

# Financial Review

References are to "Notes to the Accounts" on pages 69 to 93.

*Commentary on major variances in the Consolidated Profit and Loss Account, Balance Sheet and Cash Flow Statement*

## Consolidated Profit and Loss Account

2004 HK\$M	2003 HK\$M	Reference
<b>18,324</b>	17,387	Note 1
<b>5,134</b>	4,585	Note 2 and Note 3
<b>(937)</b>	(464)	Note 6

### TURNOVER

In the Property Division, turnover from property trading increased due to more unit closings in the USA, in particular Jade Residences. Revenue from investment properties decreased as a result of reduced gross rental income as well as fewer Albany units sold during the year. The Beverages Division's operations in Taiwan recorded moderate revenue growth of 3.2%. Turnover for the Hong Kong beverages operation remained flat due to pressure on pricing, while that of the USA declined slightly against 2003. In the Marine Services Division, Swire Pacific Offshore recorded higher charter-hire revenue due to improvements in both fleet utilisation and charter rates and the fact that the company took delivery of two new vessels during the year. In the Trading & Industrial Division, the turnover of Taikoo Motors Taiwan increased 27% over 2003. Swire Resources also recorded increased turnover with sales of sports apparel surpassing sports shoes for the first time.

### OPERATING PROFIT

In the Property Division, operating profit was higher than 2003 due to the recognition of property trading profits from unit closings at Jade Residences in the USA, partially offset by lower net rental income from the office portfolio in Hong Kong. Despite fewer units sold in The Albany, profits from sale of investment properties were higher owing to the higher selling prices achieved. The Beverages' overseas operations in Taiwan recorded improved profits through moderate sales growth enhanced by improved production and distribution efficiencies. Operating profit for the US operations increased due to higher retail pricing, while that of the Hong Kong operation declined due to pricing pressure and increased material costs. Operating profit in the Marine Services Division was at the same level as 2003, reflecting an increase in revenue for Swire Pacific Offshore offset by higher operating costs on the expanded fleet. The Trading & Industrial Division saw a significant increase in operating profit mainly arising from higher contributions from Taikoo Motors in Taiwan and from the sale of sports apparel and sports shoes in Swire Resources. The results of the division were further enhanced by the profit on sale of the Kwun Tong Car Centre and the write-back of closure provisions for the Hong Kong car business.

### NET FINANCE CHARGES

The increase in net finance charges was due to a HK\$500 million interest charge on the Taikoo Shing land premium partially offset by the write-back of over-accrued interest charges of HK\$41 million on the Horizon Gardens land premium.

## Consolidated Profit and Loss Account (continued)

	2004 HK\$M	2003 HK\$M	Reference
<b>SHARE OF PROFITS LESS LOSSES OF JOINTLY CONTROLLED COMPANIES</b>	<b>1,055</b>	530	Note 7
The significant increase was due to the write-back of provision for Ocean Shores and Tung Chung Crescent amounting to HK\$350 million, together with higher profits in the year contributed by these companies. The contribution from beverages operations in Mainland China rose by HK\$27 million due to volume growth of 21%, which more than offset the impact of higher material costs. Following the commencement of operations at the fourth berth in February 2004, total throughput handled by Shekou Container Terminals increased by 39%, resulting in an improved profit contribution to the group.			
<b>SHARE OF PROFITS LESS LOSSES OF ASSOCIATED COMPANIES</b>	<b>3,212</b>	1,522	
The profit contributions from Cathay Pacific and Dragonair increased by HK\$1,507 million in 2004, reflecting the strong growth in passenger and cargo revenue as compared with the SARS-affected 2003. These revenue gains were partially offset by the sharp increase in fuel prices, which materially inflated the operating costs of the two airlines. HAECO also contributed an increase in profit of HK\$40 million, reflecting higher utilisation of facilities in line with the rebound in traffic demand. The contribution from Hong Kong Air Cargo Terminals increased by HK\$71 million, reflecting a 12.5% increase in throughput handled for the year. Occupancy and room rates for the hotels at Pacific Place improved during the year, contributing to an increase in profit of HK\$62 million to the group.			
<b>TAXATION</b>	<b>1,234</b>	872	Note 8
The increase in tax charges was in line with the group's pre-tax profit. The slightly lower effective tax rate for both years reflects the non-taxable profit on the sale of investment properties in Hong Kong.			
<b>MINORITY INTERESTS</b>	<b>686</b>	379	
The increase was due to the share of profits attributable to minorities from the sale of properties in the USA and improved contributions from Hong Kong Air Cargo Terminals and the Beverages' operations in Taiwan and Mainland China, which are held through partly-owned subsidiary companies.			
<b>PROFIT ATTRIBUTABLE TO SHAREHOLDERS</b>	<b>6,544</b>	4,922	Note 9
The significant increase in profits from the Aviation Division has been partially offset by reduced rental income and interest charges on the Taikoo Shing land premium. Higher profits were recorded from property trading, sales of investment properties and from the Trading & Industrial Division.			

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## Consolidated Balance Sheet

	<b>2004</b> <b>HK\$M</b>	2003 HK\$M	<b>Reference</b>
<b>FIXED ASSETS</b>	<b>82,309</b>	65,473	Note 12
The increase in fixed assets was mainly due to the increase in the valuation of the investment property portfolio in Hong Kong following the recovery of the property market. The increase also included the construction costs incurred on Three Pacific Place and the land costs for the Taikoo Hui development in Guangzhou.			
<b>INVESTMENTS IN JOINTLY CONTROLLED COMPANIES</b>	<b>3,662</b>	4,311	Note 14
Remittance of funds and dividends from jointly controlled companies holding interests in the Ocean Shores and Les Saisons trading property projects accounted for the majority of the decrease in the carrying values of these companies during the year.			
<b>INVESTMENTS IN ASSOCIATED COMPANIES</b>	<b>18,770</b>	17,677	Note 15
The increase was largely attributable to the share of profit retained in the Aviation Division companies, particularly the Cathay Pacific group, and hotel interests in the Property Division. During the year, the company purchased additional shares in Cathay Pacific Airways and HAECO amounting to HK\$245 million.			
<b>PROPERTIES FOR SALE</b>	<b>874</b>	1,822	Note 17
The decrease was due to the sale of the remaining units in The Orchards in Hong Kong as well as unit closings in Jade Residences and Courts Brickell Key in the USA.			
<b>STOCKS AND WORK IN PROGRESS</b>	<b>1,236</b>	861	Note 18
The significant increase arose principally from the higher level of stocks maintained by the Taikoo Motors group and Swire Resources at the year end to meet anticipated strong sales at the beginning of 2005.			
<b>TRADE AND OTHER RECEIVABLES</b>	<b>2,059</b>	2,457	Note 19
The decrease mainly represents the settlement of proceeds receivable at the end of 2003 from the sale of units in The Orchards and The Albany.			
<b>SHORT-TERM DEPOSITS AND BANK BALANCES</b>	<b>1,500</b>	374	
The cash generated from unit closings at Jade Residences and Courts Brickell Key in the USA gave rise to additional surplus cash at the end of 2004.			
<b>TRADE AND OTHER PAYABLES</b>	<b>6,180</b>	8,205	Note 20
The payment on account of the Taikoo Shing land premium to the government in August amounting to HK\$2,027 million accounts for most of the decrease.			
<b>LONG-TERM LOANS AND BONDS</b>	<b>2,593</b>	1,325	Note 22
The increase reflects new long-term loans borrowed during the year to finance the repayment of the US\$300 million bond in September. The US dollar bond was classified under 'Long-term loans and bonds due within one year' under current liabilities at the 2003 year end.			

## Consolidated Balance Sheet (continued)

	2004 HK\$M	2003 HK\$M	Reference
<b>MINORITY INTERESTS</b>	<b>6,544</b>	5,231	
The increase was principally due to the minorities' share of the increase in the property valuations at the end of the year as well as their share of profits retained in Jade Residences.			
<b>SHAREHOLDERS' FUNDS</b>	<b>86,995</b>	68,076	
The increase relates principally to an increase in the property valuation reserve and the profit retained by the group during the year. The increase was partially offset by the share of the Cathay Pacific group's exchange losses recognised in the cash flow hedge reserve.			
<b>CASH GENERATED FROM OPERATIONS</b>	<b>4,049</b>	5,333	Note 30
The decrease is mainly due to the payment on account of the Taikoo Shing land premium of HK\$2,027 million in August 2004.			
<b>INTEREST PAID</b>	<b>713</b>	860	
The decrease in interest paid during the year is attributable to the continued decline in interest rates and to the lower level of the group's net borrowings as compared to the previous year.			
<b>PURCHASE OF FIXED ASSETS</b>	<b>1,910</b>	1,857	
The outflow includes development expenditures on the Taikoo Hui project in Guangzhou, Three Pacific Place, and the purchase of supply vessels.			
<b>PROCEEDS FROM FIXED ASSET DISPOSALS</b>	<b>909</b>	1,041	
The 2004 proceeds were mainly from the sale of residential units in The Albany and the Kwun Tong Car Centre. The receipts in 2003 included the cash proceeds from the sale of the Hong Kong Spinners Industrial Building and units in 3 Coombe Road and The Albany.			
<b>PURCHASE OF SHAREHOLDINGS IN AND LOANS TO JOINTLY CONTROLLED COMPANIES</b>	<b>500</b>	973	
The lower cash outflow is mainly due to less loans injected into jointly controlled companies as property development projects, such as Ocean Shores, were substantially complete by the end of 2003.			

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## Consolidated Cash Flow Statement (continued)

	2004 HK\$M	2003 HK\$M	Reference
<b>PURCHASE OF SHAREHOLDINGS IN AND LOANS TO ASSOCIATED COMPANIES</b>	<b>248</b>	257	
The cash outflow in 2004 mainly relates to the purchase of additional shares in Cathay Pacific Airways and HAECO.			
<b>SALE OF SHAREHOLDINGS IN AND REPAYMENT OF LOANS BY JOINTLY CONTROLLED COMPANIES</b>	<b>1,515</b>	2,748	
There were reduced loan repayments by jointly controlled companies due to less proceeds from realisation of trading properties in Hong Kong (Ocean Shores and Seaview Crescent) as the majority of these residential units had been sold at the end of 2003.			
<b>LOANS DRAWN AND REFINANCING</b>	<b>3,684</b>	1,235	
Loans drawn in 2004 were mainly for financing the repayments of the US\$300 million bond and the HK\$500 million medium term notes.			
<b>REPAYMENT OF LOANS AND BONDS</b>	<b>4,500</b>	5,321	
The outflow in 2004 represents repayments of the US\$300 million bond and HK\$500 million of the medium term notes. These were funded by operating cash inflows generated from various divisions, asset realisations in the Property Division as well as by drawing on new loans at lower interest rates. The outflows also include the repayment of bank loans for the Jade Residences trading property project in the USA with sales proceeds received upon unit closings.			

## Investment Appraisal and Performance Review

	Net assets employed			Capital commitments		
	2002 HK\$M	2003 HK\$M	2004 HK\$M	2002 HK\$M	2003 HK\$M	2004 HK\$M
Property investment						
– at cost	36,924	37,867	<b>38,638</b>	2,178	1,632	<b>4,142</b>
– net valuation surplus	23,961	21,113	<b>37,123</b>			
– working capital	(3,707)	(3,518)	<b>(1,953)</b>			
	<b>57,178</b>	<b>55,462</b>	<b>73,808</b>	<b>2,178</b>	<b>1,632</b>	<b>4,142</b>
Property trading	5,402	2,980	<b>1,358</b>			
Aviation	16,518	16,214	<b>17,258</b>		99	<b>99</b>
Beverages	3,588	3,236	<b>3,052</b>	19	24	<b>16</b>
Marine Services	3,814	4,335	<b>4,772</b>	431	170	<b>1,304</b>
Trading & Industrial	1,379	1,052	<b>1,361</b>			
Head office	117	202	<b>218</b>			
Total net assets employed	87,996	83,481	<b>101,827</b>	2,628	1,925	<b>5,561</b>
Less net debt	14,188	10,174	<b>8,288</b>			
Less minority interests	4,861	5,231	<b>6,544</b>			
Shareholders' funds	<b>68,947</b>	<b>68,076</b>	<b>86,995</b>			

	Shareholders' funds			Return on shareholders' funds *		
	2002 HK\$M	2003 HK\$M	2004 HK\$M	2002	2003	2004
Property investment	41,019	42,051	<b>59,190</b>	6.7%	6.9%	<b>4.5%</b>
Property trading	5,097	2,642	<b>1,856</b>	-3.7%	7.1%	<b>28.8%</b>
Property – overall	46,116	44,693	<b>61,046</b>	5.4%	6.9%	<b>5.5%</b>
Aviation	16,505	16,199	<b>17,243</b>	13.0%	5.2%	<b>14.3%</b>
Beverages	2,046	1,967	<b>2,151</b>	14.4%	18.1%	<b>18.7%</b>
Marine Services	2,594	2,968	<b>3,417</b>	27.3%	23.2%	<b>23.2%</b>
Trading & Industrial	888	1,262	<b>1,307</b>	0.3%	22.1%	<b>29.2%</b>
Head office	798	987	<b>1,831</b>			
Total	<b>68,947</b>	<b>68,076</b>	<b>86,995</b>	7.6%	7.2%	<b>8.4%</b>

\*The return on shareholders' funds is calculated as attributable profit for the year divided by the average of shareholders' funds at the start and end of the year.

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## Investment Appraisal and Performance Review (continued)

Swire Pacific focuses on the long-term development of businesses where it can add value through its industry-specific expertise and particular knowledge of the Greater China region. It endeavours to create value for shareholders by making investments which exceed the target rate of return appropriate for each of its businesses.

The tables on page 35 show where the group's assets are employed, capital commitments by division and changes in returns on shareholders' funds.

Comments on this information:

- **Investment property:** Net assets employed in investment property increased by HK\$18,346 million during the year as a result of a HK\$16,010 million (including minority interests) increase in the valuation of existing property, a net investment of HK\$771 million, principally in Three Pacific Place and Taikoo Hui (Guangzhou) and a reduction in working capital due to payment of land premium of HK\$2,027 million.

Capital commitments at the end of 2004 include HK\$3,515 million for construction of Taikoo Hui in Guangzhou, a mixed use commercial development.

Rents from investment property in Hong Kong declined from 2001 to 2004 due to a sharp increase in the supply of office space during a period of moderate demand. The resulting fall in profits was partly offset by profits on the sale of investment property. Sales of investment property are likely to be less significant in future. The group is however, confident that returns from its high quality investment property portfolio will improve as supply and demand move back into balance. This trend was reflected in the increase in property values assessed at the end of 2004 and is projected to feed through to rental levels as property leases are renewed.

The return on assets employed calculated for investment property reduced from 6.9% in 2003 to 4.5% in 2004 primarily due to the increase in the carrying value of property on revaluation at the end of 2004 and a HK\$500 million interest charge on Taikoo Shing land premium referred to on page 10. The return does not include the change to property values as this is treated as a reserve movement rather than being reported as profit for the year.

- **Property trading :** The group develops residential property for sale in Hong Kong and Miami. Its business in Hong Kong has substantially reduced during recent years. The return from Hong Kong property trading in 2004 was enhanced by a HK\$350 million write back of provisions made in previous years in respect of the Ocean Shores and Tung Chung developments.

Residential projects in Miami currently account for the bulk of the property trading activity and have provided an average return on shareholders' funds over the last three years of 23.1%.

- **Aviation Division:** This division comprises associated companies and investments. Net assets employed increased by HK\$1,044 million in 2004 mainly due to Cathay Pacific Airways using retained profits for expansion.

Return on shareholders' funds recovered to 14.3% following a strong pick-up in demand.

- **Beverages Division:** Whilst this division has been experiencing substantial volume growth, its assets employed have been falling as depreciation on production facilities built in the 1990s has exceeded new investment. In 2004 attributable net assets employed fell by HK\$184 million.

Beverages' average return on shareholders' funds increased marginally to 18.7% as improved profits from its Mainland China operations were partly offset by higher taxes paid by the USA operations.

- **Marine Services Division:** Marine Services' net assets increased by HK\$437 million following the acquisition of new vessels for Swire Pacific Offshore. Further growth is planned for this division with Swire Pacific Offshore having committed HK\$1,304 million to purchase a further ten vessels as at the end of 2004. Return on shareholders' funds remained little changed at 23.2%.

- **Trading & Industrial Division:** This division's net assets increased by HK\$309 million due to growth in working capital in Taikoo Motors Taiwan and reduced provisions at Swire SITA Waste Services. Improvements in operating profits for nearly all operations in the division led to average return on shareholders' funds increasing from 22.1% to 29.2%.