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 a combined fleet of 21 ships in service and under construction with over 31,000 lower berths under four mainstream brand names, Star Cruises, Norwegian Cruise Line, Orient Lines and NCL America. Star Cruises and Cruise Ferries operate six 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. In July 2004, the Group introduced the reflagged Pride of Aloha under the NCL America brand on its Hawaii itineraries.

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. 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, spa services, internet cafés, art auctions, pre-cruise and post cruise packages, 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. The Group records onboard revenues from onboard activities the Group performs directly or that are performed by independent concessionaires, from which the Group receives a percentage of their revenues.

Other Revenues

Other revenues comprise the revenues from the bareboat charter-hire of a catamaran to a third party customer and provision of transportation and tour services. Charter-hire revenue 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 repairs and maintenance and entertainment expenses, cabin consumables and ship insurance. Most of the operating expenses are generally fixed per cruise, although passenger food expenses and the cost of other consumables 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, 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), operation of the Group reservation call centres and support functions, accounting, purchasing operations, ship administration and other ship-related support activities.

Depreciation and Amortisation

Depreciation and amortisation expenses consist primarily of depreciation of ships and shoreside assets as well as amortisation of goodwill and trade names. Costs associated with drydocking a ship are deferred and included in the cost of the ships and amortised over the period to that ship's next scheduled drydocking which is generally once every two to three years.

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 2004, 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 1 to 7 years.

Substantially, all of 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 to 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 2004, the Group had interest rate swaps on debts with a notional amount of US$430.4 million with remaining lives ranging from 3 to 7 years. In addition, the Group has 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 the LIBOR rate moves beyond the cap level of 5.5% with the remaining lives of 4 years.

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 tax and the deferred tax charges.

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, as a result of 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 2004, the Group had approximately 14,900 full time employees, of which approximately 12,600 were ship officers, crew and staff on ships. The remaining was employed in shoreside operations world-wide. The Group provides 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 2004.

Corporate Reorganisation

Starting in late 2003, the Group undertook a reorganisation of the Norwegian Cruise Line and Orient Lines businesses within the Group. The reorganisation, which closed on 23 April 2004, was intended to increase the financial self-sufficiency of NCL Corporation Ltd. ("NCLC")'s business, allowing NCLC to raise general and ship-specific financing without guarantees or other financial assistance from the Company and to facilitate the renewal of NCLC's fleet as newly-built ships are placed into service. In addition, NCLC transferred six of its ships to the Company's subsidiaries at their net book values along with US$403.2 million of secured indebtedness associated with these ships. After the transfer, NCLC entered into arrangements with the Company's subsidiaries to charter these six ships for periods ranging from one to six years to continue operating them under Norwegian Cruise Line and Orient Lines brands.

Results for the year ended 31 December 2004 ("Year 2004") as compared with the year ended 31 December 2003 ("Year 2003")

Turnover

The Group's revenue for the Year 2004 was US$1,636.4 million, up 1.1% from US$1,618.2 million for the Year 2003 despite a reduction in capacity of 7.2%. Total capacity days for Year 2004 was 8,163,437 as compared to 8,796,135 for Year 2003. Net revenue increased by 4.3%. Net revenue represents revenue less air ticket costs, travel agent commissions and other direct costs (all of which are included in operating expenses). Net revenue yield for the Year 2004 increased by 12.4% as compared with the Year 2003. Net revenue yield is defined as net revenue per capacity day. Occupancy for the Year 2004 was 103.8%, up from 96.1% for the Year 2003. The Group's performance for the Year 2003 was severely affected by the impact from the Iraq conflict and the outbreak of Severe Acute Respiratory Syndrome.

Star Cruises Asia Pacific operated with 28.8% lower capacity days in the Year 2004 as compared to the Year 2003. Net revenue yield was 34.7% higher as compared with the Year 2003 and 18.3% higher as compared with the same period in 2002. Occupancy for the Year 2004 was 96.5%, up from 75.7% for Year 2003 and 84.7% for the same period in 2002 respectively.

For the Year 2004, NCLC Group offered 1.5% more capacity days (6.4 million) split as to 93.7% International Fleet and 6.3% US flag fleet. Occupancy was up from 104.2% to 105.9% overall and from 104.2% to 106.2% in the International Fleet. Occupancy on the US flag fleet (one ship) was 100.7%. Net revenue yield was up 6.9% versus Year 2003 or by 6.7% excluding the impact of revenues from the Hawaii tour operation.

Costs and expenses

Total costs and expenses before interest and non-operating items for the Year 2004 amounted to US$1,515.9 million as compared with US$1,638.7 million for the Year 2003. In the Year 2004, the Group recorded an impairment loss of US$14.5 million relating to the write down of the book value of s/s Norway and US$4.3 million custom fines on Norwegian Star resulting from necessary alteration to the ship's Hawaii/Fanning Island itinerary in response to a problem with the ship's Azipod propulsion system. In addition, the Group incurred US$0.8 million legal settlement costs in Year 2004. In the Year 2003, the Group had US$99.5 million of impairment losses from the disposals of m.v. SuperStar Capricorn and m.v. SuperStar Aries and the write down of the book values of m.v. SuperStar Express (a catamaran) and s/s Norway as well as the trade names. The Group also made provision of US$15 million in respect of legal settlement expenses and related costs, 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.

Excluding these items, total costs and expenses before interest and non-operating items was US$1,496.3 million for Year 2004 as compared with US$1,529.4 million for Year 2003, a decrease of US$33.1 million.

Operating expenses before non-recurring expenses decreased by US$29.2 million to US$1,059.5 million for Year 2004 from 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 however 0.6% higher as compared with the Year 2003. The Group's ship operating expenses per capacity day were 8.4% higher as compared with the Year 2003, in part due to rising payroll and other costs, and in part due to the heightened cost levels of the US flag operation. In Asia Pacific, ship operating expenses per capacity day for Star Cruises registered an increase of 5.3%. Ship operating expenses per capacity day for NCLC Group rose by 9.4%. Fuel cost per capacity day for 2004 was marginally down on Year 2003.

Selling, general and administrative (SG&A) expenses increased by US$11.6 million to US$255.0 million for Year 2004 from US$243.4 million for Year 2003. On a per capacity day basis, the Group's SG&A expenses increased by 12.9% as compared with the Year 2003. The increase has been driven in part by the shoreside costs of the new Honolulu operation and, during the early part of the year, by TV advertising campaigns in California and New York to support the new Hawaii operation and the year-round New York operation. Both of these markets are targeted for considerable growth in NCLC future deployment and the decision was taken to commence the investment in consumer marketing this year in advance of the build-up. In addition, the reduction in capacity also pushed the SG&A costs per capacity day up.

Costs and expenses *(continued)*
Depreciation and amortisation expenses decreased by US$15.4 million to US$181.9 million for the Year 2004 as compared with US$197.3 million for the Year 2003 as a result of the disposal of the two ships mentioned above and reduced depreciation for s/s Norway.

Operating profit/(loss)
The Group recorded an operating profit of US$120.5 million for the Year 2004 as compared with an operating loss of US$20.5 million in 2003. Excluding impairment losses and non-recurring expenses, the Group would have achieved an operating profit of US$140.1 million for the Year 2004 as compared with an operating profit of US$88.8 million for the Year 2003.

Non-operating income/(expense)
Non-operating expenses increased by 25.6% to US$128.5 million for the Year 2004 as compared with US$102.3 million for the Year 2003. During the Year 2004, the Group had forward contract losses amounting to US$11.3 million as compared to a gain of US$0.5 million in 2003. The loss resulted primarily from the strengthening of the Singapore dollar and Euro against the US dollar during the year. The Group recorded a non-cash Euro denominated debt translation loss of US$9.5 million for the Year 2004. The Group did not have any Euro denominated debt in 2003. In addition, the Group incurred US$3.5 million of legal expenses in Year 2003.

Interest expense, net of interest income and capitalised interest increased to US$104.6 million for the Year 2004 from US$91.2 million in Year 2003. Interest expenses were higher primarily due to higher average outstanding debts and higher interest rates. Capitalised interest for the Year 2004 was US$10.2 million as compared with US$2.2 million for the Year 2003.

Loss before taxation
Loss before taxation for the Year 2004 was US$8.0 million as compared to a loss before taxation of US$122.8 million for the Year 2003. Excluding the impairment losses, non-recurring expenses, non-cash Euro denominated debt translation and forward contracts losses mentioned above, the profit before taxation for the Year 2004 would be US$32.4 million as compared with loss before taxation of US$10.6 million for the Year 2003.

Taxation
The Group incurred taxation expenses of US$1.0 million for the Year 2004 as compared to US$1.7 million for the Year 2003. The lower taxation expenses in the Year 2004 were mainly a result of overprovision of shipping income of prior years.

Net loss attributable to shareholders
As a result of the changes in revenues and expenses, the Group recorded a net loss attributable to shareholders of US$9.0 million for the Year 2004. Excluding the abovementioned impairment losses, non-recurring expenses, non-cash Euro denominated debt translation and forward contracts losses, the Group would have recorded a net profit of US$31.4 million for the Year 2004.

Liquidity and capital resources

Sources and uses of funds
The majority of the cash and cash equivalents are held in U.S. dollars. For the Year 2004, cash and cash equivalents decreased to US$341.0 million from US$377.0 million as at 31 December 2003. The Group's business provided US$283.0 million of net cash from operations for the Year 2004 as compared to US$178.7 million for the Year 2003. The increase in net cash generated from operations was primarily due to an increase in advance ticket sales.

During the Year 2004, the Group's capital expenditure was approximately US$468.3 million. Approximately US$387.4 million of the capital expenditure was related to the construction of new ships. The remaining of the expenditure was for vessel refurbishments and onboard assets. During the Year 2004, the Group received net proceeds of approximately US$82.2 million from the disposal of ships and insurance proceeds related to the s/s Norway boiler accident. The Group used approximately US$15.1 million to acquire an equity interest in Valuair Limited. In addition, US$4.6 million net of cash and cash equivalents acquired, was used to acquire a subsidiary, Polynesian Adventure Tours, Inc.

In April 2004, the Group refinanced the outstanding balance of US$403.2 million of the US$623 million Fleet Loan through a drawndown of US$400 million Reducing Revolving Credit Facility. In July 2004, the Group drewdown US$480 million under the US$800 million Loan Facility and together with US$250 million from the Senior Notes issue, repaid the outstanding amount of the Pride of Aloha Loan and loans related to Norwegian Spirit and Norwegian Star as well as partially repaid the US$450 million term loan.

Liquidity and capital resources *(continued)*

Sources and uses of funds (continued)
Principal long term debts repayments of US$229.7 million was made in the Year 2004. In the Year 2004, the Group drewdown a total of US$369.7 million under the existing long term debts for the construction of the ships and working capital purposes.

Restricted cash decreased approximately US$2.2 million during the Year 2004 and was at approximately US$28.5 million as at 31 December 2004.

As at 31 December 2004, the Group had approximately US$2.2 billion of bank borrowings, US$180 million of convertible bonds and US$250 million unsecured senior notes. The outstanding bank borrowings are secured by legal charges over vessels including fixed and floating charges over assets of the Group of US$3.7 billion.

Gearing ratio
The gearing ratio as at 31 December 2004 was 0.52 times, increased slightly, as compared with 31 December 2003. The calculation of gearing ratio is based on total outstanding borrowings (including convertible bonds) of the Group of approximately US$2.60 billion (2003: US$2.45 billion) divided by the total assets at the end of the year of approximately US$4.99 billion (2003: US$4.80 billion).

Contingent liability
Details of the contingent liabilities of the Group as at 31 December 2004 are disclosed in note 29 to the accounts.

Prospects
In Asia Pacific, the recent tsunami in the Indian Ocean which devastated tourist spots in South and Southeast Asia has caused a slight disruption in the travel industry in the region. Barring further severe aftermath, the financial impact on the Group is expected to be modest with the two affected ships, m.v. SuperStar Virgo and m.v. SuperStar Gemini resuming its regular calls into Phuket once a week from early March 2005.

NCLC Group has firmly ordered one more ship and entered into a letter of intent to order another. The first is with Meyer Werft and is an exact repeat of the m.v. Norwegian Jewel. It will be delivered in February 2007. Committed financing, at attractive rates, has been secured on this ship. The second ship is a new design at a new yard. The Finnish yard, Aker Finnyards, will build a 2,400 passenger ship for delivery at the end of June 2007. Work continues on the detail of the specification and the financing package.