total
	Year ended 31 December 2006 £m	**Year ended 31 December 2006 £m**	**Year ended 31 December 2006 £m**	Year ended 31 December 2005 £m	Year ended 31 December 2005 £m	Year ended 31 December 2005 £m
Profit from operations (excluding exceptional items and specific IAS 39 mark to market movements)						
North America	**73**	**28**	**101**	21	27	48
Europe	**381**	**69**	**450**	229	54	283
Middle East	**32**	**20**	**52**	12	12	24
Australia	**121**	**3**	**124**	136	4	140
Asia	**3**	**88**	**91**	6	94	100
	610	**208**	**818**	404	191	595
Corporate costs	**(45)**	**–**	**(45)**	(59)	–	(59)
	565	**208**	**773**	345	191	536
Exceptional items and specific IAS 39 mark to market movements	**119**	**6**	**125**	68	7	75
Profit from operations	**684**	**214**	**898**	413	198	611

The regional performance is discussed in more detail on pages 26 to 37. Corporate costs are discussed on page 38.

TNP (Pluak Daeng), Thailand



Earnings per share (EPS)

2006 EPS (excluding exceptional items and specific IAS 39 mark to market movements) at 22.4p is 53% ahead of 2005. This increase principally reflects those items discussed under the heading 'profit from operations' and also reflects an increase in interest and tax expense (both of which are discussed on page 38).

Reconciliation from EPS to EPS (excluding exceptional items and specific IAS 39 mark to market movements)	**Year ended 31 December 2006 £m**	Year ended 31 December 2005 £m
EPS	**27.6p**	19.4p
Deduct after tax and minority interest profit impact of exceptional items	**(2.7)p**	(5.8)p
(Deduct)/add back after tax and minority interest (profit)/loss impact of specific IAS 39 mark to market movements	**(2.5)p**	1.0p
EPS (excluding exceptional items and specific IAS 39 mark to market movements)	**22.4p**	14.6p

Free cash flow

Free cash flow in 2006 at £456 million is 60% ahead of 2005. This increase was driven by strong operational and financial performance across the Group together with higher dividends from joint ventures and associates. This was partially offset by increased tax and interest payments (£86 million higher) and an increase in maintenance capital expenditure of £56 million.

Reconciliation from net cash inflow from operating activities to free cash flow	**Year ended 31 December 2006 £m**	Year ended 31 December 2005 £m
Net cash inflow from operating activities	**475**	338
Add back exceptional finance costs	**–**	5
Less exceptional receipt from TXU Administrators	**(14)**	(58)
Less exceptional receipt of compensation for breach of contract	**(5)**	–
Free cash flow	**456**	285

A review of liquidity is included on pages 38 and 39.

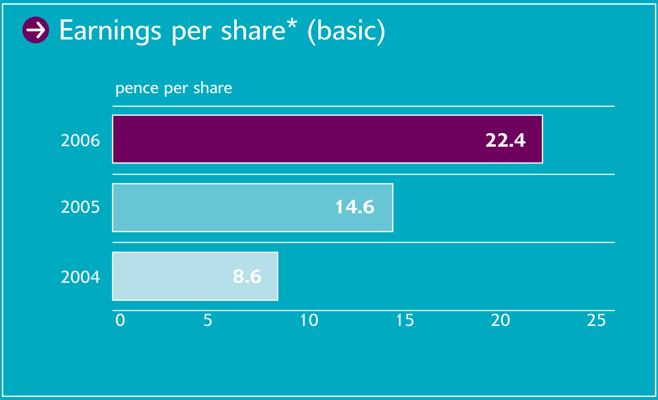
Dividend

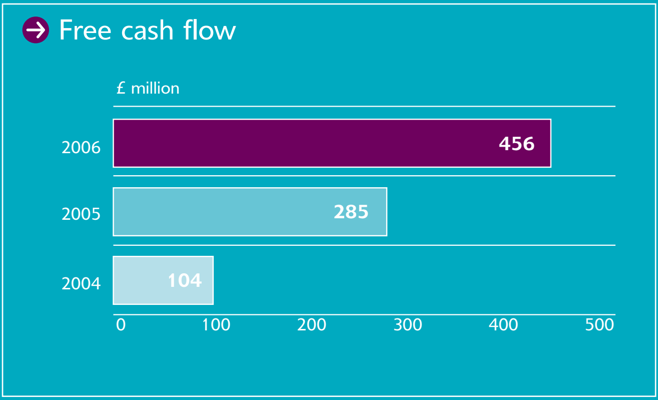
The Board is proposing a dividend of 7.9p per share (2005: 4.5p), an increase of 75% year-on-year and representing a pay-out ratio of 35% of EPS (excluding exceptional items and specific IAS 39 mark to market movements). This increase is in line with the Group's policy of progressively moving towards a dividend pay-out ratio of 40%.

Payment of this dividend to shareholders registered on the Company share register on 25 May 2007 is due to be made on 26 June 2007, following approval at the 2007 AGM, which will be held on 15 May 2007.

Outlook

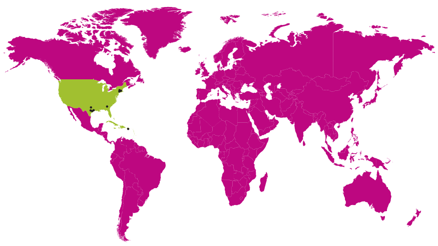
Our broadly based international portfolio has been strengthened by the successful integration of acquired assets and the addition of new greenfield projects commissioned in 2006, and provides a solid platform for our business. This, coupled with a largely forward contracted position for our merchant market capacity, gives us confidence that 2007 will be a year of further growth.





* Excluding exceptional items and specific IAS 39 mark to market movements.

Regional review North America



Profit from operations increased to £101 million compared to £48 million last year.

This increase in profitability was driven by an improved performance from the merchant assets and a first time contribution from Coleto Creek, which was acquired in July 2006. EcoEléctrica and the other contracted assets, Hartwell and Oyster Creek, also performed well delivering a consistent financial performance.

In Texas and New England, International Power benefited from increased output and improving spreads. At Midlothian in Texas, the achieved spread increased from $12/MWh to $14/MWh at a load factor of 60% compared to 55% in 2005. The Hays plant, which was mothballed until May 2005, delivered a full year of contribution with an average achieved spread of $14/MWh at a 55% load factor. In New England, the achieved spread increased significantly from $6/MWh to $12/MWh and our plants in the region ran at a 60% load factor compared to 40% in 2005.

The acquisition of the 632 MW coal fired Coleto Creek plant in Texas was successfully completed in July for a total consideration of $1.14 billion (£621 million). Since acquisition Coleto Creek has operated with excellent availability of 98% and at a load factor of 98% setting an all time annual generation record for this plant. Construction of the dust emission reduction equipment continues with completion expected in Q2 2007.

- Profit from operations increased to £101 million compared to £48 million last year
- Increased output and improved spread at merchant assets
- First time contribution from Coleto Creek, acquired in July 2006

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations	**111**	49
Exceptional items and specific IAS 39 mark to market movements – (profits)/losses	**(10)**	(1)
PFO (excluding exceptional items and specific IAS 39 mark to market movements)	**101**	48

	Fuel / Type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth)	Net capacity heat (MWth)
Assets in operation					
Hartwell, Georgia	Gas (OCGT)	310	155	–	–
Bellingham, Massachusetts [1]	Gas (CCGT)	570	570	–	–
Blackstone, Massachusetts [1]	Gas (CCGT)	570	570	–	–
Milford, Massachusetts	Gas (CCGT)	160	160	–	–
EcoEléctrica, Puerto Rico	LNG (CCGT)	524	183	–	–
Coleto Creek, Texas	Coal	632	632	–	–
Hays, Texas [1]	Gas (CCGT)	1,100	1,100	–	–
Midlothian, Texas [1]	Gas (CCGT)	1,650	1,650	–	–
Oyster Creek, Texas	Gas (Cogen/CCGT)	425	213	100 MWth	50 MWth
North America total in operation		**5,941**	**5,233**		

(1) Capacity shown for these assets is the nameplate capacity.

For 2007, approximately 55% of our expected merchant combined cycle gas turbine (CCGT) output in Texas and New England has been forward contracted and 95% of Coleto Creek's expected output for 2007 has also been forward contracted.

The Texas and New England markets continue their recovery. Driven by warm weather and a heat wave, 2006 saw new demand peaks in both Texas and New England. In Texas, peak demand touched 62,339 MW, up 3.5% on 2005, and in New England peak demand reached 28,130 MW, up 4.5% on 2005. With consistent demand growth, Texas and New England will require additional capacity over the next 3-5 years in order to maintain sufficient reserve margins.

In order to encourage new capacity, the system operator in New England has launched a capacity market. The Forward Capacity Market (FCM) started operating in December 2006, and our assets are benefiting from this regime. Under this market incremental payments are made to generators based on plant availability, and from 2010 capacity payments will be determined through planned auctions.

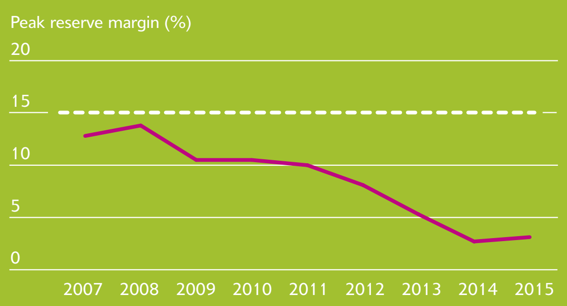
In Texas, reserve margins continue to tighten and this supports the need for capacity additions throughout the state. In 2006, TXU and other generators announced plans to install additional generation capacity of around 14,000 MW to meet growing demand, although 6,900 MW of these additions have since been cancelled. These cancellations are expected to result in a further tightening of reserve margins.

The tightening reserve margin in both Texas and New England provides potential growth opportunities for our business in these markets.

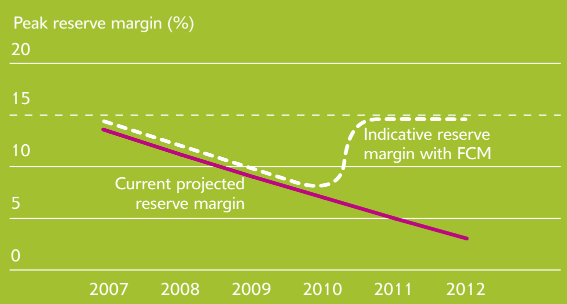
	Spread ($/MWh)			Load factor (%)		
	2005	2006	2007 forecast	2005	2006	2007 forecast
Blackstone & Bellingham, New England*	6	12	21	40	60	45
Midlothian, Texas	12	14	17	55	60	55
Hays, Texas**	12	14	13	65	55	50
Coleto Creek, Texas***	n/a	24	28	n/a	98	80

* Includes FCM payments
** Hays mothballed until 2005
*** Excludes SO_2 costs

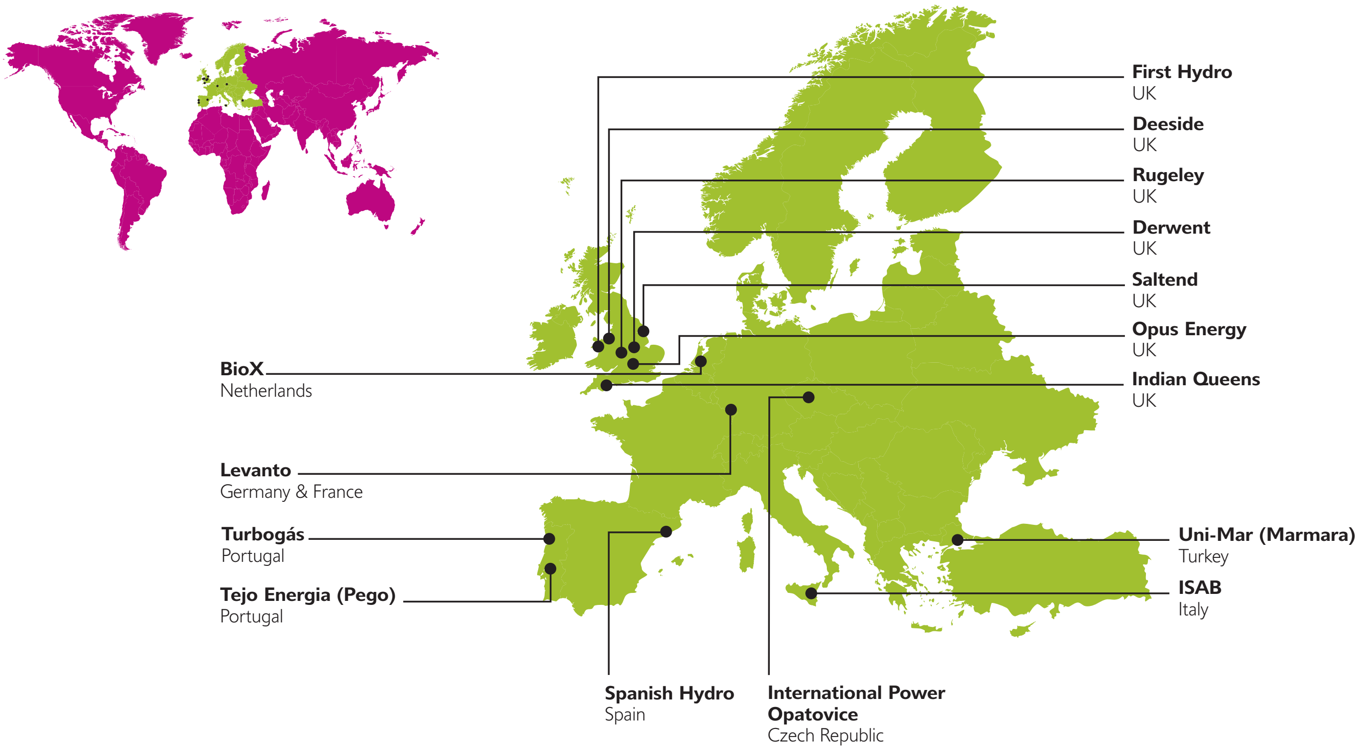
Projected reserve margin – Texas



Projected reserve margin – New England



Regional review Europe



Profit from operations increased by 59% to £450 million, from £283 million in 2005. This growth reflects strong contributions from our UK assets, primarily First Hydro, Saltend and Rugeley, and International Power Opatovice in the Czech Republic. Our assets in Iberia, Italy and Turkey are all contracted and continue to deliver good operational and financial performance.

- Profit from operations increased to £450 million from £283 million last year
- Strong contribution from the UK business
- First major wind farm acquisition with purchase of Levanto wind farm portfolio in Germany and France

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations	615	370
Exceptional items and specific IAS 39 mark to market movements – (profits)/losses	(165)	(87)
PFO (excluding exceptional items and specific IAS 39 mark to market movements)	450	283

As at 5 March 2007	Fuel / Type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth) steam (million lbs/hr)	Net capacity heat (MWth) steam (million lbs/hr)
Assets in operation					
International Power Opatovice, Czech Republic[1]	Coal/gas (Cogen)	585	585	2,040 MWth	2,040 MWth
Levanto, Europe	Wind	361	361	–	–
ISAB, Italy	Gas (IGCC)	528	181	–	–
Tejo Energia (Pego), Portugal	Coal	600	300	–	–
Turbogás, Portugal	Gas (CCGT)	990	594	–	–
Spanish Hydro, Spain	Hydro	84	57	–	–
Uni-Mar (Marmara), Turkey	Gas (CCGT)	480	160	–	–
Deeside, UK	Gas (CCGT)	500	500	–	–
Derwent, UK	Gas (CCGT)	214	50	–	–
Indian Queens, UK	Oil (OCGT)	140	140	–	–
First Hydro, UK	Pumped storage	2,088	1,462	–	–
Rugeley, UK	Coal/50 MW of OCGT	1,050	1,050	–	–
Saltend, UK	Gas (CCGT/Cogen)	1,200	840	0.30m lbs/hr	0.21m lbs/hr
Europe total in operation		**8,820**	**6,280**		
Assets under construction					
Levanto, Europe	Wind	75	75		
Europe total under construction		**75**	**75**		
Other investments					
BioX, Netherlands	Renewable energy company	–	–	–	–
Opus Energy, UK	Independent supplier of electricity to small and medium-size businesses	–	–	–	–

[1] Gross capacity amount shown for International Power Opatovice represents the actual net interest owned directly or indirectly by International Power Opatovice.

Turbogás, Portugal

In the UK, power prices were driven by high gas prices during 2006. With its relatively low and stable fuel (coal) costs, Rugeley benefited from higher power prices and achieved an average spread (excluding CO_2 costs) of £28/MWh, compared to £15/MWh in 2005. First Hydro delivered a strong performance as it benefited from high power price volatility, an improved peak/off peak power price differential, and increased demand for ancillary services. With over 40,000 successful mode changes (the number of times the plant changes from stop to start or from part to full load generation) during the year, an increase of 19% on 2005, and with reliability of almost 100%, operational performance at First Hydro was robust and enabled the plant to capture value from attractive market conditions.

Saltend benefited from a lower-than-market gas cost in 2006 (secured under the indexed gas contract), and operated at a load factor in excess of 90% during the first half of the year. In the second half, after completing a planned outage in Q3, the original equipment manufacturer advised of a further modification required to the gas turbine following a failure at a third party location. This modification work was completed in Q4 2006 and despite the unplanned outage, Saltend was a key contributor to profit growth in the region.

Profit at Deeside improved as the asset used its high flexibility to capture strong peak prices in 2006. This, together with a planned outage in Q1 accounts for its low load factor, which was more than offset by higher achieved prices.

Given the high level of power prices in 2006, we took the opportunity to forward contract most of the output at both Rugeley and Saltend for 2007 and 2008. For 2007, we have contracted 90% of expected output at Rugeley and 95% at Saltend. For 2008, we have contracted 80% of expected output at Rugeley and Saltend.

The installation of flue gas desulphurisation (FGD) equipment, required to significantly reduce sulphur dioxide (SO_2) emissions at Rugeley, is progressing well. The final commissioning of the FGD equipment will be carried out alongside a major planned outage in Q2/Q3 2008. The planned outage and FGD installation will together take approximately 13 weeks, resulting in an expected load factor of 60% in 2008.

The 140 MW oil fired open cycle gas turbine (OCGT) Indian Queens peaking plant in Cornwall was acquired from AES for £32 million and has been integrated into our UK asset portfolio. Since acquisition the asset has performed well and our experience in the balancing and reserve markets should enable us to create additional value from this asset.

In May, International Power acquired a 30% equity interest for a cash consideration of £7 million in Opus Energy, an independent supplier of electricity in the UK that focuses on the small business sector. International Power has a call option on the remaining 70% of Opus, exercisable in 2009.

The mild winter in Q4 2006 resulted in lower heat sales in the Czech Republic although this was more than offset by higher power generation sales and increased year-on-year power prices. This helped International Power Opatovice deliver another strong financial performance.

Construction of FGD and selective catalytic reduction (SCR) equipment at Pego is progressing well and is expected to be completed by mid 2008. As a consequence Pego emissions of SO_2 and oxides of nitrogen (NO_x) will be significantly lower than the limits imposed by the EU Large Combustion Plant Directive (LCPD).

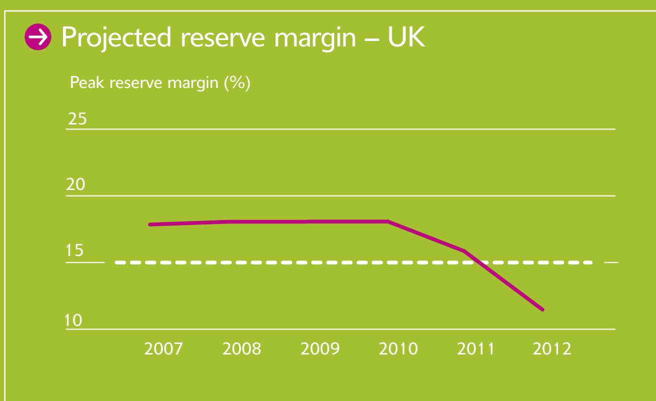
In May, International Power agreed to develop bio-fuel fired plants and Clean Development Mechanism (CDM) projects with BioX Group, one of Europe's leading integrated bio-fuel traders. As part of the agreement, International Power acquired a 10% stake in BioX Group for £8 million, and a call option over the remaining 90%, exercisable in 2010.

In November, International Power completed its first major wind farm acquisition through the purchase of the 436 MW Levanto onshore wind farm portfolio from Christofferson Robb & Company (CRC) for an equity investment of £129 million (including acquisition costs). The Levanto wind farm portfolio comprised 286 MW of capacity in operation, 126 MW under construction and 24 MW of fully permitted capacity. Since acquisition, 75 MW of wind farms under construction have reached commercial operation. The acquisition and our partnership with CRC provides the Group with an immediate renewables business of scale and access to a pipeline of development opportunities in Europe.

	Spread* (£/MWh)			Load factor (%)		
	2005	2006	2007 forecast	2005	2006	2007 forecast
Rugeley	15	28	32	60	55	70
Deeside	12	22	19	60	40	70

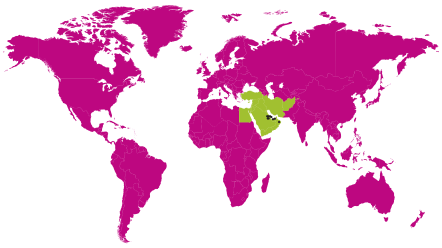
* Excludes CO_2 costs

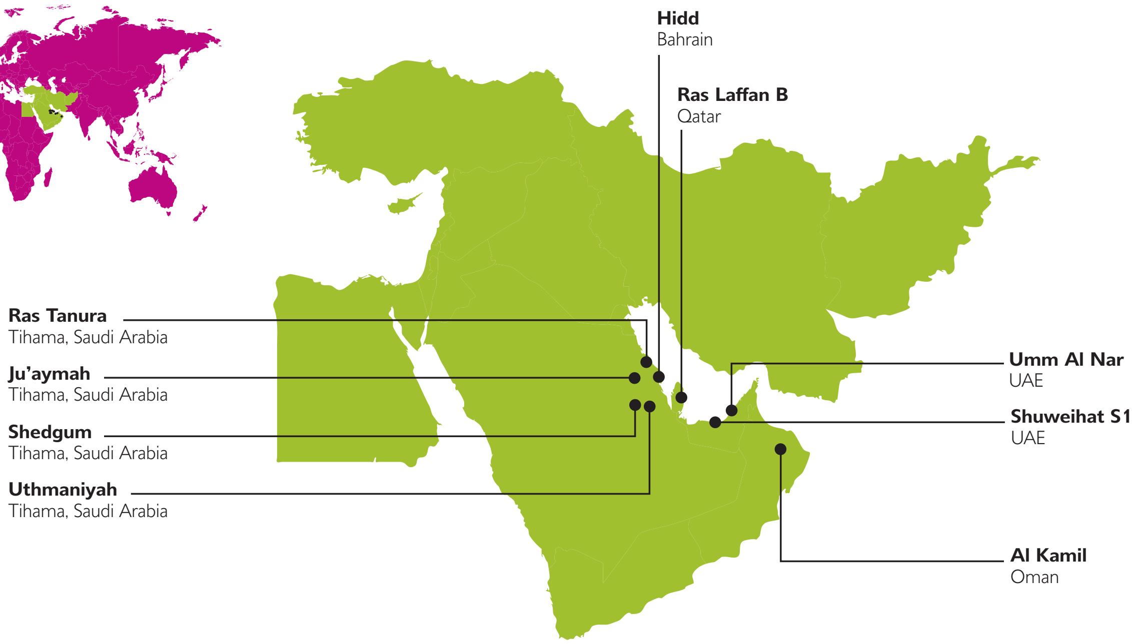
International Power Opatovice, Czech Republic




Indian Queens, UK

Regional review Middle East





Profit from operations increased to £52 million from £24 million last year, principally reflecting new capacity coming on stream at Tihama in Saudi Arabia and Ras Laffan B in Qatar, together with a first time contribution from Hidd in Bahrain. The other assets in the region, namely Al Kamil, Shuweihat and Umm Al Nar continue to deliver a good performance.

- Profit from operations increased to £52 million from £24 million last year
- Construction of Tihama plants in Saudi Arabia completed and fully operational
- New capacity (phase 1) now on stream from Ras Laffan B in Qatar
- First-time contribution from Hidd in Bahrain

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations	**52**	24
Exceptional items and specific IAS 39 mark to market movements – (profits)/losses	**–**	–
PFO (excluding exceptional items and specific IAS 39 mark to market movements)	**52**	24

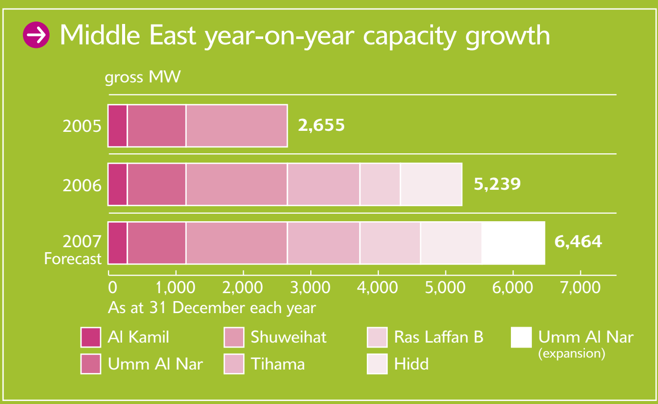
As at 5 March 2007	Fuel / Type	Gross capacity power MW	Net capacity power MW	Gross capacity desal (MIGD) steam (million lbs/hr)	Net capacity desal (MIGD) steam (million lbs/hr)
Assets in operation					
Hidd, Bahrain	Gas (CCGT)/desalination	910	364	30 MIGD	12 MIGD
Al Kamil, Oman	Gas (OCGT)	285	185	–	–
Ras Laffan B, Qatar	Gas (CCGT)/desalination	600	240	15 MIGD	6 MIGD
Tihama, Saudi Arabia	Gas (Cogen)	1,074	645	4.5m lbs/hr	2.7m lbs/hr
Shuweihat S1, UAE	Gas (CCGT)/desalination	1,500	300	100 MIGD	20 MIGD
Umm Al Nar, UAE	Gas (CCGT)/desalination	1,495	299	185 MIGD	37 MIGD
Middle East total in operation		**5,864**	**2,033**		
Assets under construction					
Hidd, Bahrain	Desalination	–	–	60 MIGD	24 MIGD
Ras Laffan B, Qatar	Gas (CCGT)/desalination	425	170	45 MIGD	18 MIGD
Umm Al Nar Expansion, UAE	Gas (CCGT)/desalination	925	185	–	–
Middle East total under construction		**1,350**	**355**		

Construction at Tihama in Saudi Arabia was completed on schedule during 2006 and all sites are now fully operational. The project consists of four separate plants (Shedgum, Uthmaniyah, Ras Tanura and Ju'aymah) with a total capacity of 1,074 MW of power and 4.5m lbs/hr of steam. Performance to date has been robust with average availability of 95%.

In Qatar, construction continues to make good progress at the Ras Laffan B project where the first three 200 MW gas turbines (phase 1) and the first desalination distiller entered commercial operation during 2006, providing 600 MW of power and 15 million imperial gallons per day (MIGD) of water. Another 300 MW is expected to reach commercial operation in the first half of 2007, and final completion of the 1,025 MW, 60 MIGD project is expected in 2008. At Umm Al Nar, the 25 MIGD desalination extension is now operational and the first three gas turbines, providing 600 MW of power, entered commercial operation during Q1 2007. The balance of the new plant (925 MW) is expected to be completed in H1 2007. At Hidd in Bahrain, construction of the 60 MIGD desalination extension is well underway and this additional capacity is expected to be operational in two phases by the end of 2007.

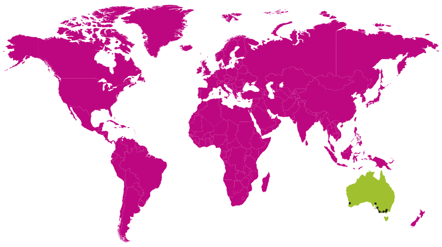
During October, International Power signed a heads of agreement with CIC Energy Corporation (CIC) for the development, construction and operation of a coal-fired project at Mmamabula in Botswana.

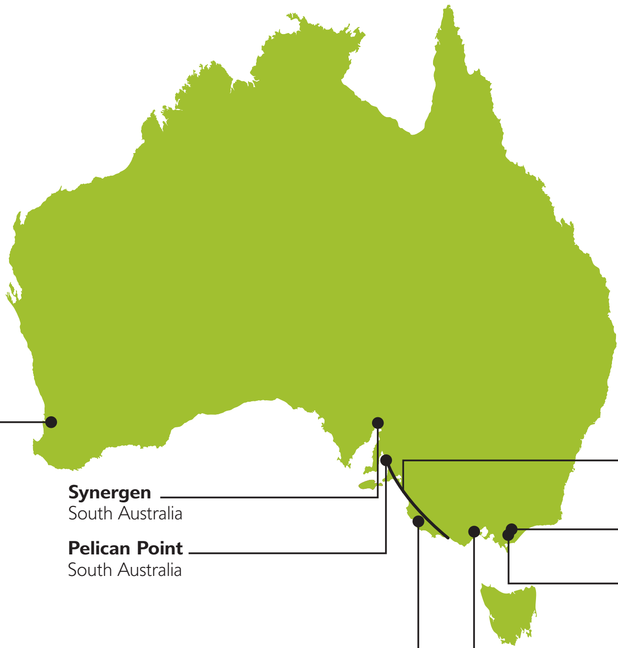
Driven by economic growth, demand for power and water in the Middle East remains high and is forecast to grow at high rates in the future. For example, the countries in which we operate require some 50,000 MW of additional power capacity by the year 2015. This presents International Power with an opportunity to expand its operations in the region, and the Company will seek high quality projects to create additional value. Overall, the Company's reputation and track record in the region places it in a good position to deliver on further growth.



Hidd, Bahrain

Regional review Australia





Profit from operations in Australia decreased 11% to £124 million (£140 million in 2005) primarily due to the expected reduction in achieved prices at Hazelwood and the sale of the 300 MW Valley Power peaking plant in August 2005.

- Profit from operations reduced to £124 million from £140 million last year
- Improved forward prices in Victoria and South Australia
- Reserve margin continues to tighten

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations	**74**	125
Exceptional items and specific IAS 39 mark to market movements – (profits)/losses	**50**	15
PFO (excluding exceptional items and specific IAS 39 mark to market movements)	**124**	140

As at 5 March 2007	Fuel / Type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth)	Net capacity heat (MWth)
Assets in operation					
Canunda, South Australia	Wind	46	46	–	–
Pelican Point, South Australia	Gas (CCGT)	485	485	–	–
Synergen, South Australia	Gas/distillate	360	360	–	–
Hazelwood, Victoria	Coal	1,635	1,500	–	–
Loy Yang B, Victoria	Coal	1,010	707	–	–
Kwinana, Western Australia	Gas (CCGT)	118	58	–	–
Australia total in operation		**3,654**	**3,156**		
Other assets and investments					
EnergyAustralia, Victoria and South Australia[1]	Electricity and gas retailer	–	–	–	–
SEA Gas pipeline, Victoria and South Australia	687 km gas pipeline from Victoria to South Australia	–	–	–	–

[1] *EnergyAustralia (50% owned by International Power) services circa 415,000 electricity and gas retail accounts in Victoria and South Australia.*

Low levels of hydro generation and a tightening reserve margin have contributed to an improvement in forward electricity prices in Victoria. In 2008 and 2009 base load prices have risen to over A$40/MWh. Expected output for 2007 is largely contracted and therefore International Power should benefit from these price increases from 2008.

	Achieved power price (A$/MWh)			Load factor (%)		
	2005	2006	2007 forecast	2005	2006	2007 forecast
Hazelwood	34	33	34	80	80	80

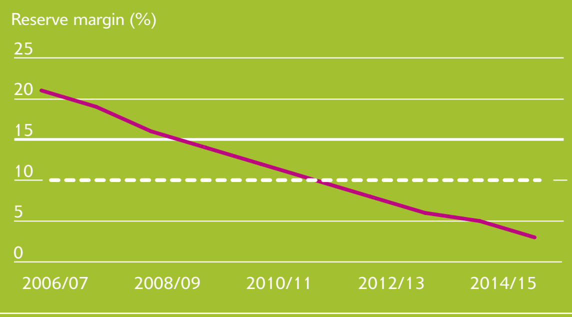
The retail partnership with EnergyAustralia in Victoria and South Australia continues to increase its customer base, with the number of power and gas accounts now at some 415,000, up from 175,000 on formation of the partnership in July 2005.

In October, Hazelwood was awarded an A$80 million grant by the federal and Victorian governments to develop innovative retrofit low emission technology to one of its 200 MW generating units. The project includes coal drying and turbine efficiency improvements and is targeting a reduction in greenhouse gas emissions. The project also includes a pilot CO_2 capture scheme which is expected to be operational by mid 2008.

Driven by steady demand growth, the reserve margin in Victoria and South Australia continues to tighten, and forward prices have risen.

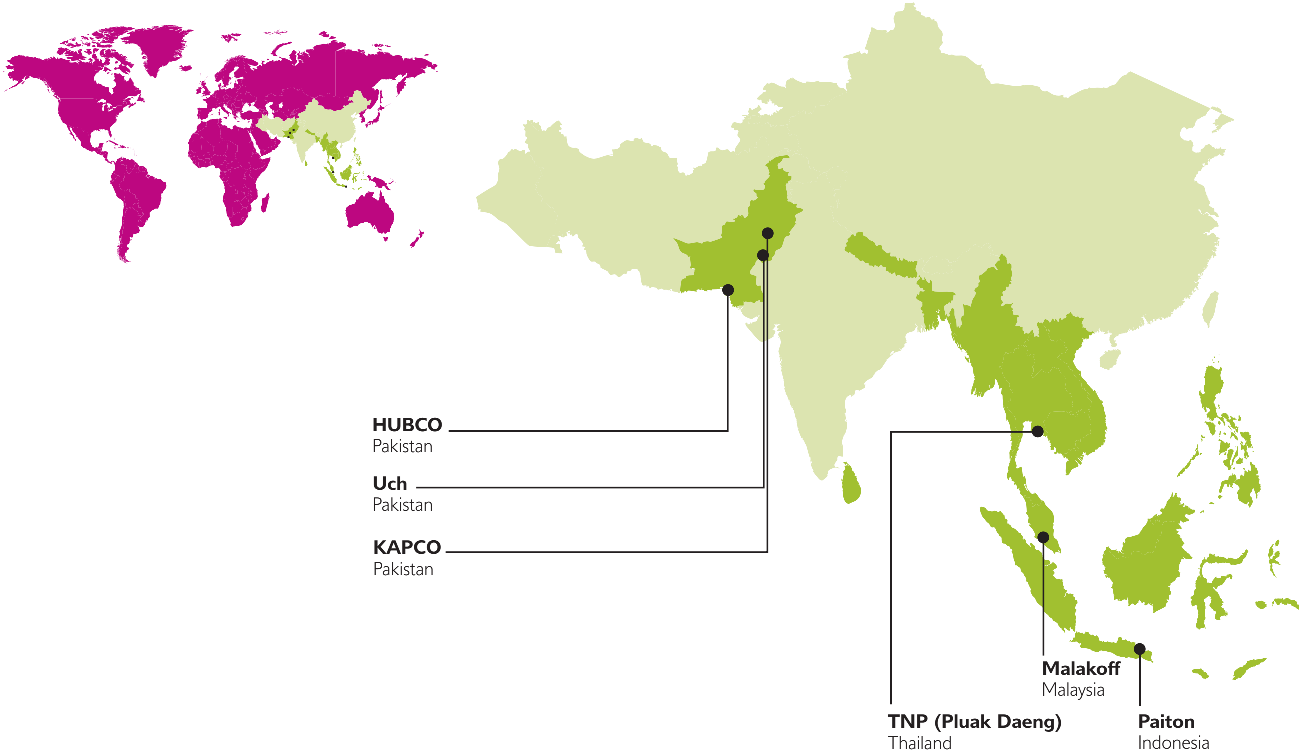
We will consider growth opportunities (greenfield and acquisitions) in our existing and other Australian markets (e.g. New South Wales and Western Australia) that meet our investment criteria.

Victoria and South Australia forecast reserve margin



Hazelwood, Victoria

Regional review Asia



Profit from operations decreased to £91 million from £100 million in 2005. Performance in this region, where all assets have long-term offtake contracts, was characterised by high levels of availability and good underlying profitability and cash flow.

- Profit from operations decreased to £91 million from £100 million last year
- First full year's contribution from Uch in Pakistan
- The sale of Malakoff in which we have an 18% shareholding is expected to complete in 2007

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations	**91**	102
Exceptional items and specific IAS 39 mark to market movements – (profits)/losses	**–**	(2)
PFO (excluding exceptional items and specific IAS 39 mark to market movements)	**91**	100

As at 5 March 2007	Fuel / Type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth) desal (MIGD)	Net capacity heat (MWth) desal (MIGD)
Assets in operation					
Paiton, Indonesia	Coal	1,230	385	–	–
Malakoff, Malaysia[(1)]	Gas (OCGT/CCGT)	3,760	677	–	–
HUBCO, Pakistan	Oil	1,290	219	–	–
KAPCO, Pakistan	Gas/oil (CCGT)	1,600	575	–	–
Uch, Pakistan	Gas (CCGT)	586	234	–	–
TNP (Pluak Daeng), Thailand	Gas (Cogen)	143	143	7.7MWth[(2)]	7.7MWth[(2)]
Asia total in operation		**8,609**	**2,233**		

(1) Gross capacity amount shown for Malakoff represents the actual net interest owned directly or indirectly by Malakoff. International Power's investment in Malakoff is classified on its group balance sheet as an asset held for sale following Malakoff's shareholder approval to divest its business to MMC, another Malaysian Corporate.

(2) District cooling system capacity.

The region benefited from a full year's contribution from Uch, although this was more than offset by a decrease in KAPCO's earnings as it became a full tax payer following the expiry of its tax holiday in June 2006. Earnings at Malakoff were down on 2005 due to lower output levels in 2006.

On 22 December 2006, the shareholders of Malakoff Berhad approved the sale of their wholesale power generating business to MMC for 10.35 Malaysian ringgits per share. International Power has an 18% shareholding in Malakoff and on completion this sale would equate to approximately £240 million (at current exchange rates) for International Power's shareholding, which is substantially above its book value. The sale process is progressing with completion expected in mid 2007.

All Asian assets are covered under long-term contracts with contractually agreed pricing for the contract duration. The completion for current contracts ranges from 2017 to 2040.

Demand for power in the region is high and is forecast to grow significantly. This offers International Power an opportunity to expand capacity at existing sites. In 2006, an additional 23 MW was added to Thai National Power and we are at early stages of reviewing expansion opportunities in Pakistan, Indonesia and Thailand. Similarly, we will consider acquisition opportunities in the region (in existing and new markets) where these add value to the portfolio. Decisions to proceed will be based on project economics.

Paiton, Indonesia

Financial position and resources

Corporate costs

International Power's headquarters is in London, where corporate and business functions are based to support our worldwide operations.

Corporate costs at £45 million are £14 million lower than 2005. This is mainly due to higher costs in 2005 arising from a number of non-recurring items, including a provision raised against certain CEGB legacy pension obligations and a high cost of employees' share options arising from the significant growth in the share price during 2005.

Interest

Net interest expense excluding exceptional items and specific IAS 39 mark to market movements at £248 million is £46 million higher than 2005. This is mainly due to the impact of additional debt relating to the acquisition of Coleto Creek, a full year impact of Saltend, which was acquired in July 2005, and first time interest expense at Tihama, where interest costs ceased to be capitalised as the assets became operational in 2006.

Tax

The tax charge excluding exceptional items and specific IAS 39 mark to market movements at £122 million is £54 million up on the 2005 charge. This is due to higher profitability slightly offset by a decrease in the effective tax rate from 31% in 2005 to 30% in 2006.

Tax on exceptional items and specific IAS 39 mark to market movements was a charge of £25 million (2005: £21 million).

Exceptional items and specific IAS 39 mark to market movements

Net exceptional gains before tax of £55 million were booked in 2006 (2005: gain of £120 million) comprising:

- £36 million – impairment reversal of Deeside power plant;
- £14 million – final TXU settlement receipt;
- £5 million – compensation for breach of contract in Turkey.

The specific IAS 39 mark to market movements reported in the year amount to a profit before tax of £44 million (2005: loss of £35 million).

Liquidity

Free cash flow for the year ended 31 December 2006 was £456 million, an increase of 60% compared to the previous year (2005: £285 million). This increase was driven by strong operational and financial performance across the Group, together with higher dividends from joint ventures and associates. This was partially offset by increased tax and interest payments (£86 million higher than 2005) and an increase in maintenance capital expenditure of £56 million.

Canunda, South Australia

Acquisitions of £842 million in 2006 mainly relate to Coleto Creek and the Levanto onshore wind farm portfolio, together with acquisitions of Indian Queens, Hidd, Opus Energy and BioX. A summary of the Group's cash flow is set out below:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit for the year	**477**	330
Depreciation, amortisation and other movements (i)	**322**	183
Dividends from joint ventures and associates	**113**	92
Capital expenditure – maintenance	**(128)**	(72)
Movement in working capital	**(15)**	(21)
Net tax and interest paid	**(313)**	(227)
Free cash flow	**456**	285
Receipt from TXU Administrators – exceptional	**14**	58
Receipt of compensation for breach of contract – exceptional	**5**	–
Finance cost – exceptional	**–**	(5)
Debt financing costs capitalised on acquisition debt	**(14)**	(7)
Capital expenditure – growth	**(142)**	(188)
Returns from joint ventures and associates (net of investments)	**24**	48
Acquisitions	**(842)**	(571)
Disposals	**1**	211
Dividends paid	**(67)**	(37)
Proceeds from share issue	**15**	2
Net funding from minority interests	**3**	80
Foreign exchange and other	**213**	(181)
Increase in net debt	**(334)**	(305)
Opening net debt	**(2,979)**	(2,745)
Transitional adjustment on first time adoption of IAS 39	**–**	44
Net (debt)/funds on acquisition of subsidiaries	**(172)**	27
Closing net debt	**(3,485)**	(2,979)

(i) Depreciation, amortisation and other movements include income statement charges for interest, tax, depreciation, the share of profit of joint ventures and associates, the exceptional profit on the TXU settlement, and the exceptional profit on compensation for breach of contract.

Summary balance sheet

A summarised, reclassified Group balance sheet is set out below:

	As at 31 December 2006 £m	As at 31 December 2005 £m
Property, plant and equipment and intangibles	**4,840**	4,590
Investments	**1,290**	1,409
Long-term receivables and others	**1,278**	593
	7,408	6,592
Net current assets/(liabilities) (excluding net debt items)	**69**	(327)
Non-current liabilities (excluding net debt items)	**(1,252)**	(911)
Net debt	**(3,485)**	(2,979)
Net assets	**2,740**	2,375
Gearing	**127%**	125%
Debt capitalisation	**56%**	56%
Net debt – joint ventures and associates	**(1,524)**	(1,625)

The increase in property, plant and equipment and intangibles of £250 million principally reflects the acquisition of Coleto Creek and capital expenditure on growth projects, including Levanto. This was offset by depreciation and amortisation charges and the impact of currency retranslation of £246 million, principally on our Australian and US dollar assets.

Long-term receivables and others increased by £685 million due to the acquisition of Levanto (£278 million), which is accounted for as a number of finance leases, and the transfer of £344 million from property, plant and equipment to finance lease receivables at Tihama and Levanto, as further capacity became operational during the year.

Non-current liabilities have increased by £341 million mainly due to the recognition of a provision for £156 million at Coleto Creek in respect of out of the money contracts on acquisition and an increase in deferred tax liabilities of £139 million.

Net debt has increased during 2006 as a result of the acquisitions of Coleto Creek and Levanto and further capital expenditure at Tihama, partially offset by strong cash flow generation.

- Net assets increased to £2,740 million
- Net debt increased to £3,485 million
- Debt capitalisation remains at 56%

Net debt and capital structure

Group net debt

at 31 December comprised:

	2006 £m	2005 £m
Cash and cash equivalents	**980**	620
Assets held for trading	**42**	52
Convertible bonds	**(237)**	(125)
Other bonds	**(678)**	(445)
Secured bank loans and preferred equity	**(3,592)**	(3,081)
Net debt	**(3,485)**	(2,979)

The above net debt of £3,485 million excludes the Group's share of joint ventures' and associates' net debt of £1,524 million (2005: £1,625 million). These obligations are generally secured by the assets of the respective joint venture or associate borrower and are not guaranteed by International Power plc or any other Group company. In view of the significance of this amount, it has been disclosed separately.

The Group has sufficient credit facilities in place to fund and support adequately its existing operations and to finance the purchase of new assets. These facilities comprise a revolving credit facility and two convertible bonds. The revolving credit facility of US$640 million (£327 million) expires in October 2009 but can be extended by a further year subject to bank approval. The convertible bond of US$252 million (£129 million) matures in August 2023 but with bond holders having the right to 'put' the bond back to the Group in August 2010, 2013, 2018 and 2023. A new convertible bond of €230 million (£155 million) was issued in July 2006 with a maturity date of July 2013 but with bondholders having the right to convert the bond into our shares at anytime. In addition, the Group has uncommitted bilateral credit lines from various banks at its disposal at the corporate level.

Secured non-recourse finance

The Group's financial strategy is to finance its assets by means of limited or non-recourse project financings at the asset or intermediate holding company level, wherever that is practical. As part of this strategy, Loy Yang B repaid the existing amortising facility of A$ 617 million (£249 million) and replaced it with an interest only facility (with full capital repayment in 2012) of the same size, and Rugeley, UK was refinanced with a non-recourse facility of £485 million, of which £145 million will be used for the installation of FGD equipment. In addition, the Group raised non-recourse facilities of US$935 million (£477 million) to support the acquisition and operation of Coleto Creek, Texas.

Corporate and Group debt

On 31 December 2006 we had aggregated debt financing of £4,507 million denominated principally in US dollars, Australian dollars, sterling, euro, Czech koruna and Thai baht. Of this amount only £389 million is recourse at corporate level, the remaining £4,118 million being secured by fixed or floating charges over the assets of certain subsidiaries.

Aggregated debt financing of £240 million is due for repayment in 2007, with the majority of the remaining debt balance due after 2011.

During 2006 Standard & Poor's, Fitch and Moody's reviewed the credit rating at corporate level. Standard & Poor's maintained the rating of BB- but upgraded the outlook to positive. Fitch maintained its rating of BB with stable outlook and Moody's maintained its rating of B2 with stable outlook.

Short-term deposits

Surplus funds are placed for short periods in investments that carry low credit risk and are readily realisable in major currencies.

Interest rate policy

The Group's policy is to fix interest rates for a significant portion of the debt (71% as at 31 December 2006) using forward rate or interest rate swap agreements. Turbogás interest costs are a pass through in the PPA tariff and therefore not an exposure to the Group. Adjusting for this item would increase fixed rate debt to 77%. The Group is broadly neutral to changes in interest rates as variable rate debt is similar in size to variable rate cash and cash equivalents. Significant interest rate management programmes and instruments require specific approval of the Board. The weighted average interest of the fixed rate debt was 7% in 2006. Where project finance is utilised, our policy is to align the maturity of the debt with the contractual terms of the customer offtake agreement.


KAPCO, Pakistan

Accounting policies

A discussion follows on the policies we believe to be the most critical in considering the impact of estimates and judgements on the Group's financial position and results of operations.

Critical accounting policies and estimates

We prepare our consolidated financial statements in compliance with International Financial Reporting Standards (IFRSs) as adopted by the EU. As such, we are required to make certain estimates, judgements and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses during the periods presented and the related disclosure of contingent assets and liabilities.

On an ongoing basis, we evaluate our estimates using historical experience, consultation with experts and other methods considered reasonable in the particular circumstances to ensure full compliance with IFRS and best practice. Actual results may differ significantly from our estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known.

Our Group accounting policies are detailed in note 1 to the consolidated financial statements. The table below identifies some of the areas where significant judgements are required, normally due to the uncertainties involved in the application of certain accounting policies.

Income recognition

The majority of our income is derived from owning and operating power plants worldwide. In merchant markets the Group enters into various types of hedging or forward contracts for the buying and selling of commodities related to this activity: principally sales of electricity and the purchase of fuel for its own power plants. These contracts typically fall within the definition of derivative financial instruments and as such are required to be fair valued. Accounting for these contracts as cash flow hedges allows, to the extent the hedge is effective, the changes in value of the derivatives to be deferred in equity. In order to achieve cash flow hedge accounting it is necessary for the Group to determine, on an on-going basis, whether a forecast transaction is both highly probable and whether the hedge is effective. This requires both subjective and objective measures of determination (see also Fair values of energy derivatives).

When our power plants sell their output under long-term power purchase agreements it is usual for the power plant owning company to receive payment (known as a 'capacity payment') for the provision of electrical capacity whether or not the offtaker requests electrical output. In these situations, where there is a long-term contract to purchase electricity output and electrical capacity, it is necessary for the Group to evaluate the contractual arrangements and determine whether they constitute a form of lease or a service contract. Where the arrangements are determined to be or to contain a form of lease an evaluation is then required of where the substantial risks and rewards of ownership reside in order to determine the form of lease it represents. For those arrangements determined to be finance leases, it is necessary to calculate the proportion of total capacity payments which should be treated as finance income, capital repayment and as a fee for service provision and for operating leases the split between rental payments and fees for service provision.

The Group receives amounts from contractors in respect of late commissioning and under performance of new power plants. Receipts which relate to compensation for lost revenue are treated as income when the compensation is due and payable by the contractor. Those receipts that relate to compensation for plants not achieving long-term performance levels specified in the original contracts are recorded as a reduction in the cost of the assets.

Fair values of energy derivatives

The Group has presented its financial statements in accordance with the requirements of IAS 32 (Financial Instruments: Presentation and Disclosure) and IAS 39 (Financial Instruments: Recognition and Measurement). In accordance with IAS 39, the Group records its derivative contracts on balance sheet at fair value (unless they qualify for the 'own use' exemption). Changes in the value of its derivative contracts in each period are recorded in earnings unless strict hedge accounting criteria are met which allow the movement in fair value to be recorded within equity. The Group estimates the fair value of its energy derivative contracts by reference to forward price curves. A forward price curve represents the Group's view as to the prices at which customers would currently contract for delivery or settlement of commodities, such as power or gas, at future dates. Generally the forward price curve is derived from published price quotations in an active market, over the short-term horizon period, and from valuation techniques over the more distant horizon period. The assumptions used during the application of valuation techniques will directly impact the shape of the forward price curve. The forward price curves are only estimates of future prices and thus possess inherent uncertainty and subjectivity.

Accounting policy	Critical accounting judgements and key sources of uncertainty derive from the determination of the:
Income recognition	– correct revenue recognition policy based on the contractual arrangements in place and the allocation of the risks and rewards of ownership of the plant – appropriate accounting treatment of receipts from contractors
Fair values of energy derivatives	– forward price curve for commodities where there is an inactive market
Recoverable amount of property, plant and equipment	– indications of impairment and the measurement of fair value using projected cash flows, together with risk adjusted discount rates, or other more appropriate methods of valuation
Fair values on acquisition	– useful economic life and residual value of certain assets – fair values of assets and liabilities acquired and hence how much of the purchase price is attributed to goodwill arising on acquisition of a business

Recoverable amount of property, plant and equipment

The original cost of greenfield developed power plants and other assets includes relevant borrowings and development costs:

- Interest on borrowings relating to major capital projects with long periods of development is capitalised during construction and then amortised over the useful life of the asset.
- Project development costs (including appropriate direct internal costs) are capitalised when it is virtually certain that the project will proceed to completion and income will be realised.

Depreciation of plant is charged so as to write down the value of the asset to its residual value over its estimated useful life:

- Gas plant is depreciated over 30 years to a 10% residual value, unless the circumstances of the project or life of specific components indicate a shorter period or a lower residual value.
- Wind farms, coal and hydro plants are considered on an individual basis.

Management regularly considers whether there are any indications of impairment to carrying values of property, plant and equipment and other assets (e.g. the impact of current adverse market conditions). Impairment reviews are generally based on risk adjusted discounted cash flow projections that require estimates of discount rates and future market prices over the remaining lives of the assets.

Fair values on acquisition

The Group is required to bring assets and liabilities acquired in business combinations on to the Group balance sheet at their fair value. Power plant and equipment usually have long operating lives, and are often bought with associated long-term contracts such as PPAs. Hence determination of the fair values of these long-life assets and contracts can require a significant amount of judgement.

Consolidation policy – amount of influence

The determination of the level of influence the Group has over a business is often a mix of contractually defined and subjective factors that can be critical to the appropriate accounting treatment of entities in the consolidated financial statements. At entities which are not subsidiaries we achieve influence through Board representation and by obtaining rights of veto over significant actions. We generally treat investments where the Group holds less than 20% of the equity as investments available for sale. These investments available for sale are carried at market value where market prices are available. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost.

Where the Group owns between 20% and 50% of the equity of an entity and is in a position to exercise significant influence over the entity's operating and financial policies, we treat the entity as an associate or jointly controlled entity. Equally, where the Group holds a substantial interest (but less than 20%) in an entity and has the power to exert significant influence over its operations, we treat it as an associate or jointly controlled entity.

Exceptional items

The Directors consider that items of income or expense which are material by virtue of their nature and amount should be disclosed separately if the financial statements are to fairly present the financial position and financial performance of the Group. The Directors label these items collectively as 'exceptional items'.

Determining which transactions are to be considered exceptional in nature is often a subjective matter. However, circumstances that the Directors believe would give rise to exceptional items for separate disclosure would include:

- disposals of investments;
- discontinued operations;
- impairments and impairment reversals.

All exceptional items are included on the appropriate income statement line to which they relate. In addition, for clarity, separate disclosure is made of all such items in one column on the face of the income statement.

Taxation

The level of current and deferred tax recognised is dependent on subjective judgement as to the outcome of decisions to be made by the tax authorities in the various tax jurisdictions in which International Power operates.

It is necessary to consider the extent to which deferred tax assets should be recognised based on an assessment of the extent to which they are regarded as recoverable.

Accounting policy	Critical accounting judgements and key sources of uncertainty derive from the determination of the:
Consolidation policy – amount of influence	– extent of influence the Group is in a position to exercise over the operations, strategic direction and financial policies of entities in which it holds an equity stake
Items of income and expense which require separate disclosure – 'exceptional items'	– items of income or expense which are material by virtue of their nature and amount which require separate disclosure. The Directors consider these items most appropriately disclosed as 'exceptional'
Taxation	– appropriate provisions for taxation taking into account anticipated decisions of the tax authorities – assessment of the ability to utilise tax benefits through future earnings

Board of Directors

Chairman

Sir Neville Simms (62)
Sir Neville became a Non-Executive Director of National Power in August 1998 and was appointed Chairman of International Power in October 2000. He is currently a member of the President's Committee of the CBI, a Governor of Ashridge Management College, Chairman of the BRE Trust and Chairman of the Government's Sustainable Procurement Task Force. Sir Neville was a Non-Executive Director of the Bank of England from 1995 to 2002.

Executive Directors

Philip Cox (55) *Chief Executive Officer*
Philip joined the Company on 1 May 2000 from Invensys plc as Chief Financial Officer. Philip was appointed Chief Executive Officer of International Power in December 2003. He has responsibility for the overall management of the business and the delivery of its strategy. He is a Non-Executive Director of Wincanton plc.

Mark Williamson (49) *Chief Financial Officer*
Mark was appointed Chief Financial Officer of International Power in December 2003. His responsibilities include financial control and reporting, tax and risk management. Mark joined the Company in September 2000 from the Simon Group plc as the Group Financial Controller with responsibility for the Company's financial reporting.

Bruce Levy (51) *Executive Director, North America*
Bruce runs International Power America, formerly American National Power (ANP). He joined the Company on 1 December 2004 having previously worked for US power company GPU, where he was senior Vice President and Chief Financial Officer. Bruce was appointed to the Board in June 2005.

Steve Riley (45) *Executive Director, Europe*
Steve joined the business in 1985, holding senior positions in two UK power stations. He was appointed International Power's Managing Director, Australia in January 2000. In August 2003 he took up his current position as Executive Director, Europe. Steve was appointed to the Board in January 2004. He has been appointed a Non-Executive Director of Shanks Group plc with effect from 29 March 2007.

Tony Concannon (43) *Executive Director, Australia*
Tony joined the industry in 1982 and has worked in a number of business areas including; power station operations, trading and international business development (based in Asia until 1999). He left his role managing two power plants in the UK to manage International Power's Australia business in August 2003 and was appointed to the Board in January 2004.

Non-Executive Directors

Adri Baan (64) *Non-Executive Director*
Adri became a Non-Executive Director of the Company in June 2002. He is the Chairman of the Remuneration Committee. He was previously CEO of Philips Consumer Electronics, and Member of the Board of Management of Royal Philips Electronics. He is currently on the Boards of KVWS, ICI PLC and OCÉ. He is Chairman of Hagemeyer and Wolters Kluwer.

Antony (Tony) Isaac (65) *Non-Executive Director*
Tony became a Non-Executive Director of the Company in October 2000. He is the Senior Independent Director and Chairman of the Audit Committee. He was previously the Chief Executive of The BOC Group plc and is a Non-Executive Director of Schlumberger Limited and Hogg Robinson Group plc.

Struan Robertson (57) *Non-Executive Director*
Struan became a Non-Executive Director of the Company on 1 October 2004. He was Group Chief Executive of Wates Group Ltd until January 2004. Before that he had a 25-year international career with BP plc, during which time he held a number of senior roles, including Chief Executive Officer of BP Oil Trading International and Executive Chairman of BP Asia Pacific. He is currently a Non-Executive Director at Forth Ports plc, Henderson TR Pacific Investment Trust plc and Tomkins plc and is the Senior Independent Director of Salamander Energy plc. Previously he was the Senior Independent Director at WS Atkins plc.

John Roberts (61) *Non-Executive Director*
John became a Non-Executive Director of the Company on 18 May 2006. He was previously Chief Executive of United Utilities, a position he held for over six years. Before that, he was Chief Executive of Hyder Utilities and of Manweb. He is a Fellow of the Royal Academy of Engineering, the Institution of Engineering and Technology and the Association of Chartered Certified Accountants. He is a Non-Executive Director of Royal Bank of Canada (Europe) Limited.

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1. Sir Neville Simms *Chairman*
2. Philip Cox *Chief Executive Officer*
3. Mark Williamson *Chief Financial Officer*
4. Bruce Levy *Executive Director, North America*
5. Steve Riley *Executive Director, Europe*
6. Tony Concannon *Executive Director, Australia*
7. Adri Baan *Non-Executive Director*
8. Tony Isaac *Non-Executive Director*
9. Struan Robertson *Non-Executive Director*
10. John Roberts *Non-Executive Director*

Senior management team

Peter Barlow

Peter is the head of corporate finance for International Power and is responsible for funding and bank relationships. He is also primarily responsible for the relationship with Mitsui, our partner in IPM Eagle, which owns the international asset portfolio we acquired from EME in 2004. Peter joined us in 1998 and has been especially involved in corporate finance, project finance and treasury activities since that time.

Penny Chalmers

Penny is head of global resources. She is responsible for Group human resources, information technology and corporate communications. Penny has nearly 20 years' experience in the energy sector and has been with us since 1997.

Gareth Griffiths

Gareth manages global trading, with responsibility for our trading operations in the UK, US and Australia. He has 14 years' experience in the industry and was previously Vice President, Marketing and Trading for our North American business.

Vince Harris OBE

Vince is the head of our Asia region and was previously head of one of the UK's first cogeneration businesses prior to becoming CEO of HUBCO in Pakistan. He is a chartered engineer and has 38 years' experience in the power generation industry. Vince was awarded his OBE in 2007 for services to British industry in Pakistan.

Ed Metcalfe

Ed heads up operations and engineering and has 33 years' experience in the industry. Prior to his appointment in July 2006 he was executive managing director of Arabian Power Company and was previously responsible for our operations in South Australia, specifically Pelican Point, Synergen and SEA Gas.

Sean Neely

Sean heads up mergers and acquisitions at International Power. He is a chartered accountant with 15 years' experience in the power sector. He joined us in October 1998, and has a background in project finance and investment banking.

Ken Oakley

Ken joined the Group as head of tax in October 2000 and has responsibility for managing the Group's tax affairs. After qualifying as a chartered accountant and chartered taxation adviser, he now has 13 years' experience in the commercial tax sector.

Stephen Ramsay

Stephen is our Company Secretary and General Counsel. He joined the Company in 1996, after 10 years as a solicitor in private practice, first working at National Wind Power and then in the international legal group before becoming Company Secretary in October 2000.

Ranald Spiers

Ranald is head of our Middle East region. He has been with us for 14 years, having previously worked for the BP Group for 12 years across a wide spectrum of industries, including petrochemicals, detergents, oil refining, downstream gas, advanced materials and aerospace.


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1. Peter Barlow
2. Penny Chalmers
3. Gareth Griffiths
4. Vince Harris OBE
5. Ed Metcalfe
6. Sean Neely
7. Ken Oakley
8. Stephen Ramsay
9. Ranald Spiers

Ras Laffan B, Qatar

- In 2006 the effectiveness of the Board was underpinned by a balance of Executive and Non-Executive Directors
- The Board is accountable to shareholders for the performance and activities of the Group
- The Board has responsibility for the Group's system of internal control and for monitoring and reviewing its effectiveness
- The Board has responsibility for defining strategy, ensuring the successful implementation of approved projects/proposals and for the financial policies of the Group

Corporate governance

We are committed to high standards of corporate governance and in this section set out how we comply with the principles in the Combined Code, and explain our reasons for any areas of non-compliance.

The Board

In 2006 the effectiveness of the Board was underpinned by a balance between Executive and Non-Executive Directors. The Board believes that it has the skills and experience necessary to provide effective leadership and control of the Company.

Jack Taylor retired from the Board on 17 May, 2006 and, on 18 May 2006, John Roberts was appointed a Non-Executive Director. There were no other changes during the year. At the end of the year the Board comprised of the Chairman (Sir Neville Simms), Executive Directors (Philip Cox, Mark Williamson, Tony Concannon, Steve Riley and Bruce Levy) and four Non-Executive Directors (Tony Isaac, Adri Baan, John Roberts and Struan Robertson). Sir Neville Simms was considered independent on his appointment as Chairman and the four Non-Executive Directors are considered to be independent. Tony Isaac is the Senior Independent Director.

The structure of the Board is not in strict compliance with the Combined Code in that the number of Non-Executive Directors is less than the number of Executive Directors. However, the Directors consider that the Board currently works effectively to carry out its duties and that the Non-Executive Directors have a strong independent presence at Board meetings to provide an effective counter balance to the Executive Directors. The size and structure of the Board is kept under review.

	Board (7 meetings)	Audit Committee (5 meetings)[1]	Remuneration Committee (4 meetings)	Appointments Committee (1 meeting)
Sir Neville Simms	7	n/a	4	1
Philip Cox	7	n/a	n/a	n/a
Adri Baan	7	5	4	1
Tony Concannon	7	n/a	n/a	n/a
Tony Isaac[2]	6	5	3	1
Bruce Levy	7	n/a	n/a	n/a
Steve Riley	7	n/a	n/a	n/a
John Roberts[3]	3	2	1	–
Struan Robertson	7	4	4	1
Jack Taylor[4]	3	2	2	n/a
Mark Williamson	7	n/a	n/a	n/a

1. In 2006 the Audit Committee held three main meetings relating to the preliminary statement, the interim statement and audit planning. All members of the Committee attended these meetings. The remainder of the meetings related to quarterly reports and US reporting issues.
2. Tony Isaac missed one Board meeting and one Remuneration Committee meeting during 2006 due to an overriding business commitment. He passed comments on each of the relevant papers to each of the chairmen prior to the meetings.
3. John Roberts joined the Board on 18 May 2006. He has attended all Board and committee meetings since that date except one Board meeting and one meeting each of the Audit, Remuneration and Appointments Committees which was due to a pre-existing commitment at the time of his appointment. For all the meetings he missed, he passed his comments on the relevant papers to each of the chairmen, prior to the meetings.
4. Jack Taylor retired from the Board on 17 May 2006. He attended all Board and committee meetings up to the date of his retirement.


First Hydro, UK

The full Board met seven times during 2006. Attendance by Directors at these and the Board committee meetings held during the year are detailed in the table on page 49.

In addition to the Board and committee meetings, a meeting of the Chairman and the Non-Executive Directors was held without the Executive Directors being present. The Non-Executive Directors also met without the Chairman being present. This meeting was chaired by Tony Isaac, the Senior Independent Director, and included a review of the Chairman's performance.

Board membership

In accordance with the Combined Code and the Company's Articles of Association, all Directors submit themselves for re-election every three years and newly appointed Directors are subject to election by shareholders at the first AGM after their appointment. In addition, the Board seeks to maintain a balance between continuity and new blood amongst the Non-Executive Directors.

In accordance with this policy, Jack Taylor stepped down as a Non-Executive Director at the 2006 AGM and, following a search carried out by an external agency, John Roberts was appointed in his place immediately following the AGM and will submit himself for re-election at the 2007 AGM.

In addition three Directors will submit themselves for re-election at the 2007 AGM in accordance with the three year re-election policy. They are Sir Neville Simms, Steve Riley and Tony Concannon.

Board training

Arrangements are in place to ensure that newly appointed Directors receive a comprehensive briefing on the Company, and training is provided for Directors on their roles and their legal obligations to ensure that they are fully conversant with their responsibilities as Directors. In accordance with this policy John Roberts met all the members of the Executive Management team individually, over a period of two days. In addition he has received guided visits to two power stations in the UK, so that he has a good understanding of the business of the company. A programme of continuous training is also provided for the Directors. Periodically the Board meets at the site of one of the Group's assets and briefings are also given at Board meetings on particular parts of the business, including regional and functional reviews. In January 2007 the Board visited the Group's business in the Middle East where it met the regional management team and received a briefing about the local business operations. Directors are also kept informed of changes to the regulatory regime such as the revisions to the Combined Code, the new Companies Act and Transparency Directive and the US Sarbanes-Oxley Act. All of the Directors have access to the advice and services of the Company Secretary and also to external independent advice should they so wish.

Insurance

The Company has in place appropriate insurance cover in respect of legal action against its Directors.

Operation of the Board

The Board has responsibility for defining strategy, ensuring the successful implementation of approved projects/proposals and for the financial policies of the Group. It also reviews the risk policies and profile of the Group. It maintains a schedule of all matters requiring specific Board approval. Throughout 2006 this included all strategy decisions and significant capital investment proposals and acquisitions. The Board receives information on capital expenditure projects and investment proposals in advance of Board meetings, as well as management reports on the operational and financial performance of the business. Financial performance is monitored on a monthly basis and the overall performance of the Group is reviewed against approved budgets. At least once a year, the CEO presents a corporate strategy plan to the Board for review and approval. Each investment decision is made in the context of this plan.

The Board has established business values and standards for the Company, which provide a framework for the Company to balance the interests of all its stakeholders in the conduct of its business. The business values (FIRST) are set out in brief in the CEO's statement section of this *Annual Report*. The Company's Code of Business Conduct has been formally adopted by the Board and is set out on the Company's website. This code includes a whistle blowing procedure.

Uch, Pakistan

In respect of Board performance for 2006, the Board, following the assessment of Board performance in 2005 by an external facilitator, decided to carry out this assessment internally for 2006. A questionnaire was circulated to the Directors and was discussed in two separate meetings – one with Executive Directors and the other with Non-Executive Directors – chaired by the Chairman and minuted by the Company Secretary. The meetings discussed overall Board performance, the effectiveness of the Board's committees and the contributions of individual Directors. The results of the review demonstrated that the Board members were satisfied with the operation of the Board. The contribution by individual Directors to Board and committee meetings was considered to be high.

Chairman and Chief Executive Officer

There is a clear division of responsibilities at the head of the Company between the roles of the Chairman and the CEO. The Chairman is responsible for the leadership and effective operation of the Board, in terms of its agenda, decision making and the utilisation of the skills and experience of the Directors. He monitors, with the assistance of the Company Secretary, the information provided to the Board to ensure that it is sufficient, pertinent, timely and clear. The Chairman is also responsible for ensuring that there is effective engagement and communication with shareholders. The CEO is responsible for the running of the Company, and leading the executive and operational teams in implementing the strategies approved by the Board.

Philip Cox is also a Non-Executive Director of Wincanton plc. His remuneration from this role is retained by him. His remuneration for the year ended 31 March 2006 was £41,000.

Non-Executive Directors and their function

Through membership of the Board committees, the Non-Executive Directors have responsibilities for: overseeing that systems of internal control and risk management are appropriate and effective; managing the relationship with the external auditor; evaluating the performance of management in meeting targets and objectives; setting the remuneration of Executive Directors; appointing Executive Directors; and planning senior management succession.

Board committees

The Company has established the following committees: the Audit Committee; the Remuneration Committee; and the Appointments Committee. No person other than a committee member is entitled to attend the meetings of these Committees, except at the invitation of the Committee. The full terms of reference for each Committee are available on the Company's website.

Audit Committee

The Committee manages the relationship with the external auditor, including fixing the level of the auditor's remuneration and the scope and adequacy of the audit. The Committee also puts in place policies and procedures to ensure that the external auditor remains independent. The Committee reviews all financial reports (preliminary statement, *Annual Report*, Form 20-F, interim statement and quarterly reports) including consideration of the Group's accounting policies and major judgemental areas. The Committee reviews the effectiveness of the Group's systems of internal control, and reviews the scope (and the annual plan) of the internal audit function and satisfies itself of its adequacy, particularly in terms of resources and its performance against its annual plan. In addition it reviews the report prepared by the Risk Committee to ensure all relevant risks are addressed in these external and internal audit processes. The Committee has also reviewed the Company's Sarbanes-Oxley compliance programme to ensure that the Company's internal control system and safeguards are such that they comply with the requirements of the Sarbanes-Oxley Act.

During 2006 the Audit Committee was comprised of all the independent Non-Executive Directors of the Company. The Audit Committee Chairman is Tony Isaac, who is a Fellow of the Chartered Institute of Management Accountants and, before becoming Chief Executive of The BOC Group plc, was its Group Finance Director. The Company Secretary acts as secretary to the Committee.

Time was set aside for the Committee to meet the external auditor and the head of internal audit without executive management present. In addition to the members of the Committee, regular attendees at the Audit Committee meetings included representatives of the external auditor, the Chairman, the CEO, CFO, other Executive Directors, the group controller and the head of internal audit.

Remuneration Committee

The Remuneration Committee is responsible for ensuring that the remuneration package of Executive Directors is maintained on a sensible and comparative basis and enables the Company to compete effectively for good calibre executives. It monitors the performance of Executive Directors against targets, it sets the performance conditions for long-term incentive plan awards and reviews the remuneration levels and other conditions of service of senior managers, immediately below Board level.

The Committee comprises all of the independent Non-Executive Directors of the Company and the Chairman. The Chairman of the Committee is Adri Baan. The Company Secretary acts as secretary to the Committee and the head of global resources acts as adviser to the Committee. Towers Perrin acts as external adviser to the Committee.

Appointments Committee

The Appointments Committee is responsible for matters of management succession and the identification and appointment of Directors. It also reviews the Board structure, size and composition and makes recommendations to the Board with regard to changes that are deemed desirable. The Committee comprises of the Chairman and all of the independent Non-Executive Directors of the Company. The Chairman of the Committee is Sir Neville Simms. The Company Secretary acts as secretary to the Committee.

Relations with shareholders

The Board is accountable to shareholders for the performance and activities of the Group. International Power ensures that its AGM provides shareholders with an opportunity to receive comprehensive information on all aspects of the Group's business activities and to question senior management about business issues and prospects.

All proxy votes are counted and the level of proxy votes lodged for each resolution is reported at the AGM and on the Company's website. In line with best practice, the Company aims to ensure that the notice of AGM and the *Annual Report* are sent to shareholders at least 20 working days before the AGM.

International Power also runs, within the terms of the regulatory framework, frequent contact programmes with industry analysts and institutional investors to discuss matters of strategy and financial performance. Contact is made principally by the CEO and the CFO. On issues of major importance the Chairman communicates with major shareholders. The Senior Independent Non-Executive Director (Tony Isaac) is also available as an alternative point of contact if shareholders have concerns over the Chairman's performance or where contact with the Chairman or the use of other communication channels would be inappropriate. At each Board meeting, an update is given on movements in major shareholdings and on contact programmes between the Executive Directors and institutional shareholders. Reports issued by financial analysts on the Company are circulated to Board members. These summaries and reports enable the Directors to gain an understanding of the views and opinions of those with an interest in the Company. All results presentations and Stock Exchange announcements are available to shareholders on the Company's website.

Accountability and audit

The Board is mindful of its responsibility to present a balanced and understandable assessment of International Power's financial position and prospects, both to investors and regulatory authorities. The *Annual Report*, preliminary, interim and quarterly results announcements are the principal means of achieving this objective.

An explanation of the respective responsibilities of the Directors and external auditor in connection with the financial statements is set out in the Statement of Directors' responsibilities. The Directors confirm in the Directors' report their view that the Group is a going concern.

The Audit Committee has a process in place to approve all non-audit services provided by the external auditor to ensure that the objectivity and independence of the external auditor is not compromised. In line with the requirements of the Sarbanes-Oxley Act, our procedures specify the services from which the external auditor is excluded and the approval process for all other services.

Internal control

The Board has responsibility for the Group's system of internal control and for monitoring and reviewing its effectiveness.

Systems are in place to meet the requirements of the Combined Code and Turnbull Guidance and procedures and systems have been implemented to ensure compliance with the requirements of the Sarbanes-Oxley Act.

Any system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. The system can only provide reasonable, and not absolute, assurance against material financial misstatement or loss. The Board reviewed the internal control procedures during 2006. The principal features of the Group's systems of internal control are:

Control environment

The Board encourages a culture of integrity and openness. The Company has an organisation structure with clear lines of accountability and authority across its worldwide operations, supported by appropriate reporting procedures. Each of the regional businesses is accountable to the CEO and is managed within the strategic guidelines and delegated authorities adopted by the Board. An executive management team, chaired by the CEO and comprising the Executive Directors, regional directors and functional heads, meets regularly to discuss issues facing the Group.

Control procedures

Control procedures have been established in each of the Company's operations to safeguard the Group's assets from loss or misuse and to ensure appropriate authorisation and recording of financial transactions. All acquisition and investment decisions are subject to disciplined investment appraisal processes. Risk management procedures are in place for the Company's operations, including its energy marketing and trading activities, which are overseen by the Global Commodities Risk Committee, which comprises Executive Directors and senior management, and is chaired by the global risk manager. The Group treasury function operates under defined policies and the oversight of the Treasury Committee, chaired by the CFO.

Performance reporting and information

Corporate plan Executive management submits an annual corporate plan to the Board for approval. The plan for each business unit is the quantified assessment of its planned operating and financial performance for the next financial year, together with strategic reviews for the following four years. Group management reviews the plans with each operational team. The individual plans are based on key economic and financial assumptions and incorporate an assessment of the risk and sensitivities underlying the projections.

Performance monitoring Monthly performance and financial reports are produced for each business unit, with comparisons to budget. Reports are consolidated for overall review by executive management, together with forecasts for the income statement and cash flow. Detailed reports are presented to the Board on a regular basis.

Performance review Each business unit is subject to performance reviews with Group management regularly during the year. Actual results and forecasts for the year are compared to budget. Key operational and financial results are reviewed together with the risk profile and business environment of the reporting unit.

Investment projects These are subject to formal review and authorisation procedures with designated levels of authority, including a review by an Investment Committee chaired by the CEO and comprising the Executive Directors and senior managers. Major projects are subject to Board review and approval.

Corporate reporting The Company has a Disclosure Committee which is chaired by the Company Secretary and is comprised of members from the internal audit, corporate communications, human resources, operations and engineering, company secretariat and financial reporting departments. It reviews the *Annual Report*, the *Summary Annual Report* and Form 20-F, and also monitors compliance with disclosures required under UK and US reporting regulations.

Rugeley, UK

Risk identification and management

As outlined in the section 'Our approach to risk and risk management' there is a continuous process for identifying, evaluating and managing the key risks faced by the Company. Activities are co-ordinated by the Risk Committee, which is chaired by the CFO, and has responsibility, on behalf of the Board, for ensuring the adequacy of systems for identifying and assessing significant risks, that appropriate control systems and other mitigating actions are in place, and that residual exposures are consistent with the Company strategy and objectives.

Monitoring

The Board reviews the effectiveness of established internal controls through the Audit Committee which receives reports from management, the Risk Committee, the Group's internal audit function and the external auditor on the systems of internal control and risk management arrangements.

Internal audit reviews the effectiveness of internal controls and risk management through a work programme which is based on the Company's objectives and risk profile and is agreed with the Audit Committee. Findings are reported to operational and executive management, with periodic reporting to the Audit Committee.

Business unit managers provide annual self-certification statements of compliance with procedures. These statements give assurance that controls are in operation and confirm that programmes are in place to address any weaknesses in internal control. The certification process embraces all areas of material risk. Internal audit reviews the statements on behalf of the Disclosure Committee and reports any significant issues to the Audit Committee.

Compliance with the Combined Code

There were two areas where the Board was not fully compliant with the requirements of the revised Combined Code throughout 2006. Throughout 2006 there were more Executive Directors than Non-Executive Directors. The Board has reviewed the structure of the Board and has concluded there is no need at this time to appoint another Non-Executive Director.

The Senior Independent Director does not have a contact programme to communicate with institutional investors, primarily to avoid potential confusion over channels of communication. During 2006 no institutional shareholder has requested such communication.

In all other respects, the Company has complied with the provisions of the Combined Code throughout the period of the review.

US corporate governance compliance

There are no significant differences in corporate governance practices as undertaken by International Power as compared to those followed by US domestic companies under the NYSE listing standards.

The Company has securities registered in the US and, as a result, it is required to comply with those provisions of the Sarbanes-Oxley Act 2002 (the Act) as it applies to foreign private issuers. The Board continues to monitor the new rules arising from the Act and reviewed the arrangements that were developed to ensure that the Company can report on its systems of internal controls over financial reporting as required as at 31 December 2006.

Shedgum, Tihama, Saudi Arabia

Levanto, Europe

Corporate responsibility

Our aim is to ensure that International Power is known throughout the world as a responsible, efficient and successful company. Our stakeholders – our employees, shareholders, customers, suppliers, regulators and host communities – expect nothing less of us.

Electricity is a unique product that has the power to enhance the quality of life for people throughout the world. Companies involved in the provision of this commodity must also demonstrate responsibility. For a global wholesale generating company like International Power, this equates to following fair and ethical principles to govern the way we manage and conduct our business. It means working in a smart and integrated way – by ensuring our key competencies, technical expertise and best practices are properly implemented over a widely dispersed and diverse range of assets to produce power, water and process heat safely and cleanly. It also means that corporate responsibility (CR) as a specific element forms an integral part of our business decisions and contributes to our global competitiveness and reputation.

Establishing a sound reputation requires commitment at all levels of the Company. We work hard to build long-term sustainable partnerships in the communities in which we operate. Our strategy is to provide local employment, support the local economy and act as a responsible neighbour and employer whilst contributing to the improvement of local health and education services.

This strong commitment to CR flows from the top. The Board is briefed regularly on our CR performance and we are committed to delivering high standards of implementation throughout the business. Consequently, environmental and social considerations form part of our strategic decision-making process. In those instances where we share ownership of an asset, we encourage our partners to adopt our CR standards and principles, typically through influence at business level board meetings.

Power production is a complex process and our assets throughout the world use different fuels and different technologies to generate electricity, heat, water or steam. However, the way we record and report our CR performance must be undertaken in a consistent and transparent way. By working to the Global Reporting Initiative and the Association of British Insurers' reporting guidelines we, and our stakeholders, can check and compare our performance with that of other power companies.

In 2006 International Power was ranked 44th in the top 100 companies in the Business in the Community corporate responsibility and environment index (in 2005 the ranking was 48th). Involvement in Business in the Community provides peer group recognition of our commitment to improve continually our corporate responsibility performance.

- The strong commitment to corporate responsibility flows from the top down
- Corporate responsibility forms an integral part of our business decisions and contributes to our global competitiveness and reputation
- We record and report our corporate responsibility performance in a consistent and transparent way
- We were ranked 44th (2005: 48th) in the top 100 companies of Business in the Community's corporate responsibility and environmental index for 2006

Guidance

Our aim of improving and developing CR is aided by the provision of policies which help provide guidance. Our CR policies include:

Business standards

Community

Environment

Health and safety

Human rights

Business standards

We strive to demonstrate our responsibility through protecting and, wherever possible, enhancing the working conditions of our employees, the environment and the host communities who trust us to do our job safely, competently and efficiently. The following statements reflect our policies.

Competitive practices International Power will comply with competition laws throughout the world; we will not take part in unlawful cartels or any form of restrictive trade practice.

Confidentiality and honesty International Power and its contractors are required to comply with the terms of confidentiality agreements under which information is provided; all information should be true and not misleading by omission.

Ethics International Power will conform to local social norms and values enshrined in host countries' laws, regulations, customs and business practices, so long as compliance does not breach our code of ethical behaviour. In such cases we would seek to lead with new, higher, local standards.

Human resources We believe in fairness and equal opportunities for all our employees or applicants, regardless of race, religion, marital status, sexual orientation, age or disability.

Procurement Our procurement will be conducted so that any supplier that has the necessary abilities to be of service to us has a fair opportunity to secure our business.

Whistle-blowing International Power encourages employees or others with serious concerns about any aspect of work to come forward and express those concerns on a confidential basis without fear of reprisal or victimisation.

These business policies are set out in a code of conduct which is circulated to all businesses, which certify their compliance with its terms on an annual basis.

Community

Our policy is to provide local employment, support the local economy, act as a responsible neighbour and employer and contribute towards the improvement of local health and education services.

The need for electricity, fresh water and heating touches every area of modern life – this gives us considerable reach and global impact on people's lives. We, in turn, accept a reciprocal responsibility to conduct our business with a proper concern for the world around us, particularly in the spheres upon which we have direct effects. Community support is a major focus of International Power's corporate activities.

We play a positive role in the communities in which we operate, not because we have to but because we want to. We aim to provide local employment; support the local economy; act as a responsible neighbour and employer; and contribute towards the improvement of local health and education services.

Al Kamil, Oman

Environment

We strive for excellence in environmental performance through legal compliance, certified management systems, stakeholder engagement and the efficient use of natural resources.

As a global power generation company we recognise the importance of developing and implementing a low carbon strategy over both the medium and long-term, and we are taking active steps to address this issue. We have a broad portfolio of assets with a small but growing percentage of renewable generation. We use state-of-the-art, proven environmental technology at our new assets and, where possible are upgrading the older assets. We believe that our performance demonstrates our committed approach with reductions in our net CO_2/kWh over the last two years, from 0.889 kg of CO_2/kWh in 2004, to 0.715 kg of CO_2/kWh in 2006. We use net reporting for CO_2, which reflects our ownership interest in an asset. As of today, due to the different regulatory regimes that exist in the markets in which we operate, the level of carbon emissions has limited impact on our business. However, we believe this will change in the near future, and we are taking steps to address our carbon emission levels whilst still remaining commercially competitive.

Most governments in developed countries have introduced legislation to incentivise increased supply from renewable sources of generation. Growth in renewable generation is likely to impact production forecasts for our fossil fuelled plants. We have dedicated resources within our operations and engineering teams to review technology trends and advances, to ensure we are best positioned to participate over the short, medium and long-term in our drive towards a lower carbon environment – not only in the UK, but very importantly, also internationally. For example, we are also investigating means of reducing CO_2 emissions from brown coal generation at our Hazelwood plant in Victoria, working with both federal and state governments, and with selected technology specialists. This is a medium to long-term project, and we are pleased to be at the forefront of addressing such an important issue for the Australian power generation business.

With respect to environmental compliance, plant operating and monitoring procedures are effective in ensuring that our plants comply with the conditions of their licenses and consents. Whilst we have experienced occasional breaches of our environmental operating limits, there have been no recent incidents that have posed a significant threat to the environment or to our ability to run our plants. Compliance with environmental limits is reported as one of our KPIs.

Full details of our environmental performance are set out on our website www.ipplc.com/ipr/environment/env/endata/

Health and safety

We are committed to the best possible health and safety performance through management commitment, legislative compliance, certified management systems and continuing stakeholder engagement.

One of our core values is to instil safe behaviour in everything we do. We therefore decided to ask DuPont, an acknowledged world authority in this field, to carry out a safety review at a selection of our assets around the globe (Paiton in Indonesia, Hays in Texas, Rugeley in the UK, Pego in Portugal and Ras Laffan in Qatar) to ensure that our commitment to excellent health and safety standards, across our portfolio, is checked and challenged, and that best practice is shared by all our plants. In addition DuPont reviewed the corporate headquarters and the 'tone at the top' and the management link between the corporate centre and the assets. The lessons learnt from the review will be shared across our business once the review is complete. Health and safety is of vital importance in our business and therefore AFR is one of the non-financial KPIs that we use to manage our business.

Safety is achieved by focusing on three main areas:

Safety by engineering Delivered by comprehensive design reviews for new build projects, or in the case of an acquisition; a rigorous due diligence process is carried out to identify any risks. Plants are operated and maintained in line with applicable engineering standards with regular maintenance programmes ensuring that the equipment is always operating within design parameters.

Safety by management All International Power assets have formally documented management systems which are derived from a set of corporate principles. These systems are reviewed against international best practice and updated regularly. The majority of our assets have obtained external accreditation of their management systems through OHSAS 18001. A process is ongoing to ensure that the remaining few assets obtain accreditation by the end of 2007.

We also ensure that anyone in a supervisory position has an externally accredited health and safety qualification. In January 2007 the Executive Directors and senior managers undertook the Institute for Occupational Safety & Health examination for senior executives.

Safety by behaviour Safety by engineering and management can only be effective if everyone involved behaves in the appropriate manner, namely, complies with the rules, looks after themselves and their colleagues and reports unsafe conditions. To support safety by behaviour we have introduced a behaviour-based safety programme, across the company, called 'Fresh Eyes'. The aim of 'Fresh Eyes' is that through regular work observations by colleagues, 'at risk' behaviour and complacency can be identified and corrective action taken before any risks escalate into an incident.

We carry out regular benchmarking both internally and externally to ensure that we are constantly up to date with international best practice. In addition to providing a safe place of work for our employees, we also have proactive health programmes in place at the majority of our assets. These programmes provide regular health checks and encourage healthy lifestyles through a combination of training, health monitoring and subsidised gym memberships.

The reporting of health and safety issues is part of the Company's regular performance reporting and review process.

Human rights

As we regard our employees as the greatest asset in the Company, mutual respect is given the highest priority. We support the Universal Declaration of Human Rights and apply its principles throughout our workforce. This commits International Power to ensure:

- the health and safety of our employees and the environment in which they work;
- respect for the opinions of our colleagues;
- abuse of a personal nature has no place within International Power;
- respect for the value of our time, both at work, and the value of time devoted by our colleagues to their families;
- respect for different cultures and religions and equal opportunity regardless of employees' location, nationality, gender, ethnic origin, sexuality or religion.

Saltend, UK

Charitable giving

The Company's charities and donations committee oversees the award of charitable and other donations. In addition to assessing requests and making awards in response to applications for assistance from a variety of charities and good causes, the committee is also responsible for selecting the Company's community-based nominated charities and annual flagship projects. Donations are also made to alleviate hardship and to support relief efforts in response to natural disasters.

Within our regional businesses, each of our assets has an annual fund for charitable projects in the local area.

Nominated charities

International Power designates a number of organisations as nominated charities for periods of three years, providing a guaranteed level of annual funding over this time to support longer-term projects and planning. In 2006, the decision was made to continue to support our three nominated charities with an annual sum of £20,000 to each of them. These include Sight Savers to fund cataract operations and train medical staff in Pakistan. In addition we have provided equipment and instruments for a clinic dealing specifically with child blindness. This clinic is now fully operational. Our other nominated charities continue to be CRISIS, a London-based organisation which supports the homeless, the Queen Elizabeth Foundation who provide support for the disabled through training, and mobility services. It was decided to add a fourth charity namely Wellchild, where, in conjunction with Clifford Chance (our legal advisors), International Power are part-funding the services of a community nurse, to serve the Tower Hamlets area of London, for children who would otherwise have to remain in hospital.

During 2006 International Power and its subsidiaries contributed £1,050,000 to charitable causes and other community projects. Companies in which we have a minority shareholding (associates and joint ventures) contributed a further £346,000.

Flagship projects

Our flagship project programme, selected each year from staff nominations, has been running for five years. These are community projects corporately funded annually by International Power. Flagship projects can range in size and scope, but they all have a common goal: to improve the quality of life in the community.

The 2006 Flagship projects were awarded to:

- The Traralgon Conservation Reserve in the Latrobe Valley, Australia, supporting the final phase of development. The award will cover an information shelter and panels illustrating the native flora, fauna and history of the Reserve. An education and development pack for students has also been produced.

  This facility is a vital community asset providing the opportunity to learn about and enjoy the ever-diminishing natural environment. It is ideally situated to provide numerous recreational and educational benefits for the local community.

  This project was proposed by Loy Yang B power station located in the Latrobe Valley, Victoria, Australia
- A second grant was awarded to Rugeley power station in the UK to support Southern Staffordshire Forest Schools Cluster Group to provide an educational approach to outdoor play and learning. The philosophy of the Schools is to encourage and inspire individuals of any age by engaging in motivating tasks and helping to develop personal, social and emotional skills.

  The award will provide the relevant equipment, materials and publicity to launch the Forest School in the Rugeley area.

Loy Yang B, Victoria

EcoEléctrica wins prestigious award

EcoEléctrica in Puerto Rico won the 'Community Development Program of the Year' award at the Platts Global Energy Awards in 2006, beating over 200 nominees. This is a prestigious award in the energy sector, that places particular emphasis on precision and full commitment.

EcoEléctrica operates the only natural gas-fired power plant in Puerto Rico, and was the first independent power producer in the world to integrate a power plant with a liquefied natural gas terminal. Based in a depressed area in the south – with high unemployment, few educational opportunities and contamination from a rundown petrochemical industry – the company opted to be a source of economic regeneration. EcoEléctrica instigated a social engagement plan called 'EEE' – Employment for the community, Education, and Environmental enhancement. The construction of the plant created over 1,000 jobs and today 82% of employees are from the local community. The company invests annually in a college scholarship programme for 40 students, and supplies materials and equipment to schools. It provided half the funds needed to purchase 85 acres of the El Convento Cave, the only ecosystem in Puerto Rico that has an underground river. EcoEléctrica and its employees are also actively involved in many other community projects.

In the opinion of the judges, EcoEléctrica's efforts in community development outshine those of much larger energy businesses for sheer commitment and social responsibility.

This is just one of International Power's global community programmes. For more details visit our website at www.ipplc.com

Employees

International Power operates in an increasingly complex business environment. We place a high priority on the recruitment, retention and training of staff at all levels, whether employed by us directly or by any of our subsidiaries, joint ventures or associates.

- We value our reputation as a caring employer and seek to attract and retain high calibre employees.
- We endeavour to ensure that all of our staff conduct themselves in a manner of the highest integrity.
- We have a number of share-based long-term incentive remuneration plans that are an integral part of our strategy to reward and retain employees.

We operate an incentive weighted compensation scheme which we believe rewards and develops staff on the following basis:

- **Achievement of tangible personal objectives** Annual targets are set for all personnel, calibrated at levels designed to ensure that individuals are able to contribute to the attainment of these objectives.
- **Professional and educational advancement** We promote and facilitate mid-career training, internal and external seminars, personal development plans and other educational programmes. In addition, we encourage our employees to participate actively in their own personal development and in relevant professional organisations.
- **Leadership** We expect our employees to exercise leadership in their dealings with colleagues, partners, customers and suppliers.

This all relies on a foundation of personal integrity and respect.

Clear communication links are critical to enhance business and commercial awareness throughout our Company. Corporate publications, the International Power website, employee awareness briefings from executive management and team briefings are all used to promote communications and an understanding of the development and application of policies and strategy. We use the latest technology to aid rapid communication with all staff around the world.

Learning and development

During 2006 particular attention was devoted to the Group's learning and development strategy. A worldwide leadership programme for high-potential managers was developed in conjunction with Ashridge Business School in the UK. Two programmes were run in 2006 with 48 managers from around the Group attending. An additional two programmes will be run in 2007.

Following a major review of all our health, safety and environmental policies and procedures, a behavioural-based safety initiative was launched in 2006 as a way to improve power station health and safety management. This programme, **Fresh Eyes,** focuses on people rather than plant or procedures. It involves a colleague or workmate observing their peers and giving feedback on safe behaviour and unsafe behaviour.

- We value our reputation as a caring employer
- We endeavour to ensure our staff conduct themselves in a manner of the highest integrity
- We seek to attract and retain high calibre employees
- We operate an incentive weighted compensation scheme which we believe rewards and develops our staff
- We promote and facilitate career training and personal development programmes

Equal opportunities

The Group is committed to equal opportunities, both from a sense of social responsibility and also because it makes sound business sense to benefit from the wide ranging knowledge and experience of individuals in all sectors of society. This commitment to equal opportunities means that decisions to appoint, reward, train, develop and promote are taken purely on the basis of skills and abilities, as matched against the requirements of the job.

The Group values its reputation as a caring employer and seeks to attract and retain high calibre employees. Opportunities for training are given a high priority to ensure that all individuals can contribute to their own career development. This approach extends itself to the fair treatment of people with disabilities in relation to their recruitment, training and development.

Diversity in the workplace

Cultural awareness and diversity training is provided to all relevant managers within the business and specific cultural awareness training is provided to our employees prior to overseas assignments.

At a regional level a number of our assets are members of diversity organisations. Our UK assets are registered as 'Investors in People'. Rugeley is also accredited to the 'Positive about Disability' standard. Our UK assets also have established a set of policies and procedures to ensure diversity in the workplace. This ensures equal opportunities are integrated into their recruitment and selection processes and subsequent employment.

The Company uses a variety of techniques for assessing applications as part of its selection process. Where external selection techniques are implemented, the Company is at pains to ensure that the providers are able to demonstrate their methodologies are free of bias. Internal selection processes revolve around objective assessment of the candidates insofar as they are able to meet the specification of the job.

Involvement in the community

The Group attaches particular importance to its programme of community support which includes the active participation of staff. The Group actively supports Business in the Community and takes part in their 'Companies that Count' initiative in the UK, whilst in Indonesia, staff at Paiton are involved in supporting local communities with their medical and nutritional requirements for babies. In Pakistan, at Uch power station, support has been provided for educational, health and infrastructure projects. Staff at Deeside in the UK, and Hub in Pakistan worked together to raise money for the relief effort following the Pakistan earthquake.

Employee share plans

International Power has in place a number of share-based remuneration plans under which employees of the Group and its subsidiary companies may acquire shares in International Power plc.

These plans form an integral part of the Group's strategy to provide appropriate reward and retention strategies for employees and, to align employee and shareholder interests through incentive targets based on clear financial criteria. Executive share options have been granted to employees in seven countries outside the UK and the Global Sharesave Plan is now in operation in four countries outside the UK. As the Group continues to grow and employee numbers continue to increase, we anticipate that the extension of share plans to overseas jurisdictions will continue apace.

Blackstone, Massachusetts

Directors' remuneration report

The establishment of remuneration policy and the determination of the compensation of Executive Directors is undertaken on behalf of the Board by the Remuneration Committee.

The Company's remuneration policy for each Executive Director takes account of the changing nature of the business in both the UK and overseas.

Executive Directors receive a remuneration package aligned with short and medium-term corporate and personal targets. The package comprises:

- a market competitive salary;
- a performance related annual bonus;
- a long-term share-related incentive scheme;
- pension benefits;
- other benefits (healthcare, company car allowance).

The Remuneration Committee has access to external independent remuneration advice. Towers Perrin has been appointed by the Committee to provide specialist advice on Executive Director and senior management remuneration. Towers Perrin did not undertake any other services on behalf of the Company during the year ended 31 December 2006.

In addition, the Committee received advice from Penny Chalmers, director of global resources, on all aspects of remuneration. The CEO attended Committee meetings to report on Executive Directors' performance (other than his own).

This report to the shareholders by the Committee covers the following: remuneration policy (including information on share options, long-term incentive plans, Directors' service contracts and Directors' pension benefits); Directors' aggregate remuneration and compensation; and Directors' interests in the Company's shares.

Remuneration policy

The Company's remuneration policy for the Executive Directors takes account of the changing nature of the business and remuneration practices both in the UK and overseas. The Committee has based its executive remuneration policy on the following principles to ensure that it remains relevant to business needs in the medium term:

- Total remuneration levels will be sufficient to retain and motivate top quality executives;
- Remuneration packages will include a significant performance related element;
- Incentives will be based upon the achievement of specific and measurable performance objectives that align executives' rewards with the creation of value for shareholders;
- Remuneration packages will include significant opportunities to acquire, and obligations to retain, International Power shares, consistent with our strategy of building a strong share ownership culture.

This approach applies to the current year and the Committee intends to continue it for the foreseeable future, taking into account developing market practice.

- The establishment of remuneration policy and the determination of Executive Directors' compensation is undertaken on behalf of the Board by the Remuneration Committee
- Executive Directors receive a remuneration package aligned with short and medium-term corporate and personal targets
- The Company's remuneration policy for the Executive Directors takes account of the changing nature of the business and in remuneration practices both in the UK and overseas
- Our pay policy is to be competitive around the median of the FTSE 51-100 group of companies. This reflects the Company's market capitalisation in the FTSE 100

Our pay policy is to be competitive around the median of the FTSE 51-100 group of companies. This reflects the Company's market capitalisation in the FTSE 100. The Committee also has regard to the pay of staff and management generally within the Group, to ensure that an appropriate balance is maintained in remuneration levels.

During 2006 the Company consulted with major institutional shareholders, together with the ABI and RREV, regarding changes to the remuneration arrangements of our Executive Directors.

In order to maintain market level remuneration packages for Executive Directors, from 1 January 2006, the Remuneration Committee decided:

- to increase the maximum level of bonuses from 70% of base salary to 100%, for implementation in the 2006 financial year onwards. The target bonus for hitting budget is increased from 47% to 67%;
- to increase Performance Share Plan awards to 200% of base salary for the CEO, and to 150% of base salary for other Executive Directors.

The Committee has concluded that the maximum level of bonus and the Performance Share Plan awards set out above will also apply for 2007.

Also, effective from 1 January 2006, the Remuneration Committee removed, for Executive Directors:

- The Bonus Share Retention Plan, which has achieved its objectives of providing a mechanism for Directors to increase substantially their shareholdings in the Company by foregoing a portion of their cash annual bonus. Therefore, no more awards will be made under this arrangement;
- Participation in the annual grants of the Executive Share Option Schemes.

Elements of remuneration

Executive Directors receive a remuneration package aligned with short and medium-term corporate and personal targets. The package comprises a market competitive base salary; performance related annual bonus (for 2006 satisfied wholly in cash); a long-term share-related incentive; pension benefits; and other benefits including a healthcare programme and a company car allowance.

Executive Director remuneration packages are structured to provide significant awards for superior performance.

Main fixed and performance related elements of remuneration effective from 1 January 2007

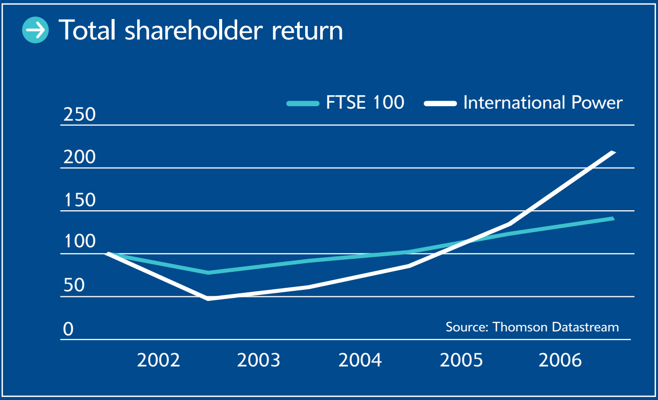
Fixed elements	Performance elements
Base salary	Annual bonus
Pension	Performance Share Plan
Benefits (e.g. car allowance, healthcare)	

The face value of the performance related elements (annual bonus and long-term incentives) represents 300% of base salary for the CEO and 250% of base salary for other Executive Directors. The level of remuneration receivable in respect of the performance-related elements is dependent upon the achieved level of performance in the relevant performance period.

Total shareholder return (TSR)

The graph shows the TSR performance of International Power's shares relative to the FTSE 100 index from the year 2002 to 2006.

The FTSE 100 index is considered to be the most appropriate benchmark for comparative purposes as the Company is a constituent member of the FTSE 100.



Base salary as at 1 January 2007

Salaries for the Executive Directors were reviewed with effect from 1 January 2007 against the background of the Directors' Remuneration Report 2005 which noted shareholders' concerns about escalating base pay. As a result the Committee has determined that unless there are changes of role, salary increases are only likely to be in line with inflation and market movements. This approach was followed in setting salaries for Executive Directors, effective from 1 January 2007, as set out below, and, therefore the salaries for UK-based Executive Directors increased by an average of 6%.

After a careful consideration of Bruce Levy's pay positioning against the US market, taking into account total pay including base pay, annual bonus and long-term incentives the Committee concluded that a salary increase of 25% should be awarded to him. The increase was required to establish his total pay on a market median competitive basis.

Name	Salary
Philip Cox	£650,000
Mark Williamson	£382,000
Tony Concannon	£350,000
Steve Riley	£350,000
Bruce Levy	US$750,000

Annual bonus

The International Power annual performance bonus is a non-pensionable payment for the achievement of targets set by the Remuneration Committee at the start of each financial year. The 2006 targets included EPS and regional profit from operations, both excluding exceptional items and specific IAS 39 mark to market movements, Group free cash flow, regional free cash flow, regional return on equity and personal targets. The maximum annual bonus opportunity for Executive Directors was set at 100% of base salary for the performance year 1 January to 31 December 2006 which will be paid fully in cash (i.e. no longer part in cash and part in shares).

For the 2006 performance period, the Committee reviewed the performance of each Executive Director against their qualitative and quantitative objectives. EPS and regional profit from operations, both excluding exceptional items and specific IAS 39 mark to market movements, Group free cash flow, regional free cash flow and regional return on equity all exceeded target in each region for the performance year 2006. In addition the Committee agreed that the Executive Director team had worked well to deliver the benefits of integrating the assets purchased as part of the Coleto Creek, Indian Queens and Levanto acquisitions whilst maintaining good operational results from the regions.

The Committee used their discretion to enhance the 2006 bonus for Bruce Levy to recognise the contribution of the significantly improved performance from our North American business.

Name	Bonus	Award
Philip Cox	100%	£610,000
Mark Williamson	100%	£360,000
Tony Concannon	100%	£330,000
Steve Riley	100%	£330,000
Bruce Levy	200%	£650,336

The details of these payments are set out in the Directors' aggregate remuneration table.

For 2007 the maximum target bonus levels have been established on the following basis:

Maximum 2007 bonus achievable

	Personal	EPS (Group)	Free cash flow (Group)	Profit from operations (Region)	Free cash flow (Region)
Philip Cox	10%	60%	30%	-	-
Mark Williamson	10%	60%	30%	-	-
Tony Concannon	10%	30%	15%	30%	15%
Steve Riley	10%	30%	15%	30%	15%
Bruce Levy	10%	30%	15%	30%	15%

Selection of performance criteria

For awards previously made under the 2002 Performance Share Plan and the Approved, Unapproved and Global Executive Share Option Plans, the performance conditions have been aligned with the key objective of growth in the EPS measure, which reflects the underlying business performance of the Company, as presented in the financial statements.

Prior to 2006 the performance condition for Performance Share Plan awards was based exclusively on EPS growth. In 2006 the Remuneration Committee concluded that the performance condition should include an element of TSR. As a result, 50% of the 2006 award is subject to a TSR performance condition measured against companies in the FTSE 51-100, whilst 50% of the award is subject to the achievement of a specific EPS growth target. The inclusion of a significant TSR element recognised shareholders' wishes to have a relative, market-based measure, when assessing performance and will be incorporated into the performance condition for future Performance Share Plan awards.

For the TSR element of the performance measure, 25% of this element of the award will vest for median TSR performance and 100% will vest for upper quartile performance. In addition, before releasing any award in respect of the TSR element, the Remuneration Committee will satisfy itself that the Company's TSR performance is a genuine reflection of the underlying performance of the Company.

For the 2007 Performance Share Plan awards, the threshold and maximum EPS performance conditions have been fixed at 27p (representing 6.4% compound annual growth on 2006 EPS performance) and 34p (representing 14.9% compound annual growth on 2006 EPS performance) respectively. They have been selected to provide a challenging performance requirement.

Straight line pro-rating will apply for performance between the threshold and maximum data points for both the TSR and EPS growth elements.

If either the TSR or EPS performance measure is not achieved the other half of the award may still vest if the relevant performance measure has been achieved. The extent of vesting will be dependent upon achieved performance as described above.

The Remuneration Committee will assess the level of performance in respect of any performance condition.

Given that the principal performance measures for the Company's share plans is based on growth in EPS and TSR, the Committee will also take into account, and adjust appropriately for, the enhancement effects of any purchase and subsequent cancellation of shares, or placing of shares into treasury, by the Company.

Share Plans for Executive Directors: performance conditions

2002 Performance Share Plan

The annual awards made under this Plan will normally vest after the end of a three-year period. Each award incorporates a performance condition that from 2002 – 2005 has reflected only EPS. For the award made in 2006, the performance condition was based on EPS and TSR. The performance conditions for awards currently outstanding are as follows:

Date of award	Performance period	Threshold performance condition	Maximum performance condition	Vesting rate
10 March 2003 (Philip Cox only*)	1 January 2003 to 31 December 2005	30% of the award will vest if EPS performance for the year ended 31 December 2005 is not less than 9.7p.	100% of the award will vest if EPS performance for the year ended 31 December 2005 is equal to or greater than 11.5p.	Vesting will be pro-rated for EPS performance between these two points.
		2005 EPS 13.5p: Performance condition met. 100% of the award vested on 8 March 2006.		
10 March 2003	1 January 2003 to 31 December 2005	30% of the award will vest if EPS performance for the year ended 31 December 2005 is not less than 9.7p.	100% of the award will vest if EPS performance for the year ended 31 December 2005 is equal to or greater than 13.0p.	Vesting will be pro-rated for EPS performance between these two points.
		2005 EPS 13.5p: Performance condition met. 100% of the award vested on 8 March 2006.		
2 March 2004	1 January 2004 to 31 December 2006	30% of the award will vest if EPS performance for the year ended 31 December 2006 is not less than 8.2p.	100% of the award will vest if EPS performance for the year ended 31 December 2006 is equal to or greater than 11.5p.	Vesting will be pro-rated for EPS performance between these two points.
		2006 EPS 22.4p: Performance condition met. 100% of the award to vest on 12 March 2007.		
11 March 2005	1 January 2005 to 31 December 2007	30% of the award will vest if EPS performance for the year ended 31 December 2007 is not less than 13.7p.	100% of the award will vest if EPS performance for the year ended 31 December 2007 is equal to or greater than 15.0p.	Vesting will be pro-rated for EPS performance between these two points.
8 March 2006	1 January 2006 to 31 December 2008	12.5% of the award will vest if EPS performance for the year ended 31 December 2008 is not less than 21.0p.	50% of the award will vest if EPS performance for the year ended 31 December 2008 is equal to or greater than 24.0p.	Vesting will be pro-rated for EPS performance between these two points.
		12.5% of the award will vest at the median of FTSE 51-100 companies' TSR performance for the three years ended 31 December 2008.	50% of the award will vest at the upper quartile of FTSE 51-100 companies' TSR performance for the three years ended 31 December 2008.	Vesting will be pro-rated for TSR performance between these two points.

* As part of the Company's 2003 succession management plan, a special conditional award was made in March 2003 to Philip Cox.

2007 awards

After the release of its preliminary results, the Company will make Performance Share Plan awards to Philip Cox equivalent to 200% of his base salary, and to Mark Williamson, Tony Concannon, Steve Riley and Bruce Levy equivalent to 150% of their base salary. These awards are subject to the performance conditions described under 'Selection of performance criteria'. Shares will vest subject to the Remuneration Committee being satisfied with the level of achievement against the applicable performance conditions.

Approved, Unapproved and Global Executive Share Option Plans

Pre-Demerger "Legacy" Share Option Plans

In accordance with the rules at the time, there are no performance conditions attached to the National Power 'Legacy' Unapproved Options granted to Tony Concannon and Steve Riley prior to the demerger from National Power.

International Power Share Option Plans

Options granted under these plans will normally become exercisable after the end of a three-year period. Each grant includes a performance condition reflecting EPS growth. There is no re-testing of the performance condition applicable to each option grant. Performance conditions for options granted are as follows:

Date of award	Performance period	Threshold performance condition	Maximum performance condition	Vesting rate
3 October 2000	1 January 2001 to 31 December 2003	Fully exercisable if average annual growth in normalised earnings per International Power Ordinary Share for the financial reporting period ending on 31 December 2000 to the reporting period ending on 31 December 2003 is equal to or exceeds 7%.		
		Performance condition achieved.		
24 May 2002	1 January 2002 to 31 December 2004	Fully exercisable if average annual EPS growth over the Performance Period (being 1 January 2002 to 31 December 2004) is not less than RPI+4%.		
		Performance condition not achieved.		
10 March 2003	1 January 2003 to 31 December 2005	30% of the award will be exercisable if EPS performance for the year ending 31 December 2005 is not less than 9.7p.	100% of the award will be exercisable if EPS performance for the year ending 31 December 2005 is equal to or greater than 11.5p.	Vesting will be pro-rated for EPS performance between these two points.
		2005 EPS 13.5p: Performance condition met, 100% of the award exercisable from 10 March 2006.		
2 March 2004	1 January 2004 to 31 December 2006	Fully exercisable if EPS for the 2006 financial year is not less than 8.7p.		
		2006 EPS 22.4p: Performance condition met. 100% of the award fully exercisable from 7 March 2007.		
11 March 2005	1 January 2005 to 31 December 2007	30% of the award will be exercisable if EPS performance for the year ending 31 December 2007 is not less than 13.7p.	100% of the award will be exercisable if EPS performance for the year ending 31 December 2007 is equal to or greater than 14.5p.	Vesting will be pro-rated for EPS performance between these two points.

No awards of Executive Share Options were made to the Executive Directors in 2006 and the Executive Directors will not participate in future grants of Executive Share Options.

As a result of the 2006 performance conditions being met, the following shares under the Performance Share Plan will be released to the Executive Directors on 12 March 2007; also the following Executive Share Options become exercisable from 7 March 2007:

	Performance Shares	Executive Share Options
Philip Cox	384,529	384,529
Mark Williamson	202,384	202,384
Tony Concannon	190,240	190,240
Steve Riley	190,240	190,240

Pensions policy

The Committee has reviewed its pensions policy for the Executive Directors against the background of the changes in pensions legislation effective from 6 April 2006. The Committee has concluded that no compensatory payments will be made as a result of this change in legislation.

The Remuneration Committee has agreed to maintain the application of the earnings cap on pensionable earnings to members who joined the Electricity Supply Pension Scheme on or after 1 June 1989.

The Committee has also concluded that from April 2006 no further contributions should be paid into a Funded Unapproved Retirement Benefit Scheme (FURBS) fund. In lieu of future contributions to a FURBS fund, from April 2006, a non-pensionable cash allowance will be paid. The cost ceiling for the provision of pension benefits for the Executive Directors who are affected by the earnings cap is 33% of salary. The value of the allowance payable is determined by deducting from the cost ceiling an allowance for actual pension provision and the cost of unapproved life cover.

Directors' service contracts

Service contract – Philip Cox

Philip Cox has a service contract subject to 12-months' notice by the Company. For termination other than for cause, he may receive a payment of 125% of annual basic salary (which includes the 12-months' notice) to take account of the value of contractual benefits. The date upon which this contract was entered into was 25 February 2003.

Service contracts – Mark Williamson, Steve Riley and Tony Concannon

Mark Williamson, Steve Riley and Tony Concannon have service contracts which are subject to 12-months' notice by the Company. For termination by the Company, these Executive Directors may receive a payment of 125% of annual basic salary (which includes the 12-months' notice) which will be paid on a monthly basis until the Executive Director secures alternative employment, up to a maximum of 12 monthly payments. The date upon which these contracts were entered into was 23 February 2004.

Appointment agreement – Bruce Levy

Bruce Levy has a US appointment agreement which is subject to 12-months' notice by the Company. For termination by the Company, he may receive a payment of 125% of annual basic salary (which includes the 12-months' notice) which will be paid in semi-monthly instalments, plus benefit continuation. If the Company elects to release Bruce Levy from the restrictive covenants in his contract, he can be required to account for any salary received to reduce the amount of these semi-monthly payments, to a maximum of 24 semi-monthly payments. The date upon which his agreement was entered into was 21 December 2005.

Service contracts – Non-Executive Directors

The Chairman of International Power plc, Sir Neville Simms, has a letter of appointment with a 12-month notice period. The letter of appointment was signed on 22 February 2000. The other Non-Executive Directors are appointed on a three-year fixed-term, annual fixed-fee basis. Their appointment is reviewed at the end of each three-year period and extended for a period of one to three years if both parties agree.

The following table summarises the appointment and termination dates for Directors:

	Date contract entered into	Contract expiry
Executive Directors		
Philip Cox	25 February 2003	12-months' notice
Mark Williamson	23 February 2004	12-months' notice
Tony Concannon	23 February 2004	12-months' notice
Steve Riley	23 February 2004	12-months' notice
Bruce Levy	21 December 2005	12-months' notice

Executive Director service contracts automatically terminate on the date they reach normal retirement age which is 22 September 2011 for Philip Cox, 16 December 2015 for Bruce Levy, 29 December 2017 for Mark Williamson, 16 August 2021 for Steve Riley and 17 December 2023 for Tony Concannon.

Non-Executive Directors		
Sir Neville Simms	22 February 2000	12-months' notice
Tony Isaac	2 October 2000	AGM May 2009
Adri Baan	30 May 2002	31 December 2007
Jack Taylor	2 October 2000	17 May 2006
Struan Robertson	27 September 2004	AGM May 2008
John Roberts	18 May 2006	18 May 2009

Sir Neville Simms' contract will expire at the 2010 AGM, following his 65th birthday, or earlier, subject to the above notice period.

Non-Executive Directors' fees and shareholding requirements

Non-Executive Director fee levels were reviewed with effect from 1 January 2006 (last increased in July 2003). Non-Executive Directors will no longer be required to use a proportion of their fee to purchase International Power shares. The annual fees for 2006 are set out below:

Sir Neville Simms	£250,000
Tony Isaac	£60,000
Adri Baan	£55,000
Jack Taylor	£45,000
Struan Robertson	£45,000
John Roberts	£45,000

The above fees for the Non-Executive Directors comprise a basic fee, which covers Board membership (i.e. attendance at Board meetings, general duties as Directors and their membership of Board committees) of £45,000, a fee of £10,000 per annum for chairing each of the Audit and Remuneration Committees and a fee of £5,000 per annum for acting as Senior Independent Director.

Audit

The detail of the Directors' remuneration, pensions and interests in share options and long-term incentive plans as disclosed below have been audited by the Company's external auditor.

Directors' pension benefits

The pension arrangements for Philip Cox and Mark Williamson are provided through the Senior Section of the International Power Group of the Electricity Supply Pension Scheme, which is an Her Majesty's Revenue and Customs (HMRC)-registered scheme. The scheme provides for: a normal retirement age of 60; an accrual rate that targets two-thirds of pensionable salary at normal retirement age; four times salary death-in-service benefits; a widow's pension of two-thirds of Executive's pension; and Executive's contribution of 6% of salary up to 15% of an earnings cap based on the limits previously imposed by HMRC.

The benefits provided through the scheme are also restricted by an earnings cap based on that previously imposed by HMRC. To compensate for this, the scheme benefits are supplemented by the Company arranging additional life assurance cover and, until 31 March 2006, paying contributions to a FURBS. The cost ceiling for the provision of pension benefits is 33% of salary. The contributions to the FURBS were determined by deducting from the cost ceiling an allowance for actual pension provision and the cost of unapproved life cover. With effect from 1 April 2006 the contributions to the FURBS were replaced by a non-pensionable cash allowance.

The pension arrangements for Tony Concannon and Steve Riley are also provided through the Senior Section of the International Power Group of the Electricity Supply Pension Scheme. As they are not restricted by the HMRC earnings limit, the scheme provides for them: a normal retirement age of 60; an accrual rate that targets two-thirds of pensionable salary at normal retirement age; four times salary death-in-service benefits; a widow's pension of two-thirds of Executive's pension; and Executive's contribution of 6% of salary. The Company does not supplement this arrangement.

	Accrued benefit			Transfer value of accrued benefit			Transfer value of increase in accrued pension excluding inflation less Directors' contributions
		Increase in year					
	At 31 December 2006 £	Including inflation £	Excluding inflation £	At 31 December 2006 £	At 31 December 2005 £	Increase less Directors' contribution £	£
Philip Cox	15,400	4,200	3,900	292,200	194,000	82,000	57,200
Mark Williamson	22,900	4,200	3,600	362,200	257,000	89,100	41,500
Steve Riley	105,500	20,400	18,100	1,551,200	1,090,100	444,100	249,100
Tony Concannon	98,900	19,000	16,900	1,307,900	920,300	370,500	206,000

- The accrued benefit, as at 31 December 2006, is the pension entitlement which would be paid annually on retirement based on service to the end of 2006. In addition to the pension shown above for service prior to 2 October 2000, Mark Williamson has an entitlement to an accrued lump sum of £346, Steve Riley has an entitlement to an accrued lump sum of £185,930 and Tony Concannon has an entitlement to an accrued lump sum of £176,471. The normal retirement age is 60.
- Dependants' pensions on death are 58% of members' pension in respect of service prior to 2 October 2000 and two-thirds of members' pension in respect of service thereafter. On death-in-service a lump sum of four times salary is payable. On death within the first five years of retirement, a lump sum is payable equal to the balance outstanding of the first five years' pension payments.
- Post-retirement increases are expected to be in line with inflation (guaranteed up to the level of 5% p.a. and discretionary above that level).
- The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.
- Members of the pension scheme have the option to pay Additional Voluntary Contributions; neither the contributions nor the resulting benefits are included in the above table.
- In addition to the above entitlements to 31 March 2006, contributions to a FURBS were £32,000 in respect of Philip Cox, and £20,900 in respect of Mark Williamson.

The pension arrangements for Bruce Levy are provided through a 401k Savings Plan, a Retirement Plan and a Supplemental Retirement Plan, which are money purchase schemes operated by International Power America (formerly American National Power), up to a cost to the Company of 30% of salary. With effect from 1 January 2006, this cost ceiling was increased to 33%.

2006 Directors' remuneration and interests

Directors' aggregate remuneration

The table below shows the aggregate remuneration of the Directors of International Power plc for the year ended 31 December 2006.

	Salary £	Fees £	Performance related bonus – cash £	Payment in lieu of pension £	Other benefits £	Aggregate remuneration year to 31 December 2006 £	Aggregate remuneration year to 31 December 2005 £
Sir Neville Simms	–	250,000	–	–	–	250,000	210,000
Philip Cox	610,000	–	610,000	137,512	16,109	1,373,621	1,342,397
Mark Williamson	360,000	–	360,000	86,429	13,441	819,870	801,173
Tony Concannon	330,000	–	330,000	–	97,860	757,860	728,148
Steve Riley	330,000	–	330,000	–	74,008	734,008	765,061
Bruce Levy	325,168	–	650,336	107,306	46,458	1,129,268	453,905
Tony Isaac	–	60,000	–	–	–	60,000	50,000
Adri Baan	–	55,000	–	–	–	55,000	45,000
Jack Taylor	–	22,500	–	–	–	22,500	40,000
Struan Robertson	–	45,000	–	–	–	45,000	40,000
John Roberts	–	27,944	–	–	–	27,944	–
Total	1,955,168	460,444	2,280,336	331,247	247,876	5,275,071	4,475,684

1. The International Power plc Non-Executive Directors' basic fee, which covers Board membership (i.e. attendance at Board meetings, general duties as Directors, and their membership of Board Committees) was £45,000. In addition, Tony Isaac received an additional fee of £5,000 for his role as Senior Independent Director. Tony Isaac also received £10,000 for his role as Chairman of the Audit Committee, and Adri Baan received an additional fee of £10,000 for his role as Chairman of the Remuneration Committee. John Roberts joined the Company on 18 May 2006. Jack Taylor resigned as a Director on 17 May 2006.
2. Sir Neville Simms' fee for 2006 was £250,000.
3. For Philip Cox, the payment in lieu of pension detailed in the above table sets out the contributions made to his death-in-service insurance premium, Funded Unapproved Retirement Benefits Scheme (FURBS) to April 2006 and a cash allowance in lieu of contributions to a FURBS from April 2006. He also received a company car allowance and private medical insurance, which are included in 'Other benefits'.
4. For Mark Williamson, the payment in lieu of pension detailed in the above table sets out the contributions made to his death-in-service insurance premium, FURBS to April 2006 and a cash allowance in lieu of contributions to a FURBS from April 2006. He also received a company car allowance and private medical insurance, which are included in 'Other benefits'.
5. Tony Concannon was appointed an Executive Director on 1 January 2004. He received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. Also included in 'Other benefits' is the value of his relocation and expatriate support. In addition, International Power Australia Pty Ltd incurs local charges regarding taxation of remuneration. For 2006, this cost is £348,157 (2005: £318,028) which was fully funded by Tony Concannon.
6. Steve Riley was appointed an Executive Director on 1 January 2004. He received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. Also included in 'Other benefits' is the value of his relocation and repatriation support.
7. Bruce Levy was appointed an Executive Director on 1 June 2005. His salary from that date is included in the above table. The payment in lieu of pension detailed in the above table sets out the contributions made to Bruce Levy's 401k Savings Plan, a Retirement Plan and a Supplemental Retirement Plan. He also received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. Also included in 'Other benefits' is the value of his relocation support. The values shown in the above table have been converted from US dollars to sterling using the average annual exchange rate of 1.8452.

The following information shows the interests of the Directors as at the end of the financial year in the Company's Performance Share Plans, Executive Share Option Plans and the Sharesave Plan.

Long-term incentive plans

i) 2002 Performance Share Plan

Conditional rights awarded over International Power plc Ordinary Shares under the 2002 Performance Share Plan held by Directors at 1 January 2006 and 31 December 2006 (together with details of awards made and vested during the period) were as follows:

	As at 1 January 2006	Awards made[1]	Market value as at date of Award (pence)	End of performance period	Awards vested[2]	Market value on vesting date (pence)	As at 31 December 2006
Philip Cox	759,169	–	62.32	31 December 2005	(759,169)	268.50	–
	384,529	–	123.53	31 December 2006	–	–	384,529
	292,887	–	179.25	31 December 2007	–	–	292,887
	–	434,163	281.00	31 December 2008	–	–	434,163
	1,436,585	434,163			(759,169)		1,111,579
Mark Williamson	99,164	–	62.32	31 December 2005	(99,164)	268.50	–
	202,384	–	123.53	31 December 2006	–	–	202,384
	172,942	–	179.25	31 December 2007	–	–	172,942
	–	192,170	281.00	31 December 2008	–	–	192,170
	474,490	192,170			(99,164)		567,496
Tony Concannon	67,994	–	62.32	31 December 2005	(67,994)	268.50	–
	190,240	–	123.53	31 December 2006	–	–	190,240
	158,995	–	179.25	31 December 2007	–	–	158,995
	–	176,156	281.00	31 December 2008	–	–	176,156
	417,229	176,156			(67,994)		525,391
Bruce Levy	158,995	–	179.25	31 December 2007	–	–	158,995
	–	184,432	281.00	31 December 2008	–	–	184,432
	158,995	184,432			–		343,427
Steve Riley	88,505	–	62.32	31 December 2005	(88,505)	268.50	–
	190,240	–	123.53	31 December 2006	–	–	190,240
	158,995	–	179.25	31 December 2007	–	–	158,995
	–	176,156	281.00	31 December 2008	–	–	176,156
	437,740	176,156			(88,505)		525,391

The performance conditions that must be satisfied for the vesting of awards are given in the Remuneration section of the *Annual Report* on page 67.

[1] Awards made on 8 March 2006. The performance conditions that must be satisfied before these awards may be released are set out in the Remuneration Report on page 67.

[2] Awards vested on 8 March 2006. The aggregate of the theoretical gain made by Directors on the vesting of the Performance Share Plan Awards during the year was £2,724,824 (2005: nil). This is calculated by reference to the closing mid-market price of the shares on the date of vesting, disregarding whether such shares were sold or retained on exercise, and is stated before tax.

ii) Executive Share Options

Options over International Power plc Ordinary Shares granted under the National Power Legacy Executive Share Option Scheme, the International Power UK Approved and Unapproved Executive Share Option Schemes and the Global Executive Share Option Schemes held by Directors at 1 January 2006 and 31 December 2006 (together with details of options exercised during the period), were as follows:

	As at 1 January 2006	Exercise price per share (pence)	Exercised during the year	Date of exercise	Market value on date of exercise (pence)	Exercise period from	Exercise period to	As at 31 December 2006
Philip Cox	17,191	174.50				24.05.2005	24.05.2012	17,191
	149,859	174.50				24.05.2005	24.05.2012	149,859
	561,616	62.32	(561,616)	14.08.2006	319.25	10.03.2006	10.03.2013	–
	384,529	123.53				02.03.2007	02.03.2014	384,529
	292,887	179.25				11.03.2008	11.03.2015	292,887
	1,406,082		(561,616)					844,466
Mark Williamson	5,403	277.55				02.10.2003	02.10.2010	5,403
	30,624	277.55				02.10.2003	02.10.2010	30,624
	7,168	209.22				22.03.2004	22.03.2011	7,168
	16,728	209.22				22.03.2004	22.03.2011	16,728
	35,415	174.50				24.05.2005	24.05.2012	35,415
	99,164	62.32	(99,164)	14.08.2006	319.25	10.03.2006	10.03.2013	–
	202,384	123.53				02.03.2007	02.03.2014	202,384
	172,942	179.25				11.03.2008	11.03.2015	172,942
	569,828		(99,164)					470,664
Tony Concannon	7,189	287.76	(7,189)	13.12.2006	388.25	23.12.1999	23.12.2006	–
	6,950	343.73				02.12.2000	02.12.2007	6,950
	7,873	313.92				01.12.2001	01.12.2008	7,873
	3,377	277.55				02.10.2003	02.10.2010	3,377
	19,139	277.55				02.10.2003	02.10.2010	19,139
	4,480	209.22				22.03.2004	22.03.2011	4,480
	10,455	209.22				22.03.2004	22.03.2011	10,455
	6,447	174.50				24.05.2005	24.05.2012	6,447
	17,835	174.50				24.05.2005	24.05.2012	17,835
	67,994	62.32	(67,994)	14.08.2006	319.25	10.03.2006	10.03.2013	–
	190,240	123.53				02.03.2007	02.03.2014	190,240
	158,995	179.25				11.03.2008	11.03.2015	158,995
	500,974		(75,183)					425,791
Bruce Levy	158,995	179.25				11.03.2008	11.03.2015	158,995
	158,995							158,995
Steve Riley	12,302	287.76	(12,302)	14.08.2006	319.25	23.12.1999	23.12.2006	–
	12,001	343.73				02.12.2000	02.12.2007	12,001
	13,904	313.92				01.12.2001	01.12.2008	13,904
	5,674	277.55	(5,674)	14.08.2006	319.25	02.10.2003	02.10.2010	–
	32,155	277.55	(32,155)	14.08.2006	319.25	02.10.2003	02.10.2010	–
	6,810	209.22	(6,810)	14.08.2006	319.25	22.03.2004	22.03.2011	–
	18,282	209.22	(18,282)	14.08.2006	319.25	22.03.2004	22.03.2011	–
	31,608	174.50				24.05.2005	24.05.2012	31,608
	88,505	62.32	(88,505)	14.08.2006	319.25	10.03.2006	10.03.2013	–
	190,240	123.53				02.03.2007	02.03.2014	190,240
	158,995	179.25				11.03.2008	11.03.2015	158,995
	570,476		(163,728)					406,748

No grants of Executive Share Options were made to Directors during the period 1 January 2006 to 31 December 2006.

Options exercisable prior to October 2003 were granted under the National Power Legacy Executive Share Option Scheme (Tony Concannon and Steve Riley). Options exercisable after October 2003 were granted under the International Power Approved and Unapproved Executive Share Option Plans (Philip Cox, Mark Williamson, Tony Concannon and Steve Riley) and the Global Executive Share Option Plan (Bruce Levy).

Details of performance criteria attaching to options capable of exercise from October 2003 onwards are given in the Remuneration section of the *Annual Report* on page 68. Options exercisable from October 2003, March 2004 and March 2006 achieved their performance criteria in full and are capable of exercise in total. Options exercisable from May 2005 did not meet their performance criteria. No performance conditions applied to those options exercisable prior to October 2003.

The aggregate of the theoretical gain made by Directors on the exercise of options during the year was £2,154,335 (2005: nil). This is calculated by reference to the difference between the closing mid-market price of the shares on the date of exercise and the exercise price of the options, disregarding whether such shares were sold or retained on exercise, and is stated before tax.

iii) Sharesave Options

Options over International Power plc Ordinary Shares granted under the International Power Sharesave Plan and Global Sharesave Plan held by Directors at 1 January 2006 and 31 December 2006 (together with details of options exercised during the period), were as follows:

	As at 1 January 2006	Granted	Exercised	Market value[3] (pence)	Option price (pence)	Exercise period From	To	As at 31 December 2006
Philip Cox[1]	20,499	–	–	–	80.12	24.12.2007	24.06.2008	20,499
Mark Williamson[1]	11,793	–	(11,793)	272.00	80.12	24.12.2005	24.06.2006	–
	–	8,050	–	–	200.00	01.03.2011	31.08.2011	8,050
Tony Concannon[1]	–	8,050	–	–	200.00	01.03.2011	31.08.2011	8,050
Bruce Levy[2]	–	8,050	–	–	200.00	01.03.2011	31.08.2011	8,050
Steve Riley[1]	–	4,675	–	–	200.00	01.03.2009	31.08.2009	4,675

(1) Options held under the UK Approved Sharesave Scheme

(2) Options held under the Global Sharesave Scheme.

(3) Date of exercise of option 21 March 2006.

Shares held in trust

As at 31 December 2006, a total of 1,241,452 Ordinary Shares of the Company were held in two separate Employee Share Ownership Trusts (31 December 2005: 2,081,573). Being potential recipients, the Directors (together with all other employees of the Company and its subsidiaries) have an interest in these shares. No shares were purchased and placed into trust during the financial year ended 31 December 2006 (2005: Nil).

Directors' beneficial interests as at 31 December 2006

The beneficial interest of the Directors in office at 31 December 2006 in the Ordinary Shares of the Company are shown in the table below:

Director	At 31 December 2006	At 1 January 2006
Sir Neville Simms	178,220	178,220
Philip Cox	528,133	173,360
Mark Williamson	121,000	105,818
Tony Concannon	123,278	71,992
Bruce Levy	90,364	30,000
Steve Riley	112,226	94,932
Adri Baan	38,801	38,801
Tony Isaac	25,501	25,501
John Roberts	25,000	–
Struan Robertson	3,163	3,163

No Director had, at any time during the financial year, any beneficial interest in the shares of any subsidiary undertaking.

The middle market quotation for an Ordinary Share of the Company on 31 December 2006 was 381.75p (2005: 239.50p) and the daily quotations during the year ranged from 243.00p to 395.25p.

Adri Baan
Chairman of the Remuneration Committee
On behalf of the Board of Directors of International Power plc
5 March 2007


Shuweihat, UAE

Directors' report

Introduction

The Directors submit their report and the audited financial statements of International Power plc (the Company) for the year ended 31 December 2006. The principal activity of the Company is to act as the holding company for a group of companies and a number of associated companies and joint ventures (the Group). The principal activities of the Group are the generation and sale of electricity, and closely related activities such as district heating and desalination.

Business review

The Company is required to present a fair review of the business and the Group during the year ended 31 December 2006 and of the position of the Group at the end of the financial year and a description of the principal risks and uncertainties facing the Group (known as a 'Business Review'). The information that fulfils the requirements of the Business Review can be found in the following sections of the *Annual Report*:

- Business and financial review; pages 8 to 43
- Current Directors' biographical details and Directors who served through the year; pages 44, 45 and 49
- Corporate governance; pages 48 to 55
- Employees; pages 62 and 63
- Directors' remuneration; pages 64 to 75.

Dividend

The Directors propose to pay a dividend of 7.9p per Ordinary Share in respect of the year ended 31 December 2006.

Charitable and political donations

The Group does not make political donations. Details of charitable donations are set out in the CR section on page 60.

Research and development

Pure research is not a core element of the business of the Company. For the period under review, the Company did not undertake any expenditure on research and development. The Company will look to take advantage of technical advances as they arise and will continue to seek to develop power stations in the regions in which the Group operates making effective use of current and new technology as and when available.

Share capital

During the period 1 January 2006 to 31 December 2006 the Company did not purchase any of its Ordinary Shares.

Resolutions will be proposed at the 2007 AGM to renew for a further year the Directors' general authority to allot shares; to renew for a year the partial disapplication of shareholders' statutory pre-emption rights over Ordinary Shares and, to renew the authority to purchase a proportion of the Company's shares.

An explanation of these and other resolutions being proposed at the 2007 AGM will be provided in the Notice of AGM, which will be sent to shareholders during April 2007.

Shares held in trust

As at 31 December 2006 1,241,452 Ordinary Shares of the Company were held in trust for the benefit of employees of the Company and its subsidiaries. These shares had a nominal value of £620,726 and a market value of £4,739,243. The employee share plan for which these shares may be utilised is the 2002 Performance Share Plan.

Substantial shareholdings

As at the date of this report, the Company is aware of interests in 3% or more of the issued share capital of the Company on behalf of the organisations as shown in the table below.

Substantial shareholdings	Number of shares	
AXA S.A.	74,899,335	5.02%
Standard Life Investments Limited	58,397,077	3.91%
Fidelity Management & Research Co	57,450,450	3.85%
Legal and General Investment Management Limited	51,404,644	3.44%
Aviva plc	45,024,267	3.02%

Going concern

The Directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future. Accordingly, the Directors continue to adopt the 'going concern' basis for the preparation of the financial statements.

Disclosure of information to the auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of this information.

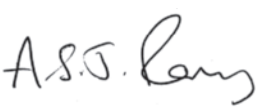
Auditor

A resolution to re-appoint KPMG Audit Plc as auditor of the Company and to authorise the Directors to agree the auditor's remuneration will be proposed at the forthcoming AGM.

Prompt payment policy

The Company aims to observe the highest standard of business practice as both a buyer and seller of products and services. The Company's average number of days outstanding in respect of trade creditors at 31 December 2006 was 38 days.

By order of the Board



Stephen Ramsay
Company Secretary
5 March 2007

Statement of Directors' responsibilities

IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the Annual Report and the Group and parent company financial statements, in accordance with applicable law and regulations.

UK Company law requires the Directors to prepare Group and parent company financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

The Group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the Group. The Companies Act 1985 provides, in relation to such financial statements, that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The parent company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the Group and parent company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' report, Directors' remuneration report and corporate governance statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent auditor's report

TO THE MEMBERS OF INTERNATIONAL POWER plc

We have audited the Group and parent company financial statements (the 'financial statements') of International Power plc for the year ended 31 December 2006 which comprise the consolidated income statement, the consolidated and Company balance sheets, the consolidated statement of changes in equity, the consolidated cash flow statement and the related notes to the consolidated financial statements. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

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

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the *Annual Report* and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the parent company financial statements and the Directors' remuneration report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities on page 77.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group financial statements, Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Business and financial review that is cross-referred from the Business Review section of the Directors' report. In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

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

Basis of audit opinion

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

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 December 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2006;
- the parent company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985;
- the information given in the Directors' report is consistent with the financial statements.

KPMG Audit Plc
Chartered accountants
Registered auditor
5 March 2007

KPMG Audit Plc

8 Salisbury Square
London
EC4Y 8BB

Consolidated income statement

FOR THE YEAR ENDED 31 DECEMBER 2006

		Year ended 31 December 2006			Year ended 31 December 2005		
		Results excluding exceptional items and specific IAS 39 mark to market movements	**Exceptional items and specific IAS 39 mark to market movements**	**Results for the year**	Results excluding exceptional items and specific IAS 39 mark to market movements (Re-presented(i))	Exceptional items and specific IAS 39 mark to market movements (Re-presented(i))	Results for the year
Note		**£m**	**£m**	**£m**	£m	£m	£m
2	Revenue: Group and share of joint ventures and associates	**3,645**	**138**	**3,783**	2,980	(44)	2,936
15	Less: share of joint ventures' revenue	**(373)**	**(6)**	**(379)**	(306)	(3)	(309)
15	Less: share of associates' revenue	**(820)**	**–**	**(820)**	(694)	–	(694)
2	**Group revenue**	**2,452**	**132**	**2,584**	1,980	(47)	1,933
8	Cost of sales	**(1,807)**	**(32)**	**(1,839)**	(1,570)	57	(1,513)
	Gross profit	**645**	**100**	**745**	410	10	420
3/8	Other operating income	**83**	**19**	**102**	64	58	122
3/8	Other operating expenses	**(163)**	**–**	**(163)**	(129)	–	(129)
2/15	Share of results of joint ventures and associates	**208**	**6**	**214**	191	7	198
	Profit from operations	**773**	**125**	**898**	536	75	611
8	Disposal of investments	**–**	**–**	**–**	–	10	10
4	Finance income	**53**	**–**	**53**	53	–	53
5/8	Finance expenses	**(301)**	**(26)**	**(327)**	(255)	–	(255)
	Net finance costs	**(248)**	**(26)**	**(274)**	(202)	–	(202)
	Profit before tax	**525**	**99**	**624**	334	85	419
8/9	Income tax expense	**(122)**	**(25)**	**(147)**	(68)	(21)	(89)
3	**Profit for the year**	**403**	**74**	**477**	266	64	330
	Attributable to:						
	Minority interests	**71**	**(4)**	**67**	52	(7)	45
	Equity holders of the parent	**332**	**78**	**410**	214	71	285
11	**Earnings per share:**						
	Basic	**22.4p**		**27.6p**	14.6p		19.4p
	Diluted	**21.3p**		**26.2p**	14.0p		18.5p

(i) The Group separately presents certain items as exceptional. These are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order for the reader to obtain a proper understanding of the financial information. In addition, in order to assist the reader to understand the underlying business performance, the Group separately discloses within the income statement specific IAS 39 mark to market movements. The 2005 comparatives are re-presented on the same basis (refer notes 1 and 8).

Consolidated balance sheet

AT 31 DECEMBER 2006

Note		31 December 2006 £m	31 December 2005 £m
	Non-current assets		
12	Goodwill	**226**	189
13	Other intangible assets	**189**	194
14	Property, plant and equipment	**4,425**	4,207
15	Investments in joint ventures and associates	**1,264**	1,405
16	Other investments	**26**	4
17	Finance lease receivables	**1,053**	448
18	Other long-term receivables	**94**	67
19	Deferred tax assets	**93**	78
22	Derivative financial assets	**38**	–
	Total non-current assets	**7,408**	6,592
	Current assets		
20	Inventories	**141**	110
21	Trade and other receivables	**399**	396
17	Finance lease receivables	**33**	12
22	Derivative financial assets	**243**	268
	Assets held for trading	**42**	52
23	Cash and cash equivalents	**980**	620
		1,838	1,458
24	Non-current assets classified as held for sale	**128**	–
	Total current assets	**1,966**	1,458
	Total assets	**9,374**	8,050
	Current liabilities		
25	Loans and bonds	**241**	187
22	Derivative financial liabilities	**204**	496
26	Trade and other payables	**529**	511
	Current tax liabilities	**142**	106
	Total current liabilities	**1,116**	1,300
	Non-current liabilities		
25	Loans and bonds	**4,266**	3,464
22	Derivative financial liabilities	**226**	191
27	Other payables	**121**	95
28	Retirement benefit obligations	**25**	27
28	Provisions	**184**	41
19	Deferred tax liabilities	**696**	557
	Total non-current liabilities	**5,518**	4,375
	Total liabilities	**6,634**	5,675
	Net assets	**2,740**	2,375
	Equity		
29/30	Share capital	**746**	737
30	Share premium account	**402**	394
30	Capital redemption reserve	**145**	145
30	Capital reserve	**422**	422
30	Hedging and translation reserves	**(72)**	(69)
30	Retained earnings	**819**	463
	Total equity attributable to equity holders of the parent	**2,462**	2,092
	Minority interests	**278**	283
	Total equity	**2,740**	2,375

The financial statements were approved by the Board of Directors on 5 March 2007 and signed on its behalf by

Philip Cox
Chief Executive Officer

Mark Williamson
Chief Financial Officer

Consolidated statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2006

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	**Attributable to equity holders of the parent £m**	Minority interests £m	**Total £m**
At 1 January 2006	737	394	145	422	(118)	49	463	**2,092**	283	**2,375**
Profit on cash flow hedges	–	–	–	–	120	–	–	**120**	4	**124**
Exchange difference arising on translation of foreign operations	–	–	–	–	4	(127)	–	**(123)**	(14)	**(137)**
Net income/(loss) recognised directly in equity	–	–	–	–	124	(127)	–	**(3)**	(10)	**(13)**
Profit for the year	–	–	–	–	–	–	410	**410**	67	**477**
Total recognised income and (expense) for the year	–	–	–	–	124	(127)	410	**407**	57	**464**
Issue of shares	9	8	–	–	–	–	–	**17**	–	**17**
Minority interests in acquisitions and disposals	–	–	–	–	–	–	–	**–**	(1)	**(1)**
Distributions	–	–	–	–	–	–	(67)	**(67)**	(54)	**(121)**
Other movements	–	–	–	–	–	–	13	**13**	(7)	**6**
At 31 December 2006	**746**	**402**	**145**	**422**	**6**	**(78)**	**819**	**2,462**	**278**	**2,740**

	Share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	**Attributable to equity holders of the parent £m**	Minority interests £m	**Total £m**
At 1 January 2005	737	392	145	422	(12)	(39)	156	**1,801**	222	**2,023**
Loss on cash flow hedges	–	–	–	–	(101)	–	–	**(101)**	3	**(98)**
Exchange difference arising on translation of foreign operations	–	–	–	–	(5)	88	–	**83**	5	**88**
Net (loss)/income recognised directly in equity	–	–	–	–	(106)	88	–	**(18)**	8	**(10)**
Profit for the year	–	–	–	–	–	–	285	**285**	45	**330**
Total recognised income and (expense) for the year	–	–	–	–	(106)	88	285	**267**	53	**320**
Recognition of equity component in 3.75% convertible US dollar bond	–	–	–	–	–	–	50	**50**	–	**50**
Issue of shares	–	2	–	–	–	–	–	**2**	–	**2**
Minority interests in acquisitions and disposals	–	–	–	–	–	–	–	**–**	16	**16**
Equity funding from minority interests	–	–	–	–	–	–	–	**–**	6	**6**
Distributions	–	–	–	–	–	–	(37)	**(37)**	(14)	**(51)**
Other movements	–	–	–	–	–	–	9	**9**	–	**9**
At 31 December 2005	737	394	145	422	(118)	49	463	**2,092**	283	**2,375**

Consolidated cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2006

Note		Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
	Cash flows from operating activities		
	Profit for the year	**477**	330
	Adjustments for:		
	Income tax expense	**147**	89
	Net finance costs	**274**	202
	Profit on disposal of investments – exceptional	**–**	(10)
	Share of results of joint ventures and associates	**(214)**	(198)
	Depreciation of property, plant and equipment and amortisation of intangible assets	**273**	188
	Impairment reversal – exceptional	**(36)**	(52)
	Profit on receipt from TXU administrators – exceptional	**(14)**	(58)
	Profit on compensation for breach of contract – exceptional	**(5)**	–
	Specific IAS 39 mark to market movements	**(64)**	42
	Other non-cash movements	**(44)**	(36)
	(Decrease)/increase in provisions	**(9)**	3
	Proceeds from sale of property, plant and equipment	**–**	3
	Decrease in finance lease receivables	**14**	10
	Dividends received from joint ventures and associates	**113**	92
	Purchase of property, plant and equipment – maintenance	**(128)**	(72)
	Operating cash flows before movements in working capital	**784**	533
	Increase in inventories	**(18)**	(13)
	Decrease/(increase) in trade and other receivables	**22**	(154)
	(Decrease)/increase in trade and other payables	**(19)**	146
	Cash generated from operations	**769**	512
	Income taxes paid	**(57)**	(31)
	Interest paid	**(293)**	(231)
	Interest received	**37**	35
	Free cash flow	**456**	285
	Cash flows relating to exceptional items:		
	Receipt from TXU administrators – exceptional	**14**	58
	Receipt of compensation for breach of contract – exceptional	**5**	–
	Finance costs – exceptional	**–**	(5)
	Net cash inflow from operating activities	**475**	338
	Cash flows from investing activities		
	Purchase of property, plant and equipment – growth	**(142)**	(188)
31	Acquisitions of subsidiaries, net of cash and cash equivalents acquired	**(650)**	(494)
31	Acquisitions of joint ventures, associates and investments	**(64)**	(50)
	Returns from joint ventures and associates (net of investments)	**24**	48
	Proceeds from disposal of a subsidiary	**–**	73
	Proceeds from disposal of investments	**1**	138
	Net cash outflow from investing activities	**(831)**	(473)
	Cash flows from financing activities		
	Dividends paid	**(67)**	(37)
	Proceeds from share issue	**15**	2
	Proceeds from long-term borrowings	**1,340**	563
	Repayment of long-term borrowings	**(495)**	(422)
	Funding from minority interests	**7**	80
	Funding repaid to minority interests	**(4)**	–
	Distributions paid to minority interests	**(54)**	(14)
	Net cash inflow from financing activities	**742**	172
	Net increase in cash and cash equivalents	**386**	37
	Cash and cash equivalents at beginning of the year	**620**	565
	Effect of foreign exchange rate changes thereon	**(26)**	18
23	**Cash and cash equivalents at end of the year**	**980**	620

Notes to the consolidated financial statements

FOR THE YEAR ENDED 31 DECEMBER 2006

1 ACCOUNTING POLICIES

a) General information

International Power plc (the Company) is a public limited company incorporated and domiciled in the United Kingdom. The address of its registered office is disclosed on the last page of this *Annual Report*. The consolidated financial statements of the Company for the year ended 31 December 2006 comprise the Company and its subsidiaries (together referred to as the Group) and the Group's interest in joint ventures and associates. The parent company financial statements present information about the Company as a separate entity and not about its Group. The principal activities of the Group are described in note 2.

b) Statement of compliance

European Union (EU) law (IAS Regulation EC 1606/2002) requires that the consolidated financial statements, for the year ended 31 December 2006, be prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU (Adopted IFRSs). These Group financial statements have been prepared and approved by the Directors in accordance with Adopted IFRSs.

The Company has elected to prepare its parent company financial statements in accordance with UK GAAP. The parent company financial statements are presented on pages 132 to 138.

c) Adopted IFRSs not yet applied

The following Adopted IFRSs were available for early application but have not been applied by the Group in these financial statements.

IFRS 7 (Financial Instruments: Disclosures) is applicable for years commencing on or after 1 January 2007. The application of IFRS 7 in 2006 would not have affected the results or net assets as the standard is concerned only with disclosure. The Group plans to adopt it in 2007.

IFRS 8 (Operating Segments) is applicable for years commencing on or after 1 January 2009. The application of IFRS 8 in 2006 would not have affected the results or net assets as the standard is concerned only with disclosure.

d) Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis, except for derivative financial instruments and financial instruments held for trading, which are carried at fair value.

Exceptional items and specific IAS 39 mark to market movements

In order to allow a better understanding of the financial information presented, and specifically the Group's underlying business performance, the Group presents its income statement in three columns such that it identifies (i) results excluding exceptional items and specific IAS 39 mark to market movements, (ii) the effect of exceptional items and specific IAS 39 mark to market movements and (iii) results for the year. For the purposes of clarity, in the explanation of the basis of preparation applied in these consolidated financial statements, we describe these columns as the 'left hand column', the 'middle column' and the 'right hand column' respectively.

Those items that the Group separately present as exceptional are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order to obtain a proper understanding of the financial information. The Group discloses exceptional items in the middle column.

The Group enters into derivative contracts to economically hedge certain of its physical and financial exposures. In relation to commodities trading, the Group considers economic hedges to be those which are asset backed, i.e. where the Group is either forward selling electricity from its own generation capacity or forward buying fuel for its own generation capacity. In respect of interest rate swaps and other treasury related derivatives the Group considers economic hedges to be those which hedge existing assets, liabilities and firm commitments.

Some of these economic hedges achieve the own use exemption under IAS 39 and are accounted for on an accruals basis. Some are accounted for as cash flow hedges under IAS 39 with fair value gains and losses recorded in the hedging reserve. Where derivative contracts do not achieve the own use exemption and the Group could not, or has not sought to, apply cash flow hedge accounting, IAS 39 requires the derivative contract to be measured at fair value (marked to market) with fair value gains and losses recognised in the income statement. The Group separately presents these mark to market movements on economic hedges, in the middle column, to assist the reader's understanding of underlying business performance and to provide a more meaningful presentation.

For economic hedges, where fair value gains and losses are recorded in the income statement, in the period in which the economically hedged transaction settles, the settlement amount of the derivative, being the cumulative fair value gains and losses recognised in the current and prior periods, is presented in the left hand column so that the transaction is measured at its contracted price (i.e. the spot price less the fair value gain or loss on the derivative contract at that date).

As the cumulative mark to market movements have already been recognised in the middle column in the current and prior periods, an equal but opposite amount is presented in the middle column so that cumulatively the amount recognised in the middle column in respect of such economic hedges is zero.

By presenting fair value gains and losses in this manner, the left hand column is not affected by mark to market movements and therefore reflects the underlying business performance at contracted prices.

The amortisation of derivatives, which are acquired with a fair value other than zero, is always recorded in the left hand column. This is achieved by presenting an equal but opposite amount in the middle column, such that specific IAS 39 mark to market movements presented in the middle column are shown net of the amortisation during the period.

Ineffectiveness in qualifying cash flow hedges under IAS 39 can arise from business combinations, where the fair value of the derivatives at acquisition is not equal to zero, or as a result of the difference between the contractual profile of the economic hedge and the profile of transactions defined as the hedged item. IAS 39 requires ineffectiveness in qualifying cash flow hedges to be recorded in the income statement, and therefore the Group records this ineffectiveness in the middle column when it relates to an economic hedge.

Mark to market movements of the fair value of embedded derivatives in convertible bonds, which relate to conversion features where the functional currency of the issuer and other factors preclude the conversion feature being treated as equity in the consolidated financial statements, are treated as specific IAS 39 mark to market movements and as such are presented in the middle column. The Directors consider the fair value gains and losses of these embedded derivatives should be appropriately disclosed within specific IAS 39 mark to market movements, in the middle column, so as to separately identify a non-cash movement which, if exercised, will ultimately be extinguished by the issue of equity.

Mark to market movements relating to proprietary trading activities, the revaluation of assets held for trading and amortisation of derivatives which are acquired with a fair value other than zero comprise part of the Group's underlying business performance and are appropriately, in the judgement of the Directors, included within the left hand column.

The right hand column presents the results for the year, showing all gains and losses recorded in the consolidated financial statements.

To the extent that exceptional items are separately identified in the income statement, they are also separately identified in the cash flow statement under the respective heading to which they relate.

Adjustments have been made to comparative figures to make them consistent with the current period in relation to the presentation of specific IAS 39 mark to market movements (refer note 8).

e) Basis of consolidation
The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. In assessing control, the potential voting rights that are currently exercisable or convertible are taken into account.

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets, liabilities and contingent liabilities recognised. Subsequently, any losses applicable to the minority interest in excess of the minority interest in the subsidiary's equity are allocated against the interests of the parent, except when there is a binding obligation to fund those losses and the minority is in a position to do so.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from when control commences or up to when control ceases, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

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

f) Revenue recognition
Certain power plants sell their output in merchant markets, where electricity is sold through existing power exchanges, pool arrangements or through bilateral contracts with third parties. In these markets, revenue from energy sales is either recorded at the spot price obtained through pool or spot mechanisms when the electrical output is delivered, or as set out below, when electricity is delivered in accordance with the terms of any related hedging or forward contracts.

(i) Because power is a non-financial item, forward contracts entered into and which continue to be held for the purpose of delivery (and sale) of power generated by our own power plants (known as 'own use' contracts) can be accounted for under accruals accounting, i.e. revenue for energy sales is recognised as output is delivered in accordance with the forward contract;

(ii) All other forward contracts, which are considered to be derivatives and do not qualify for 'own use', are recognised at fair value with changes in fair value recorded in the income statement. Where the Group applies cash flow hedge accounting changes in fair values are deferred in a hedging reserve within equity and only reclassified to earnings when the hedged transaction affects earnings. In addition, to the extent that there is ineffectiveness in the cash flow hedge accounting of forward contracts, changes in fair values of the forward contracts are taken to the income statement in the period.

Other power plants sell their output under power purchase agreements (PPAs). Under such arrangements it is usual for the Group to receive payment for the provision of electrical capacity whether or not the offtaker requests the electrical output (capacity payments) and for the variable costs of production (energy payments). In such situations, revenue is recognised in respect of capacity payments as:

(i) finance income (in accordance with note 1(p)) where the PPA is considered to be or to contain a finance lease;

(ii) as operating lease rentals, on a straight-line basis (in accordance with note 1(p)) where the PPA is considered to be or to contain an operating lease; or

(iii) as energy revenue in accordance with the contractual terms, to the extent that the capacity has been made available to the contracted offtaker during the period. Where the PPAs extend over more than one accounting period, energy revenue is recognised in each accounting period at the fair value of the Group's performance under the contract in each period.

Under lease arrangements, those payments which are not included within minimum lease payments are accounted for as energy revenue (outlined in (iii) above).

Energy payments under PPAs are recognised in revenue in all cases as the contracted power is delivered.

Liquidated damages (LDs), in respect of late commissioning, are included in other operating income.

Proprietary trading income is recognised on the basis of completed contracts and the mark to market value of outstanding contracts at the period end.

g) Foreign currencies
These Group financial statements are presented in sterling, which is the functional and presentational currency of the Company. The functional currencies of Group entities are principally determined by the primary economic environment in which the respective entity operates. Transactions entered into by Group entities are translated into the functional currencies of those entities at the exchange rate ruling at the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the exchange rate ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Foreign currency non-monetary items measured in terms of historical cost are translated at the rate of exchange at the date of the transaction. Exchange differences on non-monetary items are recognised in line with whether the gain or loss on the non-monetary item itself is recognised in the income statement or in equity.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and options (refer note 1(o), the accounting policy on derivative financial instruments for details of the Group's accounting policies in respect of such derivative financial instruments).

The net assets of the Group's overseas subsidiaries, joint ventures and associates are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period which approximates to actual rates.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Exchange differences arising are recognised in the Group's translation reserve, which is a component of equity. Such translation differences are recognised as income or as expenses in the income statement in the period of disposal of the net investment in foreign operations.

In respect of foreign operations, any differences that have arisen before 1 January 2004, the date of transition to IFRSs, are presented as part of retained earnings.

h) Goodwill
Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets, liabilities and contingent liabilities of a subsidiary, joint venture or associate at the date of acquisition.

Goodwill arising on acquisition of joint ventures and associates is included in the carrying amount of the investment.

Goodwill arising on acquisitions before the date of transition to IFRSs has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

Goodwill is recognised as an asset and reviewed for impairment annually and when there are indications of impairment. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, joint venture or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

i) Other intangible assets

Emission allowances An intangible asset is recognised on receipt of allocated emission allowances and recorded at the fair value on allocation. The fair value of the grant is also recognised on receipt and deducted from the value of the intangible asset. As a result no net asset or liability is shown on the balance sheet at initial recognition.

Emission allowances are recognised at cost when purchased. As emission allowances are utilised they are charged to the income statement within cost of sales. To the extent that these allowances were received by way of grant there is nil charge to the income statement for their utilisation.

Forward contracts for sales and purchases of emission allowances are measured at fair value. At the balance sheet date the net carrying amount of emission allowances held is compared with the fair value to assess for impairment.

A provision is made for the estimated shortfall between emission allowances held and the anticipated requirement and is charged to the income statement on a pro-rata basis according to current and expected future emissions throughout the accounting period based on the market value of those allowances.

Commodity contracts In the money commodity contracts, acquired in business combinations, which qualify as either 'own use' contracts or non derivatives in accordance with IAS 39 are classified as intangible assets and carried at cost less accumulated amortisation and impairment losses (refer accounting policy note 1(n)) where cost represents fair value at the acquisition date. The intangible asset is then amortised on a systematic basis in accordance with the pattern in which the future economic benefit of the contract is expected to be consumed by the entity.

j) Property, plant and equipment

Property, plant and equipment are stated at original cost less accumulated depreciation and any provision for impairment in value. The property, plant and equipment of certain of the Group's US operations, which had been revalued to fair value on 1 January 2004, the date of transition to IFRSs, are measured on the basis of deemed cost, being the revalued amount at the date of that revaluation. In the case of assets constructed by the Group, related works, commissioning and borrowing costs as defined under IAS 23 (Borrowing costs) (refer accounting policy note 1(u)) are included in cost. Assets in the course of construction are included in property, plant and equipment on the basis of expenditure incurred at the balance sheet date.

Depreciation is calculated so as to write-down the cost of property, plant and equipment to its residual value evenly over its estimated useful life. Estimated useful lives, residual values and depreciation methods are reviewed periodically, taking into account commercial and technological obsolescence as well as normal wear and tear, provision being made where the carrying value exceeds the recoverable amount.

The depreciation charge is based on the following estimates of useful lives:

	Years
Civil works	25-80
Power stations and wind farms	20-60
Fixtures, fittings, tools and equipment	3-10
Computer equipment and software	3-5
Combined cycle gas turbine (CCGT) hot gas path parts, on average	2-4
Leasehold improvements	Life of lease

Freehold land is not depreciated.

Project development costs are principally incurred in identifying and developing investment opportunities and typically include feasibility studies, pre-bid costs, legal, professional and other related advisory costs. These costs (including appropriate direct internal costs) are recognised as expenses as incurred, except that directly attributable costs are capitalised when it is virtually certain that the project will proceed to completion and income will be realised. Such capitalised costs are amortised over the life of the related property, plant and equipment or contract.

k) Investments in joint ventures and associates

A joint venture is an entity over whose activities the Group has joint control, established by contractual agreement.

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results, assets and liabilities of joint ventures and associates are incorporated in these financial statements using the equity method of accounting except when classified as held for sale. The results are presented after interest, tax and minority interests. Investments in joint ventures and associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture or associate, less any impairment in the value of individual investments. Losses of the joint ventures and associates in excess of the Group's interest in those joint ventures and associates are not recognised unless the Group has a legal or constructive obligation to fund those losses.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable assets, liabilities and contingent liabilities of the joint venture or associate at the date of acquisition is recognised as goodwill. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable net assets of the joint venture or associate at the date of acquisition (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

Where a Group company transacts with a joint venture or associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant joint venture or associate. Losses may provide evidence of an impairment of the asset transferred in which case appropriate provision is made for impairment.

l) Other investments

Other investments consist of available for sale investments in equity instruments which are measured at market prices where available. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost.

m) Impairment of assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its property, plant and equipment, other intangible assets and those other investments measured at cost, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

At each balance sheet date, an assessment is made to determine whether there is any indication that an impairment loss recognised in prior periods may no longer exist or has decreased. Where such an indication exists, an impairment loss is reversed to the extent that the asset's carrying value does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

n) Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of the asset's previous carrying amount and fair value less costs to sell. No depreciation is charged on assets classified as held for sale.

Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

o) Derivative financial instruments

The Group's operating activities expose it to price risks associated with selling its generation output. The Group is also exposed to price risks associated with the purchase of its fuel requirements and to financial risks of changes in foreign currency exchange rates and interest rates. The Group uses a range of derivative instruments, including energy based futures and forward contracts, swaps and options to hedge its risk to changes in power prices, fuel costs, foreign exchange rates and interest rates. Derivative financial instruments are only used for hedging purposes apart from energy based futures contracts, some of which are used for proprietary trading purposes.

The use of financial derivatives is governed by the Group's risk management policies approved by the Board of Directors, which provide written principles on the use of financial derivatives consistent with the Group's risk management strategy.

Derivative financial instruments are recognised initially, and are subsequently also measured, at fair value. The gain or loss on subsequent fair value measurement is recognised in the income statement unless the derivative qualifies for hedge accounting when recognition of any resultant gain or loss depends on the nature of the item being hedged (see below). Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in an active market are based on bid prices for assets held and offer prices for liabilities held. If the market for a financial instrument is not active, its fair value is established by using valuation techniques. These valuation techniques include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

All regular way purchases and sales of financial assets are recognised on the trade date, being the date that the Group commits to purchase or sell the assets. Regular way transactions require delivery of assets within the time frame generally established by regulation or convention in the market place.

Cash flow hedges Changes in the fair value of derivative financial instruments that are designated and are effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the period in which the hedged item also affects the income statement. However, if the hedged item results in the recognition of a non-financial asset or liability, the amounts accumulated in equity on the hedging instrument are transferred from equity and included in the initial measurement of the cost of the asset or liability.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, for forecast transactions, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Fair value hedges For an effective hedge of an exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in net income. Gains or losses from re-measuring the derivative, or for non-derivatives, the foreign currency component of its carrying amount, are recognised in net income.

Hedge of a net investment in a foreign operation Hedges of net investments in foreign operations are accounted for on a similar basis to cash flow hedges. Effective gains or losses on the hedging instrument are recognised in equity, with ineffective gains or losses recognised in the income statement. Cumulative gains or losses in equity are taken to the income statement on disposal of the foreign operation.

Embedded derivatives Derivatives embedded in other financial instruments or other non-financial host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value.

Any unrealised gains or losses on such separated derivatives are reported in the income statement.

p) Leasing

A lease is defined as an agreement whereby the lessor conveys to the lessee, in return for a payment or a series of payments, the right to use a specific asset for an agreed period of time. The definition can include arrangements such as long-term PPAs, where power plants are specifically designated to fulfil the requirements of an agreement.

Finance leases – Group as lessor Where the Group determines a long-term PPA to be or to contain a lease, and where the offtaker has the principal risks and rewards of ownership of the power plant through its contractual arrangements with the Group, the arrangement is considered a finance lease. As discussed in note 1(f), capacity payments are apportioned between capital repayments relating to the provision of the plant, finance income and energy sales. The finance income element of the capacity payment is recognised as revenue, using a rate of return specific to the plant to give a constant periodic rate of return on the net investment in each period. The energy sales element of the capacity payment is recognised as revenue as it is earned.

Arrangements that do not convey the right to use a specific asset through the term of the agreement result in the continued recognition of property, plant and equipment, rather than a finance lease receivable, which is depreciated over its economic life.

The amounts due from lessees under finance leases are recorded in the balance sheet as financial assets, classified as finance lease receivables, at the amount of the net investment in the lease after making provision for bad and doubtful debts.

Operating leases – Group as lessor An operating lease is any lease other than a finance lease. Thus where the Group determines a long-term PPA to be or to contain a lease, and where the Group retains the principal risks and rewards of ownership of the power plant, the arrangement is considered an operating lease.

For operating leases, the power plant is capitalised as property, plant and equipment and depreciated over its economic life.

Rental income from operating leases is recognised on a straight-line basis over the term of the arrangement.

Operating leases – Group as lessee Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

q) Inventories
Plant spares, operating stocks of fuel and consumables are valued at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method.

r) Cash and cash equivalents
Cash and cash equivalents comprise bank balances and cash held by the Group and short-term deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

s) Loans and bonds
Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

t) Convertible bonds
Convertible bonds are regarded as compound instruments, consisting of a liability component and either an equity component or an embedded derivative component.

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component represents the value of either an equity component or an embedded derivative component attributable to the embedded option to convert the bonds into equity of the Group.

IAS 32 states that a derivative contract that will be settled by the entity receiving or delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. It also states that a contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. For the purposes of the consolidated financial statements, when making the assessment of whether a convertible bond, when exercised, gives rise to the exchange of a fixed or variable amount of cash, or other financial asset, the functional currency of the issuing company relative to the currency denomination of the bonds is considered in addition to other features within the bond.

For convertible bonds issued by the Group where there is a difference between the currency of the bond and the functional currency of the issuing company, the embedded option to convert the bonds is recorded as a derivative liability because it is not a contract to exchange a fixed number of shares for a fixed amount of bonds. The embedded derivative liability component is separately identified and measured at fair value through the income statement.

For convertible bonds issued by the Group where the currency of the bond and the functional currency of the issuing company are the same, i.e. where on conversion of the bonds a fixed number of shares is exchanged for a fixed amount of bonds, the value of the embedded option to convert the bonds is recorded within equity on initial recognition.

Issue costs are apportioned between the liability and embedded option components of the convertible bonds (recorded as equity or as a derivative liability) based on their relative carrying amounts at the date of issue.

The interest expense on the liability component is calculated by applying the prevailing market interest rate for similar non-convertible debt to the liability component of the instrument. This interest expense, recognised in the income statement, is calculated using the effective interest method, i.e. the difference between the interest expense on the liability component and the interest paid is added to the carrying amount of the convertible bond.

u) Borrowing costs
Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to be prepared for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in net income in the period in which they are incurred.

v) Provisions
Provisions are recognised when the Group has a present obligation as a result of a past event, it is probable that the Group will be required to settle that obligation and the amount can be reliably estimated. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

w) Decommissioning costs
Provision is made for the reliably estimated decommissioning costs at the end of the useful economic life of the Group's power stations and generating assets, if and when a legal or constructive obligation arises, on a discounted basis. The amount provided represents the present value of the expected costs. An amount equivalent to the initial provision is capitalised within property, plant and equipment and is depreciated over the useful lives of the related assets. The unwinding of the discount is included within finance costs. Where there is a subsequent change in estimates of decommissioning costs, the present value of the change is recognised in the income statement.

x) Environmental liabilities
Provision for environmental liabilities is made when expenditure on remedial work is probable, the Group is obliged, either legally or constructively through its environmental policies, to undertake such work and the amount can be reliably estimated. Where the amount is expected to be incurred over the long-term, the amount recognised is the present value of the estimated future expenditure and the unwinding of the discount is included within finance costs.

y) Tax
The tax expense represents the sum of the expected tax payable on taxable income for the year, including adjustments in respect of prior periods and deferred tax. Taxable profit differs from accounting profit, as reported in the income statement, because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill, not deductible for tax purposes, or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, joint ventures and associates. Where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future, no deferred tax liability is recognised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

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

Deferred tax assets and deferred tax liabilities are only offset to the extent that there is a legally enforceable right to offset current tax assets and current tax liabilities, they relate to taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis or to realise an asset and settle a liability simultaneously.

z) Pension schemes

Payments to defined contribution pension plans are charged as an expense as they fall due. Payments made to state managed defined benefit pension plans are dealt with as payments to defined contribution plans where the Group's obligations under the plans are equivalent to those arising in a defined contribution pension plan.

For defined benefit pension plans, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date.

The corridor method is applied in recognising actuarial gains and losses. Gains and losses in an individual scheme are recognised to the extent they exceed the greater of 10% of the gross assets or gross liabilities of the scheme. The amount recognised in the following year is the excess amortised over the remaining average service lives of the employees in the scheme and is recognised in the income statement.

The net defined benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligations adjusted for unrecognised actuarial gains and losses and unrecognised service costs and as reduced by the fair value of the plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

aa) Share-based payments

The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the date of grant of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest and where applicable, adjusted for the effect of non market-based vesting conditions including service conditions.

For the Group's Executive Share Option Plans the fair values are measured using the Black-Scholes pricing model. The expected lives used in these models have been adjusted, based on management's best estimate, for the effects of non-transferability, any exercise restrictions and behavioural considerations.

For conditional awards made under the 2002 Performance Share Plan without a market-related performance condition, the fair values have been calculated as the face value of the award, discounted for the non-entitlement to dividends during the vested period.

Where conditional awards, made under the 2002 Performance Share Plan, contain a market-related performance condition, the fair values are measured using a Monte Carlo simulation method.

2 SEGMENT REPORTING

The Group is a global energy business that operates solely in one business segment, that of electricity generation. The international operations are managed on a geographical basis, reflecting the different characteristics within each geographical market. The Group reports its primary segment information by geographic segment as this reflects how results are reported for management purposes in the day-to-day management of the business. In presenting information on the basis of geographical segments, segment revenues and segment assets are based in the geographical location of both customers and assets. There is no inter-segmental revenue.

	Year ended 31 December 2006			Year ended 31 December 2005		
	Subsidiaries £m	**Share of joint ventures and associates £m**	**Total £m**	Subsidiaries £m	Share of joint ventures and associates £m	Total £m
a) Revenue (excluding exceptional items and specific IAS 39 mark to market movements)						
North America	**732**	**183**	**915**	527	171	698
Europe	**1,266**	**411**	**1,677**	1,014	397	1,411
Middle East	**51**	**99**	**150**	24	43	67
Australia	**378**	**107**	**485**	388	48	436
Asia	**25**	**393**	**418**	27	341	368
	2,452	**1,193**	**3,645**	1,980	1,000	2,980
Revenue (including exceptional items and specific IAS 39 mark to market movements)						
North America	**761**	**183**	**944**	523	171	694
Europe	**1,426**	**411**	**1,837**	990	397	1,387
Middle East	**51**	**99**	**150**	24	43	67
Australia	**321**	**113**	**434**	369	51	420
Asia	**25**	**393**	**418**	27	341	368
	2,584	**1,199**	**3,783**	1,933	1,003	2,936

b) Profit from operations (excluding exceptional items and specific IAS 39 mark to market movements)						
North America	**73**	**28**	**101**	21	27	48
Europe	**381**	**69**	**450**	229	54	283
Middle East	**32**	**20**	**52**	12	12	24
Australia	**121**	**3**	**124**	136	4	140
Asia	**3**	**88**	**91**	6	94	100
	610	**208**	**818**	404	191	595
Corporate costs	**(45)**	**–**	**(45)**	(59)	–	(59)
	565	**208**	**773**	345	191	536
Exceptional items and specific IAS 39 mark to market movements included within profit from operations			**125**			75
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)			**898**			611
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)						
North America	**83**	**28**	**111**	20	29	49
Europe	**547**	**68**	**615**	315	55	370
Middle East	**32**	**20**	**52**	12	12	24
Australia	**64**	**10**	**74**	119	6	125
Asia	**3**	**88**	**91**	6	96	102
	729	**214**	**943**	472	198	670
Corporate costs	**(45)**	**–**	**(45)**	(59)	–	(59)
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)	**684**	**214**	**898**	413	198	611

2 SEGMENT REPORTING continued

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)	**898**	611
Disposal of investments – exceptional	**–**	10
Net finance costs – excluding exceptional items and specific IAS 39 mark to market movements	**(248)**	(202)
Net finance costs – exceptional items and specific IAS 39 mark to market movements	**(26)**	–
Profit before tax	**624**	419
Income tax expense – excluding exceptional items and specific IAS 39 mark to market movements	**(122)**	(68)
Income tax expense – exceptional items and specific IAS 39 mark to market movements	**(25)**	(21)
Profit for the year	**477**	330

An analysis of exceptional items and specific IAS 39 mark to market movements is included in note 8.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
c) Depreciation and amortisation expenses (excluding exceptional items)		
North America	**52**	35
Europe	**150**	84
Middle East	**3**	3
Australia	**63**	62
Asia	**2**	2
	270	186
Corporate costs	**3**	2
	273	188

Depreciation and amortisation expenses are included within profit from operations. An impairment reversal of £36 million, relating to Deeside power plant, has been recorded in the income statement in 2006 (refer note 8). In 2005 an impairment reversal of £52 million relating to Rugeley power plant was recorded in the income statement. These impairment reversals are not included within the Europe totals in the above table.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
d) Additions to property, plant and equipment		
North America	**62**	26
Europe	**83**	24
Middle East	**47**	159
Australia	**34**	53
Asia	**9**	4
	235	266
Corporate	**1**	1
	236	267

	Year ended 31 December 2006			Year ended 31 December 2005		
	Goodwill £m	**Commodity contracts £m**	**Emission allowances £m**	Goodwill £m	Commodity contracts £m	Emission allowances £m
e) Expenditure on goodwill and other intangible assets						
North America	**40**	**37**	**64**	–	–	–
Europe	**–**	**2**	**39**	2	234	25

The table above includes both purchased goodwill and intangible assets recognised on the acquisition of subsidiaries during the year in addition to expenditure incurred on other intangible assets.

	At 31 December 2006			At 31 December 2005		
	Segment assets £m	**Investments in joint ventures and associates £m**	**Total £m**	Segment assets £m	Investments in joint ventures and associates £m	Total £m
f) Segment assets						
North America	**1,502**	**184**	**1,686**	773	199	972
Europe	**3,475**	**363**	**3,838**	2,972	341	3,313
Middle East	**366**	**92**	**458**	383	71	454
Australia	**1,972**	**43**	**2,015**	2,196	39	2,235
Asia	**194**	**582**	**776**	63	755	818
	7,509	**1,264**	**8,773**	6,387	1,405	7,792
Corporate	**601**	**–**	**601**	258	–	258
Total assets	**8,110**	**1,264**	**9,374**	6,645	1,405	8,050

The Asia region segment assets includes assets held for sale amounting to £128 million. In 2005 these assets were included in investments in joint ventures and associates (refer note 24).

	Segment liabilities £m	**Investments in joint ventures and associates £m**	**Total £m**	Segment liabilities £m	Investments in joint ventures and associates £m	Total £m
g) Segment liabilities						
North America	**1,149**	**–**	**1,149**	588	–	588
Europe	**2,565**	**–**	**2,565**	2,102	–	2,102
Middle East	**340**	**–**	**340**	335	–	335
Australia	**1,504**	**–**	**1,504**	1,676	–	1,676
Asia	**95**	**–**	**95**	95	–	95
	5,653	**–**	**5,653**	4,796	–	4,796
Corporate	**981**	**–**	**981**	879	–	879
Total liabilities	**6,634**	**–**	**6,634**	5,675	–	5,675

The analysis of total assets and liabilities includes all attributable goodwill and excludes intercompany balances, which have been eliminated on consolidation. Corporate assets and liabilities include cash held at the corporate level, included in cash and cash equivalents; corporate borrowings, included in loans and bonds; and provisions and deferred tax liabilities included in non-current liabilities.

3 PROFIT FOR THE YEAR

Other operating income includes compensation for the late commissioning of plants, billings in respect of operations and maintenance services and profit on sale of development sites. Other operating expenses comprise corporate costs, Group-wide general administrative overheads and project development expenses.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit for the year is stated after charging/(crediting):		
Amortisation of other intangible assets	**105**	40
Depreciation of property, plant and equipment	**168**	148
Development costs, net of recoveries and amounts capitalised	**3**	3
Operating exceptional items before tax (note 8)	**(55)**	(110)
Liquidated damages and insurance recoveries for property, plant and equipment	**6**	–
Property lease rentals payable (net of recoveries)	**3**	3
Auditors' remuneration		
Audit of these financial statements	**0.8**	0.7
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**1.7**	1.1
Other services pursuant to such legislation	**1.4**	0.4
Other services relating to taxation	**0.1**	0.1
Services relating to corporate finance transactions entered into or proposed to be entered into by or on behalf of the Company or the Group	**0.2**	0.4
	4.2	2.7

'Other services pursuant to such legislation' in 2006 and 2005 relates principally to reporting to the Securities and Exchange Commission (SEC), interim reviews and additional audit work relating to the Group's compliance with the requirements of Section 404 of the Sarbanes-Oxley Act 2002 (which relate to internal controls over financial reporting).

'Services relating to corporate finance transactions' incorporate due diligence assistance on potential and completed acquisitions during the year and reviews of financial models for funding purposes.

The Audit Committee and the firm of external auditors have safeguards in place to avoid the possibility that the auditors' objectivity and independence could be compromised. These safeguards include the implementation of a policy on the use of the external auditor for non-audit related services. This policy incorporates the provisions of the Sarbanes-Oxley Act 2002 and subsequent SEC rules.

Where it is deemed that the work to be undertaken is of a nature that is generally considered reasonable to be completed by the auditor of the Group for sound commercial and practical reasons, the conduct of such work will be permissible provided that it has been pre-approved by the Audit Committee. Examples of pre-approved services include the completion of regulatory audits, provision of taxation and regulatory advice, reporting to the SEC and the completion of certain financial due diligence work. All these services are also subject to a predefined fee limit. Any work performed in excess of this limit must be approved by the Chief Financial Officer and the Audit Committee.

4 FINANCE INCOME

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Group finance income		
Interest income	**51**	50
Net gain on re-measurement of assets held for trading	**2**	3
Total Group finance income	**53**	53

Interest income comprises interest earned from bank deposits and other financial assets. Included within share of results of joint ventures and associates is interest income of £21 million (2005: £16 million).

5 FINANCE EXPENSES

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Group finance expenses		
Interest on:		
Bank loans and overdrafts	**226**	211
Other loans and bonds	**83**	57
	309	268
Unwinding discount on provisions	**1**	1
Less: amounts capitalised in the cost of qualifying assets	**(9)**	(14)
Group finance costs excluding exceptional items and specific IAS 39 mark to market movements	**301**	255
Specific IAS 39 mark to market movements on derivative financial instruments	**26**	–
Total Group finance expenses	**327**	255

Included within share of results of joint ventures and associates is interest expense of £121 million (2005: £106 million). Specific IAS 39 mark to market movements included within interest expense of joint ventures and associates amount to an expense of £1 million (2005: an income of £7 million).

6 EMPLOYEE BENEFIT COSTS AND EMPLOYEE NUMBERS

Employee benefit costs, including Directors' remuneration, were as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Wages and salaries	**129**	121
Share-based payments	**9**	6
Social security costs	**11**	10
Contributions to defined contribution plans	**4**	3
Charge for defined benefit plans (note 7)	**10**	7
Sub-total	**163**	147
Less: amount capitalised as part of property, plant and equipment	**(4)**	(2)
Total employee benefit costs	**159**	145

Details of Directors' remuneration along with information concerning shareholdings, options and retirement benefits are set out in the audited part of the Directors' remuneration report on pages 64 to 75. There are no personnel, other than the Directors, who as key management have authority and responsibility for planning, directing and controlling the activities, directly or indirectly, of International Power plc.

The average number of employees during the financial year, analysed by geographic segment was:

	Year ended 31 December 2006 Number	Year ended 31 December 2005 Number
North America	**276**	220
Europe	**1,196**	1,195
Middle East	**625**	615
Australia	**769**	742
Asia	**628**	633
Corporate and development	**177**	174
Average number of employees	**3,671**	3,579

7 PENSION SCHEMES

Group entities operate pension arrangements in order to provide pension benefits to retired employees. Benefits granted have been developed to reflect local practice and may be provided through defined benefit or defined contribution schemes.

The main defined benefit plans are in the UK and Australia:

UK: The majority of pensions for UK employees are funded through the industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), which is a defined benefit scheme with assets invested in separate trustee administered funds. The ESPS is divided into sections, and the International Power Group of the ESPS was opened to members on 1 April 2002 and employees' past service rights were transferred into the Group later that year.

The majority of employees taken on in First Hydro, as part of the acquisition of the EME portfolio, are members of another section of the ESPS, the First Hydro Group.

The liabilities and costs shown in the disclosures for the UK schemes are based on the most recent actuarial valuations at 31 March 2004. The results of these valuations have been updated to 31 December 2006 by independent qualified actuaries to take account of the requirements of IAS 19.

AUSTRALIA: Employees at Hazelwood and Loy Yang B participate in a standard Australian superannuation fund called Equipsuper. This plan provides benefits primarily for employees in the electricity, gas and water industry, and was developed from the scheme sponsored by the State Electricity Commission of Victoria. Employees at Synergen participate in the Electricity Industry Superannuation Scheme.

The liabilities and costs shown in the disclosures for the Australian schemes are based on the most recent actuarial valuations at 31 December 2006.

The liabilities and costs for IAS 19 were determined using the projected unit credit method. The Group has decided to recognise gains and losses through the income statement over the expected working lifetime of active employees to the extent that gains or losses are in excess of the 'corridor' (10% of the greater of the defined benefit obligation and the plan assets).

The charge for 2006 in respect of defined contribution plans was £4 million (2005: £3 million).

The Group used the following assumptions to calculate the scheme liabilities under IAS 19:

	31 December 2006		31 December 2005		31 December 2004	
Financial assumptions	**UK %**	**Australia %**	UK %	Australia %	UK %	Australia %
Discount rate	**5.1**	**4.9**	4.7	4.6	5.3	4.5
Rate of increase in salaries	**4.6**	**4.3**	4.4	4.0	4.4	4.0
Inflation rate	**3.1**	**3.0**	2.9	3.0	2.9	3.0
Increase to deferred benefits during deferment	**3.1**	**n/a**	2.9	n/a	3.0	n/a
Increases to pensions payments	**3.1**	**n/a**	2.9	n/a	2.9	n/a

7 PENSION SCHEMES continued

The amounts charged to profit from operations, recorded in the income statement, in relation to the defined benefit pension plans for the year ended 31 December 2006 were as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Current service cost	**11**	9
Expected return on schemes' assets	**(13)**	(11)
Interest on schemes' liabilities	**10**	9
Curtailment cost	**2**	–
Total operating charge	**10**	7

The assets in the schemes and expected rates of return (weighted averages) were:

	31 December 2006		31 December 2005		31 December 2004	
Long-term rate of return expected:	**UK %**	**Australia %**	UK %	Australia %	UK %	Australia %
Equities	**7.5**	**7.8**	7.1	7.5	7.5	7.3
Bonds	**4.7**	**4.6**	4.4	5.0	4.9	4.8
Other	**6.2**	**5.9**	6.0	5.9	6.0	5.5
Total long-term rate of return expected	**7.1**	**6.7**	6.6	6.7	7.0	6.5

The expected rates of return reflect the Group's best estimate of the investment returns that will be earned on each asset class. These returns are based on advice provided by independent qualified actuaries.

	31 December 2006			31 December 2005			31 December 2004		
Assets in schemes:	**UK £m**	**Australia £m**	**Total £m**	UK £m	Australia £m	Total £m	UK £m	Australia £m	Total £m
Equities	**108**	**55**	**163**	84	52	136	66	44	110
Bonds	**17**	**15**	**32**	14	17	31	11	16	27
Other	**10**	**21**	**31**	16	15	31	12	10	22
Total market value of assets	**135**	**91**	**226**	114	84	198	89	70	159

Other assets principally comprise property and cash.

The reconciliation of the schemes' (deficits)/surpluses to the balance sheet amount is:

	31 December 2006			31 December 2005			31 December 2004		
	UK £m	**Australia £m**	**Total £m**	UK £m	Australia £m	Total £m	UK £m	Australia £m	Total £m
Total market value of assets	**135**	**91**	**226**	114	84	198	89	70	159
Present value of scheme liabilities	**(158)**	**(83)**	**(241)**	(151)	(79)	(230)	(114)	(70)	(184)
(Deficit)/surplus in the scheme	**(23)**	**8**	**(15)**	(37)	5	(32)	(25)	–	(25)
Unrecognised actuarial (gains)/losses	**–**	**(10)**	**(10)**	12	(7)	5	–	(4)	(4)
Unrecognised asset due to limit in IAS 19 para 58(b)	**–**	**–**	**–**	–	–	–	–	–	–
Pension liability before deferred tax	**(23)**	**(2)**	**(25)**	(25)	(2)	(27)	(25)	(4)	(29)

Movements in fair value of assets:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
At 1 January	**198**	159
Expected return on assets	**13**	11
Actuarial gains	**9**	16
Employer contributions	**12**	9
Scheme participants' contributions	**3**	3
Benefits paid	**(3)**	(2)
Expenses, taxes and premiums paid	**(1)**	(1)
Exchange differences	**(5)**	3
At 31 December	**226**	198

Movements in defined benefit obligations:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
At 1 January	**230**	184
Service cost	**11**	9
Interest cost	**10**	9
Actuarial (gains)/losses	**(6)**	25
Scheme participants' contributions	**3**	3
Benefits paid	**(3)**	(2)
Expenses, taxes and premiums paid	**(1)**	(1)
Settlements and curtailments	**2**	–
Exchange differences	**(5)**	3
At 31 December	**241**	230

History of asset experience gains and losses

The transition date for conversion to IFRS for International Power was 1 January 2004 and therefore the following historical data has been presented from that date. This will be built up into a rolling five-year record over the next two years.

	Year ended 31 December 2006	Year ended 31 December 2005	Year ended 31 December 2004
Difference between the actual and expected return on schemes' assets:			
Amount (£m)	**9**	16	9
Percentage of schemes' assets	**4%**	8%	6%
Experience (losses)/gains on schemes' liabilities*:			
Amount (£m)	**(2)**	11	7
Percentage of the present value of schemes' liabilities	**1%**	5%	4%

*Does not include the effect of changes in assumptions.

Contributions in 2007

The Group expects to make contributions of approximately £8 million to its defined benefit pension arrangements in 2007.

8 EXCEPTIONAL ITEMS AND SPECIFIC IAS 39 MARK TO MARKET MOVEMENTS

In accordance with the basis of preparation outlined in note 1, the Group separately discloses exceptional items and specific IAS 39 mark to market movements to allow a better understanding of the financial information presented, and specifically the Group's underlying business performance.

Those items that the Group separately presents as exceptional are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order to obtain a proper understanding of the financial information.

The Group enters into derivative contracts to economically hedge certain of its physical and financial exposures. Where these contracts do not achieve the own use exemption, hedge accounting or wholly effective hedge effectiveness under IAS 39, the Group separately presents the mark to market movements on these contracts, recorded within the income statement to allow an understanding of underlying business performance.

Mark to market movements on convertible bonds, where the conversion option, if exercised, will ultimately be extinguished by the issue of equity are also separately presented to allow an understanding of the underlying business performance.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Mark to market movements	**132**	(47)
Amounts recognised in revenue	**132**	(47)
Impairment reversal of Deeside plant	**36**	–
Impairment reversal of Rugeley plant	**–**	52
Mark to market movements	**(68)**	5
Amounts recognised in cost of sales	**(32)**	57
Compensation in respect of the tolling agreement with TXU	**14**	58
Compensation in respect of breach of contract	**5**	–
Amounts recognised in other operating income	**19**	58
Mark to market movements	**6**	7
Amounts recognised in share of results of joint ventures and associates	**6**	7
Profit on disposal of Tri Energy	**–**	4
Profit on disposal of shares in Interconnector UK	**–**	3
Profit on disposal of land in Thailand	**–**	3
Amounts recognised in disposal of investments	**–**	10
Mark to market movements	**(26)**	–
Amounts recognised in finance expenses	**(26)**	–
Taxation on Deeside plant impairment reversal	**(11)**	–
Taxation on Rugeley plant impairment reversal	**–**	(16)
Taxation on compensation in respect of the tolling agreement with TXU	**(4)**	(17)
Taxation on disposal of shares in Interconnector UK and on disposal of land in Thailand	**–**	(1)
Taxation on mark to market movements	**(10)**	13
Taxation on exceptional items and specific IAS 39 mark to market movements	**(25)**	(21)
Total exceptional items and specific IAS 39 mark to market movements after attributable taxation	**74**	64

In the year ended 31 December 2006, Rugeley Power received further payments from the TXU Administrators amounting to £16 million. An exceptional gain of £14 million has been recorded, net of payments to creditors.

In June 2006 the Company received a settlement of £10 million following the conclusion of an international arbitration action under ICC rules for breach of a contract entered into in 2000 to transfer operating rights over three power plants in Turkey. An exceptional gain of £5 million has been recorded, net of cost recoveries.

At the end of 2006 the Group carried out a review of the recoverable amount of its Deeside power plant based on its estimated value in use. This led to the full impairment reversal of the remaining £36 million impairment charge previously booked against this asset (refer note 14).

In order to separately identify specific IAS 39 mark to market movements, these adjustments are separately identified within the table, described as 'mark to market movements'. For the year ended 31 December 2006 the impact of these adjustments on profit before tax is a profit of £44 million and on tax expense a charge of £10 million. For the year ended 31 December 2005 the impact of these adjustments on profit before tax is an expense of £35 million and on tax expense a credit of £13 million.

The mark to market movement recognised within finance expenses includes a charge of £28 million (2005: £nil) in respect of the fair value gains and losses on the 3.25% convertible euro bonds 2013. The conversion feature of the 3.75% convertible US dollar bonds 2023 is recognised in equity (refer note 25).

9 TAX

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
a) Income tax expense for the year		
Current tax charge		
UK corporation tax charge	**52**	25
Foreign tax	**40**	27
Adjustments in respect of prior years	**6**	2
Total current tax charge for the year	**98**	54
Deferred tax charge		
Origination and reversal of temporary differences	**64**	43
Benefits of tax losses recognised	**(15)**	(8)
Total deferred tax charge for the year	**49**	35
Income tax expense excluding exceptional items and specific IAS 39 mark to market movements	**122**	68
Income tax expense on exceptional items and specific IAS 39 mark to market movements	**25**	21
Total income tax expense for the year	**147**	89

Included in the income tax expense are the following amounts relating to exceptional items and specific IAS 39 mark to market movements, included in:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Revenue (deferred tax)	**33**	(14)
Cost of sales (deferred tax)	**(4)**	18
Other operating income (current tax)	**4**	17
Share of results of joint ventures and associates (deferred tax)	**–**	(1)
Disposal of investments (current tax)	**–**	1
Finance expenses (deferred tax)	**(8)**	–
Income tax expense on exceptional items and specific IAS 39 mark to market movements	**25**	21

The deferred tax charge is derived as follows: £46 million from UK operations (2005: £11 million) and £3 million from foreign operations (2005: £24 million).

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Income tax charged to:		
Income statement	**147**	89
Equity	**(43)**	(46)
	104	43

9 TAX continued

	Year ended 31 December 2006		Year ended 31 December 2005	
	Results excluding exceptional items and specific IAS 39 mark to market movements £m	**Results including exceptional items and specific IAS 39 mark to market movements £m**	Results excluding exceptional items and specific IAS 39 mark to market movements £m	Results including exceptional items and specific IAS 39 mark to market movements £m
b) Reconciliation of income tax expense to accounting profit				
Profit before tax (before exceptional items and specific IAS 39 mark to market movements)	**525**	**525**	334	334
Exceptional items and specific IAS 39 mark to market movements	**–**	**99**	–	85
Profit before tax	**525**	**624**	334	419
Tax at domestic income tax rate of 30% (2005: 30%)	**158**	**187**	100	126
Tax effect of:				
Different tax rates of subsidiaries operating in other jurisdictions	**14**	**14**	23	23
Share of results of joint ventures and associates	**(38)**	**(38)**	(37)	(39)
Tax holidays	**(10)**	**(10)**	(12)	(12)
(Income not taxable)/expenses not deductible in determining taxable profit	**(4)**	**(6)**	16	13
Utilisation of tax losses not previously recognised	**(4)**	**(6)**	(24)	(24)
Adjustment to prior year provisions	**6**	**6**	2	2
Income tax expense for the year	**122**	**147**	68	89

Included in profit before tax excluding exceptional items and specific IAS 39 mark to market movements is a tax charge of £55 million (2005: £53 million) relating to the Group's share of results of joint ventures and associates. The £38 million shown above (2005: £37 million) represents 70% (2005: 70%) of this tax charge. The remaining 30% is already included within the tax charge calculated at the domestic income tax rate.

Included in profit before tax including exceptional items and specific IAS 39 mark to market movements is a tax charge of £54 million (2005: £56 million) relating to the Group's share of results of joint ventures and associates. The £38 million shown (2005: £39 million) above represents 70% of this tax charge (2005: 70%). The remaining 30% is already included within the tax charge calculated at the domestic income tax rate.

10 DIVIDENDS

At the Company's Annual General Meeting (AGM) held on 17 May 2006, shareholders approved the payment of a final dividend of 4.5p (2005: 2.5p) per Ordinary Share to shareholders registered on the Company share register on 26 May 2006. This dividend amounted to £67 million (2005: £37 million) and was paid on 23 June 2006. In respect of the current year, the Directors propose a dividend of 7.9p per Ordinary Share, to be paid on 26 June 2007. The dividend is subject to approval by shareholders at the Group's AGM and has not been included as a liability at 31 December 2006. There are no income tax consequences to the Company from the estimated total dividend to be paid of £118 million.

11 EARNINGS PER SHARE (EPS)

Earnings per share is presented both before exceptional items and specific IAS 39 mark to market movements and after exceptional items and specific IAS 39 mark to market movements in order to allow a better understanding of the financial information presented, and specifically the Group's underlying business performance. Further details of the exceptional items and specific IAS 39 mark to market movements can be found in note 8 to these consolidated financial statements.

	Year ended 31 December 2006 pence	Year ended 31 December 2005 pence
a) Earnings per share (basic)		
Before exceptional items and specific IAS 39 mark to market movements	**22.4**	14.6
After exceptional items and specific IAS 39 mark to market movements	**27.6**	19.4
b) Earnings per share (diluted)		
Before exceptional items and specific IAS 39 mark to market movements	**21.3**	14.0
After exceptional items and specific IAS 39 mark to market movements	**26.2**	18.5
c) Basis of calculation (basic) – earnings	**£m**	£m
Profit attributable to equity holders of the parent before exceptional items and specific IAS 39 mark to market movements	**332**	214
Exceptional items and specific IAS 39 mark to market movements (net of tax and minority interests)	**78**	71
Profit attributable to equity holders of the parent after exceptional items and specific IAS 39 mark to market movements	**410**	285
d) Basis of calculation (diluted) – earnings	**£m**	£m
Profit attributable to equity holders of the parent before exceptional items and specific IAS 39 mark to market movements	**332**	214
After tax dilutive effect of interest on convertible bonds	**7**	7
Profit attributable to equity holders of the parent before exceptional items and specific IAS 39 mark to market movements	**339**	221
Exceptional items and specific IAS 39 mark to market movements (net of tax and minority interests)	**78**	71
Profit attributable to equity holders of the parent after exceptional items and specific IAS 39 mark to market movements	**417**	292
e) Basis of calculation (basic) – number of Ordinary Shares	**Million**	Million
Weighted average number of issued Ordinary Shares for the purposes of basic EPS	**1,486.2**	1,473.5
Weighted average number of shares held by Employee Share Ownership Plans (ESOPs)	**(1.4)**	(2.8)
Weighted average number of shares	**1,484.8**	1,470.7
f) Basis of calculation (diluted) – number of Ordinary Shares	**Million**	Million
Weighted average number of shares – basic	**1,484.8**	1,470.7
Dilutive potential Ordinary Shares:		
Employee share schemes	**14.0**	19.8
Convertible bond	**91.1**	89.1
Weighted average number of Ordinary Shares for the purposes of diluted EPS	**1,589.9**	1,579.6

In July 2006 the Group issued 3.25% convertible euro bonds 2013, which in 2006 were anti-dilutive and have therefore been excluded from the diluted earnings per share calculation. In future periods this financial instrument could potentially dilute basic earnings per share.

12 GOODWILL

	31 December 2006 £m	31 December 2005 £m
Cost		
At 1 January	**189**	197
Acquired through business combinations	**40**	2
Eliminated on partial disposal of a subsidiary	**–**	(9)
Exchange differences	**(3)**	(1)
At 31 December	**226**	189

The addition of £40 million in 2006 relates to the acquisition of Coleto Creek (refer note 31(a)).

Given the geographical diversity of the Group's power plants and the nature of their operations, for impairment testing purposes the Directors consider that each power plant owning subsidiary is a separate cash generating unit. The following cash generating units have significant carrying amounts of goodwill:

	31 December 2006 £m	31 December 2005 £m
First Hydro (UK)	**153**	153
Coleto Creek (US)	**38**	–
Turbogás (Portugal)	**26**	27
IPO (Czech Republic)	**8**	7
Others	**1**	2
	226	189

The Group tests goodwill for impairment annually or when there is an indication that goodwill might be impaired. The cash generating units' recoverable amounts are determined from value in use calculations. These are based on projected cash flows, which may extend forward as much as 40 years, from individual project whole life asset models. These cash flows have been discounted using rates in the range 6% to 13% on a pre-tax basis. Key assumptions include the discount rates and market prices for electricity and fuel costs over the lives of the assets. These market prices are considered in the light of forward price curves (which represent the Group's view as to prices at which customers would currently contract for delivery or settlement of commodities, such as power or gas, at future dates) and forecast demand and supply growth over the lives of the assets. The projected cash flows extend over the whole of the assets' expected lives as this best reflects the long-term nature of the returns generated by the long-life assets. Pre-tax risk adjusted discount rates take into account current market assessments of the time value of money and risks specific to the respective cash generating unit.

13 OTHER INTANGIBLE ASSETS

	31 December 2006 £m	31 December 2005 £m
Intangible assets		
Commodity contracts	**131**	194
Emission allowances	**58**	–
Carrying amount at 31 December	**189**	194

The above intangible assets balance can be analysed as follows:

	31 December 2006 £m	31 December 2005 £m
Intangible assets – commodity contracts		
Cost		
At 1 January	**234**	–
Acquisition of subsidiaries	**39**	234
Exchange differences	**(1)**	–
At 31 December	**272**	234
Accumulated amortisation		
At 1 January	**40**	–
Charge for the year	**101**	40
At 31 December	**141**	40
Carrying amount		
At 1 January	**194**	–
At 31 December	**131**	194
Intangible assets – emission allowances		
Carrying amount		
At 1 January	**–**	–
Additions	**39**	25
Acquisition of subsidiaries	**64**	–
Charge for the year	**(4)**	–
Disposals	**(39)**	(25)
Exchange differences	**(2)**	–
At 31 December	**58**	–

Commodity contracts are amortised over the period in which benefits are expected to arise. The addition in 2006 relates to commodity contracts acquired as part of the acquisitions of Coleto Creek and Indian Queens.

The Group has recognised any allocated emission allowances net of the fair value of the grant. As a result, no net asset or liability is shown on the balance sheet at initial recognition. The amortisation of any emission allowances purchased or acquired through business combinations is charged to cost of sales in the income statement over the period in which benefits are expected to arise. Emission allowances acquired as part of the acquisition of Coleto Creek amount to £64 million.

As part of the European Union (EU) Emissions Trading Scheme (EUETS), designed to reduce greenhouse gas emissions in the EU over the medium term, the Group was granted emission allowances amounting to £49 million in respect of the year ended 31 December 2006 (2005: £55 million).

14 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Plant, machinery and equipment £m	Assets in course of construction £m	Total £m
Cost				
At 1 January 2005	174	3,865	161	4,200
Additions	5	78	184	267
Acquisition of subsidiaries	–	365	–	365
Disposals	(2)	(9)	–	(11)
Disposal of subsidiaries	–	(54)	–	(54)
Reclassifications and transfers	–	54	(54)	–
Exchange differences	3	241	25	269
At 31 December 2005	180	4,540	316	5,036
Additions	3	169	64	236
Acquisition of subsidiaries	5	653	54	712
Disposals	–	(13)	–	(13)
Reclassifications and transfers	(20)	(19)	(314)	(353)
Exchange differences	(4)	(254)	(36)	(294)
At 31 December 2006	**164**	**5,076**	**84**	**5,324**
Accumulated depreciation				
At 1 January 2005	25	633	–	658
Depreciation charge for the year	11	137	–	148
Disposals	(2)	(9)	–	(11)
Disposal of subsidiaries	–	(3)	–	(3)
Impairment reversal	–	(52)	–	(52)
Exchange differences	–	89	–	89
At 31 December 2005	34	795	–	829
Depreciation charge for the year	10	158	–	168
Disposals	–	(8)	–	(8)
Impairment reversal	–	(36)	–	(36)
Reclassifications and transfers	(7)	7	–	–
Exchange differences	(1)	(53)	–	(54)
At 31 December 2006	**36**	**863**	**–**	**899**
Carrying amount				
At 1 January 2005	149	3,232	161	3,542
At 31 December 2005	146	3,745	316	4,207
At 31 December 2006	**128**	**4,213**	**84**	**4,425**

At the end of the year the Group carried out a review of the recoverable amount of its UK power plants. This led to the recognition of an impairment reversal of £36 million for Deeside, based on the estimated value in use of this asset. The post-tax risk adjusted discount rate used in measuring value in use was 8%. The post-tax risk adjusted discount rate which was used at the time of the initial impairment in 2002 was 8%. The impairment reversal has been included in cost of sales.

Interest capitalised in the year was £9 million (2005: £14 million). On a cumulative basis, after taking into account exchange differences and depreciation, the carrying amount of interest capitalised is £80 million (2005: £80 million).

The total value of land, included within land and buildings, that is not depreciated is £46 million (2005: £49 million).

Property, plant and equipment with a carrying amount of £4,163 million (2005: £3,924 million) is subject to fixed and floating charges from banks providing borrowing facilities which are non-recourse to the Company.

Reclassifications and transfers consist of amounts moved from assets in course of construction to finance lease receivables and inventories.

15 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

Summarised financial information in respect of the Group's joint ventures and associates is set out below:

	31 December 2006 £m	31 December 2005 £m
a) Joint ventures' net assets (including goodwill)		
Non-current assets	**1,220**	1,362
Current assets	**316**	280
Total assets	**1,536**	1,642
Current liabilities	**(204)**	(188)
Non-current liabilities	**(588)**	(743)
Total liabilities	**(792)**	(931)
Net assets	**744**	711
Group's share of joint ventures' net assets	**365**	349
b) Associates' net assets (including goodwill)		
Non-current assets	**5,630**	7,690
Current assets	**1,247**	1,755
Total assets	**6,877**	9,445
Current liabilities	**(695)**	(840)
Non-current liabilities	**(3,788)**	(5,401)
Total liabilities	**(4,483)**	(6,241)
Net assets	**2,394**	3,204
Group's share of associates' net assets	**899**	1,056
c) Results of joint ventures		
Revenue	**771**	631
Profit for the year	**124**	104
Group's share of results of joint ventures		
Share of revenue	**379**	309
Share of profit for the year	**59**	50
d) Results of associates		
Revenue	**2,501**	2,024
Profit for the year	**460**	449
Group's share of results of associates		
Share of revenue	**820**	694
Share of profit for the year	**155**	148

At 31 December 2006 the Group's investments that are listed on a recognised stock market are those in The Hub Power Company Limited (HUBCO), Kot Addu Power Company Limited (KAPCO) and Malakoff Berhad. HUBCO and KAPCO are considered associates and International Power continues to equity account for HUBCO despite its shareholding being less than 20% (refer note 40). The Group's share of HUBCO and KAPCO was valued at £46 million (2005: £45 million) and £108 million (2005: £149 million), respectively, on the major Pakistan stock markets and the Group's share in Malakoff Berhad was valued at £236 million (2005: £203 million) on the Kuala Lumpur stock market. Market values for Group shareholdings in these investments were in excess of the respective carrying amounts at the year end.

A subsidiary, Al Kamil, is listed on the Muscat Securities Market and was valued at £14 million on 31 December 2006 (2005: £15 million). The Group owns 65% of Al Kamil.

The reporting period of Malakoff Berhad does not coincide with International Power's financial year. Consequently, the results of Malakoff Berhad for the period 1 December to 30 November have historically been equity accounted by the Group each year as adjusted for any significant events in December. This treatment prevents Malakoff's results being made publicly available before its own shareholders have received the information through dissemination by Malakoff Berhad. The Group's shareholding in Malakoff is now recognised as an asset held for sale (refer note 24).

Included within the Group's share of net assets of joint ventures and associates is net debt of £1,524 million (2005: £1,625 million). These obligations are generally secured by the assets of the respective joint venture or associate borrower and are not guaranteed by International Power plc or any other Group company.

A full list of significant joint ventures and associates is included in note 40.

16 OTHER INVESTMENTS

	31 December 2006 £m	31 December 2005 £m
Investments available for sale	**26**	4

The Group owns debt instruments and minority shareholdings in a number of businesses related to power generation and fuel supply activities in Europe and Asia. The debt instruments are stated at fair value based on an estimate of the discounted cash flows. The equity instruments are not quoted but are shares in privately owned companies. Therefore the fair value of the equity instruments cannot be measured reliably and the carrying amount has been determined by using the cost of acquiring the shares in these companies.

17 FINANCE LEASE RECEIVABLES

			Present value of minimum lease payments	
	31 December 2006 £m	31 December 2005 £m	**31 December 2006 £m**	31 December 2005 £m
Minimum lease payments:				
Within one year	**110**	48	**33**	12
Later than one year and not later than five years	**428**	192	**144**	57
After five years	**1,398**	649	**834**	391
	1,936	889	**1,011**	460
Add: unguaranteed residual value (after five years)	**75**	–		
Gross investment in the lease	**2,011**	889		
Less: unearned finance income	**(925)**	(429)		
Total finance lease receivables	**1,086**	460		
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)	**1,053**	448		
Current finance lease receivables (recoverable within 12 months)	**33**	12		
Total finance lease receivables	**1,086**	460		
Analysed as:				
Present value of minimum lease payments	**1,011**	460		
Add: unguaranteed residual value	**75**	–		
Total finance lease receivables	**1,086**	460		

Rentals receivable under finance leases by the Group during the year amounted to £63 million (2005: £48 million). Excluding assets which are constructed by the Group, the cost of assets acquired by the Group during the year for onward finance leasing was £281 million (2005: £nil).

International Power's business is the generation of electricity. Sometimes the Group enters into arrangements such as long-term PPAs to secure contracted revenues for a long period of time. Some of these arrangements are determined to be or to contain finance leases. The average term of the finance leases entered into is usually a substantial portion of the asset's useful economic life.

Unguaranteed residual values of assets leased under finance leases at the balance sheet date are estimated at £75 million (2005: £nil).

The interest rate inherent in the lease is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8% per annum.

The fair value of the Group's finance lease receivables as at 31 December 2006 is estimated at £1,114 million (2005: £460 million) based on discounting estimated cash flows at the market rate.

18 OTHER LONG-TERM RECEIVABLES

	31 December 2006 £m	31 December 2005 £m
Total other long-term receivables	**94**	67

19 DEFERRED TAX

Deferred tax accounted for in the consolidated balance sheet and the potential amounts of deferred tax are:

	31 December 2006 £m	31 December 2005 £m
Deferred tax liabilities:		
Property, plant and equipment accelerated capital allowances	**(569)**	(552)
Other temporary differences	**(271)**	(238)
Dividends of overseas subsidiaries	**(57)**	(40)
Total deferred tax liabilities	**(897)**	(830)

	31 December 2006 £m	31 December 2005 £m
Deferred tax assets:		
Provisions	**43**	42
Tax losses	**161**	161
Other temporary differences	**245**	299
Total gross deferred tax assets	**449**	502
Less: deferred tax assets not recognised	**(155)**	(151)
Total deferred tax assets	**294**	351
Net deferred tax liabilities	**(603)**	(479)

Deferred tax assets will be offset against suitable taxable profits when they arise.

Of the £161 million (2005: £161 million) deferred tax asset in respect of tax losses, £106 million (2005: £102 million) can be carried forward for a period of between 10 and 19 years. The balance can be carried forward indefinitely. No deferred tax asset in relation to the £106 million of losses has been recognised (2005: £nil).

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries, associates and joint ventures was £888 million (2005: £634 million). At 31 December 2006 a deferred tax provision of £57 million (2005: £40 million) has been recognised in respect of temporary differences which are likely to reverse in the near future or where the Group is unable to control the reversal of the timing difference.

Calculation of the potential deferred tax liability for the total aggregate undistributed earnings has not been undertaken as the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future. If the temporary differences were to reverse in the future, it is probable that the majority of the potential tax liability would be covered by tax credits in respect of tax paid locally.

Certain deferred tax assets and liabilities have been offset in accordance with the Group's accounting policy. The following is the analysis of the deferred tax balances (after offset) for balance sheet purposes.

	31 December 2006 £m	31 December 2005 £m
Deferred tax liabilities	**(696)**	(557)
Deferred tax assets	**93**	78
Net deferred tax liabilities	**(603)**	(479)

19 DEFERRED TAX continued

Movement in temporary differences during the year:

	1 January 2006 £m	**Recognised in income £m**	**Other balance sheet movements £m**	**Recognised in equity £m**	**Acquisition of subsidiaries £m**	**31 December 2006 £m**
Property, plant and equipment	306	(17)	–	–	35	**324**
Other temporary differences	133	49	(3)	43	–	**222**
Dividends of overseas subsidiaries, associates and joint ventures	40	17	–	–	–	**57**
	479	49	(3)	43	35	**603**

	1 January 2005 £m	Recognised in income £m	Other balance sheet movements £m	Recognised in equity £m	Acquisition/ disposal of subsidiaries £m	31 December 2005 £m
Property, plant and equipment	316	(10)	–	–	–	306
Other temporary differences	100	21	7	(46)	51	133
Dividends of overseas subsidiaries, associates and joint ventures	16	24	–	–	–	40
	432	35	7	(46)	51	479

20 INVENTORIES

	31 December 2006 £m	31 December 2005 £m
Plant spares	**26**	22
Fuel inventories	**55**	37
Consumables	**60**	51
Total inventories	**141**	110

Inventories with a carrying amount of £116 million (2005: £50 million) are subject to fixed and floating charges of project finance facilities at various power plant subsidiaries. These project finance facilities are non-recourse to International Power plc.

21 TRADE AND OTHER RECEIVABLES

	31 December 2006 £m	31 December 2005 £m
Trade receivables	**139**	163
Other receivables	**157**	108
Prepayments and accrued income	**103**	125
Total amounts falling due within one year	**399**	396

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value. Trade and other receivables are stated net of allowance for irrecoverable amounts.

22 DERIVATIVE FINANCIAL INSTRUMENTS

	31 December 2006 Assets £m	31 December 2006 Liabilities £m	31 December 2005 Assets £m	31 December 2005 Liabilities £m
Energy derivatives	**236**	**362**	267	661
Interest rate swaps	**15**	**9**	1	26
Options over equity	**30**	**59**	–	–
	281	**430**	268	687
Current	**243**	**204**	268	496
Non-current	**38**	**226**	–	191
	281	**430**	268	687

The Group utilises interest rate swaps to manage its interest rate exposures by swapping an element of its borrowings from floating rates to fixed rates. As at 31 December 2006, the total notional value of interest rate swaps was £2,007 million (2005: £1,416 million).

The Group utilises foreign currency exchange contracts to manage its foreign exchange rate exposures. As at 31 December 2006, the total notional value of these contracts was £45 million (2005: £6 million) and the mark to market was £nil (2005: £nil).

The Group owns purchased call options over the equity of various energy related businesses. The Group already has an equity interest in some of these businesses. The Group has convertible bonds which can convert into Ordinary Shares of International Power plc. The conversion feature in the 3.25% convertible euro bond is accounted for as an embedded derivative (refer note 25).

23 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise bank balances and cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates to their fair value.

	31 December 2006 £m	31 December 2005 £m
Cash and cash equivalents in the cash flow statement	**980**	620

The total cash and cash equivalents balance includes £211 million (2005: £71 million) of cash which is considered to be 'restricted' as it is primarily to secure amounts required for debt repayments and letters of credit.

24 ASSETS HELD FOR SALE

On 22 December 2006, the shareholders of Malakoff Berhad approved the sale of their wholesale power generating business to MMC, another Malaysian corporate, for 10.35 Malaysian ringgits per share. The sale process is expected to be completed in the first half of 2007. The estimated proceeds, from the sale of International Power's shareholding in Malakoff Berhad, are significantly more than the 31 December 2006 carrying amount of £128 million. As at 22 December 2006, the carrying amount was reclassified from investments in joint ventures and associates to non-current assets classified as held for sale. The asset held for sale is included within the Asia region segmental assets shown in note 2. International Power's share of Malakoff's earnings are included within the Asia region segmental results.

25 LOANS AND BONDS

	31 December 2006 £m	31 December 2005 £m
a) Interest-bearing loans and bonds (current)		
Current portion of secured bank loans	**231**	187
Secured bonds	**10**	–
	241	187
b) Interest-bearing loans and bonds (non-current)		
Secured bank loans	**3,209**	2,721
Secured bonds	**668**	445
Preferred equity facility	**152**	173
3.75% Convertible US dollar bonds 2023	**113**	125
3.25% Convertible euro bonds 2013	**124**	–
	4,266	3,464
Total interest-bearing loans and bonds	**4,507**	3,651

25 LOANS AND BONDS continued

Secured bank loans and secured bonds

The bank loans and bonds with a carrying amount of £4,118 million are secured by fixed and floating charges over the assets of certain subsidiaries. Substantially all of the Group's power stations, generating assets and other operating assets are financed under facilities which are non-recourse to International Power plc and secured solely on the assets of the subsidiary concerned.

Preferred equity facility

The preferred equity facility comprises US$300 million in preference shares which were issued by Impala Magpie Limited to Mitsui Power Ventures Limited for the purposes of financing the acquisition of the EME portfolio which was completed in December 2004.

Impala Magpie Limited is a 70% owned subsidiary of International Power plc and Mitsui Power Ventures Limited is a wholly-owned subsidiary of Mitsui & Co of Japan. Mitsui Power Ventures Limited is International Power's partner in IPM Eagle LLP, which is the owner of the assets formerly owned by Edison Mission Energy, and Saltend.

The preference shares entitle the holder to a preferred dividend coupon of US dollar LIBOR plus 2%. The preference shares are redeemable from 16 December 2008 and may also be redeemed if funds become available following the sale of certain assets.

International Power (Impala), a wholly-owned subsidiary of International Power plc, has granted Mitsui Power Ventures Limited a put option to sell 70% of the preference shares it holds on the date of exercise. The put option is exercisable in certain circumstances, including where Impala Magpie Limited fails to redeem the preference shares on maturity.

International Power plc has agreed to guarantee International Power (Impala)'s obligations to Mitsui & Co of Japan and Mitsui Power Ventures Limited.

3.75% Convertible US dollar bonds 2023

On 22 August 2003, International Power (Jersey) Limited, a wholly-owned subsidiary company incorporated in Jersey, issued US$252.5 million 3.75% convertible notes due 2023, convertible into preference shares of International Power (Jersey) Limited at the holder's option, immediately exchangeable for Ordinary Shares of, and unconditionally guaranteed by, International Power plc.

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 173p at any time up to 12 August 2023. Each US$1,000 principal amount of notes will entitle the holder to convert into a US$1,000 paid-up value of preference shares of International Power (Jersey) Limited. The notes may be redeemed at the holder's option at their principal amount, together with accrued interest, to the date fixed for redemption.

The convertible bonds mature in August 2023 but with bondholders having the right to put the bond back to the Group in August 2010, 2013, 2018 and 2023.

If the conversion option is not exercised, the convertible unsecured notes will be redeemed on 22 August 2023 at a redemption price equivalent to their principal amount.

Following the extinguishment of a cash settlement option on 17 January 2005, the remaining conversion feature, being an equity call option held by the bondholders was recognised in equity. The remaining debt element of the convertible bond accretes to par value over the life of the bond at a constant periodic rate based on its carrying amount.

The interest charged for the year is calculated by applying an effective interest rate of 3.65% to the liability component for the period since the convertible US dollar bond was issued. This is in addition to the coupon interest rate of 3.75% per annum.

The Directors estimate the fair value of the liability component of the convertible US dollar bonds at 31 December 2006 to be approximately £114 million (31 December 2005: £125 million). This fair value has been determined by reference to the market price at 31 December 2006.

3.25% Convertible euro bonds 2013

On 20 July 2006, International Power Finance (Jersey) II Limited, a wholly-owned subsidiary company incorporated in Jersey, issued €230 million 3.25% convertible notes due 2013, convertible into preference shares of International Power Finance (Jersey) II Limited at the holder's option, immediately exchangeable for Ordinary Shares of, and unconditionally guaranteed by, International Power plc.

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 391p at any time up to 20 July 2013. Each €50,000 principal amount of notes will entitle the holder to convert into a €50,000 paid-up value of preference shares of International Power Finance (Jersey) II Limited. The notes may be redeemed at the holder's option at their principal amount, together with accrued interest, to the date fixed for redemption.

If the conversion option is not exercised, the convertible unsecured notes will be redeemed on 20 July 2013 at a redemption price equivalent to their principal amount.

	31 December 2006 £m
Net proceeds of convertible euro bonds issued	**152**
Embedded derivative component	**(30)**
Liability component at date of issue	**122**
Interest charged	**2**
Liability component at 31 December	**124**

The net proceeds received from the issue of the convertible bond have been split between the debt element and an embedded derivative component. This embedded derivative component represents the fair value of the equity conversion call option held by the bondholders.

The interest charged for the year is calculated by applying an effective interest rate of 3.39% to the liability component for the period since the convertible euro bond was issued. This is in addition to the coupon interest rate of 3.25% per annum.

The Directors estimate the fair value of the liability component of the convertible euro bonds at 31 December 2006 to be approximately £133 million. This fair value has been determined by reference to the market price at 31 December 2006.

26 TRADE AND OTHER PAYABLES (CURRENT)

	31 December 2006 £m	31 December 2005 £m
Trade payables	**85**	118
Other payables	**226**	153
Accruals	**218**	240
Total trade and other payables	**529**	511

The Directors consider the carrying amounts of trade and other payables approximate to their fair value.

27 OTHER PAYABLES (NON-CURRENT)

	31 December 2006 £m	31 December 2005 £m
Other payables	**40**	14
Loans from minority interests	**81**	81
Total other payables	**121**	95

28 PROVISIONS

	Retirement benefit obligations £m	Commodity contracts £m	Other £m	Total £m
At 1 January 2006	27	–	41	68
Acquisitions	–	156	3	159
Provisions made during the year	10	–	14	24
Provisions used during the year	(12)	(16)	(5)	(33)
Exchange differences	–	(7)	(2)	(9)
At 31 December 2006	**25**	**133**	**51**	**209**

Commodity contracts added in 2006 relate to 'out of the money' power sales contracts acquired as part of the acquisition of Coleto Creek. The provisions utilised are credited to revenue in the income statement and are expected to be fully utilised by 2014.

The majority of the 'other' provisions relate to liabilities in respect of onerous property leases, employee-related compensation, amounts provided for long service and annual leave liabilities, and for mine site restoration. These liabilities are not expected to arise in the short-term. The Directors are uncertain as to the timing of when these provisions will be utilised.

29 SHARE CAPITAL

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2006	2,266,000,000	1,133	1,474,736,637	737
Issue of shares under Executive Share Option Plan	–	–	13,073,207	6
Issue of shares under the Sharesave Plan	–	–	1,196,959	1
Issue of shares under Performance Share Plan	–	–	3,046,107	2
At 31 December 2006	**2,266,000,000**	**1,133**	**1,492,052,910**	**746**

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2005	2,266,000,000	1,133	1,473,269,066	737
Issue of shares under the Sharesave Plan	–	–	858,892	–
Issue of shares under Executive Share Option Plan	–	–	608,679	–
At 31 December 2005	2,266,000,000	1,133	1,474,736,637	737

Ordinary Shares
Ordinary Shares rank equally between each other with regard to the right to receive dividends and also in a distribution of assets on the winding up of the Company.

29 SHARE CAPITAL continued

Deferred shares

The Group has 21 Deferred Shares of 1 pence each in issue. These shares were issued to ensure the demerger was effected as efficiently as possible. The holders of Deferred Shares have no rights to receive dividends or to attend or vote at any general meeting.

Unclassified share

Further to the redemption of the Special Share in August 2000, the Group's authorised share capital includes one unclassified share of £1.

Employee share schemes

a) Number of shares and exercise prices under Share Option Plans

The Group operates the following employee share plans for which shares may be issued by the Group out of authorised but unissued share capital upon exercise of options: the UK Approved Sharesave Plans and the Global Sharesave Plans; the UK Approved and Unapproved Executive Share Option Plans, and the Global Executive Share Option Plans; and the 2002 Performance Share Plan. The total number of options outstanding at the end of the year was as follows:

			Number of Ordinary Shares	
	Option price range	Date exercisable	Year ended 31 December 2006	Year ended 31 December 2005
Sharesave Plans	70.33p-200.00p	2006-2011	**5,889,678**	4,783,486
Executive Share Option Plans	62.32p-343.73p	2000-2016	**21,294,173**	32,687,124
2002 Performance Share Plan	74.79p	2003 onwards	**1,230,108**	4,276,215
Total options outstanding			**28,413,959**	41,746,825

Details of each Plan are set out on the following pages:

i) Sharesave Plans

The UK Approved Sharesave Plan and the Global Sharesave Plan are savings related and enable employees in the UK and a number of other jurisdictions to invest up to a maximum of £250 (or foreign currency equivalent) per month for the purpose of acquiring shares in the Group. The option prices are fixed at a discount of 20% to the market value of the Group's Ordinary Shares as at the date of grant of the option. Options are exercisable at the prices set out below. The option exercise period commences either three or five years after the option has been granted (determined at the time that the employee enters into the savings agreement) and if the options remain unexercised after a period of six months following the beginning of the option exercise period, the options expire. Except for certain specific circumstances (e.g. redundancy) options lapse if the employee leaves the Group before the option exercise period commences. Details of the share options outstanding at the end of the year are as follows:

		Number of Ordinary Shares	
Option price	Date exercisable	Year ended 31 December 2006	Year ended 31 December 2005
167.37p	2006	–	10,082
178.06p	2006-2007	**6,631**	6,631
80.12p	2005-2006	–	253,314
80.12p	2007-2008	**2,578,756**	2,673,050
97.93p	2006-2007	**79,672**	104,158
97.93p	2008-2009	**69,582**	69,582
70.33p	2006	–	800,205
70.33p	2008	**568,855**	654,658
97.93p	2007	**94,277**	107,329
97.93p	2009	**99,331**	104,477
200.00p	2009	**1,311,675**	–
200.00p	2011	**1,080,899**	–
		5,889,678	4,783,486

The number and weighted average exercise prices of Sharesave Plan share options are as follows:

	Year ended 31 December 2006		Year ended 31 December 2005	
	Number of Ordinary Shares	**Weighted average exercise price pence**	Number of Ordinary Shares	Weighted average exercise price pence
Options outstanding at beginning of the year	**4,783,486**	**78.90**	5,963,482	79.18
Granted during the year	**2,481,799**	**200.00**	–	–
Exercised during the year	**(1,196,959)**	**74.24**	(858,892)	80.67
Expired during the year	**(178,648)**	**140.10**	(321,104)	79.45
Options outstanding at end of the year	**5,889,678**	**129.02**	4,783,486	78.90
Options exercisable at end of the year	**86,303**		253,314	

The weighted average share price at the date of exercise for Sharesave Plan share options exercised during the year was 287.15 pence (2005: 240.43 pence). The share options outstanding at the end of the year have exercise prices in a range from 70.33 pence to 200.00 pence as outlined in the table above.

For these share options outstanding at the end of the year the weighted average remaining contractual life is 2.36 years (2005: 2.12 years).

ii) Executive Share Option Plans

The UK Approved and Unapproved Executive Share Option Plans and the Global Executive Share Option Plans are discretionary employee share option plans. Options are granted to those employees selected to participate in the Plan at the discretion of the Directors of the Company. The exercise price of the options is fixed at the market value of the Company's Ordinary Shares as at the date that the options are granted. The option exercise period is between the third and tenth anniversaries of the date of grant of the options and if the options are not exercised before the expiry of the tenth anniversary of the date of grant then the options lapse. Except for certain specific circumstances (e.g. redundancy) options lapse if the employee leaves the Group before the option exercise period commences or if the employee resigns from the Company. Details of the share options outstanding at the end of the year are as follows:

		Number of Ordinary Shares	
Option price	**Date exercisable**	**Year ended 31 December 2006**	Year ended 31 December 2005
287.76p	1999-2006	**–**	416,298
343.73p	2000-2007	**440,687**	499,572
313.92p	2001-2008	**586,630**	712,903
277.55p	2003-2010	**1,527,844**	2,574,081
209.22p	2004-2011	**631,668**	1,612,812
193.19p	2004-2011	**49,959**	136,076
174.50p	2005-2012	**3,329,619**	3,673,817
62.32p	2006-2013	**622,483**	10,626,586
123.53p	2007-2014	**6,228,318**	6,845,144
179.25p	2008-2015	**5,215,424**	5,589,835
281.00p	2009-2016	**2,661,541**	–
		21,294,173	32,687,124

The number and weighted average exercise prices of Executive Share Options are as follows:

	Year ended 31 December 2006		Year ended 31 December 2005	
	Number of Ordinary Shares	**Weighted average exercise price pence**	Number of Ordinary Shares	Weighted average exercise price pence
Options outstanding at beginning of the year	**32,687,124**	**145.14**	29,770,835	141.65
Granted during the year	**2,671,718**	**281.00**	5,589,835	179.25
Exercised during the year	**(13,073,207)**	**104.51**	(608,679)	142.02
Expired during the year	**(991,462)**	**156.52**	(2,064,867)	187.83
Options outstanding at end of the year	**21,294,173**	**186.60**	32,687,124	145.14
Options exercisable at end of the year	**7,188,890**		9,625,559	

29 SHARE CAPITAL continued

The weighted average share price at the date of exercise for Executive Share Options exercised during the year was 293.26 pence (2005: 232.62 pence). The share options outstanding at the end of the year have exercise prices in a range from 62.32 pence to 343.73 pence.

For these share options outstanding at the end of the year the weighted average remaining contractual life is 6.8 years (2005: 7.1 years).

iii) 2002 Performance Share Plan
Under this Plan, Directors and certain senior managers of the Group are awarded conditional awards over Ordinary Shares in the Group. These conditional awards may vest three years after the awards have been made subject to the satisfactory performance of a performance condition (determined at the time that the conditional awards are made). In 2003 the Group granted to the Trustee of the International Power Employee Share Ownership Trust an option to acquire 3,807,057 Ordinary Shares in the Group at an option price of 84 pence per share. Following the Rights Issue in 2004, the number of shares under option was increased to 4,276,215 and the option exercise price was adjusted to 74.79 pence per share. This option can only be exercised to the extent required to satisfy conditional awards made under the Performance Share Plan. These conditional awards can only vest after the end of the relevant performance period and only to the extent to which the performance conditions have been satisfied.

During 2006 the Trustee exercised this option to the extent of 3,046,107 shares in respect of Performance Share Plan awards released in March 2006. At 31 December 2006 there remained 1,230,108 options outstanding and exercisable at an exercise price of 74.79 pence per share.

The life of this option is open-ended. It is anticipated that this share option will be utilised to satisfy the release of awards made under the 2002 Performance Share Plan from 2007 onwards. Assuming full vesting of the awards made as at 31 December 2006, it is estimated that this option will have been fully exercised by the end of 2008.

b) Fair value of options under Share Option Plans

i) Sharesave plans
The estimated fair value of the options granted during the year was 82 pence per share (2005: None granted).

These fair values were calculated using the Black-Scholes option pricing model. The inputs into the model were as follows:

	2006	2005
Weighted average share price	**250p**	n/a
Weighted average exercise price	**200p**	n/a
Expected volatility	**30%**	n/a
Expected life	**4 years**	n/a
Risk free rate	**4.16%**	n/a
Expected dividend yield	**2.36%**	n/a

ii) Executive Share Options Plans
The estimated fair value of the options granted during the year was 61 pence per share (2005: 47 pence per share).

These fair values were calculated using the Black-Scholes option pricing model. The inputs into the model were as follows:

	2006	2005
Weighted average share price	**269p**	179p
Weighted average exercise price	**281p**	179p
Expected volatility	**30%**	30%
Expected life	**4 years**	4 years
Risk free rate	**4.39%**	4.84%
Expected dividend yield	**2.36%**	1.94%

Expected volatility was determined by calculating the historical volatility of the Company's share price over the previous six years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

iii) 2002 Performance Share Plan
No performance share plan options were granted during the current or prior year.

c) Managers' share bonus arrangements
During 2004, 571,710 Ordinary Shares in International Power plc were acquired in respect of a project incentive arrangement for staff for a consideration of £887,497. These shares have been placed in an Employee Share Ownership Trust. No additional purchases were made during 2006 in respect of this plan (2005: nil).

d) Employee Share Ownership Trust
A number of International Power plc Ordinary Shares are held in Employee Share Ownership Trusts (ESOTs). These shares are held by the ESOTs to meet awards made under the Group's 2002 Performance Share Plan. At 31 December 2006, the ESOTs held a total of 1,241,452 International Power plc Ordinary Shares (2005: 2,081,573). At 31 December 2006 the market value of these shares was £4,739,243 (2005: £4,985,367). The maximum number of Ordinary Shares required to meet all outstanding awards (assuming full vesting of those awards) as at 31 December 2006 was 6,444,745 (2005: 7,522,005).

30 SHARE CAPITAL AND RESERVES

	Attributable to equity holders of the parent							
	Share capital £m	**Share premium account £m**	**Capital redemption reserve £m**	**Capital reserve £m**	**Hedging reserve £m**	**Translation reserve £m**	**Retained earnings £m**	**Total equity £m**
At 1 January 2006	737	394	145	422	(118)	49	463	2,092
Profit for the year	–	–	–	–	–	–	410	410
Other recognised income and expenses relating to the year (net)	–	–	–	–	124	(127)	–	(3)
Issue of shares	9	8	–	–	–	–	–	17
Distributions	–	–	–	–	–	–	(67)	(67)
Other movements	–	–	–	–	–	–	13	13
At 31 December 2006	**746**	**402**	**145**	**422**	**6**	**(78)**	**819**	**2,462**

	Attributable to equity holders of the parent							
	Share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
At 1 January 2005	737	392	145	422	(12)	(39)	156	1,801
Profit for the year	–	–	–	–	–	–	285	285
Other recognised income and expenses relating to the year (net)	–	–	–	–	(106)	88	–	(18)
Recognition of equity component in 3.75% convertible US dollar bond	–	–	–	–	–	–	50	50
Issue of shares	–	2	–	–	–	–	–	2
Distributions	–	–	–	–	–	–	(37)	(37)
Other movements	–	–	–	–	–	–	9	9
At 31 December 2005	737	394	145	422	(118)	49	463	2,092

The share capital represents the authorised Ordinary Shares in the Company issued at par which carry a right to participate in the distribution of dividends or capital of the Company.

The share premium account represents the difference between the issue price and the nominal value of shares issued.

The capital redemption reserve was created in March 1995 when the Company purchased and then cancelled approximately 98 million of its Ordinary Shares in conjunction with HM Treasury's sale of its remaining 40% shareholding in the Company. The reserve was subsequently increased in the years ended 31 March 1996, 31 March 2000 and 31 December 2003 when further share purchases were made and these shares were cancelled. The capital redemption reserve is not distributable.

The capital reserve was vested in the Company at 31 March 1990 under the Transfer Scheme whereby the net assets of the Central Electricity Generating Board (CEGB) were divided among the CEGB successor companies. It is not distributable.

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the Company, as well as from the translation of liabilities that hedge the Company's net investment in foreign operations.

On 17 January 2005, the Group waived its option to cash settle the conversion option of the 3.75% convertible US dollar bonds 2023. This election transferred the fair value of the embedded derivative to reserves, recognising the mark to market carrying amount as an equity component of the bond.

£527 million (2005: £124 million) of the Group's retained earnings is not distributable as it arose from unrealised gains on intra-group transfers.

Set off against retained earnings at 31 December 2006 are treasury shares of £1 million (2005: £1 million).

31 ACQUISITIONS AND DISPOSALS

a) Coleto Creek

On 7 July 2006 American National Power Inc, a wholly-owned subsidiary of International Power, acquired the 632 MW coal fired Coleto Creek power generation facility in Texas from Topaz Power Group, a joint venture between Carlyle/Riverstone and Sempra Generation, for cash consideration, including acquisition costs, of £621 million (US$1.14 billion). The result of Coleto Creek has been consolidated as a subsidiary from this date using the acquisition method.

The details of the transaction, results and fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Goodwill	–	40	40
Other intangible assets	20	81	101
Property, plant and equipment	199	424	623
Inventories	9	1	10
Trade and other receivables	12	–	12
Trade and other payables	(9)	–	(9)
Provisions	–	(156)	(156)
Total assets acquired	**231**	**390**	**621**

Components of cost of acquisition	
Cash	617
Directly attributable acquisition costs	4
Consideration (including acquisition costs) and cash outflow to the Group	**621**

In the period from 7 July 2006 to 31 December 2006, Coleto Creek contributed £74 million of revenue and £26 million to the Group's profit from operations (both excluding exceptional items and specific IAS 39 mark to market movements). Including exceptional items and specific IAS 39 mark to market movements, it contributed £77 million of revenue and £29 million to the Group's profit from operations. It also contributed £34 million to the Group's net operating cash flows and paid £22 million in respect of net interest and £nil in respect of tax.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of sulphur dioxide allowances, included as intangible assets; the recognition of the plant at fair value, included as property, plant and equipment; and the fair value of out of the money power purchase agreements (agreements to sell power), included as provisions. Goodwill arises on the acquisition of Coleto Creek as a result of the fair value of property, plant and equipment being restricted to the lower of depreciated replacement cost and value in use. As the depreciated replacement cost of the Coleto Creek power plant is lower than its value in use and all other assets and liabilities and contingent liabilities have been identified, then goodwill arises.

It is impracticable to state what the impact would have been on Group revenue and profit for the year had the acquisition been completed on 1 January 2006 due to the difficulty in ascertaining the valuation of commodity contracts, at that time, reflected in the fair value balance sheet acquired as intangible assets and provisions, and their respective corresponding amortisation charge and credit to the income statement during that period.

b) Levanto

On 1 November 2006, International Power plc, through its wholly-owned subsidiary International Power Levanto Holdings BV, completed the purchase of the Levanto portfolio of onshore wind farms, predominantly located in France and Germany, from Christofferson Robb & Company (CRC) for £129 million, including acquisition costs. This comprises the acquisition of 100% of the issued share capital of Levanto Structured Energy (Lux) S.a.r.l. and Levanto GSEF (Lux) S.a.r.l. Levanto GSEF (Lux) S.a.r.l. owns bonds issued by the lender of finance to one of the wind farm owning entities. At the date of acquisition the Levanto wind farms comprised 286 MW of capacity in operation, 126 MW under construction, which is due to commence operation in 2007, and 24 MW of fully permitted capacity, which is planned to commence operation in 2008. As required, the results of the Levanto group of businesses have been consolidated as subsidiaries from this date using the acquisition method.

The details of the transaction, results and provisional fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Assets in course of construction	54	–	54
Finance lease receivables – non-current	184	94	278
Finance lease receivables – current	3	–	3
Trade and other receivables	14	–	14
Cash and cash equivalents	104	–	104
Loans and bonds – current	(34)	–	(34)
Trade and other payables	(16)	–	(16)
Loans and bonds – non-current	(243)	–	(243)
Deferred tax liabilities	–	(28)	(28)
Provisions	(3)	–	(3)
Total assets acquired	**63**	**66**	**129**

Components of cost of acquisition	
Cash	67
Vendor subordinated loan	60
Directly attributable acquisition costs	2
Consideration (including acquisition costs)	**129**
Satisfied by:	
Cash consideration paid (including acquisition costs)	69
Amount owed to vendor as a subordinated loan	60
Cash and cash equivalents acquired	(104)
Net cash outflow to the Group	**25**

In the period from 1 November 2006 to 31 December 2006, Levanto contributed immaterial amounts of revenue, profit from operations and net operating cash flows to the Group results.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of the finance lease receivables and associated deferred tax on the temporary timing difference created by the fair value adjustment. Due to the proximity of the date of acquisition to the year end and the complexity of the business acquired the fair values attributed to the acquired assets and liabilities are provisional and may be revised.

Similarly, for the same reasons, it is impracticable to state what the impact would have been on Group revenue and profit for the year had the acquisition been completed on 1 January 2006 due to the difficulty in ascertaining the valuation of assets and liabilities at that time.

31 ACQUISITIONS AND DISPOSALS continued

c) Indian Queens

On 18 September 2006 International Power plc, through a wholly-owned subsidiary, completed the purchase of 100% of the share capital of Indian Queens Power Limited and Indian Queens Operations Limited, the owner and operating companies respectively of the Indian Queens oil fired OCGT peaking plant in Cornwall, England from AES for £32 million. The results of both Indian Queens businesses have been consolidated as subsidiaries from this date using the acquisition method.

The details of the transaction, results and fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Intangible assets	–	2	2
Property, plant and equipment	24	11	35
Inventories	1	–	1
Trade receivables	2	–	2
Cash and cash equivalents	24	–	24
Finance lease payable – current	(2)	–	(2)
Trade payables	(2)	–	(2)
Finance lease payable – non-current	(26)	5	(21)
Deferred tax liabilities	(1)	(6)	(7)
Total assets acquired	**20**	**12**	**32**
Satisfied by:			
Cash consideration paid (including acquisition costs)			32
Cash and cash equivalents acquired			(24)
Net cash outflow to the Group			**8**

In the period 18 September 2006 to 31 December 2006, Indian Queens contributed £3 million of revenue and £1 million to the Group's profit from operations. It also contributed £2 million to the Group's net operating cash flows and paid £2 million in respect of net interest and nil in respect of tax.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of the property, plant and equipment, the fair value of the finance lease payable and the associated deferred tax adjustments on the temporary timing differences created.

If the acquisition of Indian Queens had taken place on 1 January 2006, Indian Queens would have contributed £13 million of revenue (and Group revenue would have been £2,594 million) for the year ended 31 December 2006 and the profit from operations contributed by Indian Queens would have been £3 million (and Group profit from operations would have been £900 million).

d) Acquisition of subsidiaries net of cash and cash equivalents acquired

In addition to the net cash outflow to the Group of £621 million on the acquisition of Coleto Creek, the cash outflows of £25 million relating to the acquisition of Levanto and £8 million relating to Indian Queens, a £1 million cash outflow arose on acquisition of the remaining 1% shareholding in International Power Opatovice, in the Czech Republic, and a £5 million cash inflow arose from amounts received from Calpine relating to the acquisition of Saltend in 2005.

e) Acquisition of investments in associates

The following acquisitions took place in 2006:

Hidd

On 22 January 2006 Hidd Power Company BSC(c), a company owned 40% by International Power, 30% by Suez-Tractebel SA and 30% by Sumitomo Corporation, signed an agreement to acquire the Hidd independent power and water project in Bahrain, and signed a 20-year power and water purchase agreement with the Ministry of Electricity and Water for its output. Hidd Power Company took over operation of the plant on 23 January 2006, which was the effective date of acquisition, and the transaction was completed on 11 July 2006.

Opus

On 10 May 2006 International Power Retail UK Limited, a wholly-owned subsidiary of International Power plc, completed the purchase of 30% of the share capital of Oxford Power Holdings Limited for £7 million. Its principal subsidiary is Opus Energy Limited, an independent supplier of electricity in the UK that focuses on the small business sector.

32 NET DEBT

Analysis of changes in net debt

	1 January 2006 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2006 £m
Cash and cash equivalents	620	(26)	–	–	386	**980**
Assets held for trading	52	(3)	–	2	(9)	**42**
Total funds	672	(29)	–	2	377	**1,022**
Loans due within one year	(187)	5	(26)	(96)	73	**(231)**
Loans due after more than one year	(2,721)	224	(40)	84	(756)	**(3,209)**
Secured bonds	(445)	(2)	(234)	3	–	**(678)**
Preferred equity facility	(173)	21	–	–	–	**(152)**
Convertible bonds	(125)	16	–	24	(152)	**(237)**
Total debt	(3,651)	264	(300)	15	(835)	**(4,507)**
Net debt	(2,979)	235	(300)	17	(458)	**(3,485)**

	1 January 2005 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2005 £m
Cash and cash equivalents	565	18	–	–	37	620
Assets held for trading	47	2	–	3	–	52
Total funds	612	20	–	3	37	672
Loans due within one year	(71)	–	–	(73)	(43)	(187)
Loans due after more than one year	(2,503)	(145)	–	63	(136)	(2,721)
Secured bonds	(449)	–	–	4	–	(445)
Preferred equity facility	(154)	(18)	–	(1)	–	(173)
Convertible bonds	(136)	(17)	–	(3)	31	(125)
Total debt	(3,313)	(180)	–	(10)	(148)	(3,651)
Net debt	(2,701)	(160)	–	(7)	(111)	(2,979)

33 FINANCIAL INSTRUMENTS

a) Energy trading risk, energy market risk and hedge accounting

The Group hedges exposures that arise from the ownership and operation of power plants and related sales of electricity and purchases of fuel and utilises derivatives to optimise the return achieved from these assets. The Group enters into derivative commodity financial instruments to convert floating or indexed electricity and fuel prices to fixed prices in order to lessen its vulnerability to reductions in electricity prices for the electricity it generates and to increases in fuel prices for the fuel it consumes in its power plants. Commodity derivative financial instruments also provide a way to meet customers' pricing requirements while achieving a price structure consistent with the Group's overall pricing strategy.

The Group accounts for certain energy sales and fuel purchases as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

b) Treasury policy

Treasury policy seeks to ensure that adequate financial resources are available for the development of the Group's business whilst managing its currency, interest rate and counterparty credit risks. The Group's treasury policy is not to engage in speculative transactions. Group treasury acts within clearly defined guidelines that are approved by the Board.

c) Risk identification and management

There is a continuous process for identifying, evaluating and managing the key risks faced by the Group. Activities are co-ordinated by the Risk Committee, which is chaired by the CFO, and has responsibility, on behalf of the Board, for ensuring the adequacy of systems for identifying and assessing significant risks, that appropriate control systems and other mitigating actions are in place, and that residual exposures are consistent with the Group's strategy and objectives. Assessments are conducted for all material entities.

d) Interest rate risk and hedge accounting

The Group's policy is to fix interest rates for a significant portion of its debt. This equates to 71%, as at 31 December 2006, using forward rate or interest rate swap agreements. Significant interest rate management programmes and instruments require the specific approval of the Board. The weighted average interest rate of fixed rate debt was 7%. Where project finance is utilised, our policy is to align the maturity of the debt with the contractual terms of the customer offtake agreement. The Group accounts for certain interest rate swaps as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

Effective interest rates and maturity analysis

The following is a table illustrating the effective interest rates of interest earning financial assets and interest bearing financial liabilities and the periods in which they mature:

								31 December 2006
	Effective interest rate	Carrying amount £m	Maturity less than 12 months £m	Maturity 1-2 years £m	Maturity 2-3 years £m	Maturity 3-4 years £m	Maturity 4-5 years £m	Maturity more than 5 years £m
Financial assets								
Finance lease receivable:								
Euro	7.5%	798	26	27	28	29	30	658
US dollars	10.0%	288	7	7	8	8	7	251
Assets held for trading:								
Australian dollars	6.1%	42	42	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	6.1%	80	80	–	–	–	–	–
Czech koruna	2.4%	15	15	–	–	–	–	–
Euro	3.6%	149	149	–	–	–	–	–
Sterling	5.1%	549	549	–	–	–	–	–
US dollars	5.2%	179	179	–	–	–	–	–
Other currencies	4.5%	8	8	–	–	–	–	–
Total financial assets		**2,108**	**1,055**	**34**	**36**	**37**	**37**	**909**
Financial liabilities								
Secured bank loans:								
Australian dollars	7.5%	987	27	39	54	38	45	784
Effect of interest rate swap	*0.2%*	*(796)*	*(43)*	*(111)*	*(20)*	*(250)*	*(358)*	*(14)*
Czech koruna	3.3%	49	49	–	–	–	–	–
Effect of interest rate swap	*0.1%*	*(7)*	*(7)*	–	–	–	–	–
Euro	5.9%	456	64	32	27	45	36	252
Effect of interest rate swap	*0.1%*	*(35)*	*(5)*	*(20)*	*(10)*	–	–	–
Sterling	7.1%	511	54	43	36	37	33	308
Effect of interest rate swap	*(0.2)%*	*(300)*	*19*	*14*	*(125)*	*(141)*	*(67)*	–
US dollars	8.1%	1,404	35	29	33	490	40	777
Effect of interest rate swap	*(0.2)%*	*(869)*	*(20)*	*(21)*	*(175)*	*(271)*	*(195)*	*(187)*
Other currencies	7.3%	33	2	3	3	3	3	19
Sub-total of secured bank loans	7.4%	3,440	231	146	153	613	157	2,140
Sub-total of effect of interest rate swaps	*0.1%*	*(2,007)*	*(56)*	*(138)*	*(330)*	*(662)*	*(620)*	*(201)*
Secured bonds:								
Euro	5.4%	236	10	11	12	12	12	179
Sterling	8.1%	442	–	–	–	–	–	442
Preferred equity facility:								
US dollars	7.4%	152	–	152	–	–	–	–
Convertible bonds[(1)]:								
Euro	6.6%	124	–	–	–	–	–	124
US dollars	7.4%	113	–	–	–	113	–	–
Sub-total of loans and bonds included in net debt		4,507	241	309	165	738	169	2,885
Loans from minority interests:								
US dollars	8.0%	25	16	3	4	2	–	–
Sterling	5.7%	56	–	–	–	–	–	56
Total financial liabilities		**4,588**	**257**	**312**	**169**	**740**	**169**	**2,941**

	Effective interest rate	Carrying amount £m	Maturity less than 12 months £m	Maturity 1-2 years £m	Maturity 2-3 years £m	Maturity 3-4 years £m	Maturity 4-5 years £m	Maturity more than 5 years £m
								31 December 2005
Financial assets								
Finance lease receivable:								
Euro	7.9%	460	12	12	14	15	16	391
Assets held for trading:								
Australian dollars	5.5%	52	52	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	5.4%	109	109	–	–	–	–	–
Czech koruna	1.9%	4	4	–	–	–	–	–
Euro	2.4%	55	55	–	–	–	–	–
Sterling	4.5%	331	331	–	–	–	–	–
US dollars	4.3%	109	109	–	–	–	–	–
Other currencies	3.2%	12	12	–	–	–	–	–
Total financial assets		1,132	684	12	14	15	16	391
Financial liabilities								
Secured bank loans:								
Australian dollars	6.7%	1,108	40	41	80	71	46	830
Effect of interest rate swap	*0.7%*	*(701)*	*(17)*	*(160)*	*(169)*	*(71)*	*(266)*	*(18)*
Czech koruna	2.8%	55	8	47	–	–	–	–
Effect of interest rate swap	*0.8%*	*(40)*	*–*	*(40)*	*–*	*–*	*–*	*–*
Euro	4.8%	371	21	22	24	23	27	254
Effect of interest rate swap	*0.4%*	*(43)*	*(5)*	*(5)*	*(8)*	*(21)*	*(4)*	*–*
Sterling	6.8%	335	85	17	15	22	17	179
Effect of interest rate swap	*(0.3)%*	*(192)*	*(19)*	*(12)*	*(10)*	*(15)*	*(136)*	*–*
US dollars	7.2%	1,013	31	33	37	31	540	341
Effect of interest rate swap	*0.2%*	*(440)*	*56*	*(23)*	*(24)*	*(200)*	*(17)*	*(232)*
Other currencies	7.7%	26	2	2	2	3	3	14
Sub-total of secured bank loans	6.6%	2,908	187	162	158	150	633	1,618
Sub-total of effect of interest rate swaps	*0.4%*	*(1,416)*	*15*	*(240)*	*(211)*	*(307)*	*(423)*	*(250)*
Secured bonds:								
Sterling	8.3%	445	–	–	–	–	–	445
Preferred equity:								
US dollars	7.2%	173	–	–	173	–	–	–
Convertible bond(1):								
US dollars	7.4%	125	–	–	–	–	125	–
Sub-total of loans and bonds included in net debt		3,651	187	162	331	150	758	2,063
Loans from minority interests:								
US dollars	8.0%	81	–	21	–	–	60	–
Total financial liabilities		3,732	187	183	331	150	818	2,063

(1) The effective interest rates for the convertible bonds represent the coupon on the par value of the bond and the accretion of the liability element which excludes the equity or embedded derivative components (refer note 25).

The effect of interest rate swaps refers to the amortisation profile in the notional amount of the interest rate swap, and are included in the above table to identify to which financial liability they relate. They are not included within total financial liabilities shown above as they are recognised as derivative financial instruments in the balance sheet.

The effect of the Group interest rate swaps effectively replaced £796 million (2005: £701 million) of floating rate Australian dollar borrowings, £869 million (2005: £440 million) of floating rate US dollar borrowings, £300 million (2005: £192 million) of floating rate sterling borrowings, £7 million (2005: £40 million) of floating rate Czech koruna borrowings and £35 million (2005: £43 million) of floating rate euro borrowings with fixed rate borrowings.

Management estimates that a one percentage point increase in interest rates would have the effect of decreasing the Group's profit before tax by approximately £3 million (2005: £8 million).

The floating rate financial liabilities comprise bank borrowings bearing interest rates fixed in advance for various time periods up to 12 months by reference to LIBOR for that time period.

33 FINANCIAL INSTRUMENTS continued

e) Currency exposures

Currency translation exposure
The results of the Group's foreign operations are translated into sterling at the average exchange rates for the period concerned. The balance sheets of foreign operations are translated into sterling at the closing exchange rates. In order to hedge the net assets of foreign operations, borrowings are generally in the same currency as the underlying investment. The Group aims to hedge a reasonable proportion of its non-sterling assets in this way. It is our policy not to hedge currency translation through foreign exchange contracts or currency swaps.

Currency transaction exposure
This arises where a business unit makes sales and purchases in a currency other than its functional currency. Transaction exposure also arises on the remittance from overseas of dividends or surplus funds. The Group's policy is to match transaction exposure where possible, and hedge remaining transactions as soon as they are committed, by using foreign currency contracts and similar instruments.

Currency exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations.

Management estimates that a one percentage point strengthening of sterling against all currencies would reduce the Group's profit before tax by approximately £3 million.

f) Borrowing facilities

The Group has substantial borrowing facilities available to it. The undrawn committed facilities available at 31 December 2006 in respect of which all conditions precedent have been met at that date amount to £667 million (2005: £441 million).

	31 December 2006			31 December 2005		
	Facility £m	**Undrawn £m**	**Available £m**	Facility £m	Undrawn £m	Available £m
US dollar Corporate revolving credit facility (October 2009)[1]	**327**	**322**	**322**	373	142	142
US dollar ANP Funding 1 revolving credit facility (May 2010)[2]	**56**	**40**	**40**	64	34	34
US dollar Tihama term facility (December 2021)	**249**	**–**	**–**	284	72	72
Australian dollar Canunda facility (December 2014)	**37**	**–**	**–**	39	12	12
Sterling Rugeley FGD construction facility (July 2014)	**145**	**129**	**129**	–	–	–
Sterling Rugeley working capital and credit facility (July 2014)	**195**	**100**	**100**	–	–	–
Czech koruna IPO revolving credit facility (May 2007)	**24**	**24**	**24**	24	20	20
Sterling Corporate working capital facility (January 2006)[3]	**–**	**–**	**–**	60	60	60
Sterling Corporate letter of credit facilities[4]	**324**	**11**	**11**	94	1	1
Subsidiary facilities in various currencies	**110**	**41**	**41**	153	100	100
Total	**1,467**	**667**	**667**	1,091	441	441

(1) The drawn element of the US dollar Corporate revolving credit facility relates to letters of credit issued of £5 million.

(2) The ANP Funding 1 revolving credit facility includes a US$50 million supported and US$60 million unsupported working capital credit facility with capacity to issue letters of credit. At 31 December 2006, £4 million (2005: £8 million) and £12 million (2005: £22 million) of letters of credit had been drawn from each of these facilities respectively.

(3) The Corporate working capital facility could have been utilised to draw cash and issue letters of credit in relation to merchant trading support. It was not renewed when it expired in January 2006.

(4) The Corporate letter of credit facilities can be utilised to issue letters of credit. At 31 December 2006, £347 million of letters of credit had been drawn from these facilities (2005: £93 million) and £212 million of cash and cash equivalents was used as collateral in relation to these facilities (2005: £28 million).

Uncommitted facilities available at 31 December 2006 were:

	31 December 2006			31 December 2005		
	Total £m	**Drawn £m**	**Undrawn £m**	Total £m	Drawn £m	Undrawn £m
Facility						
Bank borrowing and overdraft facilities	**35**	**–**	**35**	36	18	18
Subsidiary facilities in various currencies	**4**	**2**	**2**	11	2	9
	39	**2**	**37**	47	20	27

Bank borrowing facilities are normally reaffirmed by the banks annually although they can theoretically be withdrawn at any time.

g) Fair values of financial assets and liabilities

Set out below is a comparison by category of the carrying amounts and fair values of all the Group's financial assets and liabilities as at 31 December 2006:

	31 December 2006		31 December 2005	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial assets				
Other investments	**26**	**26**	4	4
Finance lease receivables	**1,086**	**1,114**	460	460
Other long-term receivables	**29**	**29**	–	–
Trade receivables (current)	**139**	**139**	163	163
Other receivables (current)	**157**	**157**	108	108
Derivative financial assets	**281**	**281**	268	268
Assets held for trading	**42**	**42**	52	52
Cash and cash equivalents	**980**	**980**	620	620
Total financial assets	**2,740**	**2,768**	1,675	1,675
Financial liabilities				
Trade payables (current)	**303**	**303**	358	358
Other payables (current)	**226**	**226**	153	153
Other payables (non-current)	**40**	**40**	14	14
Derivative financial liabilities	**430**	**430**	687	687
Secured bank loans	**3,440**	**3,439**	2,908	2,928
Preferred equity facility	**152**	**152**	173	173
Convertible bonds	**237**	**247**	125	125
Secured bonds	**678**	**727**	445	480
Loans from minority interests	**81**	**81**	81	81
Provisions	**43**	**43**	33	33
Total financial liabilities	**5,630**	**5,688**	4,977	5,032

The methods and assumptions used to estimate fair values of financial assets and liabilities are as follows:

(i) Other investments comprise equity held in privately owned, unquoted companies as well as debt instruments in which there is no active market available to value them. Therefore fair value cannot be reliably measured. The fair value has thus been based on the cost amount.

(ii) The fair value of finance lease receivables and other long-term receivables have been estimated by discounting estimated cash flows.

(iii) Trade and other receivables (current) and trade and other payables (current) are stated at fair value, set equal to book value, because of their short maturity.

(iv) The fair value of energy derivatives is measured by reference to forward price curves using discounted cash flows and other similar quantification techniques (refer note 41).

(v) The fair value of the Group's forward exchange contracts, foreign currency swaps and foreign currency options have been calculated using market rates in effect at the balance sheet dates.

(vi) Assets held for trading have been estimated using quoted market prices and discounted cash flows.

(vii) All loans and bonds have been calculated using market prices where available or the present value of future cash flows arising.

h) Hedges

As explained on pages 15 to 17 of the business and financial review, the Group's policy is to hedge the following exposures:

(i) Energy price fluctuations – using physical hedges through the operation of energy supply and trading activities together with financial products.

(ii) Interest rate risk – using interest rate swaps, options and forward rate agreements.

(iii) Structural and transactional currency exposures – using currency borrowings, forward foreign currency contracts, currency options and swaps.

(iv) Currency exposures on future expected sales – using currency swaps, forward foreign currency contracts, currency options and swaps.

The hedging of structural currency exposures associated with foreign currency net investments is recognised in the consolidated balance sheet.

33 FINANCIAL INSTRUMENTS continued

i) Cash flow hedging reserve movements

The cash flow hedging reserve balance at 31 December 2006 and the periods in which the cash flows are expected to occur are as follows:

	Year ended 31 December 2006			Year ended 31 December 2005		
	Energy derivatives £m	**Interest rate swaps £m**	**Total £m**	Energy derivatives £m	Interest rate swaps £m	Total £m
Unrecognised gains/(losses) at 31 December 2006	**3**	**3**	**6**	(103)	(15)	(118)
Cash flows expected in:						
Less than 12 months	**22**	**(1)**	**21**	(67)	(2)	(69)
1-2 years	**(12)**	**–**	**(12)**	(27)	(1)	(28)
2-3 years	**(4)**	**(1)**	**(5)**	(10)	(1)	(11)
3-4 years	**(3)**	**(1)**	**(4)**	1	(1)	–
4-5 years	**–**	**–**	**–**	–	(4)	(4)
More than 5 years	**–**	**6**	**6**	–	(6)	(6)
	3	**3**	**6**	(103)	(15)	(118)

Gains and losses recognised in the hedging reserve during the year were as follows:

	Year ended 31 December 2006			Year ended 31 December 2005		
	Energy derivatives £m	**Interest rate swaps £m**	**Total £m**	Energy derivatives £m	Interest rate swaps £m	Total £m
Gains and (losses) recognised in the hedging reserve during the year	**39**	**16**	**55**	(104)	7	(97)
Gains and (losses) arising in previous years that were recognised during the year	**67**	**2**	**69**	(7)	(2)	(9)
Amount removed from hedging reserve and included within the income statement during the year due to settlement of contracts	**(4)**	**–**	**(4)**	(33)	3	(30)
Cash settlement of derivatives during the year	**4**	**1**	**5**	33	(8)	25
Amount removed from hedging reserve and included within a non-financial item during the year	**–**	**(1)**	**(1)**	–	5	5
	106	**18**	**124**	(111)	5	(106)

j) Hedge of a net investment

An economic foreign currency exposure arises from net investments in Group entities whose functional currency differs from the parent's. An accounting exposure arises from differences between the functional currency of the net investments and the Group's presentation currency. Changes in exchange rates between the functional currency of the net investment and that of its parent will cause the amount of the net investment to vary.

In the absence of hedge accounting the foreign exchange gains and losses on retranslating the net assets of the foreign operation would be taken to reserves, whilst those on the loan would be recognised in the income statement. This creates a mismatch in foreign currency translation. When net investment hedging is applied, this mismatch is eliminated.

The Group, as part of its hedging strategy, has therefore chosen to borrow some debt denominated in foreign currencies in order to hedge the net investments in certain assets within its portfolio. As the hedging instrument is foreign currency borrowings rather than a derivative, no fair value for this instrument is included within the fair value of derivatives disclosed on the balance sheet.

k) Counterparty credit risk
The Group's policy is to manage its credit exposure to trading and financial counterparties within clearly defined limits. Energy trading activities are strictly monitored and controlled through delegated authorities and procedures, which include specific criteria for the management of counterparty credit exposures in each of our key regions. Counterparty exposure via customer offtake agreements is monitored and managed by the local asset team with assistance from Group treasury where appropriate. In addition, Group treasury manages the Group-wide counterparty credit exposure on a consolidated basis for financial counterparties, with the active and close involvement of the global risk manager. Financial counterparty credit exposure is limited to relationship banks and commercial paper with strong investment grade credit ratings.

We are exposed to credit-related losses in the event that counterparties to traded contracts and financial instruments do not perform according to the terms of the contract or instrument. This is mitigated by the fact that for the majority of the Group's commodity trading arrangements there is a legally enforceable right of set-off that reduces the credit exposure of the Group in the event of counterparty default.

Where possible the Group will also enter into master netting agreements that further serve to mitigate its credit exposure.

With regard to financial instruments subject to credit risk, we select counterparties with appropriate ratings for the size, type and duration of the instrument involved. A small proportion of counterparties trading energy are below investment grade. For those energy market transactions with counterparties below investment grade, and which are not supported by appropriate collateral, reserves are carried against the trading risk. Exposures within this band are restricted and closely monitored within narrow limits. We do not expect any significant credit loss to result from non-performance of instruments or traded contracts.

The immediate credit exposure of financial instruments is represented by those financial instruments that have a net positive fair value by counterparty at 31 December 2006. At 31 December 2006, the exposures for interest rate swaps, currency swaps and forward exchange contracts were not considered to be material. Contracts for differences also involve a degree of credit risk. This risk is controlled by appropriate authorisation and monitoring procedures.

34 COMMITMENTS

Lease and capital commitments

	31 December 2006 £m	31 December 2005 £m
Capital commitments: contracted but not provided	**174**	82
Future minimum lease payments under non-cancellable operating leases:		
Within one year	**7**	6
Between one and five years	**23**	21
After five years	**24**	27
	54	54
Offset by future minimum receipts under non-cancellable operating subleases	**(5)**	(8)

Operating lease payments substantially represent rentals payable by the Group for office properties and wind turbine equipment.

Fuel purchase and transportation commitments
At 31 December 2006, the Group's subsidiaries had contractual commitments to purchase and/or transport coal and fuel oil. Based on contract provisions, which consist of fixed prices, subject to adjustment clauses in some cases, these minimum commitments are currently estimated to aggregate to £385 million (2005: £301 million) expiring within one year, £1,373 million (2005: £978 million) expiring between one and five years and £880 million (2005: £915 million) expiring after more than five years.

35 CONTINGENT LIABILITIES

a) Legal proceedings against the Company

The Company is aware of the following matters, which involve or may involve legal proceedings against the Group:

(i) Claims and potential claims by or on behalf of current and former employees, including former employees of the Central Electricity Generating Board (CEGB), and contractors in respect of industrial illness and injury.

RWE npower has agreed to indemnify International Power plc on an after-tax basis to the extent of 50% of any liability that the Company may incur whether directly or indirectly as a consequence of those proceedings to the extent such liability is not insured by Electra Insurance Limited.

(ii) In 1994 separate complaints were made by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Miners Association (SWSMA) to the European Commission against the Company, PowerGen plc, British Coal Corporation and HM Government. The complaint alleges violations of EU competition law arising out of the coal purchasing arrangements entered into by the CEGB prior to 1 April 1990 and requests the Commission to find that the CEGB's practices violated EU law. NALOO and SWSMA allege that such a finding would be grounds for a claim for damages in the English courts by their respective members. The Commission ruled on the complaint in 1998 and did not make any findings against the Company. Appeals against the Commission's findings were brought by NALOO and SWSMA. The SWSMA appeal was initially ruled out of time, but on appeal a faction was allowed to proceed. Progress with this claim will be influenced by the outcome of the NALOO appeal. At first instance, the European Court ruled that the Commission is under an obligation to investigate the complaint by NALOO. The Company, PowerGen plc, British Coal Corporation and the Commission appealed against the ruling to the European Court of Justice which delivered a judgment on 2 October 2003 for the main part dismissing the appeal. In its judgment, the court decided that the Commission has the power to investigate and the matter is now with the Commission for consideration. It is not practicable to estimate legal costs or possible damages, at this stage. RWE npower has agreed to indemnify International Power on an after-tax basis to the extent of 50% of any liability that the Company may incur whether directly or indirectly as a consequence of those proceedings.

The Directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions carried in the balance sheet, that it is remote that the matters referred to above will, in aggregate, have a material effect on the Group's financial position, results of operations or liquidity.

b) Taxation

The Company is aware of a number of issues which are, or may be, the subject of disputes with the tax authorities in the territories where the Group has operations, including its joint ventures and associates. The Directors are of the opinion, having regard to the professional advice received, that adequate provision has been made for the settlement of any tax liabilities that might arise.

c) Bonds and guarantees

Various growth and expansion projects are supported by bonds, letters of credit and guarantees issued by the Group totalling £442 million.

Energy trading activities relating to merchant plant are supported by letters of credit and guarantees issued by the Group totalling £487 million.

d) Joint ventures and associates

(i) Bonds and guarantees

The Group's joint ventures and associates also have various growth and expansion projects that are supported by bonds, letters of credit and guarantees. The Group's share of these bonds, letters of credit and guarantees amount to £70 million. These obligations are normally secured by the assets of the respective joint venture or associate. Any amounts guaranteed by International Power plc or any other Group subsidiary are included within bonds and guarantees disclosed in note 35(c).

(ii) Legal proceedings

A number of the Group's joint ventures and associates, particularly in the Middle East, are involved in major construction projects. The Company is aware of a number of issues which may be the subject of disputes with the EPC contractors responsible for the construction projects. The Directors are of the opinion, having regard to professional advice received, that adequate provision has been made for the settlement of any liabilities that may arise out of these disputes.

36 RELATED PARTY TRANSACTIONS

The key management personnel of International Power plc comprises the Chairman, Executive Directors and Non-Executive Directors. The compensation of key management personnel can be found in the Directors' remuneration report set out on pages 64 to 75 of the *Annual Report*.

(i) Operations and maintenance contracts
In the course of normal operations, the Group has contracted on an arm's length basis to provide power station operation and maintenance services to joint ventures and associates. During the year the Group derived income of £50 million (2005: £69 million) from these arrangements. Included in trade receivables is £8 million (2005: £6 million) in relation to these contracts.

(ii) Retail supply contracts
In the course of normal operations, the Group has contracted on an arm's length basis to provide power and gas to its retail joint ventures. During the year the Group derived income of £34 million (2005: £8 million) from these arrangements. Included in trade receivables is £3 million (2005: £1 million) in relation to these contracts.

(iii) Transportation contracts
In the course of normal operations, the Group has contracts in place, in relation to fuel transportation, with one of its joint ventures. During the year, the Group incurred costs of £8 million (2005: £8 million) in relation to these contracts. There was no trade payable or receivable in relation to these contracts at 31 December 2006 (2005: £nil).

37 EVENTS AFTER THE BALANCE SHEET DATE

There are no events after the balance sheet date to report.

38 EVENTS SUBSEQUENT TO THE DATE OF THE AUDITOR'S REPORT

There are no events to report subsequent to the date of the auditor's report.

39 SUBSIDIARIES

The Group has the following significant investments in subsidiaries.

Name and nature of business	Country of incorporation and registration	Type of share	Group effective shareholding
Canunda Power Pty Limited* (power generation)	Australia	Ordinary Shares	100%
Gippsland Power Pty Limited* (power generation)	Australia	Ordinary Shares	70%
Hazelwood Power Partnership* (power generation)	Australia	Partners' Capital	92%
Latrobe Power Partnership* (power generation)	Australia	Partners' Capital	70%
Perth Power Partnership* (power generation)	Australia	Partners' Capital	49%
Synergen Power Pty Limited* (power generation)	Australia	Ordinary Shares	100%
International Power Opatovice A.S.* (power generation)	Czech Republic	Ordinary Shares	100%
Deeside Power Development Company Limited (power generation)	England and Wales	Ordinary Shares	100%
First Hydro Company* (power generation)	England and Wales	Ordinary Shares	70%
First Hydro Finance plc* (financing company)	England and Wales	Ordinary Shares	70%
Indian Queens Power Limited* (power generation)	England and Wales	Ordinary Shares	100%
IPM Eagle LLP* (investment holding company)	England and Wales	Partners' Capital	70%
Normanglade 4 LLP* (financing company)	England and Wales	Partners' Capital	70%
Pelican Point Power Limited* (power generation)	England and Wales(1)	Ordinary Shares	100%
Rugeley Power Limited (power generation)	England and Wales	Ordinary Shares	100%
Saltend Cogeneration Company Limited* (power generation)	England and Wales	Ordinary Shares	70%
International Power Levanto Holdings BV (investment holding company)	Netherlands(2)	Ordinary Shares	100%
IPR Insurance Company Limited* (insurance captive)	Guernsey	Ordinary Shares	100%
International Power (Jersey) Limited (financing company)	Jersey(3)	Ordinary Shares	100%
International Power Finance (Jersey) II Limited (financing company)	Jersey(3)	Ordinary Shares	100%
Al Kamil Power Company SAOG* (power generation)	Oman	Ordinary Shares	65%
Turbogás – Produtora Enérgetica S.A* (power generation)	Portugal	Ordinary Shares	60%
Tihama Power Generation Company Limited* (power generation)	Saudi Arabia	Ordinary Shares	60%
Electro Metalurgica del Ebro SL* (power generation)	Spain	Ordinary Shares	64%
Ibérica de Enérgías SL* (power generation)	Spain	Ordinary Shares	70%
Thai National Power Company Limited* (power generation)	Thailand	Ordinary Shares	100%
ANP Bellingham Energy Company, LLC* (power generation)	US	Ordinary Shares	100%
ANP Blackstone Energy Company, LLC* (power generation)	US	Ordinary Shares	100%
ANP Funding I, LLC* (financing company)	US	Ordinary Shares	100%
Coleto Creek Power LLC* (power generation)	US	Ordinary Shares	100%
Hays Energy Limited Partnership* (power generation)	US	Partners' Capital	100%
Midlothian Energy Limited Partnership* (power generation)	US	Partners' Capital	100%
Milford Power Limited Partnership* (power generation)	US	Partners' Capital	100%

All subsidiaries operate in their country of incorporation, except as indicated below. All subsidiaries have a 31 December year end. The Group also has a number of overseas branch offices.

* Held by an intermediate subsidiary

(1) Operates in Australia

(2) International Power Levanto Holdings BV owns indirectly, through wholly-owned subsidiaries, equity and bonds relating to the Levanto wind farm portfolio. As required, we consolidate 100% of the results of the Levanto wind farm portfolio.

(3) Operates in the UK

40 JOINT VENTURES AND ASSOCIATES

The Group has the following significant investments in joint ventures and associates.

Name and nature of business	Country of incorporation, registration and operation	Accounting period end	Type of share	Group effective shareholding
Joint ventures				
EA – IPR Retail Partnership* (retail supplier)	Australia	31 December	Partners' Capital	50%
South East Australia Gas Pty Limited* (gas pipeline)	Australia	30 June	Ordinary Shares	33%
EcoEléctrica LP* (power generation)	Bermuda**	31 December	Partners' Capital	35%
Prazská Teplárenská A.S.* (power generation)	Czech Republic	31 December	Ordinary Shares	49%
Hartwell Energy Limited Partnership* (power generation)	US	31 December	Partners' Capital	50%
Oyster Creek Limited Partnership* (power generation)	US	31 December	Partners' Capital	50%
Associates				
Hidd Power Company BSC(c)* (power generation)	Bahrain	31 December	Ordinary Shares	40%
Derwent Cogeneration Limited* (power generation)	England and Wales	31 March	Ordinary Shares	23%
Opus Energy Limited (retail supplier)	England and Wales	31 March	Ordinary Shares	30%
PT Paiton Energy Company* (power generation)	Indonesia	31 December	Ordinary Shares	31%
ISAB Energy Srl* (power generation)	Italy	31 December	Ordinary Shares	34%
Kot Addu Power Company Limited* (power generation)	Pakistan	30 June	Ordinary Shares	36%
Uch Power Limited* (power generation)	Pakistan	31 December	Ordinary Shares	40%
The Hub Power Company Limited* (power generation)	Pakistan	30 June	Ordinary Shares	17%
Carbopego – Abastecimento de Combustiveis, S.A.* (fuel supplies)	Portugal	31 December	Ordinary Shares	50%
Pegop – Energia Electrica, S.A.* (power station operations)	Portugal	31 December	Ordinary Shares	50%
Tejo Energia – Producao e Distribuicao de Energia Electrica, S.A.* (power generation)	Portugal	31 December	Ordinary Shares	50%
Q Power QSC* (power generation)	Qatar	31 December	Ordinary Shares	40%
Uni-Mar Enerji Yatirimlari A.S.* (power generation)	Turkey	31 December	Ordinary Shares	33%
Arabian Power Company PJSC* (power generation)	UAE	31 December	Ordinary Shares	20%
Shuweihat CMS International Power Company PJSC* (power generation)	UAE	31 December	Ordinary Shares	20%

International Power continues to equity account for HUBCO, despite its shareholdings being less than 20%, as it continues to exert and has the power to exert significant influence over the entity. At HUBCO, International Power continues to have significant board representation.

* Held by an intermediate subsidiary

** Operates in Puerto Rico

41 CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The Group's accounting policies are set out in note 1 to these financial statements. Management is required to exercise significant judgement in the application of these policies. Areas which management believe require the most critical accounting judgements are as follows (apart from those policies involving estimation which are outlined in (b) below).

a) Critical accounting judgements in applying the Group's accounting policies

Cash flow hedge accounting

The Group enters into various types of hedging or forward contracts for the buying and selling of commodities: principally sales of electricity and the purchase of fuel for its own power plants. In merchant markets these contracts typically fall within the definition of derivative financial instruments and accordingly have to be marked to market. Accounting for these contracts as cash flow hedges allows, to the extent the hedge is effective, the changes in value of the derivatives to be deferred in equity. In order to achieve cash flow hedge accounting it is necessary for the Group to determine, on an on-going basis, whether a forecast transaction is both highly probable and whether the hedge is effective. This requires both subjective and objective measures of determination.

Income recognition from long-term PPAs

When power plants sell their output under long-term PPAs it is usual for the power plant owning company to receive payment (known as a 'capacity payment') for the provision of electrical capacity whether or not the offtaker requests electrical output. In these situations, where there is a long-term contract to purchase electricity output and electrical capacity, it is necessary for the Group to evaluate the contractual arrangements and determine whether they constitute a form of lease or a service contract.

For those arrangements determined to be or to contain leases, further judgements are required to determine whether the arrangement is a finance or operating lease. This assessment requires an evaluation of where the substantial risks and rewards of ownership reside. For finance leases it is necessary to calculate the proportion of total capacity payments which should be treated as finance income, capital repayment and as a fee for service provision. For operating leases it is necessary to determine the allocation of total capacity payments between rental payments and fees for service provision.

Evaluation of levels of control and influence

The determination of the level of influence the Group has over a business is often a mix of contractually defined and subjective factors that can be critical to the appropriate accounting treatment of entities in the consolidated financial statements. We achieve control or influence through Board representation and by obtaining rights of veto over significant actions. We generally treat investments where the Group holds less than 20% of the equity as investments available for sale. These investments available for sale are carried at market value where market prices are available. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost.

Where the Group owns between 20% and 50% of the equity of an entity and is in a position to exercise significant influence over the entity's operating and financial policies, we treat the entity as a joint venture or an associate. Equally, where the Group holds a substantial interest (but less than 20%) in an entity and has the power to exert significant influence over its operations, we treat it as a joint venture or an associate. This treatment is applied to our interest in The Hub Power Company in Pakistan of which we own 17% (refer note 40). Where the Group has the power to control the operations of an entity, and it has less than 50% of the equity, we treat the entity as a subsidiary when required.

Exceptional items

The Directors consider that items of income or expense which are material by virtue of their nature and amount should be disclosed separately if the financial statements are to fairly present the financial position and financial performance of the entity. The Directors label these items collectively as 'exceptional items'.

Determining which transactions are to be considered exceptional in nature is often a subjective matter. However, circumstances that the Directors believe would give rise to exceptional items for separate disclosure would include:

(i) disposals of investments;

(ii) discontinued operations;

(iii) impairments and impairment reversals.

All exceptional items are included on the appropriate income statement line item to which they relate. In addition, for clarity, separate disclosure is made of all items in one column on the face of the income statement.

Taxation

The level of current and deferred tax recognised is dependent on subjective judgement as to the outcome of decisions to be made by the tax authorities in the various tax jurisdictions around the world in which International Power operates. It is necessary to consider the extent to which deferred tax assets should be recognised based on an assessment of the extent to which they are regarded as recoverable.

b) Key sources of estimation uncertainty

Useful economic lives of property, plant and equipment
The original cost of greenfield developed power plant and other assets includes relevant borrowings and development costs:

(i) Interest on borrowings relating to major capital projects with long periods of development is capitalised during construction and then amortised over the useful life of the asset;

(ii) Project development costs (including appropriate direct internal costs) are capitalised when it is virtually certain that the contract will proceed to completion and income will be realised.

Depreciation of plant and other assets is charged so as to write down the value of those assets to their residual value over their respective estimated useful lives. The Directors are required to assess the useful economic lives and residual values of the assets so that depreciation is charged on a systematic and proportionate basis to the current carrying amount. It is Group policy to depreciate gas plant over 30 years to a 10% residual value, unless the circumstances of the project or life of specific components indicate a shorter period or a lower residual value. Coal plants, hydro plants and wind farms are considered on an individual basis.

Fair values of energy derivatives
The Group has presented its financial statements in accordance with the requirements of IAS 32 "Financial Instruments: Presentation and Disclosure" and IAS 39 "Financial Instruments: Recognition and Measurement". In accordance with IAS 39, the Group records its derivative contracts on its balance sheet at fair value (unless they qualify for the 'own use' exemption). Changes in the value of its derivative contracts in each period are recorded in earnings unless strict hedge accounting criteria are met which allow the movement in fair value to be recorded within equity. The Group estimates the fair value of its energy derivative contracts by reference to forward price curves. A forward price curve represents the Group's view as to the prices at which customers would currently contract for delivery or settlement of commodities, such as power or gas, at future dates. Generally the forward price curve is derived from published price quotations in an active market, over the short-term horizon period, and from valuation techniques over the more distant horizon period. The assumptions used during the application of valuation techniques will directly impact the shape of the forward price curve. The forward price curves are only estimates of future prices and thus possess inherent uncertainty and subjectivity.

Fair values on acquisition
The Group is required to bring acquired assets and liabilities on to the Group balance sheet at their fair value. Power plant and equipment usually have long operating lives, and are often bought with associated long-term contracts such as PPAs. Hence determination of the fair values of these long-life assets and contracts can require a significant amount of judgement.

Impairment analysis
Management regularly considers whether there are any indications of impairment to the carrying amounts of its power plants and other long life assets. This includes a review of market conditions in both the short-term and long-term. Impairment reviews are generally based on pre-tax risk adjusted discounted cash flow projections that require estimates of discount rates and future market prices over the remaining lives of the assets. We benchmark the results of this testing against post-tax risk adjusted cash flows, discounted on a post-tax basis. At each balance sheet date, consideration is also given as to whether there is any indication that an impairment loss recognised in prior periods has reversed. During the year the Group reversed the impairment of its Deeside plant in the UK (refer note 14).

Provisions
Within the Group there are a number of long-term provisions. The carrying amount of these provisions is estimated based on assumptions about such items as the risk adjustment to cash flows or discount rates used, future changes in prices and estimates of costs. For example, the pensions liability is based on assumptions relating to discount rates used, future changes in salaries and future changes in prices affecting other costs. A change in estimates could have a material impact on the carrying amount of these provisions.

Company balance sheet

AS AT 31 DECEMBER 2006

Note		As at 31 December 2006 £m	As at 31 December 2005 £m
	Fixed assets		
5	Tangible assets	**2**	2
6	Investments:		
	Subsidiary undertakings	**3,979**	3,065
	Other investments	**1**	1
	Total fixed asset investments	**3,980**	3,066
	Total fixed assets	**3,982**	3,068
	Current assets		
7	Debtors	**181**	343
	Cash at bank and in hand	**329**	53
	Total current assets	**510**	396
8	Creditors: amounts falling due within one year	**(1,559)**	(1,415)
	Net current liabilities	**(1,049)**	(1,019)
	Total assets less current liabilities	**2,933**	2,049
4/9	Retirement benefit obligations	**(12)**	(18)
9	Provisions for liabilities and charges	**(31)**	(33)
	Net assets	**2,890**	1,998
	Capital and reserves		
10/11	Called up share capital	**746**	737
11	Share premium account	**402**	394
11	Capital redemption reserve	**145**	145
11	Capital reserve	**415**	415
11	Profit and loss account	**1,182**	307
	Shareholders' funds – equity	**2,890**	1,998

The financial statements were approved by the Board of Directors on 5 March 2007 and signed on its behalf by

Philip Cox
Chief Executive Officer

Mark Williamson
Chief Financial Officer

Notes to the Company financial statements

FOR THE YEAR ENDED 31 DECEMBER 2006

1 ACCOUNTING POLICIES

a) Basis of preparation
The financial statements have been prepared in accordance with applicable accounting standards, and under the historical cost accounting rules.

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements, except as noted below.

Under section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account.

As the results of the Company are being presented together with its consolidated financial statements (refer pages 79 to 131), the Company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the Group (or investees of the Group qualifying as related parties).

The following accounting standard was available for early application but has not been applied by the Company in these financial statements. The Group has not adopted the amendments to FRS 17 (Retirement Benefits) requiring additional disclosure of the scheme's assets and liabilities. This amendment applies to accounting periods beginning on or after 6 April 2007.

b) Income recognition
Dividend income from subsidiary undertakings is recognised in the profit and loss account on receipt of the cash.

c) Pension schemes
The Company operates a pension scheme (by participating in the International Power section of the Electricity Supply Pension Scheme) providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of the Company.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit credit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

The pension scheme surplus (to the extent that it is recoverable) or deficit is recognised in full. The movement in the scheme surplus/deficit is split between operating charges, finance items and, in the statement of total recognised gains and losses, actuarial gains and losses.

For defined contribution arrangements, contributions are charged to the profit and loss account as they fall due.

d) Tangible fixed assets
Tangible fixed assets are stated at original cost less accumulated depreciation and any provision for impairment in value.

Depreciation is calculated so as to write-down the cost of tangible fixed assets to their residual value evenly over their estimated useful lives.

The depreciation charge is based on the following estimates of useful lives:

	Years
Fixtures, fittings, tools and equipment	3-10
Computer equipment and software	3-5
Leasehold improvements	Life of lease

e) Fixed asset investments
Investments in subsidiary undertakings are stated at cost less provision for impairment.

f) Deferred taxation
Deferred taxation is provided on timing differences, arising from the different treatment for accounts and taxation purposes of transactions and events recognised in the financial statements of the current year and previous years. Deferred taxation is calculated at the rates at which it is estimated that tax will arise. Deferred tax assets and liabilities are not discounted.

g) Loans and bonds
Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

h) Financial guarantees
Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

i) Share-based payments
The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non-market-based vesting conditions) at the date of grant. The fair value determined at the date of grant of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the shares that will eventually vest and where applicable, adjusted for the effect of non market-based vesting conditions.

For the Group's Executive Share Option Plans the fair values are measured using the Black-Scholes pricing model. The expected lives used in these models have been adjusted, based on management's best estimate, for the effects of non-transferability, any exercise restrictions and behavioural considerations.

For conditional awards made under the 2002 Performance Share Plan without a market-related performance condition, the fair values have been calculated as the face value of the award discounted for the non-entitlement to dividends during the vesting period.

Where conditional awards made under the 2002 Performance Share Plan contain a market-related performance condition, the fair values are measured using a Monte Carlo simulation method.

j) Foreign currencies
Foreign currency monetary assets and liabilities are translated at the rate of exchange at the balance sheet date. Foreign currency non-monetary items measured in terms of historical cost are translated at the rate of exchange at the date of the transaction. Exchange differences on monetary items are dealt with in the profit and loss account. Exchange differences on non-monetary items are recognised in line with whether the gain or loss on the non-monetary item itself is recognised in the profit and loss account or in equity.

2 PROFIT OF THE PARENT COMPANY

The profit of the parent company for the financial year amounted to £932 million (2005: £21 million). By virtue of Section 230(4) of the Companies Act 1985, the Company is exempt from presenting a separate profit and loss account.

3 EMPLOYEES

The average number of persons employed by the Company (including Directors) during the year, analysed by category, was as follows:

	Year ended 31 December 2006 Number	Year ended 31 December 2005 Number
Based in UK	**179**	162
Based overseas	**33**	34
	212	196

The aggregate payroll costs of these persons were as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Wages and salaries	**21**	21
Share-based payments	**9**	6
Social security costs	**5**	6
Other pension costs	**8**	4
	43	37

For details of the Company's share-based payments, refer to note 29 of the Group accounts.

4 PENSION ARRANGEMENTS

The valuation used for the FRS 17 disclosure at 31 December 2006 has been based on a full assessment of the liabilities of the International Power section of the Electricity Supply Pension Scheme at 31 March 2004 updated to 31 December 2006 by independent qualified actuaries.

The major assumptions used by the actuary were:

	Year ended 31 December 2006 %	Year ended 31 December 2005 %	Year ended 31 December 2004 %
Inflation assumption	**3.1**	2.9	2.9
Rate of increase in salaries	**4.6**	4.4	4.4
Rate of increase of pensions in payment	**3.1**	2.9	3.0
Rate of increase of deferred pensions	**3.1**	2.9	3.0
Rate used to discount plan liabilities	**5.1**	4.7	5.3

The assets in the scheme and the expected rates of return were:

	31 December 2006		31 December 2005		31 December 2004	
	Long-term rate of return %	**Value £m**	Long-term rate of return %	Value £m	Long-term rate of return %	Value £m
Equities	**7.5**	**71**	7.1	60	7.5	44
Bonds	**5.0**	**8**	4.6	7	5.0	5
Other	**6.4**	**9**	6.0	7	6.2	6
Total market value of assets		**88**		74		55
Present value of scheme liabilities		**(100)**		(92)		(67)
Deficit in scheme		**(12)**		(18)		(12)
Related deferred tax asset		**4**		5		4
Net pension liability		**(8)**		(13)		(8)

Analysis of amounts charged to operating profit:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Current service cost	**6**	4
Settlement/curtailment cost	**2**	–
Total operating cost	**8**	4

Analysis of amounts credited to other finance income:

	2006 £m	2005 £m
Expected return on pension plan assets	**5**	4
Interest on pension plan liabilities	**(4)**	(4)
Net return	**1**	–

Analysis of amount recognised in statement of total recognised gains and losses:

	2006 £m	2005 £m
Actual return less expected return on pension scheme assets	**2**	9
Experience losses arising on the scheme liabilities	**–**	(6)
Changes in assumptions underlying the present value of the scheme liabilities	**5**	(9)
Actuarial gain/(loss) recognised in statement of total recognised gains and losses	**7**	(6)

Analysis of movement in deficit during the year:

	2006 £m	2005 £m
Deficit in scheme at 1 January	**(18)**	(12)
Current service cost	**(6)**	(4)
Settlement/curtailment cost	**(2)**	–
Contributions	**6**	4
Other finance income	**1**	–
Actuarial gain/(loss)	**7**	(6)
Deficit in scheme at 31 December	**(12)**	(18)

History of experience gains and losses:

	2006	2005	2004	2003
Difference between the actual and expected return on pension scheme assets:				
Amount (£m)	**2**	9	3	4
Percentage of scheme assets	**2%**	12%	5%	9%
Experience (losses)/gains arising on the scheme liabilities:				
Amount (£m)	**–**	(6)	4	–
Percentage of the present value of scheme liabilities	**–**	7%	6%	–
Total amount recognised in statement of total recognised gains and losses:				
Amount (£m)	**7**	(6)	–	4
Percentage of the present value of scheme liabilities	**7%**	7%	–	7%

Reconciliation to balance sheet:

	31 December 2006 £m	31 December 2005 £m
Total market value of assets	**88**	74
Scheme liabilities	**(100)**	(92)
Deficit in scheme	**(12)**	(18)

5 TANGIBLE FIXED ASSETS

	Freehold land and buildings £m	Plant, machinery and equipment £m	Total £m
Cost			
At 1 January 2006	2	7	9
Additions	–	1	1
At 31 December 2006	**2**	**8**	**10**
Depreciation			
At 1 January 2006	1	6	7
Provided during the year	–	1	1
At 31 December 2006	**1**	**7**	**8**
Net book value			
At 31 December 2006	**1**	**1**	**2**
At 31 December 2005	1	1	2

6 FIXED ASSET INVESTMENTS

	Subsidiary undertakings			
	Investment £m	Loans to investments £m	Other £m	Total £m
At 1 January 2005	2,637	577	2	3,216
Additions	173	175	–	348
Capitalisation of loan due from subsidiary undertakings	69	(69)	–	–
Distribution and loan repayments	(392)	(187)	–	(579)
Disposals	–	–	(1)	(1)
Impairment loss reversed	40	15	–	55
Exchange differences	42	(15)	–	27
At 31 December 2005	2,569	496	1	3,066
Additions	514	1,426	–	1,940
Capitalisation of loan due from subsidiary undertakings	52	(52)	–	–
Distribution and loan repayments	–	(323)	–	(323)
Disposals	(974)	–	–	(974)
Impairment loss charged	(70)	–	–	(70)
Impairment loss reversed	311	45	–	356
Exchange differences	–	(15)	–	(15)
At 31 December 2006	**2,402**	**1,577**	**1**	**3,980**

Details of the principal subsidiary undertakings, associates and joint ventures are provided in notes 39 and 40 of the Group accounts.

7 DEBTORS

	31 December 2006 £m	31 December 2005 £m
Amounts falling due within one year:		
Due from subsidiary undertakings	**135**	275
Other debtors	**11**	25
Corporation tax	**30**	38
Prepayments and accrued income	**5**	5
Total amounts falling due within one year	**181**	343

8 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	31 December 2006 £m	31 December 2005 £m
Trade creditors	**1**	2
Amounts due to subsidiary undertakings	**1,491**	1,286
Other creditors	**19**	15
Other taxation and social security	**1**	1
Bank loans	**–**	64
Accruals and deferred income	**47**	47
Total creditors: amounts falling due within one year	**1,559**	1,415

9 PROVISIONS

	Retirement benefit obligations £m	Deferred tax £m	Other £m	Total £m
At 1 January 2005	12	24	7	43
Charged to profit and loss	4	–	6	10
Credited to profit and loss	(4)	–	(2)	(6)
Charged/(credited) to reserves	6	(2)	–	4
At 31 December 2005	18	22	11	51
Charged to profit and loss	7	–	–	7
Credited to profit and loss	(6)	(3)	(1)	(10)
(Credited)/charged to reserves	(7)	2	–	(5)
At 31 December 2006	**12**	**21**	**10**	**43**

10 SHARE CAPITAL

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2006	2,266,000,000	1,133	1,474,736,637	737
Issue of shares under Executive Share Option Plan	–	–	13,073,207	6
Issue of shares under the Sharesave Plan	–	–	1,196,959	1
Issue of shares under Performance Share Plan	–	–	3,046,107	2
At 31 December 2006	**2,266,000,000**	**1,133**	**1,492,052,910**	**746**

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2005	2,266,000,000	1,133	1,473,269,066	737
Issue of shares under the Sharesave Plan	–	–	858,892	–
Issue of shares under Executive Share Option Plan	–	–	608,679	–
At 31 December 2005	2,266,000,000	1,133	1,474,736,637	737

Ordinary Shares
Ordinary Shares rank equally between each other with regard to the right to receive dividends and also in a distribution of assets on the winding up of the Company.

Deferred shares
The Company has 21 Deferred Shares of 1 pence each in issue. These shares were issued to ensure the demerger was effected as efficiently as possible. The holders of Deferred Shares have no rights to receive dividends or to attend or vote at any general meeting.

Unclassified share
Further to the redemption of the Special Share in August 2000, the Company's authorised share capital includes one unclassified share of £1.

11 SHARE CAPITAL AND RESERVES

	Attributable to equity holders of the parent					
	Called up share capital £m	**Share premium account £m**	**Capital redemption reserve £m**	**Capital reserve £m**	**Profit and loss account £m**	**Total shareholders' funds – equity £m**
At 1 January 2006	737	394	145	415	307	1,998
Profit for the year	–	–	–	–	932	932
Issue of shares	9	8	–	–	–	17
Dividends	–	–	–	–	(67)	(67)
Other movements	–	–	–	–	10	10
At 31 December 2006	**746**	**402**	**145**	**415**	**1,182**	**2,890**

	Attributable to equity holders to the parent					
	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Profit and loss account £m	Total shareholders' funds – equity £m
At 1 January 2005	737	392	145	415	321	2,010
Profit for the year	–	–	–	–	21	21
Issue of shares	–	2	–	–	–	2
Dividends	–	–	–	–	(37)	(37)
Other movements	–	–	–	–	2	2
At 31 December 2005	737	394	145	415	307	1,998

The share premium account, capital redemption reserve and capital reserve are not distributable.

A number of International Power plc Ordinary Shares are held in Employee Share Ownership Trusts (ESOTs). These shares are held by the ESOTs to meet awards made under the Company's 2002 Performance Share Plan. At 31 December 2006, the ESOTs held a total of 1,241,452 International Power plc Ordinary Shares (2005: 2,081,573). At 31 December 2006 the market value of these shares was £4,739,243 (2005: £4,985,367). The maximum number of shares required to meet all outstanding awards (assuming full vesting of those awards) at 31 December 2006 was 6,444,745 (2005: 7,522,005).

£527 million (2005: £124 million) of the Company's profit and loss reserve is not distributable as it arose from unrealised gains on intra-group transfers.

12 COMMITMENTS

Lease commitments

	31 December 2006 £m	31 December 2005 £m
Property leases (annual commitment):		
Expiring within one year	–	–
Expiring between one and five years	–	–
Expiring after five years	**5**	5

13 CONTINGENT LIABILITIES

a) Legal proceedings against the Company
Details of legal proceedings against the Company are shown in note 35 to the consolidated financial statements.

b) Taxation
Details of contingent liabilities relating to tax issues are shown in note 35 to the consolidated financial statements.

c) Bonds and guarantees
Various growth and expansion projects are supported by bonds, letters of credit and guarantees issued by the Company totalling £292 million.
Energy trading activities relating to merchant plant are supported by letters of credit and guarantees issued by the Company totalling £418 million.

14 RELATED PARTY DISCLOSURES

The Company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the Group.

Five-year financial summary

The following tables are the consolidated income statements, the consolidated income statements excluding exceptional items and specific IAS 39 mark to market movements and the summary balance sheets for the five years ended 31 December 2006. For the years ended 31 December 2003 and 31 December 2002 the results have been prepared under UK GAAP. They have been re-presented under an IFRS format, in the table below, to aid comparability.

CONSOLIDATED INCOME STATEMENTS

	Year ended 31 December 2006 (IFRS) £m	Year ended 31 December 2005 (IFRS) £m	Year ended 31 December 2004 (IFRS) £m	Year ended 31 December 2003 (UK GAAP) £m	Year ended 31 December 2002 (UK GAAP) £m
Revenue: Group and share of joint ventures and associates	**3,783**	2,936	1,267	1,273	1,129
Less: share of joint ventures' and associates' revenue	**(1,199)**	(1,003)	(499)	(421)	(412)
Group revenue	**2,584**	1,933	768	852	717
Cost of sales	**(1,839)**	(1,513)	(637)	(1,133)	(661)
Gross profit/(loss)	**745**	420	131	(281)	56
Other operating income	**102**	122	56	66	134
Other operating expenses	**(163)**	(129)	(67)	(64)	(85)
Share of results of joint ventures and associates	**214**	198	113	195	222
Profit/(loss) from operations	**898**	611	233	(84)	327
Disposal of investments	**–**	10	4	27	–
Finance income	**53**	53	30	42	24
Finance expenses	**(327)**	(255)	(138)	(169)	(156)
Profit/(loss) before tax	**624**	419	129	(184)	195
Income tax expense	**(147)**	(89)	(25)	(28)	(76)
Profit/(loss) for the year	**477**	330	104	(212)	119
Attributable to:					
Minority interests	**67**	45	6	7	6
Equity holders of the parent	**410**	285	98	(219)	113
Basic earnings/(loss) per share	**27.6p**	19.4p	7.5p	(17.6)p	9.0p
Diluted earnings/(loss) per share	**26.2p**	18.5p	7.4p	(17.6)p	9.0p

The share of results from joint ventures and associates for the year ended 31 December 2002 and 31 December 2003, presented under UK GAAP, in the above table, is shown before interest, taxation and minority interests.

With effect from 1 January 2004, we reverted to equity accounting for our 36% stake in KAPCO and now account for it as an associate. KAPCO had previously been accounted for as a trade investment with dividend receipts recorded in income from investments. To aid comparability the dividends received in 2003 and 2002 have been included in the share of results of joint ventures and associates in the above table.

CONSOLIDATED INCOME STATEMENTS EXCLUDING EXCEPTIONAL ITEMS AND SPECIFIC IAS 39 MARK TO MARKET MOVEMENTS

	Year ended 31 December 2006 (IFRS) £m	Year ended 31 December 2005 (IFRS) £m	Year ended 31 December 2004 (IFRS) £m	Year ended 31 December 2003 (UK GAAP) £m	Year ended 31 December 2002 (UK GAAP) £m
Revenue: Group and share of joint ventures and associates	**3,645**	2,980	1,267	1,273	1,129
Less: share of joint ventures' and associates' revenue	**(1,193)**	(1,000)	(499)	(421)	(412)
Group revenue	**2,452**	1,980	768	852	717
Cost of sales	**(1,807)**	(1,570)	(637)	(729)	(558)
Gross profit	**645**	410	131	123	159
Other operating income	**83**	64	56	66	134
Other operating expenses	**(163)**	(129)	(78)	(64)	(85)
Share of results of joint ventures and associates	**208**	191	113	160	180
Profit from operations	**773**	536	222	285	388
Finance income	**53**	53	30	42	24
Finance expenses	**(301)**	(255)	(107)	(153)	(156)
Profit before tax	**525**	334	145	174	256
Income tax expense	**(122)**	(68)	(25)	(54)	(77)
Profit for the year	**403**	266	120	120	179
Attributable to:					
Minority interests	**71**	52	8	7	6
Equity holders of the parent	**332**	214	112	113	173
Basic earnings per share	**22.4p**	14.6p	8.6p	9.1p	13.8p

The comments set out below the table on the preceding page also apply to the results presented above.

CONSOLIDATED BALANCE SHEETS

	As at 31 December 2006 (IFRS) £m	As at 31 December 2005 (IFRS) £m	As at 31 December 2004 (IFRS) £m	As at 31 December 2003 (UK GAAP) £m	As at 31 December 2002 (UK GAAP) £m
Non-current assets	**7,408**	6,592	5,667	2,585	2,981
Inventories	**141**	110	91	65	55
Other current asset receivables and derivatives	**803**	676	238	160	134
Cash and cash equivalents and assets held for trading	**1,022**	672	612	743	842
Current assets	**1,966**	1,458	941	968	1,031
Current liabilities	**(1,116)**	(1,300)	(545)	(846)	(1,405)
Non-current liabilities	**(5,518)**	(4,375)	(4,005)	(1,147)	(838)
Net assets	**2,740**	2,375	2,058	1,560	1,769
Net debt	**3,485**	2,979	2,745	692	812
Gearing	**127%**	125%	133%	44%	46%
Debt capitalisation	**56%**	56%	57%	31%	31%
Capital expenditure (including acquisitions)	**1,080**	847	1,549	130	183

Shareholder profile

AS AT 31 DECEMBER 2006

CATEGORY OF HOLDINGS

	Number of shareholders	Percentage of total shareholders	Ordinary Shares	Percentage of issued share capital
Private individual	412,557	99.03	182,216,192	12.21
Nominee companies	3,718	0.89	1,280,011,573	85.79
Limited and public limited companies	201	0.05	10,714,134	0.72
Other corporate bodies	100	0.03	10,825,480	0.73
Pension funds, insurance companies and banks	18	0.00	8,285,531	0.55
Total	**416,594**	**100.00**	**1,492,052,910**	**100.00**

RANGE OF HOLDINGS

	Number of shareholders	Percentage of total shareholders	Ordinary Shares	Percentage of issued share capital
1 – 199	100,072	24.02	15,307,659	1.03
200 – 499	225,737	54.19	65,079,560	4.36
500 – 999	61,531	14.77	41,973,630	2.81
1,000 – 4,999	25,961	6.23	45,323,020	3.04
5,000 – 9,999	1,856	0.45	12,292,855	0.82
10,000 – 49,999	684	0.16	13,239,011	0.89
50,000 – 99,999	166	0.04	11,912,183	0.80
100,000 – 499,999	297	0.07	70,659,575	4.74
500,000 – 999,999	105	0.03	77,313,137	5.18
1,000,000 – highest	185	0.04	1,138,952,280	76.33
Total	**416,594**	**100.00**	**1,492,052,910**	**100.00**

Shareholder services and information

Annual General Meeting (AGM)

The 2007 AGM will be held on Tuesday 15 May 2007. Further details will be set out in the Notice of the AGM to be sent out in April 2007.

Electronic Voting

For the AGM you can register your vote electronically by logging on to the following website: **www.sharevote.co.uk**. You will need your voting reference numbers (the three 8-digit numbers shown on your Proxy Form). Alternatively, if you have already registered for a shareview portfolio with Lloyds TSB Registrars, then log on to your portfolio at **www.shareview.co.uk** and click on company meetings.

Receive your *Annual Report* over the Internet

If you have access to the Internet, in future you can receive your copy of the ***Annual Report*** by registering with **www.shareview.co.uk**. This is a service offered by Lloyds TSB Registrars that also enables you to check your holdings in many UK companies and helps you to organise your investments electronically. Once you have registered for a portfolio, you can also use this service to change your address details online as well as register your vote for a company's General Meeting safely, securely and privately.

Dividend Reinvestment Plan (DRIP)

As an alternative to receiving a cash dividend you can choose to reinvest your money in the Company's shares by using a Dividend Reinvestment Plan. The DRIP works by reinvesting your dividend money by way of buying shares in the open market. If you would like to receive further information and an application form for the International Power DRIP, please contact Lloyds TSB Registrars on **0870 241 3018**.

Individual Savings Accounts (ISAs)

Information on the International Power corporate ISA, which offers a tax-efficient way of holding shares, can be obtained from the provider, Lloyds TSB Registrars, on **0870 24 24 244**.

Shareholder enquiries

If you have any queries on the following:

- transfer of shares;
- change of name or address;
- lost share certificates;
- lost or out-of-date dividend cheques and payment of dividends directly into a bank or building society account;
- death of the registered holder of shares;
- receiving duplicate copies of this report;
- receiving the *Annual Report* in addition to the *Summary Annual Report*;

please contact Lloyds TSB Registrars on **0870 600 3978** or write to them at The Causeway, Worthing, West Sussex BN99 6DA, quoting International Power and including your shareholder reference number (on your share certificate).

Additional information can be found on the Lloyds TSB website at **www.lloydstsb-registrars.co.uk**.

Share dealing services

Lloyds TSB Registrars have in place a low-cost share dealing service for both the purchase and sale of shares. This is a postal service only. For information on the low-cost dealing service, or to obtain a dealing form, please contact Lloyds TSB Registrars on **0870 600 3978**.

Share price

Our latest share price information is available on **www.ipplc.com/ipr/investors/shareinfo/** This link will provide you with International Power's latest share price, historical closing prices and volumes and an interactive share price graph.

In addition, you can now access the latest share price on your Blackberry, PDA or mobile phone at **http://mobile.ipplc.com**.

General enquiries

Please contact:
Stephen Ramsay
Company Secretary
International Power plc
Senator House
85 Queen Victoria Street
London EC4V 4DP.
Tel: 020 7320 8706

Corporate investor & media enquiries

Please contact:
Aarti Singhal
Head of Communications
International Power plc
Senator House
85 Queen Victoria Street
London EC4V 4DP.
Tel: 020 7320 8681

Website

The recently re-launched website – **www.ipplc.com** contains the 2006 ***Annual Report*** and ***Summary Annual Report***, along with a wide range of other information on the Group.

The website also hosts an Alert Service **www.ipplc.com/ipr/siteservices/alerts/**, where you can sign up for e-mail alerts of news releases, reports, results and presentations, and events.

Corporate social responsibility

Our annual corporate responsibility report is available on our website **www.ipplc.com/ipr/environment/corpresp/**.

Financial calendar

Announcement of Q1 results	10 May 2007
Annual General Meeting	15 May 2007
Ex dividend date	23 May 2007
Dividend payment date	26 June 2007
Announcement of interim results for the period ended 30 June 2007	9 August 2007
Announcement of Q3 results	8 November 2007

GLOSSARY/INDEX

ABI Association of British Insurers, a body which, inter alia, sets standards of corporate governance on behalf of insurance companies.

AGM Annual General Meeting.

ANP American National Power (now International Power America).

Availability A measure giving the proportion of electrical energy that was actually available to be generated during the period, after taking account of both planned and unplanned outages, expressed as a percentage of the maximum potential electrical energy generation.

Bond Security that obligates the issuing company to make specified payments to the bondholders (financial institutions).

Brownfield Building a plant on a previously operational site.

CCGT Combined cycle gas turbine – the combination of a gas turbine (GT) and steam turbine (ST) in a configuration that enables electricity to be generated directly from a generator driven by the GT and, by using exhaust gases from the GT to produce steam, a ST coupled to the same generator or another generator.

CO Carbon monoxide.

CO_2 Carbon dioxide.

Cogeneration The simultaneous generation of electricity and heat in the form of steam, typically where the need for both arises for industrial or commercial purposes and where the steam is generated by utilising the waste heat from electricity generation.

Combined code The code which sets out the expected corporate governance standards for companies listed on the London Stock Exchange.

Corridor approach Under this approach to recognising surpluses and deficits in defined benefit pension plans, actuarial gains and losses are not recognised immediately. Only when the cumulative gains or losses fall outside the corridor is a specified portion recognised in the income statement from the following year onwards. The corridor is 10% of the present value of the pension rights accrued or of the fund assets at market value, if greater.

CR Corporate responsibility.

Debt capitalisation Net debt divided by the sum of the net debt and total equity.

Desalination plant The specific plant located within a power and water producing complex that has the purposes of utilising waste heat from electricity generation to produce potable water from seawater via a steam distillation process.

Emission allowances Under various environmental schemes, emission allowances are required to cover the amount of relevant emissions made by an asset. Cap and trade schemes are a common type of scheme. Under a cap and trade scheme, operators are required to purchase sufficient emission allowances to cover their actual emissions, and the operator may or may not be granted an initial volume of allowances. Examples of such schemes include the EU Emissions Trading Scheme (EUETS) which covers emissions of CO_2, based on a cap and trade system. Other examples include the Clean Air Act in the US which covers emissions of NO_x and SO_x.

EPS Earnings per share, calculated by dividing the profit after interest, tax and minority interests by the weighted average number of shares in issue.

FGD Flue gas desulphurisation.

Functional currency The currency of the primary economic environment in which the entity operates.

Gearing Net debt divided by total equity.

Generator nameplate capacity (installed) The maximum output of a generator, under specific conditions designated by the manufacturer. Installed generator capacity (megawatts) is usually indicated on a nameplate physically attached to the generator.

Greenfield Building a power plant on a new site.

Hedge contracts A contract that gives protection against risks of future commodity price movements.

HSE Health, safety and environment.

HUBCO The Hub Power Company.

IFRSs International Financial Reporting Standards.

ISO 14001 The international standard of environment management systems.

KAPCO The Kot Addu Power Company.

KPI Key performance indicator

LNG Liquefied natural gas

Load factor The proportion of electricity actually sold, compared with the maximum possible sales of electricity at maximum net capacity.

LTIP Long-term incentive plan.

Merchant market	A merchant market is a deregulated market.
Merchant plant	Our merchant plants operate in deregulated markets selling power into the traded market without long-term power purchase agreements (PPAs).
Mitsui	Mitsui & Co. of Japan. Our partners in IPM Eagle LLP.
MIGD	Millions of imperial gallons per day.
MW	Megawatt; one MW equals 1,000 kilowatts.
MWth	One megawatt of thermal power.
National Allocation Plan	The Plan issued under the EU Emissions Trading Scheme that sets out how greenhouse gas emission allowances will be allocated to affected industry sectors and the assets within the relevant sector.
NO_x	Oxides of nitrogen.
Non–recourse debt	Debt secured on an asset, and where the lender has no recourse to the shareholder.
O&M	Operations and maintenance, usually used in the context of operating and maintaining a power station.
OCGT	Open cycle gas turbine – turbines, typically fuelled by gas or diesel oil, are used to drive the generators to produce electricity.
Offtake agreement	Power purchase agreement between a company owning a power station and its customer (the offtaker) whereby the customer takes the electricity generated by a power station.
OFR	Operational and financial review.
OHSAS 18001	Occupational Health and Safety Assessment Series 18001. A management system specification, developed by British Standards Institute, for health and safety which is compatible with ISO 9001:1994 (Quality) and ISO 14001:1996 (Environmental) management.
Peak load	The maximum demand for electricity during a specified high demand period. This may require use of plant (for example pumped storage) that is kept in reserve for peak periods.
PPA	Power Purchase Agreement (see also Offtake agreement).
Proprietary trading	The trading of commodities for the purposes of making a profit, when the commodity, such as electricity, is not generated by our own power stations or purchased for use by our own power stations, e.g. fuel or carbon allowances.
Put	To sell a security back to the issuer at a pre-determined price.
Recourse debt	Debt where the lender has recourse to parties other than the borrower, usually a parent company or shareholder.
Reserve margin	The amount of available plant reserve capacity above the system's peak electricity requirements.
Rights Issue	The offer of new shares to shareholders pro-rata to their current holding, usually at a discounted price.
RPI	Retail Price Index.
RREV	Research Recommendations Electronic Voting. A body which acts on behalf of institutional investors monitoring the corporate governance performance of quoted companies, and which issues recommendations for voting on resolutions at those companies' general meetings.
SO_2	Sulphur dioxide.
Spread	The difference between the fuel costs to generate electricity and the price at which electricity is sold.
Turnbull Guidance	The Turnbull Guidance expands upon the Combined Code requirements for the Directors' review of the effectiveness of the Group's system of internal controls.
US Sarbanes-Oxley Act	The Sarbanes-Oxley Act of 2002 was enacted in reaction to the highly publicised bankruptcies of Enron and WorldCom and is concerned with strictly enforcing corporate governance and financial disclosure.

International Power has recently revamped its corporate website – **www.ipplc.com**

Key features include:

- Global reach, information on our asset portfolio
- Shareholder information section, to help you manage your shareholding
- Investor data section, for summarised financial information
- Online 2006 *Annual Report*

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www.naturalassociates.com

Board and senior management photography by Orla Deevy

It is important to us that our *Annual Report* is produced in an environmentally responsible manner, including the sourcing of materials. This *Annual Report* is printed, by Royle Corporate Print who are accredited with the ISO 14001 Environmental Management System (BS-EN-ISO 14001:2004), using vegetable-based inks on paper that is totally chlorine free and produced at a mill with ISO 14001 & EMAS (Eco Management & Audit Scheme) accreditation. On average, 70% of all waste associated with its production is recycled.

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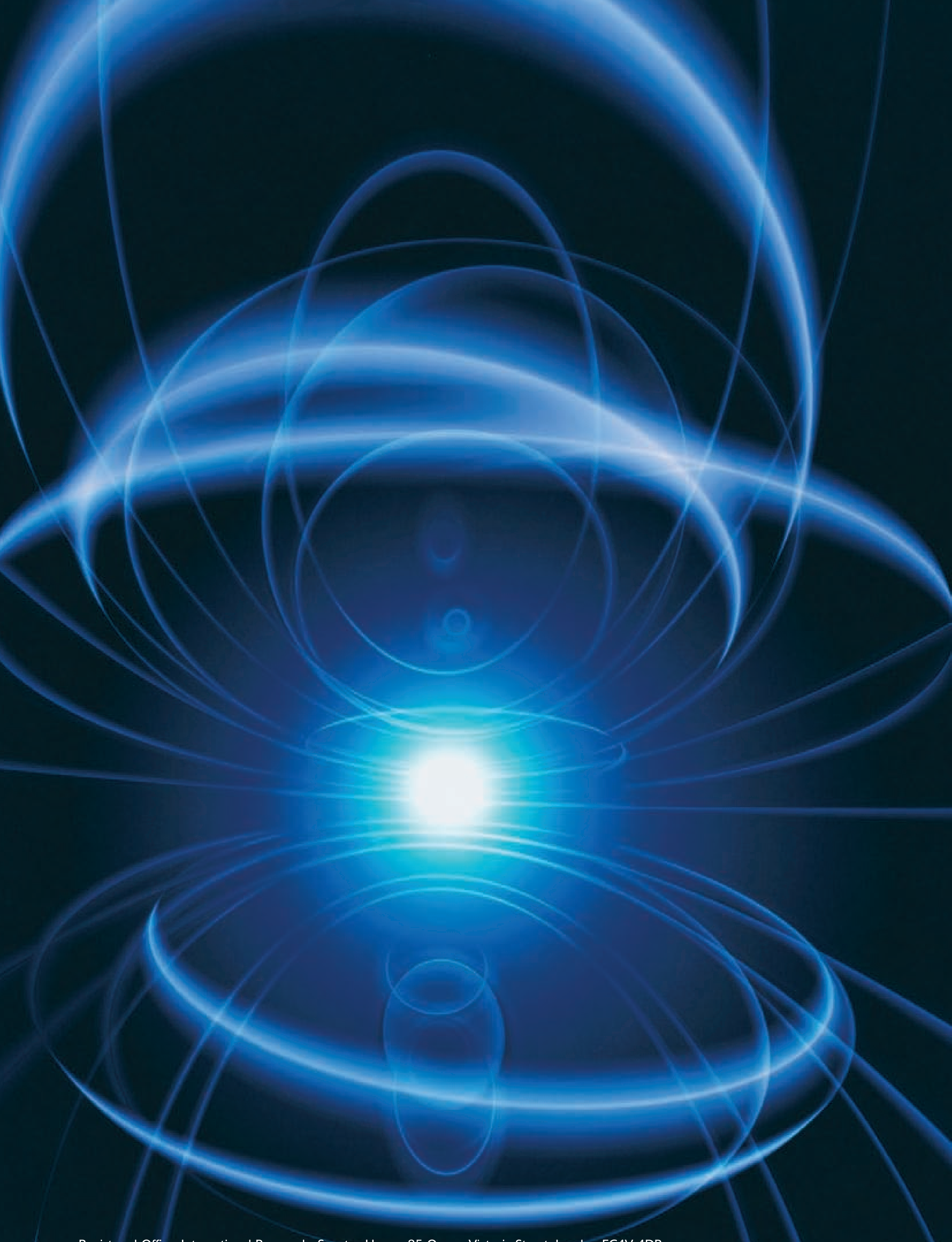

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