The following discussion is based on, and should be read in conjunction with, the financial statements and the notes thereto included elsewhere in the annual report.

General

The Group is the third largest cruise line in the world by lower berths with 18 ships and over 23,000 lower berths under three mainstream brand names, Star Cruises, Norwegian Cruise Line and Orient Lines. Star Cruises and Cruise Ferries operate eight ships offering various cruise itineraries and calls destinations primarily in the Asia Pacific region. Norwegian Cruise Line and Orient Lines operate ten cruise ships offering a wide variety of itineraries in North America (including Alaska and Hawaii), Central and South America, Antarctica, Bermuda, the Caribbean, Europe and the Mediterranean. The Group recently launched another brand, NCL America, under which the Group will expand its operations to Hawaii.

Revenues from Cruise and Cruise-related Activities

Revenues from cruise and cruise-related activities can be further categorised as "cruise revenues" and "on-board revenues". Cruise revenues are derived from the sale of passenger tickets. Passenger ticket sales comprise a one-off up-front payment collected from passengers for accommodation, meals in certain restaurants on the ship, certain on-board entertainment and, where relevant, air and land transportation to and from the ship. Passenger ticket sales also includes amounts collected as passenger handling charges, which are charged to the passengers separately from the price of passenger tickets, but which are recorded as passenger ticket sales. These passenger handling charges include port fees, berthing charges, embarkation and disembarkation fees, baggage handling charges and other related charges. Revenues from passenger ticket sales are collected from passengers prior to their departure on the cruise, usually at the time of booking the cruise.

On-board revenues consist of revenues from gaming, beverage sales, shore excursions, a la carte dining outlets and revenues from on-board retail sales. On-board revenues vary according to the size of the ships in operation, the length of cruises operated, and the markets in which the ships operate.

Charter-hire Revenues

The Group derived revenues from the bareboat charter-hire of a catamaran to a third party customer. The revenues the Group derived from charter-hire generally vary according to the number of ships it has on charter-hire during a given period.

Operating Expenses

Operating expenses are made up of air and land transportation expenses, overnight shoreside hotel expenses, passenger transfer costs, travel agent commission and all shipboard operating expenses including crew wages and benefits, port charges, fuel, food, ship maintenance and entertainment expenses, cabin consumables and ship insurance. Most of the operating expenses are generally fixed per cruise, while passenger food expenses and port expenses typically vary according to the number of passengers on board a particular cruise ship.

Selling, General and Administrative Expenses

Selling expenses consist of the expenses of the Group's marketing activities. These marketing activities include advertising and promotional activities, operation of the Group reservation call centres and support functions, and other passenger related services, such as the Group's loyalty programmes.

General and administrative expenses consist of shoreside personnel wages and benefits, and expenses relating to the Group's world-wide offices, information technology support, crew training and support (including the operation of the Star Cruises Ship Simulator Centre), purchasing operations and other ship-related support activities.

Depreciation and Amortisation

Depreciation and amortisation expenses consisted primarily of depreciation of ships and shoreside assets (including the amortisation of dry docking costs) as well as amortisation of goodwill and trade names and trademarks.

Foreign Exchange and Interest Rate Swaps

The functional currency of the Group is the U.S. dollar as a substantial portion of the Group's transactions are realised or settled in U.S. dollars. Transactions in currencies other than U.S. dollars ("foreign currencies") are translated into U.S. dollars at exchange rates in effect at the transaction dates. Monetary assets and liabilities expressed in foreign currencies are translated at exchange rates at the balance sheet date. All such exchange differences are reflected in the consolidated profit and loss account.

The Group does not undertake extensive hedging of its foreign currency cashflows as the Directors believe that the main foreign currencies in which the Group derives its revenues, the Singapore dollar and the Hong Kong dollar, are generally stable. The Group does from time to time enter into hedging arrangements in connection with anticipated foreign currency fluctuations against the U.S. dollar. As at 31 December 2003, the Group was a party to certain forward contracts with a total notional amount of US$206.7 million in respect of the Singapore dollars and US$60.7 million in respect of the Hong Kong dollars. These forward contracts have remaining life ranging from 2 to 8 years. In addition, the Group also has forward contract maturing every two months up to April 2004 with a total notional amount of US$160.7 million to hedge against the Euro denominated shipbuilding commitments on the completion of the Pride of America vessel.

The Group's indebtedness and its related interest expenses are denominated in U.S. dollars and are based upon floating rates of interest. In order to limit its exposure in interest rate fluctuation, variable to fixed interest rate swaps have been utilised from time to time, to fix a portion of interest costs over a period of time. The Group continuously evaluates its debt portfolio, including interest rate swaps to achieve a desired proportion of variable and fixed debt based on its view of interest rate movement. As at 31 December 2003, the Group had interest rate swaps on debts with a notional amount of US$430.4 million with remaining lives ranging from 4 to 8 years. In addition, the Group also entered into a series of 5.5% capped USD LIBOR-in-arrears interest rate swaps with a notional amount of approximately US$140.8 million to limit its exposure to fluctuations in interest rate movements if rate moves beyond the cap level of 5.5%. The notional amount of these interest rate swaps for each interest period will be reduced six-monthly in varying amounts over 5 years from August 2003.

Taxation

Bermuda, the jurisdiction of continuation for Star Cruises Limited (the "Company") and the jurisdiction of incorporation for certain of its operating subsidiaries, and the Isle of Man, the jurisdiction of incorporation for most of the Company's operating subsidiaries, impose no tax on income derived outside of those respective jurisdictions. The Company's operating subsidiaries do, however, file relevant returns in the tax regimes of the relevant jurisdictions in which they operate, and pay taxes as required by those regimes. Income tax expense includes current taxes and the change in deferred taxes.

Seasonality

The cruise industry in Asia Pacific is less seasonal than the North American cruise market. This lower degree of seasonality is primarily attributable to the lower degree of seasonal climate variation in certain parts of Asia Pacific, particularly South East Asia. However, the Group has generally experienced a decrease in demand in December and January in the Hong Kong market attributable to unfavourable weather patterns during that time of year. This seasonal decrease in demand is generally offset by increased demand in other markets, such as Singapore, Thailand, and Malaysia, related to public holidays in December and January.

The cruise industry in North America is, however, moderately seasonal with greater demand generally occurring during the months of June to August.

Demand, however, also varies by ship and itinerary.

Human Resources

As at 31 December 2003, the Group had approximately 15,800 full time employees, of which approximately 13,400 were ship officers, crew and staff on ships. The remaining were employed in shoreside operations world-wide. The Group has provided employee benefits including provident fund scheme and medical insurance schemes for its staff.

The Group has a Post-listing Employees' Share Option Scheme, under which options may be granted to employees of the Group entitling them to subscribe for shares of the issued and paid up share capital of the Company from time to time.

There is no significant change in the remuneration policies; bonus and share options schemes and training schemes for the Group during the year ended 31 December 2003.

Results for the year ended 31 December 2003 as compared with the year ended 31 December 2002

Turnover

The Group's revenue for the year ended 31 December 2003 was US$1,618.2 million, increased by 2.8% from US$1,573.6 million for the year ended 31 December 2002. However, net revenue decreased marginally by 0.9%. Net revenue represents revenue less air ticket costs, travel agent commissions and other direct costs (all of which are included in operating expenses). Despite a 3.0% capacity increase, net revenue was lower primarily due to lower ticket prices and shipboard revenue as well as overall occupancy level. Occupancy was 2.0% lower at 96.0% for the year ended 31 December 2003 as compared with 98.0% for 2002 and net yield declined by 3.8% as compared with 2002. The lower net yield and occupancy level were mainly the result of the effect of the Severe Acute Respiration Syndrome ("SARS") pandemic in the Asia Pacific segment during 2003. Net yield is defined as net revenue per capacity day.

Star Cruises Asia Pacific operated with 2.8% lower capacity days in the year ended 31 December 2003 as compared to the year ended 31 December 2002. Occupancy and net yield were 9.0% and 12.2% lower respectively as compared with 2002.

NCL Group recorded an increase in capacity days of 5.5% for year 2003 as compared to year 2002. Occupancy rates were slightly higher, at 104.2% for the year ended 31 December 2003 versus 103.9% for 2002. Net yield was up 0.7% over 2002.

Cost and expenses

Total costs and expenses before interest and non-operating items for the year ended 31 December 2003 amounted to US$1,638.7 million as compared with US$1,412.7 million for the year ended 31 December 2002. The comparison with 2002 is affected by the inclusion of impairment loss and non-recurring charges in year 2003 and non-recurring charges in 2002. In the year 2003, the Group had US$99.5 million of assets impairment losses and US$15 million of non-recurring expenses, which was partially offset by US$5.3 million net proceeds from the loss-of-hire coverage arising from the s/s Norway boiler accident. In 2002, the Group recorded US$3.6 million of non-recurring expenses, which was primarily consisted of the results of the binding arbitration settlement relating to the redelivery of the M/S Leeward, including additional legal and lease expenses and were net of amounts received related to the early redelivery of the M/S Norwegian Star 1. The Group plans to rejuvenate the fleet by progressively replacing the older tonnage in the Star Cruises fleet with the mid-size NCL modern and relative new ships once the new builds are added to the NCL Group. As part of that strategy, the Group is on the look-out for opportunities to dispose of identified older Star Cruises ships. A substantial amount of the US$99.5 million of impairment loss recorded in 2003 is in respect of the older tonnage ships, SuperStar Capricorn and SuperStar Aries where the Group has reached agreements to dispose and impairment of the Orient Lines trade names and trademarks. In addition, the Group made provisions in respect of legal settlement expenses and related costs in the amount of US$15 million during the year ended 31 December 2003.

Operating expenses before non-recurring expenses increased by US$97.4 million from US$991.3 million for year 2002 to US$1,088.7 million in year 2003. Ship operating expenses (excluding costs such as travel agent commissions, air tickets and other direct costs as they are already included in the net revenue calculation) was 3.7% higher on a per capacity day basis for the year ended 31 December 2003 as compared with year 2002. This was due to the impact of higher fuel prices, the US$3.5 million of costs incurred in response to the SARS outbreak, start up costs for the new Hawaii operations and the expenses relating to s/s Norway which has been laid up since May 2003. These were partially offset by savings from costs reduction initiative. Fuel costs were up by 14.4% on a per capacity day basis in 2003 as compared with 2002.

Selling, general and administrative expenses before non-recurring expenses was 2.2% lower on a per capacity days basis for the year ended 31 December 2003 as compared with year 2002. In the second quarter of 2003, Star Cruises Asia Pacific spent about US$1.8 million in streamlining the operations and heavy advertising and promotional expenses to introduce at short notice the two megaships in Australia during their temporary deployment there.

Depreciation and amortisation expenses increased US$21.1 million from US$176.2 million for the year ended 31 December 2002 to US$197.3 million for the year ended 31 December 2003. The increase was primarily due to additional depreciation associated with the Norwegian Dawn and ship refurbishment expenditure during the year.

Operating profit/(loss)
The Group recorded an operating loss of US$20.5 million for the year ended 31 December 2003 as compared with operating profit of US$160.8 million in 2002. Excluding assets impairment losses and non-recurring expenses, the Group would have achieved an operating profit of US$88.8 million for 2003 as compared with an operating profit of US$164.4 million for 2002.

Non-operating expense
Non-operating expenses was reduced by 5.6% to US$102.3 million for the year ended 31 December 2003 as compared with US$108.4 million in year 2002. In 2003, the Group has a non-cash gain on foreign exchange amounted to US$0.6 million as compared to a non-cash loss on foreign exchange of US$3.0 million recorded in year 2002. In 2003, the Group has US$3.5 million of legal expenses and related costs in relation to a valuation proceedings, and in 2002 the Group recorded losses on extinguishment of debts of approximately US$5.9 million. Interest expense, net of interest income and excluding capitalised interest reduced in the year ended 31 December 2003 as compared with 2002 primarily because of lower interest rate despite higher average outstanding debts. Capitalised interest was US$2.2 million in 2003 due primarily to investments in ship construction projects.

Profit/(Loss) before taxation
The Group recorded loss before taxation of US$122.8 million in the year ended 31 December 2003 as compared to a profit before taxation of US$52.4 million for the year ended 31 December 2002.

Taxation
The Group incurred taxation expenses of US$1.7 million in 2003 as compared with US$1.5 million in 2002.

Net loss attributable to shareholders
As a result, the Group recorded a net loss attributable to shareholders of US$124.5 million for the year ended 31 December 2003.

Liquidity and capital resources

Sources and uses of cash
The majority of the cash and cash equivalents are held in U.S. dollars. For the year ended 31 December 2003, cash and cash equivalents decreased to US$377.0 million from US$417.0 million as at 31 December 2002. The Group's business provided US$178.7 million of net cash from operations for the year ended 31 December 2003 as compared to US$275.9 million for the year ended 31 December 2002. The decrease in net cash generated from operating activities was primarily due to losses during the year ended 31 December 2003 and an increase in advance ticket sales in 2002 as compared with 2003.

During the year ended 31 December 2003, the Group's capital expenditure was approximately US$327.7 million. Approximately US$246.5 million of the capital expenditure was related to capacity expansion and the remaining was mainly for the vessel refurbishments, drydocking and onboard assets.

In July 2003, the Group refinanced the US$225 million M/S Norwegian Sun Post-delivery Loan through a drawndown of US$225 million term loan and repaid the US$45 million term loan. The Group made scheduled principal repayments of US$265.2 million in relation to its other long-term bank loans during the year ended 31 December 2003. The Group drewdown €128.1 million (equivalent to approximately US$150.0 million) under the €298 million secured term loan agreements for completion of the ship, Pride of America.

During the year ended 31 December 2003, the Group issued approximately 346.3 million rights shares of US$0.10 each in the proportion of 7 rights shares for every 100 shares held at HK$2.25 (US$0.29) per rights share as well as a US$180 million convertible bonds. The net proceeds of approximately US$275.3 million will be used for the acquisition or construction of vessels, as general working capital and/or to reduce certain of the Group's outstanding bank loans.

Approximately US$74.5 million of restricted cash was released to Norwegian Cruise Line Limited ("NCLL") by the previous bankcard processor and was at approximately US$30.7 million as at 31 December 2003. The restricted cash is being released to NCLL following the issuance of the letters of credit facilities on 26 September 2003 as security to the bankcard processor.

Liquidity and capital resources *(continued)*

Gearing ratio

The gearing ratio as at 31 December 2003 was 0.51 times, essentially unchanged, as compared with 31 December 2002. The calculation of gearing ratio is based on total outstanding borrowings (including the convertible bonds) of the Group of approximately US$2.45 billion (2002: US$2.43 billion) divided by the total assets at the end of the year of approximately US$4.80 billion (2002: US$4.76 billion).

Contingent liabilities

Details of the contingent liabilities of the Group as at 31 December 2003 are disclosed in note 28 to the accounts.

Future funding

As at 31 December 2003, the Group had approximately US$2.27 billion of bank borrowings and US$180 million of convertible bonds. The outstanding bank borrowings are secured by legal charges over vessels including fixed and floating charges over assets of the Group of US$3.4 billion and guarantees given by the Group.

Loan covenant breaches

In April 2003, Ship Holding LLC, a Group subsidiary, entered into agreements with a syndicate of banks to obtain €298 million term loan (the "Term Loan"), equivalent to US$363.5 million as at 31 December 2003, to part finance the completion of the Pride of America vessel (the "Vessel"). As at 31 December 2003, approximately US$150 million was drawn down to pay installments to the shipyard under the construction contract. In January 2004, while in the final stages of construction, the Vessel suffered damage during a severe storm resulting in a significant delay in the expected delivery date of the Vessel to the Group and subsequently the shipyard was placed under receivership. Due to certain clauses in the Term Loan agreements, the lenders under these agreements may be entitled to accelerate the loan in which case the facility would be immediately repayable at call. Consequently the Term Loan amount drawn down as at 31 December 2003 has been classified as current in the Group's balance sheet. Management is now in the process of seeking a waiver from the syndicate of banks and expects to obtain such a waiver.

Due to the ability of the lenders of the Term Loan to accelerate repayment of the Term Loan, one of the Group's other loans (the "US$450 million term loan") could be deemed to be in default due to cross default clauses contained in this loan facility agreement whilst other loans of the Group would be deemed to be in default in the event that the lenders accelerate repayment of the Term Loan. Although the relevant lenders at the date of this report have not designated the US$450 million term loan as being in default, nevertheless, in accordance with Hong Kong GAAP, the long-term portion outstanding of US$337.5 million in respect of the US$450 million term loan that currently could be deemed to be in default has been classified as current in the Group's and Company's balance sheets. Management is confident that the potential deemed defaults will be remedied by obtaining the necessary waivers from lenders or by taking other measures necessary to satisfactorily address this matter.

Loan refinancing

NCLL has a reducing revolving credit facility with a syndicate of banks that originally provided for borrowings of up to US$623 million (the "Facility"). The total outstanding amount under this facility as at 31 December 2003 was US$403.2 million, which includes a scheduled and balloon payment of US$363.8 million due on 15 December 2004.

It is the intention of the Group to refinance the Facility in the normal course of business. As such, the Facility would be refinanced prior to the due date of the balloon payment. In February 2004, the Group accepted an offer from a syndicate of banks to act as underwriters for a US$400 million Reducing Revolving Credit Facility (the "Proposed Facility") to refinance the Facility. The offer is subject to acceptable documentation and satisfaction of certain other conditions. The offer can be withdrawn for various reasons including if facility agreements are not entered into by 31 March 2004 or if in the opinion of the syndicate there is a material adverse change that has or could affect the Group's financial condition, business or ability to meet its obligations under the Proposed Facility. Management is working with the syndicate to finalise and draw down the Proposed Facility and is confident that the refinancing will be in place prior to the due date of the balloon payment.

The Proposed Facility will be repayable in 14 equal installments payable at six-monthly intervals commencing six months from the first draw down under the facility with a balloon payment at the end of the tenure. The Proposed Facility will bear interest at LIBOR plus a margin.