Aviation Division

The Aviation Division comprises significant investments in associated companies, including the Cathay Pacific group (which consolidated Dragonair as a wholly owned subsidiary from 1st October 2006), the Hong Kong Aircraft Engineering group and Hong Kong Air Cargo Terminals. Cathay Pacific and HAECO are listed on the Hong Kong Stock Exchange. Dragonair provides passenger and freighter services to destinations primarily in Mainland China. Other companies provide cargo services and aviation-related services including flight catering, ramp and cargo handling.

The Cathay Pacific group now operates a total of 149 aircraft, signifying a new era of expansion.

	2006 HK$M	2005 HK$M
Profit on shareholding realignment of Dragonair and Cathay Pacific	**1,334**	–
Share of post-tax profits from associated companies		
Cathay Pacific group *	**1,681**	1,418
Hong Kong Dragon Airlines	**19**	43
Hong Kong Aircraft Engineering group	**379**	279
Hong Kong Air Cargo Terminals	**288**	283
	2,367	2,023
Attributable profit	**3,605**	1,928

Turnover of these associated companies at entity level is:

	Turnover (100%) 2006 HK$M	Turnover (100%) 2005 HK$M
Cathay Pacific group	**60,783**	50,909
Hong Kong Aircraft Engineering group	**3,844**	3,121
Hong Kong Air Cargo Terminals	**3,081**	2,939

Swire Pacific's Aviation Division includes the following associated companies:

	Shareholding of group companies at year end			
	Direct or by Swire Aviation**	By Cathay Pacific group	Total	Swire Pacific effective interest
Cathay Pacific Airways	40.0%	–	40.0%	40.0%
Hong Kong Dragon Airlines	–	100.0%	100.0%	40.0%
Hong Kong Aircraft Engineering Co	32.7%	27.4%	60.1%	43.6%
Hong Kong Air Cargo Terminals **	30.0%	10.0%	40.0%	20.0%

* These figures do not include Cathay Pacific's share of profits from the Hong Kong Aircraft Engineering group and Dragonair, a subsidiary of Cathay Pacific with effect from 1st October 2006, which have been included in the attributable figures for those companies.

** Cathay Pacific accounts for its shareholding in Hong Kong Air Cargo Terminals as an investment interest and consequently the group does not include this holding in its effective interest. Swire Aviation is a 66.7% held subsidiary company of Swire Pacific.


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Operating Statistics

Key Operating Highlights

		Cathay Pacific* and Dragonair	Cathay Pacific		
		2006	**2006**	2005	**Change**
Available tonne kilometres ("ATK")	Million	**19,684**	**18,866**	17,751	**+6.3%**
Available seat kilometres ("ASK")	Million	**91,769**	**89,118**	82,766	**+7.7%**
Revenue passenger kilometres ("RPK")	Million	**72,939**	**71,172**	65,110	**+9.3%**
Revenue passengers carried	'000	**18,097**	**16,728**	15,438	**+8.4%**
Passenger load factor	%	**79.5**	**79.9**	78.7	**+1.2% pts**
Passenger yield	HK cents	**48.0**	**47.0**	46.3	**+1.5%**
Cargo carried	'000 tonnes	**1,308**	**1,199**	1,118	**+7.2%**
Cargo and mail load factor	%	**68.6**	**68.3**	67.0	**+1.3% pts**
Cargo and mail yield	HK$	**1.70**	**1.69**	1.75	**-3.4%**
Cost per ATK	HK$	**2.23**	**2.21**	2.19	**+0.9%**
Cost per ATK without fuel	HK$	**1.57**	**1.53**	1.55	**-1.3%**
Aircraft utilisation	Hours per day	**12.5**	**12.8**	12.6	**+1.6%**
On-time performance	%	**85.2**	**85.9**	86.1	**-0.2% pts**

* Consolidated operating statistics include Dragonair's operation from 1st October 2006.

2006 OVERVIEW

The benefit of strong demand across the industry was partially impacted by consistently high fuel prices and the division reported 17% profit growth, excluding the profit arising from the shareholding realignment of Dragonair and Cathay Pacific.

On 28th September Dragonair became a wholly owned subsidiary of Cathay Pacific following a shareholding realignment involving Cathay Pacific, Air China, CNAC, CITIC and Swire Pacific.

As part of the realignment, Cathay Pacific increased its shareholding in Air China to 17.3%, Air China purchased 17.5% of Cathay Pacific and Swire Pacific's interest in Cathay Pacific reduced to 40%. A gain of HK$1.3 billion has been recognised from this transaction primarily attributable to the dilution of Swire Pacific's interest in Cathay Pacific.

The synergies and new business opportunities that arise from linking Cathay Pacific's international network with Dragonair's extensive Mainland services will bring benefits to both carriers and their customers.

Cathay Pacific Airways

The Cathay Pacific group, celebrating its 60th anniversary as Hong Kong's airline, made a consolidated profit of HK$4,088 million in 2006, an increase of 24% from HK$3,298 million in 2005.

Record passenger numbers and freight volumes contributed to a 13.8% increase in turnover from 2005. Continuing high fuel prices with total net fuel cost 10.9% higher than the previous year, partially offset the benefits of the increased turnover.

Passenger Services

Cathay Pacific achieved its highest ever passenger revenue with record passenger numbers and an average load factor of 79.9%. Passenger demand remained buoyant throughout the year. Strong front end demand helped to drive up yield by 1.5% to HK¢47.0. Yields in economy class suffered, however, due to strong competition on key long haul and regional flights. Capacity increased by 7.7% with two additional aircraft joining the fleet.

Cargo

Cathay Pacific set new revenue and tonnage records with cargo capacity increasing by 5.2%. Cargo yield dropped by 3.4% with weak demand for exports out of Australia, Europe and the United States. Growth in cargo tonnage out of Mainland China remained strong despite a significant increase in competitor capacity.

Network, Product & Fleet

Network

During 2006:

– a daily service to Shanghai was launched
– Kota Kinabalu, Phuket and, in January 2007, Busan were added to the network from codeshare arrangements with Dragonair
– additional services commenced to Adelaide, Bahrain, Dubai, Frankfurt, Riyadh, Rome and Seoul, while three Penang flights each week were upgraded to a direct service
– new freighter services were launched to Beijing, Chennai, Stockholm and Toronto, bringing the total number of freighter destinations to 31

Product

Cathay Pacific won the following awards in the year:

– "Airline of the Year 2006" by leading industry magazine Air Transport World
– "Airline of the Year 2006" in the OAG 24th Annual Awards, along with "Best Airline Based in Asia" and "Best Transpacific Airline"
– joint winner, with Air China, of the Centre for Asia Pacific Aviation ("CAPA") "Airline of the Year" honour
– CAPA "Cargo Airline of the Year"
– "Airline of the Year" from leading regional trade publication Travel Trade Gazette; and
– "Best Inflight Travel Retailer in Asia Pacific" in the Raven Fox Awards

In September, the airline gave a preview of its new long haul inflight product that will completely overhaul all travel classes. The new product will feature new seats, an improved entertainment system and cabin design and will be rolled out progressively on every aircraft in the long haul fleet from early 2007.

Fleet

At the end of 2006 Cathay Pacific had 102 aircraft. Key additions and orders made during the year were:

– the passenger fleet took delivery of an Airbus A330-300, the airline's 100th aircraft, and a Boeing 777-300
– the firm order for 16 Boeing 777-300 ERs "Extended Range" aircraft was increased to 18 with delivery commencing in September 2007
– the cargo fleet took delivery of two Boeing 747-400 BCFs "Boeing Converted Freighters" and acquired two more Boeing 747-400 aircraft that will be converted for deployment in 2007
– six new Boeing 747-400 ERFs "Extended Range Freighters" were ordered with delivery commencing in May 2008

Hong Kong Dragon Airlines ("Dragonair")

Dragonair operates passenger services to 30 destinations in Asia, including 21 in Mainland China and provides freighter services to ten destinations covering cities in Asia, Europe, Middle East and the United States.

Despite strong turnover, the high price of fuel continued to affect the airline's profitability. Fuel costs now account for 19% of the airline's total net operating expenses.

Passenger Services

Passenger revenue was high with 5.6 million passengers carried. Passenger load factor was 67.8% while capacity increased by 5.4%. Yields were dampened with increasing competition on key routes.

Cargo

Cargo turnover decreased with yield declining as a result of intense competition and softening markets. The airline carried 395,385 tonnes of freight during the year.

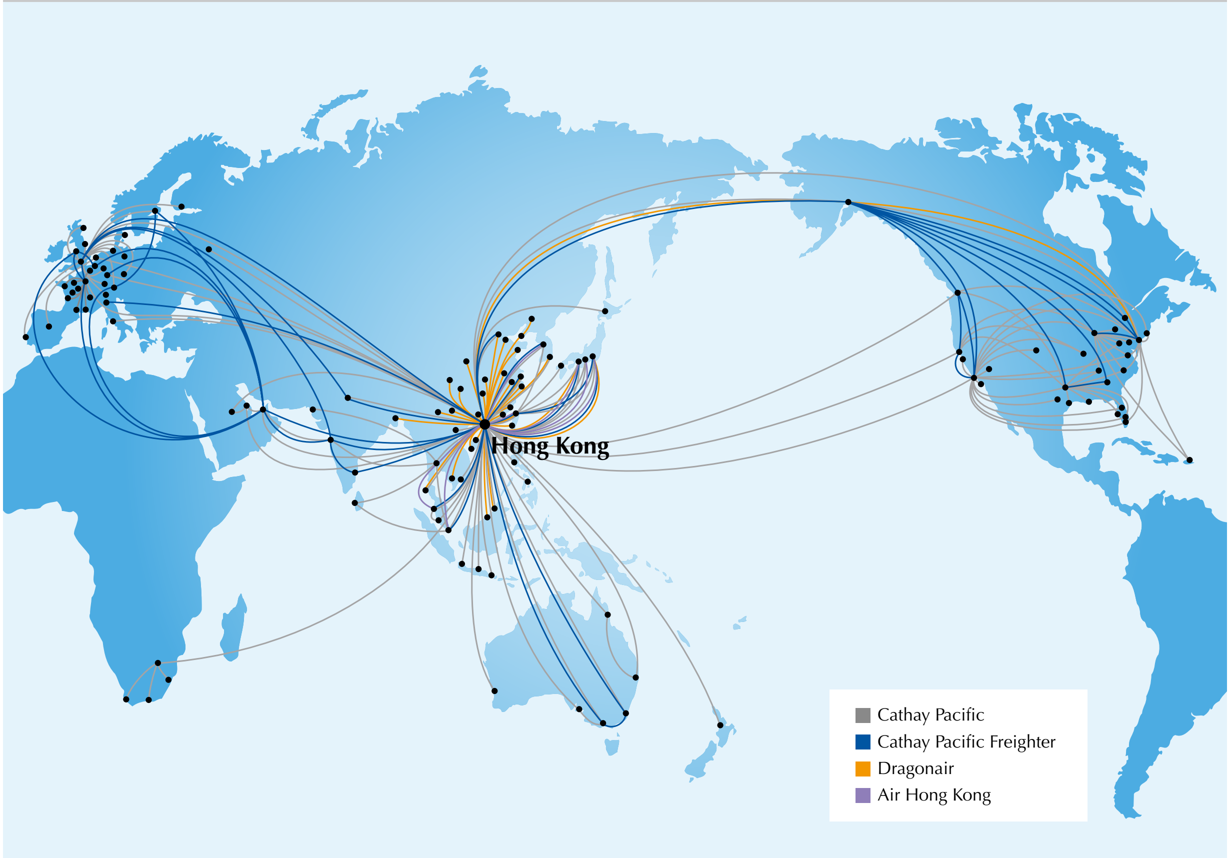
Network, Product & Fleet

During the year new services to Shenyang and Phuket were introduced and to Busan in January 2007. Codeshare services have started operating with Cathay Pacific to seven destinations.

Dragonair was voted "Best Airline – China" for the fifth consecutive year in the international Skytrax passenger survey and was voted "Best China Airline" for the second consecutive year in the 2006 Business Traveller Asia-Pacific Awards.

Three Airbus A330-300 aircraft were received during the year offsetting the return of an operating lease Airbus A320. By the end of the year the freighter fleet had reached five with the addition of one Boeing 747-400 BCF. Another converted freighter was delivered in January 2007. Firm orders are in place for three further freighters.

Network Coverage



AHK Air Hong Kong ("AHK")

AHK, a 60% subsidiary of Cathay Pacific, further expanded its express cargo network during the year, increasing the number of destinations it serves in Asia to eight.

During the year, the company took delivery of two new Airbus A300-600 freighters, increasing its fleet size to eight.

AHK recorded a higher profit in 2006 despite the adverse impact of higher fuel prices.

Cathay Pacific Catering Services ("CPCS")

CPCS, a wholly owned subsidiary of Cathay Pacific, operates six inflight catering facilities in Asia and North America. The company produced a record 20.7 million meals in 2006 and accounts for 67% of the airline catering market in Hong Kong. Business volume increased by 13% over 2005. The company recorded a satisfactory result in 2006 with effective cost controls and productivity improvement initiatives.

Hong Kong Airport Services ("HAS")

HAS, a wholly owned subsidiary of Cathay Pacific, is the largest franchised ramp handling company at Hong Kong International Airport providing services including aircraft loading, passenger steps and air-bridge operation, baggage handling, passenger and staff buses, aircraft load control, cargo and mail delivery.

HAS achieved a satisfactory profit in 2006 despite margins coming under pressure as airlines attempted to reduce their costs, while operating costs for the company increased.

Hong Kong International Airport Services ("HIAS")

Following the acquisition of Dragonair, HIAS became a wholly owned subsidiary of Cathay Pacific.

The company provides airport ground handling services in Hong Kong to Dragonair and other airlines. The company handled 34,055 flights in 2006 and recorded a satisfactory performance for the year.

Air China

Air China is Mainland China's national flag carrier providing passenger, cargo and other airline related services. The airline serves 78 domestic and 43 international destinations.

Following the completion of the shareholding realignment, Air China now holds a 17.5% interest in Cathay Pacific and Cathay Pacific holds a 17.3% interest in Air China. Cathay Pacific now accounts for Air China as an associate interest.

Hong Kong Aircraft Engineering Company ("HAECO")

The HAECO group provides a range of aviation maintenance and repair services. The primary operations are aircraft maintenance and modification work in Hong Kong and Xiamen, and Rolls-Royce engine overhaul work performed by its jointly controlled companies Hong Kong Aero Engine Services Limited ("HAESL") and Singapore Aero Engine Services Limited ("SAESL").

The attributable profit for the HAECO group comprised:

	2006 HK$M	2005 HK$M	Change
HAECO			
Hong Kong operations	**305**	256	19%
TAECO	**221**	102	117%
Share of:			
HAESL and SAESL	**282**	229	23%
Other jointly controlled companies	**39**	31	26%
	847	618	37%

These results were derived from capacity expansion and continuing strong demand for its services. The majority of the growth was due to strong demand for heavy maintenance in both Xiamen and Hong Kong. There was also good growth in engine overhaul work performed by HAESL and SAESL.

HAECO continues to expand rapidly. The company's second hangar at Hong Kong International Airport commenced operation in December 2006 and a third Hong Kong hangar is planned to open in early 2009. TAECO is constructing two more hangars in Xiamen – one of which is planned to open in mid 2007 and the other in early 2009. A new joint venture has been formed to overhaul landing gear in Xiamen. HAESL is building an extension to its engine build shop which is due to open in early 2008.

The HAECO group is investing heavily in the recruitment and training of engineering staff. Its total headcount increased by 1,935 to approximately 10,100 during the year, and further growth is planned in 2007 to fully staff the new facilities.

Prospects for the HAECO group are good given the recent increase in hangar capacity, strong demand for its heavy maintenance services and the growth in the fleets of its Hong Kong based customers. It will, however, take time to increase the number of fully trained staff to a level which matches the additional capacity and results will be moderated by associated cost increases and by the impact of the appreciation of the Renminbi on TAECO's margins.

Hong Kong Air Cargo Terminals ("Hactl")

Hactl achieved throughput growth of 5.3% handling a record 2.56 million tonnes on continued strong growth in transhipment cargoes.

Philip Chen