Management's Discussion and Analysis of Financial Condition and Results of Operations

General Description of the Group's Business

The Group is the third largest cruise line in the world by lower berths, with a combined fleet of 21 ships and about 32,300 lower berths in service with an additional 3 ships and 10,780 lower berths due to be delivered by 2010. The Group operates under three principal brand names, Star Cruises (including Cruise Ferries), Norwegian Cruise Line (including NCL America) and Orient Lines.

Star Cruises (including Cruise Ferries) operates seven ships offering various cruise itineraries and calls destinations primarily in the Asia Pacific region. Norwegian Cruise Line (including NCL America) and Orient Lines operate fourteen cruise ships offering a wide selection of itineraries in Antarctica, Bermuda, Alaska, the Caribbean, Europe, the Mediterranean, Hawaii, Central and South America. In April 2006, NCL America took delivery of m.v. Pride of Hawaii on its inter-island Hawaii itineraries and in November 2006, Norwegian Cruise Line took delivery of m.v. Norwegian Pearl which is presently sailing to Western and Southern Caribbean.

Terminology

Capacity Days represent double occupancy per cabin multiplied by the number of cruise days for the period.

Net Revenue Yield represents total revenues less commissions, transportation and other expenses, and onboard and other expenses per Capacity Day. The Group utilises Net Revenue Yield to manage its business on a day-to-day basis and believes that it is the most relevant measure of the pricing performance and is commonly used in the cruise industry to measure pricing performance.

Ship Operating Expenses represent operating expenses excluding commissions, transportation and other expenses and onboard and other expenses.

Passenger Cruise Days represent the number of passengers carried for the period, multiplied by the number of days in their respective cruises.

Occupancy Percentage, in accordance with cruise industry practice, represents the ratio of Passenger Cruise Days to Capacity Days. A percentage in excess of 100% indicates that three or more passengers occupied some cabins.

Overview

Total revenues

Total revenues of the Group consist of the following:

Revenues from the Group's cruise and cruise-related activities can be further categorised as "passenger ticket revenues" and "onboard and other revenues". Passenger ticket 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 onboard entertainment, and include payments for service charges and, where relevant, air and land transportation to and from the ship. Revenues from passenger ticket sales are generally collected from passengers prior to their departure on the cruise, usually at the time of booking the cruise.

Onboard and other 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, revenues from onboard retail sales and passenger baggage and cancellation insurance. Onboard 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.

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 the Southeast 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 the 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.

Operating expenses
Operating expenses consist of commissions, transportation and other expenses, onboard and other expenses, payroll and related expenses, fuel, food costs and other operating expenses.

Commissions, transportation and other expenses consist of those amounts directly associated with passenger ticket revenues. These amounts include travel agent commissions, air and other transportation expenses, credit card fees and certain port expenses.

Onboard and other expenses consist of direct costs that are incurred primarily in connection with onboard and other revenues. These costs are incurred in connection with gaming, shore excursions, bar sales, land packages and sales of travel protection for vacation packages.

Payroll and related expenses represent the cost of wages and benefits for shipboard employees.

Fuel expenses include fuel costs, the impact of fuel hedges and fuel delivery costs.

Food expenses consist of food costs for passengers and crew, which typically vary according to the number of passengers onboard a particular ship.

Other operating expenses consist of costs such as repair and maintenance, ship insurance, ship charter costs and other ship costs.

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 expenses
Depreciation and amortisation expenses consist primarily of depreciation of ships and shoreside assets. 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.

Year ended 31 December 2006 ("Year 2006") compared with year ended 31 December 2005 ("Year 2005")

Turnover
The Group's total revenue for the Year 2006 was US$2,343.1 million, increased by 19.1% from US$1,967.4 million for the Year 2005. Total capacity days for the Year 2006 was 10,403,738 compared to 8,823,133 for the Year 2005. Net revenue increased by 15.1% primarily driven by a 17.9% increase in capacity which was partially offset by a 2.4% decrease in net revenue yield. The capacity increase in the Year 2006 was mainly due to the addition of m.v. Pride of America, m.v. Norwegian Jewel, m.v. Pride of Hawaii and m.v. Norwegian Pearl, which entered service in June 2005, August 2005, May 2006 and November 2006, respectively. Occupancy level for the Year 2006 was at 100.9% compared with 103.8% in the Year 2005.

Star Cruises Asia operated with 22.5% higher capacity in the Year 2006 compared to the Year 2005 mainly due to the addition of m.v. SuperStar Libra which commenced operation in September 2005. Net revenue was 4.4% higher as a result of the higher capacity which was partially offset by a 13.8% lower net revenue yield. The lower net revenue yield for the Year 2006 was mainly a result of the lower than average occupancy of m.v. SuperStar Libra in both her first inaugural seasons in India and Eastern Mediterranean. Occupancy level in Star Cruises Asia operations for the Year 2006 was down to 83.6% from 93.5% for the Year 2005.

Turnover *(continued)*
NCLC Group recorded an increase in capacity days of 16.9% for the Year 2006 compared to the Year 2005. The increase in capacity was primarily due to the additions of m.v. Pride of America, m.v. Norwegian Jewel, m.v. Pride of Hawaii and m.v. Norwegian Pearl which entered service in June 2005, August 2005, May 2006 and November 2006, respectively, partially offset by the departure of m.v. SuperStar Libra to Star Cruises upon expiration of its charter agreement in August 2005. Net revenue increased 17.7% in the Year 2006 compared to the Year 2005 primarily due to a 16.9% capacity increase and to a lesser extent, a 0.7% net revenue yield increase. The increase in net revenue yield was primarily due to a slight increase in onboard and other revenues while passenger ticket prices remained relatively unchanged. The increase in net onboard and other revenues was due to the increase in amounts spent per passenger primarily due to revenues related to Polynesian Adventure Tours, Inc., a tour bus operator in Hawaii, which was acquired in November 2004. Although passenger ticket prices for NCLC's international-flagged fleet slightly increased, this increase was partially offset by downward pricing pressure related to NCLC's inter-island cruises in Hawaii. Occupancy level for NCLC Group for the Year 2006 decreased to 105.1% from 106.1% for the Year 2005.

Costs and expenses
Total costs and expenses before interest and non-operating items for the Year 2006 amounted to US$2,278.2 million compared with US$1,822.8 million for the Year 2005, an increase of US$455.4 million.

Operating expenses increased by US$361.4 million to US$1,728.5 million for the Year 2006 from US$1,367.1 million for the Year 2005. Ship operating expenses was 23.8% higher compared with the Year 2005 primarily due to increases in both payroll and related expenses and fuel costs. The higher payroll and related expenses were mainly related to the U.S. crew deployed for inter-island cruises in Hawaii which began operations in June 2004 and expanded to three ships with the introduction of m.v. Pride of America at the end of second quarter of 2005 and m.v. Pride of Hawaii in May 2006. Average fuel prices in the Year 2006 increased approximately 21.7% compared with the Year 2005. Fuel costs accounted for approximately 19% of ship operating expenses in the Year 2006 compared with 17% in the Year 2005. On a per capacity day basis, ship operating expenses were 5.0% higher compared with the Year 2005. The abovementioned increases in payroll and related expenses and fuel costs represented nearly 2.9 and 2.8 percentage points, respectively, of the increase in the ship operating expenses per capacity day.

Selling, general and administrative expenses ("SG&A") increased by US$25.0 million to US$303.2 million for the Year 2006 from US$278.2 million for the Year 2005. The increase in SG&A expenses was primarily attributable to increases in shoreside expenses for NCLC Group reservation centers partially offset by other operating efficiencies. SG&A expenses per capacity day decreased by 7.6% compared with the Year 2005 mainly due to the benefits of the economies of scale achieved from the capacity increase.

Depreciation and amortisation expenses increased by US$39.9 million to US$215.9 million for the Year 2006 compared with US$176.0 million for the Year 2005. The increase in depreciation and amortisation was primarily due to additions of m.v. Pride of America, m.v. Norwegian Jewel, m.v. Pride of Hawaii and m.v. Norwegian Pearl.

An impairment loss of US$30.6 million in respect of a ship and Orient Lines trade name was recorded in the Year 2006 following the completion of the annual impairment review. A net impairment loss of US$1.4 million was recorded in the Year 2005 arising from a US$2.7 million impairment loss on the disposal of a catamaran which was partially offset by a US$1.3 million reversal of impairment loss on s/s Norway following the completion of her disposal in January 2006.

Operating profit
As a result of the above factors, operating profit decreased US$79.6 million to US$64.9 million for the Year 2006 from US$144.5 million of operating profit for the Year 2005.

Non-operating income / (expense)
Non-operating expense increased by US$96.9 million to US$220.9 million for the Year 2006 compared with US$124.0 million for the Year 2005. The increase was mainly due to the net effect of the following items:

(a) Interest expense, net of interest income and capitalised interest increased by US$46.9 million to US$194.3 million for the Year 2006 compared with US$147.4 million for the Year 2005 as a result of both higher average outstanding debts and interest rates. Capitalised interest decreased to US$7.5 million for the Year 2006 from US$18.4 million for the Year 2005 mainly due to a lower average level of investment in ships under construction as certain ships have been delivered during the year.

(b) The Group recorded a translation loss on Euro denominated loans of US$35.1 million in the Year 2006 compared to a gain of US$29.4 million in the Year 2005 as a result of the strengthening of Euro against the USD in the Year 2006.

Non-operating income / (expense) *(continued)*

(c) During the Year 2006, the Group wrote off its non-cruise investment in Orangestar Investment Holdings Pte. Ltd. of US$10.3 million.

(d) During the Year 2006, the Group recorded a compensation income of US$7.3 million in connection with a settlement agreement for a portion of the claims against the builder of m.v. Pride of America.

(e) During the Year 2006, the Group recorded gains on disposal of m.v. Norwegian Crown and a subsidiary of US$16.7 million and US$1.3 million, respectively.

Profit / (Loss) before taxation

Loss before taxation for the Year 2006 was US$156.1 million compared to profit before taxation of US$20.5 million for the Year 2005.

Taxation

The Group incurred taxation expenses of US$0.1 million for the Year 2006 compared with US$2.6 million for the Year 2005. For the Year 2006, NCLC Group recorded a tax benefit of US$1.2 million due to the reversal of over provision of its previous years' federal and state income tax on U.S. sourced non-incidental activities of its foreign flagged operations which was partially offset by US$0.4 million corporate tax provision. For the Year 2006, Star Cruises Asia recorded a tax expense of US$0.9 million, net of reversal of deferred tax liabilities, compared with US$1.5 million for the Year 2005.

Net profit / (loss) attributable to shareholders

The Group recorded a net loss attributable to shareholders of US$156.2 million for the Year 2006 compared with a net profit attributable to shareholders of US$17.9 million for the Year 2005.

Liquidity and capital resources

Sources and uses of funds

The majority of the Group's cash and cash equivalents are held in U.S. dollars. For the Year 2006, cash and cash equivalents (net of bank overdraft) increased to US$467.2 million from US$187.7 million as at 31 December 2005. The increase of US$279.5 million in cash and cash equivalents (net of bank overdraft) was mainly due to the net effect of the following items:

(a) The Group's business provided US$235.5 million of net cash from operations for the Year 2006 compared to US$220.0 million for the Year 2005. The increase in net cash generated from operations was primarily due to changes of operating assets and liabilities during the Year 2006 compared with the Year 2005, partially offset by an increase in interest payment and losses during the Year 2006.

(b) The Group's capital expenditure was approximately US$828.5 million during the Year 2006. Approximately US$779.3 million of the capital expenditure was related to capacity expansion and the remaining was vessel refurbishments and onboard assets. In the Year 2006, the Group received net proceeds of approximately US$122.8 million from the disposals of s/s Norway and m.v. Norwegian Crown.

(c) The Group used approximately US$5.9 million to acquire an additional equity interest in Resorts World at Sentosa Pte. Ltd.

(d) The Group repaid US$597.7 million of its long-term bank loans during the Year 2006 and drewdown a total of US$974.6 million under the existing bank loans to finance its ships construction, deliveries of m.v. Pride of Hawaii and m.v. Norwegian Pearl and for general working capital purposes. In the Year 2006, the Group also paid loan arrangement fees in the amount of US$18.3 million.

(e) In December 2006, Star Cruises Asia refinanced the outstanding balance of the SuperStar Virgo loan, US$450 million term loan and US$400 million reducing revolving credit facility through a drawndown of US$500 million term loan. In December 2006, NCLC Group refinanced the outstanding balance of Norwegian Sun and Norwegian Dawn term loans through a drawdown of US$610 million revolver loan. These refinancing activities have resulted in the net proceeds of approximately US$43.3 million to the Group.

Liquidity and capital resources *(continued)*

Sources and uses of funds (continued)

(f) During the Year 2006, the Group issued approximately 1,484.1 million rights shares of US$0.10 each in proportion of 7 new ordinary shares for every 25 existing ordinary shares held pursuant to a rights issue at the subscription price of HK$1.08 (US$0.1388). The net proceeds from the rights issues are being used for part funding for the construction of vessels. In addition, the Group received excess cash of approximately US$98.8 million from the rights issue application which was refunded in January 2007.

(g) Restricted cash decreased by US$45.3 million during the Year 2006 to US$2.9 million as at 31 December 2006. In May 2006, the cash collateral requirements imposed by credit card processors were lifted and these requirements can be reinstated at the credit card processors' discretion.

Gearing ratio

The gearing ratio as at 31 December 2006 was 0.56 times, a slight increase, from 0.54 times as at 31 December 2005. The calculation of gearing ratio is based on total outstanding borrowings (including the equity component of the convertible bonds) of the Group of approximately US$3.42 billion (2005: US$2.94 billion) divided by the total assets at the end of the year of approximately US$6.14 billion (2005: US$5.41 billion).

Contingent liabilities

Details of the Group's contingent liabilities as at 31 December 2006 are disclosed in note 34 to the consolidated financial statements.

Future commitments and funding sources

As at 31 December 2006, the Group had approximately US$3.0 billion of bank borrowings, US$180 million of convertible bonds (including the equity component of the convertible bonds) and US$250 million unsecured senior notes. Details of the borrowings and a schedule setting out the repayments of such borrowings are disclosed in note 26 to the consolidated financial statements. The outstanding bank borrowings are secured by legal charges over vessels including fixed and floating charges over assets of the Group of US$4.6 billion.

The Group has three ships under construction for additional capacity of approximately 10,780 berths with scheduled deliveries in the fourth quarter of 2007, the fourth quarter of 2009 and the second quarter of 2010. The aggregate cost of the ships under construction and on firm order is approximately US$2.6 billion, of which the Group has paid US$0.2 billion (based on the exchange rate for Euro to USD at 31 December 2006).

As at 31 December 2006, the Group's liquidity was US$922.1 million consisting of US$468.8 million in cash and cash equivalents and US$453.3 million available under the Group's existing credit facilities. In addition, the Group has specific funding for the three ships under construction for the equivalent of approximately US$2.2 billion (based on the exchange rate for Euro to USD at 31 December 2006).

Prospects

Since the start of what has been characterised as the industry's "wave period", NCLC Group has seen a strong response to its new marketing campaign and an improvement in the pace of bookings following weak bookings during the fourth quarter of 2006. On a capacity adjusted basis, NCLC Group is significantly ahead of last year in terms of volumes booked for 2007 during wave period. Demand for NCLC Group's summer programmes continues to be solid, particularly its European deployment, and demand in the Caribbean has shown modest improvement from the weak fourth quarter of 2006. As a result, NCLC Group has been selectively increasing prices on certain sailings and itineraries since the start of wave. Because of a large year over year increase in capacity in its inter-island Hawaii cruises, and substantially increased competitive capacity on other Hawaii itineraries, NCLC Group continues to experience strong downward pricing pressures in this trade. It is clear that the addition of capacity - both NCLC's and their foreign flag competitors - has outstripped demand in the short term, and NCLC Group is not achieving the pricing needed to support its higher US flag operating costs. Based upon these circumstances in Hawaii and a weaker Caribbean than last year, more notably on NCLC Group's older ships, NCLC Group expects net revenue yield to be negative for the first half of 2007 compared to the first half of 2006.

In Asia Pacific, m.v. SuperStar Aquarius will make her debut in Hong Kong in June 2007 where she will commence daily international water cruises as well as offering a series of destination cruises to China. Currently, she is sailing as m.v. Norwegian Wind under the NCL brand.

Human Resources

As at 31 December 2006, the Group had approximately 20,600 employees, consisting of approximately 17,600 (or 85%) ship-based officers and crew as well as approximately 3,000 (or 15%) staff employed in the various world-wide offices of the Group. The Group provides competitive salaries, benefits and incentives including provident fund schemes and medical insurance schemes for its staff. In addition, the Group has adopted a Post-listing Employees' Share Option Scheme under which options may be granted to eligible employees of the Group entitling them to subscribe for shares in the share capital of the Company.

For the year ended 31 December 2006, there is no significant change in the remuneration policies, bonus, share options scheme and training schemes for the Group.

Financial Instruments

General

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 income statement.

The Group is exposed to market risk attributable to changes in interest rates, foreign currency exchange rates and fuel prices. The Group minimises these risks through a combination of the normal operating and financing activities and through the use of derivative financial instruments. The financial impacts of these hedging instruments are primarily offset by corresponding changes in the underlying exposures being hedged. The Group achieves this by closely matching the amounts, terms and conditions of the derivative instruments with the underlying risk being hedged.

Foreign currency exchange rate risk

The Group's exposure to foreign currency exchange rate risk relates primarily to the ship building contracts and the Euro-denominated debt. The ship contracts are denominated in Euro and the associated debt agreements are denominated in either the U.S. dollar or Euro with certain conversion options. If denominated in Euro, the principal and interest payments for the debt will be payable in Euro, and will be subject to the exchange rate of the Euro at the time these payments are due. From time to time, the Group enters into foreign currency forward contracts and / or option contracts for these payments. As at 31 December 2006, the Group had approximately €598 million or approximately US$789 million of the total outstanding loan which is denominated in Euros.

The Group is also exposed to foreign currency exchange rate fluctuations on the U.S. dollar value of the Group's foreign currency denominated forecasted transactions. The Group's principal net foreign currency exposure relates to the Singapore dollar, the Hong Kong dollar, and the Euro. To manage this exposure, the Group takes advantage of any natural offsets of the Group's foreign currency revenues and expenses and from time to time enters into foreign currency forward contracts and / or option contracts for a portion of the remaining exposure related to these forecasted transactions. As at 31 December 2006, the Group was a party to certain forward contracts with a total outstanding notional amount of US$49.1 million in respect of the Singapore dollars. These forward contracts have remaining lives ranging from 1 to 5 years.

Interest rate risk

The majority 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 rate debt based on its view of interest rate movement. As at 31 December 2006, the Group had interest rate swaps on debts with a total outstanding notional amount of US$263.3 million with remaining lives ranging from 1 to 5 years. In addition, the Group has a series of 5.5% capped USD LIBOR-in-arrears interest rate swaps with a total outstanding notional amount of approximately US$66.2 million to limit its exposure to fluctuations movements if the London Interbank Offer Rate ("LIBOR") rate moves beyond the cap level of 5.5% with the remaining lives of 2 years. With these interest rate swaps in place and the conversion of certain portion of the borrowing from LIBOR-based rate to a fixed rate, as at 31 December 2006, 41% of the Group's debts was fixed and the remaining 59% was floating.

Fuel price risk

The Group's exposure to market risk for changes in fuel prices relates to the consumption of fuel on the ships. Fuel costs, as a percentage of the total revenues, was approximately 8.6% in 2006 and 7.4% in 2005. The Group uses fuel hedging agreements to mitigate the financial impact of fluctuations in fuel prices. As at 31 December 2006, the Group had fuel swap agreements to pay fixed prices for fuel with an aggregate outstanding notional amount of approximately US$18.9 million, maturing by June 2007.