Financial Review

Review of Operating Results

The principal activities of the Swire Pacific group, together with the contribution of each of activity to the group results, are as follows:

	The Company and its subsidiaries		Jointly controlled companies	Associated companies	Group	
Year 2001	Operating profit HK$M	Net finance charges HK$M	Share of profits less losses HK$M	Share of profits less losses HK$M	Profit before taxation HK$M	Profit attributable to Swire Pacific shareholders HK$M
Property						
Property investment	3,471	(352)			3,119	2,571
Property trading	128		229		357	346
Sale of investment properties	205				205	205
Hotels and restaurants			(57)	50	(7)	(17)
Provision for land premium on development properties					–	–
Provision for diminution in value of development property			(312)		(312)	(312)
	3,804	**(352)**	**(140)**	**50**	**3,362**	**2,793**
Aviation						
Airline services and airline catering				373	373	282
Aircraft engineering				155	155	139
Cargo handling				156	156	96
Others		6			6	3
	–	**6**	**–**	**684**	**690**	**520**
Beverages	**304**	**(58)**	**85**	**–**	**331**	**252**
Marine Services						
Ship repair, land engineering and harbour towage			36		36	33
Container handling			25	295	320	272
Shipowning and operating	336	(28)	9		317	312
	336	**(28)**	**70**	**295**	**673**	**617**
Trading & Industrial						
Car distribution	96	(14)			82	19
Shoe & apparel distribution	47	(1)	9		55	37
Waste services			121		121	97
Brewing - normal operations			14		14	10
Brewing - sale of business					–	–
Beverages can supply			(27)		(27)	(27)
Paint supply			13		13	12
Other activities	(31)		8		(23)	(18)
	112	**(15)**	**138**	**–**	**235**	**130**
Central items	**(165)**	**(46)**	**–**	**–**	**(211)**	**(194)**
Total	**4,391**	**(493)**	**153**	**1,029**	**5,080**	**4,118**

Analysis of return on Shareholders' Funds

The return of each division on shareholders' funds is:

	Attributable profit		Attributable net assets employed		Return on shareholders' funds (note 1)	
	2001 HK$M	2000 HK$M	**2001 HK$M**	2000 HK$M	**2001 %**	2000 %
Property	**2,793**	947	**49,854**	55,688	**5.3**	1.8
Aviation	**520**	2,510	**15,996**	16,193	**3.2**	16.5
Beverages	**252**	185	**1,859**	2,458	**11.7**	7.1
Marine Services	**617**	505	**2,229**	1,925	**29.7**	25.1
Trading & Industrial	**130**	(84)	**1,542**	1,617	**8.2**	(4.7)
Central items	**(194)**	(170)	**1,469**	(458)	**–**	–
	4,118	3,893	**72,949**	77,423	**5.5**	5.3

Note 1: The return on shareholders' funds is calculated as attributable profit for the year divided by the average of attributable net assets at the start and end of the year.

Year 2000	The Company and its subsidiaries: Operating profit HK$M	The Company and its subsidiaries: Net finance charges HK$M	Jointly controlled companies: Share of profits less losses HK$M	Associated companies: Share of profits less losses HK$M	Group: Profit before taxation HK$M	Profit attributable to Swire Pacific shareholders HK$M
Property						
Property investment	3,354	(276)			3,078	2,736
Property trading	145		63		208	49
Sale of investment properties					–	–
Hotels and restaurants			(48)	73	25	13
Provision for land premium on development properties	(151)				(151)	(151)
Provision for diminution in value of development property			(1,700)		(1,700)	(1,700)
	3,348	**(276)**	**(1,685)**	**73**	**1,460**	**947**
Aviation						
Airline services and airline catering				2,302	2,302	2,257
Aircraft engineering				166	166	156
Cargo handling				129	129	76
Others		41			41	21
	–	**41**	**–**	**2,597**	**2,638**	**2,510**
Beverages	**256**	**(92)**	**69**	**–**	**233**	**185**
Marine Services						
Ship repair, land engineering and harbour towage			66		66	61
Container handling			23	294	317	270
Shipowning and operating	231	(55)	4		180	174
	231	**(55)**	**93**	**294**	**563**	**505**
Trading & Industrial						
Car distribution	158	(1)			157	38
Shoe & apparel distribution	28		4		32	28
Waste services			101		101	85
Brewing - normal operations			(45)		(45)	(45)
Brewing - sale of business			(132)		(132)	(132)
Beverages can supply			(37)		(37)	(37)
Paint supply			(9)		(9)	(9)
Other activities	(12)	1	7		(4)	(12)
	174	**–**	**(111)**	**–**	**63**	**(84)**
Central items	**(160)**	**(50)**	**(2)**	**–**	**(212)**	**(170)**
Total	**3,849**	**(432)**	**(1,636)**	**2,964**	**4,745**	**3,893**

Financial Review

Commentary on major variances in the Consolidated Profit and Loss Account and Balance Sheet

Consolidated Profit and Loss Account	2001 HK$M	2000 HK$M	Reference
TURNOVER In the Property Division, the increase in turnover is mainly due to proceeds from the sale of units in The Albany. In addition, there was a slight increase in gross rental income, offset by reduced proceeds from property trading. The Beverages Division's operations in the USA recorded a 6% increase in turnover whilst the turnover for Hong Kong and Taiwan reduced slightly. The Marine Services Division contributed increased turnover following improved vessel utilisation and higher overall charter rates achieved by Swire Pacific Offshore. The Trading & Industrial Division suffered a reduction in turnover as a result of the sale of Swire Engineering and Swire Loxley during 2000 and the closure of Swire Engineering Services in January 2001. Turnover fell in Taikoo Sugar and at Taikoo Motors' businesses in Taiwan and Hong Kong, though this was offset by higher sales from Swire Resources in Hong Kong.	**15,198**	15,050	Note 1
OPERATING PROFIT In the Property Division, net rental income was marginally higher than 2000 due to higher contributions from retail premises and savings on outgoings. Operating profit was further enhanced by the sale of 9 units in The Albany. The Beverages Division recorded improved profits attributable to volume growth in the USA and significant cost savings in Taiwan following the restructuring in 2000. The strong operating profit for the Marine Services Division reflects the higher fleet utilisation and charter rates achieved by Swire Pacific Offshore. The decrease in operating profit in the Trading & Industrial Division is mainly attributable to lower contributions from the car businesses in Taiwan and Hong Kong, offset by improved operating results from sportswear and apparel in Hong Kong.	**4,391**	3,849	Note 2
NET FINANCE CHARGES Whilst net debt levels have remained relatively constant, the beneficial effect of lower prevailing rates of interest have been more than offset by a significant reduction in interest deferred into properties under development for sale.	**(493)**	(432)	Note 5
SHARE OF PROFITS LESS LOSSES OF JOINTLY CONTROLLED COMPANIES The marked increase reflects the absence of a provision for the diminution in value of Ocean Shores and the loss on the sale of Carlsbrew Brewery (Shanghai), which were included in the 2000 results. 2001 does include provisions for diminution in value of development properties in Tung Chung and for stamp duty in respect of Ocean Shores.	**153**	(1,636)	Note 6

References are to "Notes to the Accounts" on pages 58 to 77.

	2001 HK$M	2000 HK$M	Reference
SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES The majority of the reduction in profits reflects the downturn in the demand for air traffic for Cathay Pacific, Air Hong Kong and Dragonair. The contribution from HAECO decreased as a result of the inclusion in the 2000 results of non-recurring profits of HK$122 million at the company level.	**1,029**	2,964	Note 7
TAXATION The low effective tax rate of 11.9% reflects tax losses brought forward from previous years and the non-taxable profit on the sale of units in The Albany.	**602**	565	Note 8
MINORITY INTERESTS The increase is primarily due to improved contributions from both retail and office space in Festival Walk and the fact that certain pre-operating and marketing costs in Festival Walk were written off in 2000.	**360**	287	
PROFIT ATTRIBUTABLE TO SHAREHOLDERS A marked fall in contribution from Cathay Pacific has been more than offset by a reduction in provisions in the Property Division, modest growth in rental income, and a net 35% increase in contributions from Marine Services, Beverages and Trading & Industrial Divisions.	**4,118**	3,893	

Consolidated Balance Sheet

FIXED ASSETS The decrease in fixed assets is mainly due to the decrease in the valuation of the investment property portfolio in Hong Kong following a downturn in the property market generally.	**71,261**	77,378	Note 12
INVESTMENTS IN JOINTLY CONTROLLED COMPANIES The increase reflects loans advanced to jointly controlled companies in the Property Division, particularly the Ocean Shores project, and profit retained during the year. This is partially offset by a fall in valuation of investment properties held by jointly controlled companies.	**8,058**	6,978	Note 14
INVESTMENTS IN ASSOCIATED COMPANIES The decrease principally reflects the drop in profit retained in the Cathay Pacific Group as its 2000 final dividend, declared and paid in 2001, was larger than the pre-dividend profit in 2001.	**17,685**	18,373	Note 15

Financial Review

	2001 HK$M	2000 HK$M	Reference
PROPERTIES FOR SALE The decrease is mainly due to the sale of carparks in Lei King Wan, apartments within the StarCrest development in Hong Kong, and the sale of trading properties in the USA. This is offset by development costs incurred on the Taikoo Valley Site V residential site (The Orchards) in Hong Kong and Courts Brickell Key in the USA.	**1,683**	1,958	Note 17
TRADE AND OTHER PAYABLES The accruals at the end of 2000 included land premium for Horizon Gardens and the acquisition cost for land at Tai Ho on Lantau and the Aik San Factory Building and Melbourne Industrial Building. These amounts were settled during the year, which accounts for the decrease in trade and other payables.	**7,399**	8,377	Note 20
LONG-TERM LOANS AND BONDS DUE WITHIN ONE YEAR The increase is mainly due to the reclassification of the HK$1,500 million floating rate notes due in June 2002 from long-term loans and bonds.	**1,748**	200	Note 22
LONG-TERM LOANS AND BONDS The decrease reflects the reclassification of HK$1,500 million floating rate notes to current liabilities, partially offset by the refinancing of short-term loans through the issue of longer-term debt.	**9,625**	10,486	Note 22
MINORITY INTERESTS The decrease reflects the minority's share of the property revaluation deficit and the repayment of shareholders' loans to minority interests in the Property and Beverages Divisions, partially offset by retained profits attributable to minority interests during the year.	**4,651**	5,203	
SHAREHOLDERS' FUNDS The decrease relates principally to a decrease in the property revaluation reserve partially offset by profits retained during the year.	**72,949**	77,423	

Investment Appraisal and Operations Performance Review

Swire Pacific's executive management sets target rates of return for each company in the group based on its assessment of the risk premium appropriate for its business. The target rate of return is a weighted average of the cost of debt and the estimated cost of equity. The cost of equity is based on the Beta and hence equity risk premium of relevant quoted equities, adjusted by management's assessment of the competitive position and particular circumstances of the company.

These target rates of return are considered when appraising all new investments and recommending them to the Board for approval.

The actual and projected returns of each company in the group are compared annually to target rates of return with a view to increasing investment where the group can add significant value and rationalising investment where expected returns are not commensurate with the cost of capital and management time.

Financial Risk Management Policy

Financing for Swire Pacific subsidiaries in Hong Kong is provided primarily by Swire Pacific, which raises funds both directly and through wholly-owned finance subsidiaries. Certain working capital lines and overdraft facilities are arranged by individual subsidiaries. The principal areas of financial risk management activity including, inter alia:

- funding;
- commodity, currency and interest rate hedging;
- credit monitoring;
- debt maturity; and
- event and refinancing risk management

are subject to policies, guidelines, exposure limits, and systematic authorisation and reporting. The group's listed associated companies, Cathay Pacific and HAECO, arrange their financial affairs on a stand-alone basis. Their financing activities are undertaken in a manner consistent with the overall financial policies of the group.

Use of Derivatives

In the normal course of business, Swire Pacific and Cathay Pacific use interest rate and currency swaps in connection with their borrowings. Such derivative transactions are entered into in order to manage exposure to fluctuations in foreign currency exchange rates and interest rates. In addition, Cathay Pacific is a party to forward contracts and options for the purchase of aviation fuel. It is the policy of the Swire Pacific group not to enter into derivative transactions for speculative purposes. The implementation of the hedging policy is only undertaken following approval from the Board.

Derivatives involve, to varying degrees, credit and market risk. With regard to credit risk, the group would be exposed to loss in the event of non-performance by a counterparty. The group controls credit risk through approved counterparty limits and monitoring procedures.

Market risk is the possibility that a movement in interest rates or currency rates will cause the value of a derivative to fluctuate or change the cost of settling the underlying obligations. Derivatives are used solely for management of an underlying risk and the group is not exposed to market risk since gains and losses on the derivatives are offset by losses and gains on the assets, liabilities or transactions being hedged. The group is not required by its counterparties to provide collateral or any other form of security against any change in the market value of a derivative.

Derivative transactions entered into by Swire Pacific and its wholly-owned subsidiary companies, and outstanding at the year end

Maturity	Type	Purpose	Currency paid	Principal HK$	Basis of rate paid	Currency received	Basis of rate received
2004	Cross Currency Coupon only	To hedge USD coupons	HKD	389,985,000.00	Fixed	USD	Fixed
2004	Cross Currency Coupon only	To hedge USD coupons	HKD	779,970,000.00	Fixed	USD	Fixed
2004	Cross Currency Coupon only	To hedge USD coupons	HKD	389,985,000.00	Fixed	USD	Fixed
2004	Cross Currency Coupon only	To hedge USD coupons	HKD	389,965,000.00	Fixed	USD	Fixed
2004	Cross Currency Coupon only	To hedge USD coupons	HKD	389,965,000.00	Fixed	USD	Fixed
2004	Cross Currency Coupon only	To hedge USD coupons	HKD	194,980,000.00	Fixed	USD	Fixed
2003	Cross Currency Swap	To hedge principal repayment of USD debt	HKD	852,445,000.00	Floating	USD	Floating
2004	Cross Currency Swap	To hedge principal repayment of USD debt	HKD	154,540,000.00	Fixed	USD	Fixed
2004	Cross Currency Swap	To hedge principal repayment of USD debt	HKD	1,007,435,000.00	Floating	USD	Floating
2004	Cross Currency Swap	To hedge principal repayment of USD debt	HKD	1,159,125,000.00	Fixed	USD	Fixed
2003	Interest rate swap	To swap into floating rate debt	HKD	1,200,000,000.00	Floating	HKD	Fixed
2004	Interest rate swap	To swap into floating rate debt	HKD	500,000,000.00	Floating	HKD	Fixed
2003	Cross Currency Swap	To hedge principal repayment of HKD debt and HKD coupons	USD	1,000,000,000.00	Floating	HKD	Floating

Financial Review

Management of Currency Exposure

Exposure to movements in exchange rates on individual transactions in the Swire Pacific group is minimised using forward foreign exchange contracts where active markets for the relevant currencies exist. With the exception of the Perpetual Capital Securities, which have no scheduled maturity, all significant foreign currency borrowings are covered by appropriate currency hedges.

Translation exposure arising on consolidation of the group's overseas net assets is reduced, where practicable, by broadly matching assets with borrowings in the same currency. Substantial proportions of the revenues, costs, assets and liabilities of Swire Pacific and its subsidiary companies are denominated in Hong Kong dollars.

The long-term financial obligations of Cathay Pacific have been arranged primarily in currencies in which it has substantial positive operational cash flows, thus establishing a natural currency hedge. The policy adopted requires that anticipated surplus foreign currency earnings should be at least sufficient to meet the foreign currency interest and principal repayment commitments in any year.

Capital Resources and Liquidity

Swire Pacific's total shareholders' funds have decreased to HK$72,949 million at the end of 2001 compared with HK$77,423 million at the end of 2000, mainly due to the downward revaluation of the group's investment property portfolio, partially offset by earnings retained in the year.

At 31st December 2001 the Swire Pacific group held cash deposits of HK$366 million whilst bank loans and other borrowings due within one year amounted to HK$2,914 million.

An analysis of the group's net borrowings by currency at 31st December 2001, including US$600 million (HK$4,642 million) of Perpetual Capital Securities, is shown below:

Currency	HK$M	
Hong Kong Dollar	10,549	63%
United States Dollar	5,689	34%
New Taiwan Dollar	546	3%
Others	(28)	–
	16,756	100%

Sources of Finance

At 31st December 2001, committed loan facilities and debt securities amounted to HK$19,355 million, of which 16.6% (HK$3,212 million) remained undrawn. In addition, there were uncommitted facilities undrawn at the year end amounting to HK$2,083 million. Sources of funds at the end of 2001 comprised:

	Available HK$M	Drawn HK$M	Undrawn HK$M
Committed facilities			
Perpetual Capital Securities	4,642	4,642	–
Bonds	2,321	2,321	–
Private Placement	852	852	–
Fixed/Floating Rate Notes	4,700	4,700	–
Bank and other loans	6,840	3,628	3,212
	19,355	16,143	3,212
Uncommitted facilities			
Money market and others	3,121	1,038	2,083

Financing Activities during the Year

In April 2001, a Medium Term Note Programme allowing outstanding issues of up to US$1,500 million was arranged and a total of HK$2,200 million fixed/floating rate notes were issued with maturities ranging from 2 to 5 years. A HK$5,000 million syndicated loan was arranged in August 2001 to refinance facilities that were soon to mature or had a higher cost of funding. Facilities refinanced include a syndicated loan facility of HK$2,850 million scheduled to mature in March 2002 and various bilateral facilities. The benefit resulting from the year's financing activities is a lower average cost of financing.

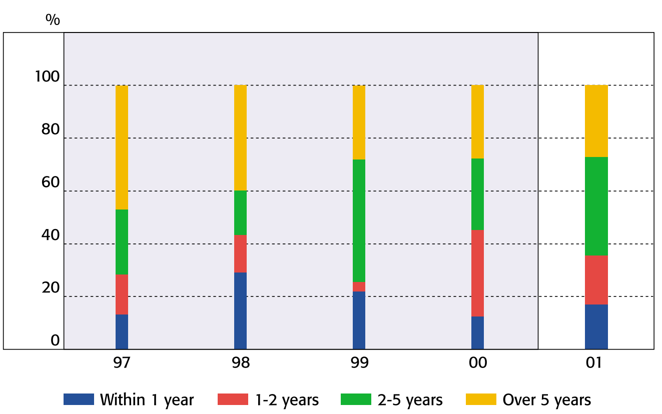
The group's weighted average cost of debt:

	2001	2000
Weighted average cost of debt	**6.52%**	7.95%
Weighted average cost of debt excluding perpetuals	**5.52%**	7.49%

Maturity Profile

It is group policy to secure adequate funding so as to match cash flows associated with both current and planned investments. The maturity profile of the group's gross borrowings at the end of each of the last five years is set out below:

Maturity profile



The refinancing activities during the year extended the group's weighted average term of debt. As the perpetual capital securities have no scheduled maturity the first call dates have been taken as the maturity dates.

The group's weighted average term of debt:

	2001	2000
Weighted average term of debt	**4.57 years**	4.42 years
Weighted average term of debt excluding perpetuals	**2.80 years**	1.92 years

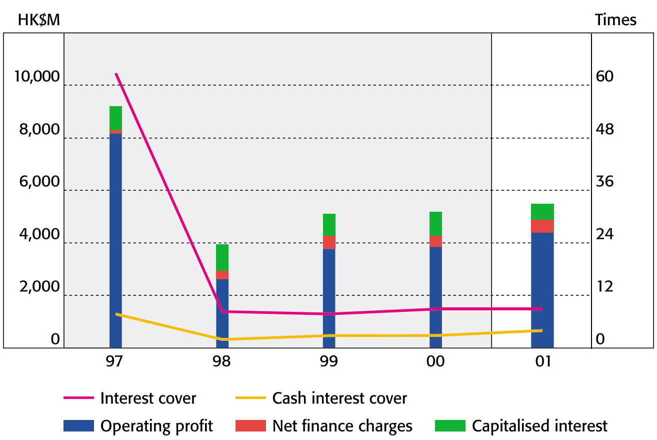
Interest Rate Profile

In addition to raising funds on a fixed rate basis, the group uses interest rate swaps and other instruments where appropriate in the management of its interest rate profile. At 31st December 2001, 53.2% of the group's gross borrowings were on a floating rate basis and 46.8% were on a fixed rate basis.

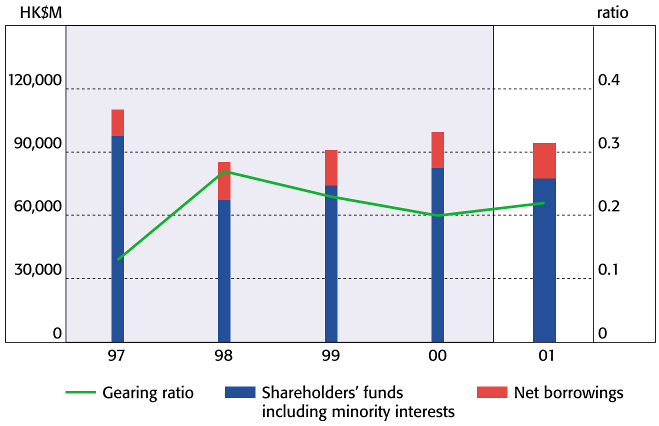
Interest Cover and Gearing

The following graphs illustrate interest cover, cash interest cover and gearing ratios for each of the last five years. Interest cover for the year ended 31st December 2001 was 8.91 times while cash interest cover, calculated by reference to total interest charges including those capitalised, was 4.01 times. The gearing ratio was 22% at the end of 2001.

Interest cover and cash interest cover



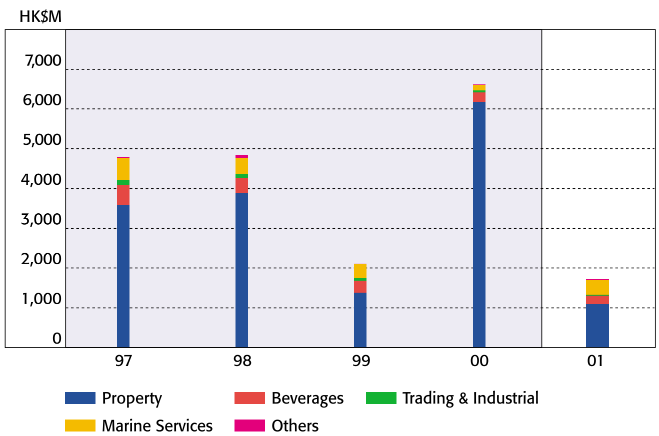
Gearing ratio



Capital Expenditure

Capital expenditure incurred by the group in 2001 was HK$1,644 million. The following graph illustrates capital expenditure by division over the last five years:

Capital expenditure by division



The major outgoings during 2001 in the Property Division related to expenditure on Cambridge House, the Cityplaza renovation, Pacific Forum and the acquisition of the Aik San Factory Building and Melbourne Industrial Building. Expenditure in the Beverages Division was mainly on property, production and distribution equipment. Within the Marine Services Division, capital expenditure related principally to instalment payments on 14 new offshore support vessels for delivery in 2002 and 2003.