Credit Analysis

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Treasury Management

Structure and Policy

Swire Pacific's Head Office Treasury sets financial risk management policies in accordance with policies and procedures approved by its Board. It also manages the majority of the group's funding needs and currency, interest rate, credit and event risk exposures. Within the same policy framework, operating subsidiaries manage currency, interest rate and commodity exposures that are specific to particular transactions within their businesses. It is the policy of the Swire Pacific group not to enter into derivative transactions for speculative purposes.

The group's listed associated companies, Cathay Pacific and HAECO, arrange their financial and treasury affairs on a stand-alone basis, in a manner consistent with the overall policies of the group.

Non-listed associated and jointly controlled companies also arrange their financial and treasury affairs on a stand-alone basis. Swire Pacific provides financial support by way of guarantees in cases where significant cost savings are available and risks are acceptable.

Interest Rate Exposure

The level of fixed rate debt for the group is decided after taking into consideration the potential impact of higher interest rates on profit, interest cover and the cash flow cycles of the group's businesses and investments.

In addition to raising funds on a fixed rate basis, the Swire Pacific group uses interest rate swaps in the management of its long-term interest rate exposure. It also uses forward rate agreements to manage its exposure to short-term interest rate volatility.

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. All significant foreign currency borrowings with a fixed maturity date are covered by appropriate currency hedges.

Translation exposure arising on consolidation of the group's overseas net assets is reduced, where practicable, by 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.

Commodity Exposure

Certain Swire Pacific group companies have underlying exposures to commodity risk. Derivatives including swaps, forwards and options are used in the management of these exposures in accordance with the policies approved by the Board.

Credit Exposure

When depositing surplus funds or entering into derivative contracts, the group controls its exposure to non-performance by counterparties by transacting with investment grade counterparties, setting approved counterparty limits and applying monitoring procedures. 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. There are no specific conditions that would require the termination of derivative contracts should the credit rating of Swire Pacific be downgraded.

Derivatives

It is the policy of the Swire Pacific group not to enter into derivative transactions for speculative purposes. 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. Swire Pacific has elected not to adopt HKAS 39 early and hence derivatives are not required to be valued at their market values as at 31st December 2004.

Derivative transactions entered into by Swire Pacific and its subsidiary companies, and outstanding at the year end are summarised below by their respective types and maturities:

Maturity	Type	Purpose	Currency paid	Principal HK$	Basis of rate paid	Currency received	Basis of rate received
2005	Cross currency coupon only swap	To hedge USD coupons	HKD	390,000,000	Fixed	USD	Fixed
2006	Cross currency coupon only swap	To hedge USD coupons	HKD	3,315,000,000	Fixed	USD	Fixed
2006	Interest rate swap	To swap floating rate debt into fixed rate	HKD	700,000,000	Fixed	HKD	Floating
2007	Cross currency coupon only swap	To hedge USD coupons	HKD	974,250,000	Fixed	USD	Fixed
2007	Interest rate swap	To swap fixed rate debt into floating rate	HKD	700,000,000	Floating	HKD	Fixed
2009	Interest rate swap	To swap floating rate debt into fixed rate	HKD	250,000,000	Fixed	HKD	Floating

In addition to the derivatives shown above the group takes out foreign exchange forward contracts to hedge binding commitments.

Credit Profile

Swire Pacific aims to maintain a capital structure that is appropriate for long term credit ratings of A3 to A1 on Moody's scale, A- to A+ on Standard & Poor's scale, and A to AA on Fitch's scale. Actual credit ratings may depart from these levels from time to time due to economic circumstances. As at 31st December 2004 our long term credit ratings were A3 from Moody's, BBB+ from Standard & Poor's, and A- from Fitch.

Key Credit Ratios

The table below sets out those credit ratios of the group which credit agencies commonly assess when determining credit ratings:

	2000	2001	2002	2003	**2004**
Operating margin	29.8%	33.1%	32.5%	30.1%	**31.3%**
EBIT/net interest	4.2	5.5	6.5	7.9	**6.9**
FFO+net finance charges/net interest	4.6	5.8	6.3	7.4	**6.3**
Rental income/net interest	2.7	3.4	4.2	4.3	**2.9**
FFO/net debt	33.8%	34.7%	34.7%	52.1%	**69.3%**
Net debt/net capital	17.0%	17.8%	16.1%	12.2%	**8.1%**

Operating margin = Operating profit before depreciation and amortisation / turnover
EBIT = Earnings before interest and taxes
FFO (Funds from operations) = Net income plus depreciation plus deferred tax plus non-cash items
Net capital = Shareholders' funds plus minority interests plus proposed dividends plus net debt
Net interest is stated before deducting capitalised interest.

Cash Flow Summary

	2004 HK$M	2003 HK$M
Net cash generated by businesses and investments:		
Cash generated from operations	**4,049**	5,333
Cash from asset realisations*	**2,481**	3,838
Dividends received	**2,239**	1,563
Capital expenditure and investments**	**(2,679)**	(3,130)
Tax and net interest paid	**(1,232)**	(1,256)
	4,858	6,348
Cash paid to shareholders and net funding by external debt :		
Share repurchases	**–**	(60)
Dividends paid	**(2,549)**	(1,999)
Decrease in borrowings	**(1,249)**	(4,352)
Capital contribution from minority interest	**15**	–
	(3,783)	(6,411)
Increase/(decrease) in cash and cash equivalents	**1,075**	(63)

* Includes proceeds from fixed asset disposals and the sale of shareholdings in and repayments of loans by associated and jointly controlled companies and investment securities as well as net changes in long-term receivables.
** Includes additions to fixed assets and deferred expenditure, purchase of shareholdings in and loans to subsidiary, associated and jointly controlled companies and investment securities.

Cash generated from operations fell as a result of the HK$2,027 million Taikoo Shing land premium payment in August 2004.

Cash from asset realisations were derived mainly from the sale of properties in The Albany, Ocean Shores and the sale of the Kwun Tong Car Centre.

The significant contributions to capital expenditure and investments are the construction costs for Three Pacific Place, the purchase of land use rights for the Taikoo Hui development, the renovation of Parkside West, the purchase of additional offshore support vessels and the purchase of shares of Cathay Pacific and HAECO.

Changes in Financing

On 21st July a US$93 million loan guaranteed by Swire Pacific was secured for the development by Swire Properties of the Carbonell condominium project in the USA. On 5th November 2004 Swire Pacific's wholly owned subsidiary, Swire Pacific MTN Financing, issued HK$1,500 million of fixed and floating rate notes under its Medium Term Note (MTN) Programme. Under its MTN Programme, notes in an aggregate amount of up to US$1,500 million may be issued and will be unconditionally and irrevocably guaranteed by Swire Pacific. As at 31st December 2004, HK$2,000 million of issued notes are outstanding under the MTN Programme. In addition, credit lines of HK$1,700 million from various banks were secured during the year to provide additional revolving committed facilities.

The major debt repayments during the year comprised a US$300 million 144A bond and a HK$500 million fixed rate note issued under the MTN Programme. Other repayments relate to funds drawn from syndicated and bilateral revolving credit loans, funded by cash from operations and asset realisations. In addition, Swire Properties repaid a US$155 million loan, taken out in 2002 to finance the Jade Residences development in the USA.

Currency Profile

An analysis of debt by currency net of hedges at 31st December 2004 is shown below:

Currency	Total HK$M	%
Hong Kong Dollar	**6,446**	78
United States Dollar	**1,708**	20
New Taiwan Dollar	**309**	4
Others	**(175)**	(2)
	8,288	100

Credit Analysis

Sources of Finance

At 31st December 2004, committed loan facilities and debt securities amounted to HK$12,615 million, of which HK$3,855 million (31%) remained undrawn. In addition, the group has undrawn uncommitted facilities totalling HK$2,540 million. Sources of funds at the end of 2004 comprised:

	Available HK$M	Drawn HK$M	Undrawn HK$M
Committed facilities			
Perpetual Capital Securities	4,642	4,642	–
Fixed/Floating Rate Notes	2,000	2,000	–
Bank and other loans	5,973	2,118	3,855
	12,615	8,760	3,855
Uncommitted facilities	3,662	1,122	2,540

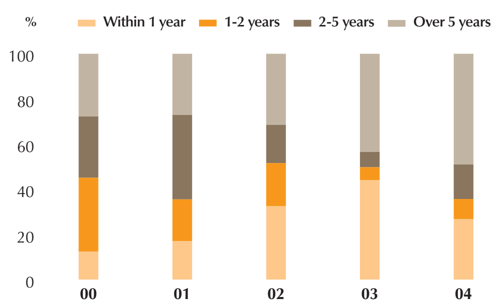
Maturity Profile and Refinancing

The group's weighted average term and cost of debt is:

	2004	2003
Weighted average term of debt	**5.8 years**	4.8 years
Weighted average term of debt (excluding Perpetuals)	**2.6 years**	2.1 years
Weighted average cost of debt	**7.6%**	6.4%
Weighted average cost of debt (excluding Perpetuals)	**1.2%**	4.7%

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



Included in the group's debt is HK$4,642 million of Perpetual Capital Securities, half of which the group can call at any time after 30th October 2006. The other half can be called at any time after 13th May 2017. As the call is at the option of the group, this debt is reported as having a life of the longer of the first call date and ten years.

The group manages refinancing risks by spreading the maturity of its facilities over a number of years so that refinancing needs are not excessive in any one year. The repayment schedule of the group's committed debt facilities is detailed below:

Debt Maturity

	2005 HK$M	2006 HK$M	2007 HK$M	2008 HK$M	beyond 2008 HK$M
Capital market debts	–	500	700	–	5,442
Bank loans	1,348	1,825	500	2,300	–
	1,348	2,325	1,200	2,300	5,442

Covenants and Credit Triggers

There are no specific covenants given by the group for its debt facilities which would require debt repayment or termination of a facility should the group's credit rating be revised by the credit rating agencies.

Swire Pacific has entered into financial covenants in respect of gearing limits and maintenance of minimum consolidated net worth, to secure funding for itself and its subsidiaries. These covenants are as set out below:

	Covenant limits	**2004**	2003
Gearing:			
Consolidated borrowed money/ adjusted consolidated net worth	≤ 2	**0.09**	0.14
Secured consolidated borrowed money/ adjusted consolidated net worth	≤ 1	–	0.01
	HK$M	**HK$M**	HK$M
Maintenance of minimum consolidated tangible net worth:			
Consolidated tangible net worth	≥ 20,000	**93,539**	73,306

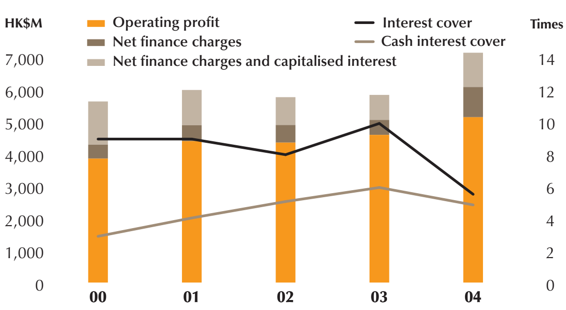
During the term of these facilities, none of the covenants was breached.

Interest Cover and Gearing

At 31st December 2004, 59% of the group's gross borrowings were on a fixed rate basis and 41% were on a floating rate basis.

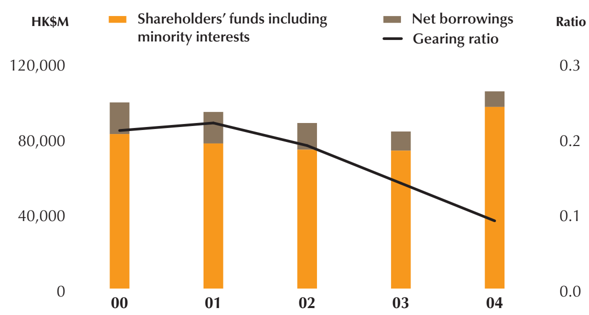
The following graphs illustrate interest cover and gearing ratios for each of the last five years. Interest cover for the year ended 31st December 2004 was 5.48 times while cash interest cover, calculated by reference to total interest charges including capitalised interest was 4.82 times. The gearing ratio was 9% at the end of 2004.

Interest cover and cash interest cover



2004 net finance charges include a one-off interest charge of HK$500 million in respect of the Taikoo Shing land premium.

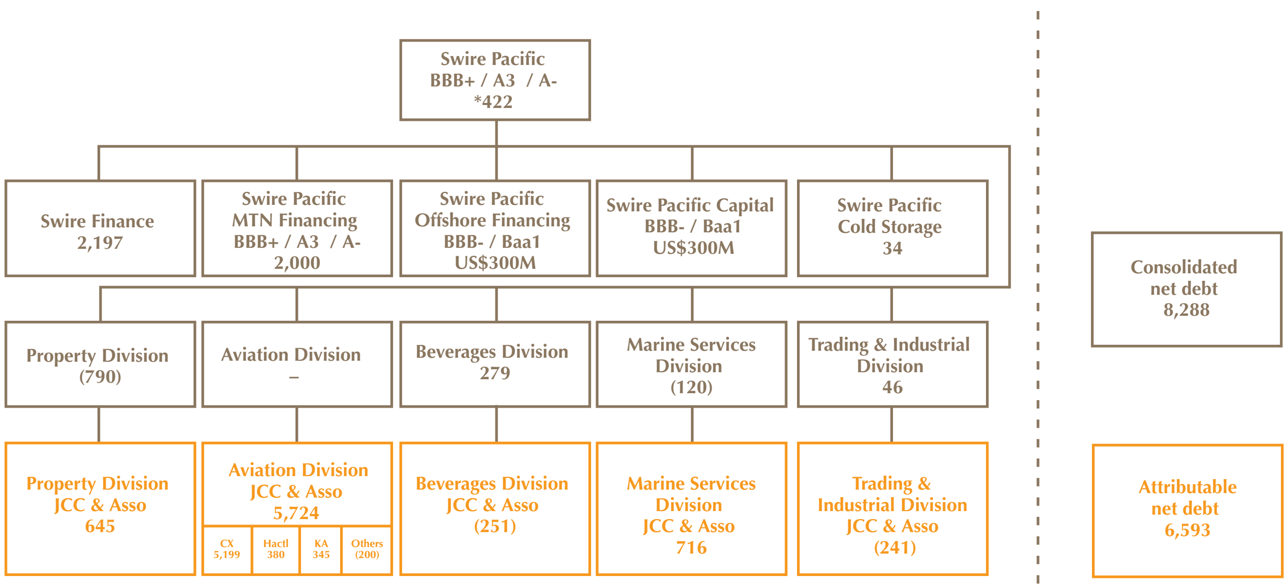
Gearing ratio



Total Financial Obligations

The chart below illustrates net debt by borrowing entity, attributable net debt in jointly controlled and associated companies ("JCC & Asso") and undertakings given to third parties.

(In HK$M except specified)



* Undertakings given to third parties.

Credit Analysis

Debt in Jointly Controlled and Associated Companies

In accordance with Hong Kong accounting standards, the group's balance sheet does not include the net debt in its jointly controlled and associated companies. These companies had the following net debt positions at the end of 2004 and 2003:

	Total net debt		Portion of net debt attributable to Swire Pacific		Debt guaranteed by Swire Pacific or its subsidiaries	
	2004 HK$M	2003 HK$M	**2004** HK$M	2003 HK$M	**2004 HK$M**	2003 HK$M
Property Division	**2,020**	2,245	**645**	697	**329**	337
Aviation Division						
Cathay Pacific	**11,187**	11,111	**5,199**	5,151	**–**	–
Hactl	**1,542**	2,076	**380**	512	**–**	–
Dragonair	**1,948**	1,601	**345**	256	**–**	–
Other Aviation Division companies	**11**	(51)	**(200)**	(93)	**8**	8
Beverages Division	**(515)**	(575)	**(251)**	(278)	**–**	–
Marine Services Division	**3,030**	2,104	**716**	665	**500**	500
Trading & Industrial Division	**(570)**	(325)	**(241)**	(124)	**–**	–
	18,653	18,186	**6,593**	6,786	**837**	845

Financial Assistance to Affiliated Companies and Their Proforma Combined Balance Sheet

Pursuant to Chapter 13 of the Listing Rules, a proforma combined balance sheet of those affiliated companies with financial assistance from the group and the group's attributable interest in those affiliated companies are presented below.

Affiliated companies comprise the group's jointly controlled and associated companies. As at 31st December 2004, the group had loans to affiliated companies totalling HK$10,382 million (before group provisions) and has given guarantees of HK$1,316 million in respect of facilities granted to affiliated companies, fnancial assistance totalling HK$11,698 milion. These amounts exceed 8% of the group's total assets as at 31st December 2004.

	31st December 2004	
	Proforma combined balance sheet	**The group's attributable interest**
	HK$M	**HK$M**
Non-current assets	**29,484**	**10,230**
Current assets	**3,821**	**1,184**
Current liabilities	**(3,202)**	**(978)**
Non-current liabilities	**(3,936)**	**(1,387)**
Minority interests	**(248)**	**(121)**
Shareholders' advances	**(26,977)**	**(10,382)**
	(1,058)	**(1,454)**