Credit Analysis

Introduction

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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.

Occasionally, the group also enters into fixed-to-floating interest-rate swaps to hedge the fair value interest-rate risk arising where it has borrowed at fixed rates in excess of its requirements.

As the group has no significant interest-bearing assets, the group's income and operating cash flows are substantially independent of changes in market interest rates.

Currency Exposure

The group operates internationally and is exposed to foreign exchange risk arising from various currency exposures. Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities, and net investments in foreign operations.

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.

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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.

Price Risk
The group is exposed to equity securities price risk because investments held by the group are classified on the consolidated balance sheet as available-for-sale investments.

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 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.

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged.

When the group enters into a derivative contract, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions is documented. At inception and on an ongoing basis the derivatives that are used in hedging transactions are assessed to ensure that they are highly effective.

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the profit and loss account, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the profit and loss account.

Certain economic hedges that the group entered into prior to the release of HKAS 39, do not meet its hedge recognition criteria. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the profit and loss account.

Derivative transactions entered into by Swire Pacific and its subsidiary companies, and outstanding at the year end are summarised and set out in note 23 to the accounts on page 111 by their respective types.

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 2005 the Company's long-term credit ratings were A3 from Moody's, A- 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:

	2001	2002	2003	2004 (restated)	**2005**
Operating margin					
– per accounts	33.1%	32.5%	30.1%	117.6%	**107.7%**
– underlying				31.2%	**42.3%**
EBIT/net interest					
– per accounts	5.5	6.5	7.9	21.2	**34.2**
– underlying				6.7	**15.0**
FFO+net finance charges/net interest					
– per accounts	5.8	6.3	7.4	6.7	**16.0**
– underlying				6.6	**15.2**
FFO/net debt					
– per accounts	34.7%	34.7%	52.1%	76.5%	**177.9%**
– underlying				75.4%	**168.9%**
Net debt/net capital					
– per accounts	17.8%	16.1%	12.2%	8.9%	**5.1%**
– underlying				8.1%	**4.6%**
Rental income/net interest	3.4	4.2	4.3	2.8	**5.2**

Operating margin = Operating profit before depreciation and amortisation/turnover
EBIT = Earnings before interest and taxes
FFO (Funds from operations) = Operating profit less net finance charges less change in fair value of investment properties less tax paid plus depreciation plus profit or loss on sale of property, plant and equipment plus dividend from jointly controlled companies and associated companies plus non-cash items
Net capital = Equity attributable to the Company's shareholders plus minority interests plus net debt
Net interest is stated before deducting capitalised interest.
Underlying credit ratios are calculated by excluding the impact of adopting HKAS 40 and HKAS-Int 21 on investment properties and income taxes.

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Cash Flow Summary

	2005 HK$M	2004 (restated) HK$M
Net cash generated by businesses and investments		
Cash generated from operations	**5,030**	6,064
Payment of land premium	**(1,531)**	(2,027)
Cash from asset realisations*	**4,165**	2,472
Dividends received	**2,152**	2,239
Capital expenditure and investments**	**(2,338)**	(2,658)
Tax and net interest paid	**(785)**	(1,368)
	6,693	4,722
Cash paid to shareholders and net funding by external debt		
Dividends paid	**(3,686)**	(2,549)
Decrease in borrowings	**(2,297)**	(816)
Repayment of capital contribution to minority interest	**(314)**	(282)
	(6,297)	(3,647)
Increase in cash and cash equivalents	**396**	1,075

* Includes proceeds from disposals of property, plant and equipment, investment properties, and the sale of shareholdings in a subsidiary company, sale of shareholdings in and repayments of loans by associated and jointly controlled companies.
** Includes additions to property, plant and equipment, investment properties, leasehold land and land use rights, intangible assets, purchase of shareholdings in and loans to associated and jointly controlled companies.

Cash generated from operations was derived largely from the unit closings in The Carbonell and Jade Residences in Miami.

Cash from asset realisations was derived mainly from HK$2,897 million generated from the sale of the group's 17.6% shareholding in Modern Terminals Limited in August 2005. Other receipts included the proceeds received from the sale of residential properties in The Albany and Ocean Shores and the sale of a 7.5% interest in Shekou Container Terminals.

Principal capital expenditure and investments include the construction costs for Three Pacific Place, the purchase of a 20% interest in Richly Leader Limited which acquired the PCCW Tower, the acquisition of an additional 7.5% shareholding interest in the Shekou Container Terminals Phase II and the purchase of additional offshore support vessels.

Changes in Financing

On 6th October 2005, a committed revolving credit facility of HK$300 million was renewed on the same terms and conditions. In December, Swire Coca-Cola USA renewed its committed revolving credit facility, increasing the facility to US$50 million.

The major debt repayments during the year included a US$100 million revolving credit loan for Swire Pacific Holdings Inc. repaid in April and a US$93 million term loan, for The Carbonell condominium project in the USA, repaid in December 2005. Other repayments related to funds drawn from syndicated and bilateral revolving credit loans, funded by cash from operations and asset realisations.

Surplus Funds

The group has surplus funds of HK$2,000 million which consists of short-term deposits and bank balances and certain available-for-sale investments as at 31st December 2005, compared to HK$1,593 million as at 31st December 2004.

Currency Profile

An analysis of net debt by currency at 31st December 2005 is shown below:

Currency	Total HK$M	%
Hong Kong Dollar	**4,525**	83
United States Dollar	**1,207**	22
New Taiwan Dollar	**96**	2
Others	**(380)**	(7)
Total	**5,448**	100

Sources of Finance

At 31st December 2005, committed loan facilities and debt securities net of other borrowing costs amounted to HK$11,190 million, of which HK$3,966 million (35%) remained undrawn. In addition, the group has undrawn uncommitted facilities totalling HK$3,545 million. Sources of funds at the end of 2005 comprised:

	Available HK$M	Drawn HK$M	Undrawn HK$M
Committed facilities			
Perpetual Capital Securities	4,633	4,633	–
Fixed/Floating Rate Notes	1,975	1,975	–
Bank and other loans	4,582	616	3,966
Total committed facilities	11,190	7,224	3,966
Uncommitted facilities	3,769	224*	3,545

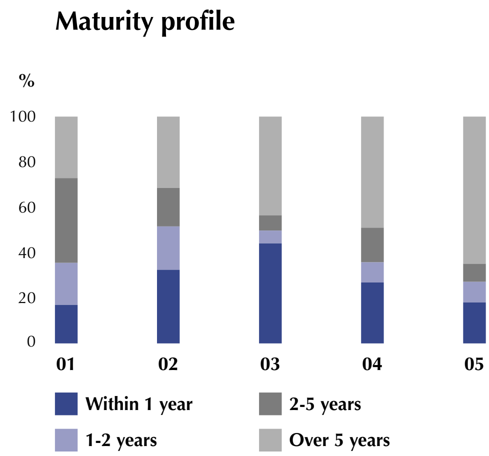
*Reflects set-off of security deposits against borrowings of HK$43 million

Maturity Profile and Refinancing

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

	2005	2004
Weighted average term of debt	**5.6 years**	5.8 years
Weighted average term of debt (excluding Perpetuals)	**2.0 years**	2.6 years
Weighted average cost of debt	**7.1%**	7.6%
Weighted average cost of debt (excluding Perpetuals)	**3.6%**	1.2%

The maturity profile of the group's gross borrowings net of other borrowing costs and security deposits at the end of each of the last five years is set out below:



Included in the group's debt is HK$4,633 million of Perpetual Capital Securities, HK$2,319 million of which the group can call at any time after 30th October 2006. The other HK$2,314 million 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

	2006 HK$M	2007 HK$M	2008 HK$M	2009 HK$M	beyond 2009 HK$M
Capital market debts	500	677	–	599	4,833
Bank loans	1,786	500	2,295	–	–
	2,286	1,177	2,295	599	4,833

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.

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These covenants are as set out below:

	Covenant limits	2005	2004 (restated)
Gearing:			
Consolidated borrowed money/ adjusted consolidated net worth	≤ 200%	**5%**	10%
Secured consolidated borrowed money/ adjusted consolidated net worth	≤ 100%	**–**	–
	HK$M	**HK$M**	HK$M
Maintenance of minimum consolidated tangible net worth:			
Consolidated tangible net worth	≥ 20,000	**100,772**	84,568

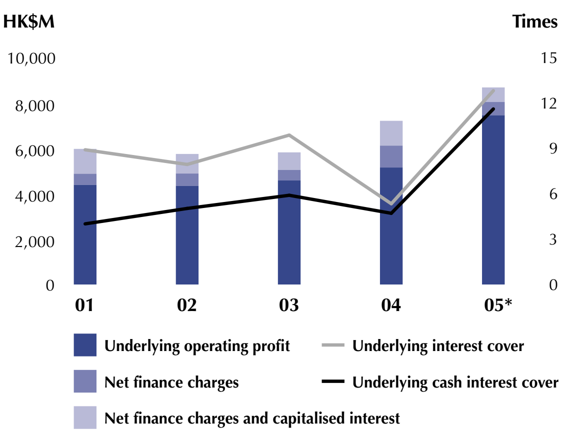
During the term of these facilities, none of the covenants were breached.

Interest Cover and Gearing

At 31st December 2005, 82% of the group's gross borrowings were on a fixed rate basis and 18% were on a floating rate basis.

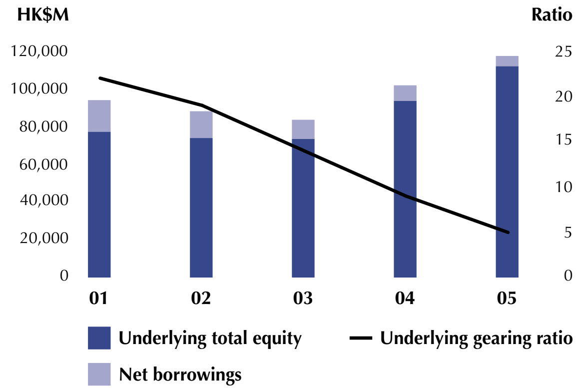
The following graphs illustrate the underlying interest cover and the underlying gearing ratios for each of the last five years.

Interest cover and cash interest cover



* 2005 net finance charges include interest charge of HK$158 million (2004: HK$500 million) in respect of the Taikoo Shing land premium dispute.

Gearing ratio



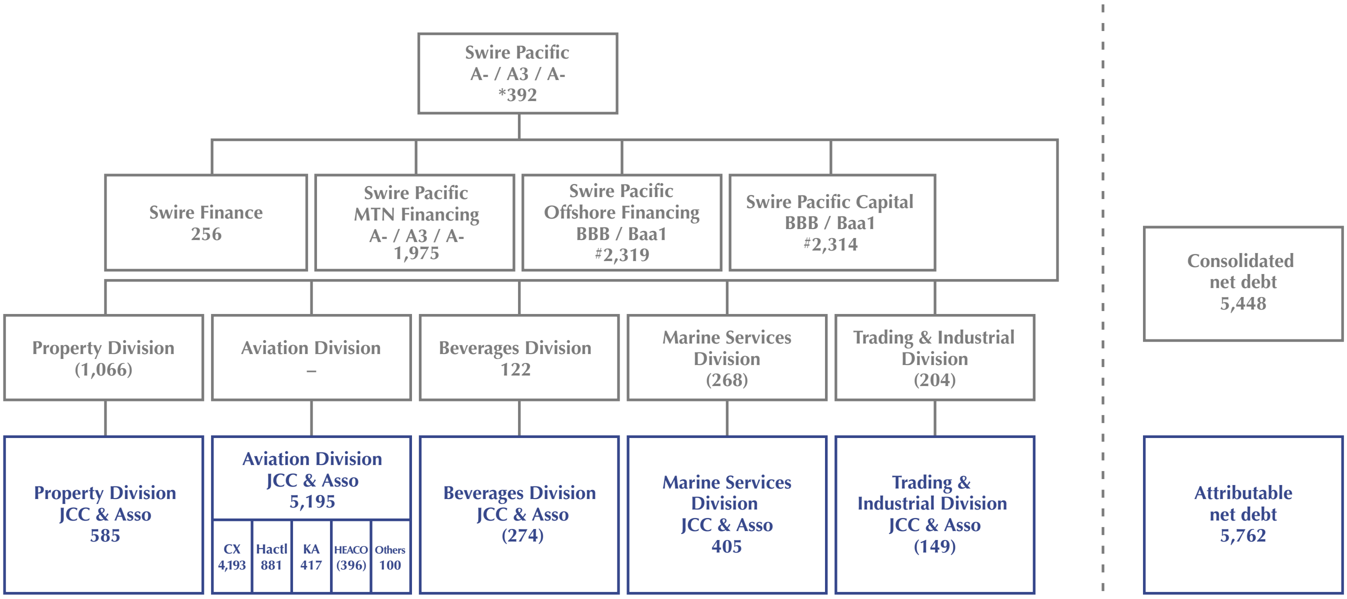
	Note	2005	2004 (restated)
Gearing ratio	1		
Per accounts		**5%**	10%
Underlying		**5%**	9%
Interest cover – times	2		
Per accounts		**34.09**	21.72
Underlying		**12.82**	5.34
Cash interest cover – times	3		
Per accounts		**30.86**	19.18
Underlying		**11.61**	4.71

Notes:
1. Gearing represents the ratio of net borrowings to total equity (including minority interests).
2. Interest cover is calculated by dividing operating profit by net finance charges.
3. Cash interest cover is calculated by dividing operating profit by net finance charges and capitalised interest.
4. The calculation of underlying operating profit and underlying total equity is shown in the Financial Review section on pages 35 to 37.
5. Figures for 2001 to 2003 have not been restated.

Swire Pacific Group – 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
# Represents the US$300 million perpetual capital securities

Debt in Jointly Controlled and Associated Companies

In accordance with Hong Kong Financial Reporting Standards, the group's balance sheet does not include the net debt of its jointly controlled and associated companies. These companies had the following net debt positions at the end of 2005 and 2004. If the attributable position of the net debt in jointly controlled and associated companies were to be added to the group's net debt, gearing would rise to 11% and underlying gearing would rise to 10%.

	Total net debt		Portion of net debt attributable to Swire Pacific		Debt guaranteed by Swire Pacific or its subsidiaries	
	2005 HK$M	2004 HK$M	**2005 HK$M**	2004 HK$M	**2005 HK$M**	2004 HK$M
Property Division	**1,763**	2,020	**585**	645	**315**	329
Aviation Division						
Cathay Pacific	**9,050**	11,187	**4,193**	5,199	**–**	–
Hactl	**3,578**	1,542	**881**	380	**–**	–
Dragonair	**2,352**	1,948	**417**	345	**–**	–
HAECO	**(877)**	(576)	**(396)**	(260)	**–**	–
Other Aviation Division companies	**623**	587	**100**	60	**6**	8
Beverages Division	**(538)**	(515)	**(274)**	(251)	**–**	–
Marine Services Division	**707**	3,030	**405**	716	**500**	500
Trading & Industrial Division	**(301)**	(570)	**(149)**	(241)	**–**	–
	16,357	18,653	**5,762**	6,593	**821**	837

Credit Analysis

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 2005, the group had loans to affiliated companies totalling HK$10,263 million (before group provisions) and has given guarantees of HK$1,286 million in respect of facilities granted to affiliated companies, financial assistance totalling HK$11,549 million. These amounts exceed 8% of the group's total assets as at 31st December 2005.

	31st December 2005	
	Proforma combined balance sheet	**The group's attributable interest**
	HK$M	**HK$M**
Non-current assets	**24,680**	**9,188**
Current assets	**3,122**	**974**
Current liabilities	**(3,543)**	**(1,014)**
Non-current liabilities	**(2,715)**	**(1,103)**
Minority interests	**(249)**	**(121)**
Shareholders' advances	**(26,612)**	**(10,263)**
	(5,317)	**(2,339)**