MANAGEMENT DISCUSSION AND ANALYSIS

Introduction

On 1 January 2005, a number of new and revised Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards ("New HKFRS") came into effect. The resulting changes in accounting treatment and presentation of various profit and loss and balance sheet items may render certain comparative figures not strictly comparable. Details of changes are shown in Note 2 to the unaudited condensed interim accounts.

Review of Income

The Group is principally engaged in the provision of dry bulk shipping services through the operation of a large, modern and uniform fleet of handysize vessels. During the six months ended 30 June 2005, the Group's consolidated turnover on a time charter equivalent ("TCE") basis was US$135.5 million as compared with the corresponding period last year of US$71.6 million. Net profit attributable to shareholders increased to US$85.5 million from US$43.6 million last year.

As presented in the 2004 annual accounts, turnover is shown gross of voyage-related expenses. These expenses were incurred by the IHC Pool and related primarily to commissions, ships' bunkers, port-related costs and short-term hire expenses of chartered-in vessels. Approximately 96.6% of turnover was generated from the employment of the Group's owned and chartered fleet and the remaining 3.4% was generated from the provision of commercial and technical management services for third-party vessels and revenues from marine services businesses. The total amount of voyage-related expenses deducted from gross turnover of US$191.1 million (2004: US$81.7 million) was US$55.6 million (2004: US$10.1 million), resulting in turnover of US$135.5 million (2004: US$71.6 million) on a TCE basis.

In the first half of 2005, the Group achieved an average daily charter rate from its fleet of owned and chartered handysize vessels of approximately US$18,600, compared with approximately US$18,000 in the first half of 2004. Including our two handymax chartered-in vessels, the average daily charter rate was approximately US$18,100.

The average number of owned vessels increased to 33 in the first half of 2005 from 16 in the first half of 2004. The average number of chartered-in vessels in the first half of 2005 was eight as compared to five in the first half of 2004. Details of the movements in the fleet are set out in Interim Report of the Directors – Fleet Developments above.

Review of Costs

Direct costs in the first half of 2005 were US$53.4 million (2004: US$23.8 million). Direct costs include charter-hire expenses of vessels, vessel operating costs, cost of marine products sold, cost of marine services, and an overhead allocation of US$10.1 million (2004: US$2.9 million) representing shore-based costs of staff, offices and related expenses directly attributable to the employment and operation of the owned and chartered fleet.

Charter-hire expenses of vessels increased to US$11.9 million in the first half of 2005 from US$6.9 million in the first half of 2004. This increase was firstly a result of the increase in the average number of vessels chartered-in, and secondly a result of the increase in the average daily charter rate to approximately US$8,500 in the first half of 2005 from approximately US$7,800 in the first half of 2004.

The increase in depreciation expense of US$8.9 million primarily resulted from the doubling in the average number of vessels in the Group's owned fleet between the first half of 2004 and the first half of 2005. As a result of the adoption of Hong Kong Accounting Standard 16 "Property, Plant & Equipment", the Group has changed the accounting policy in relation to drydocking costs. Drydocking costs were previously charged to the profit and loss account when incurred but are now treated as a component cost of vessels and are depreciated over their estimated useful lives. This policy applies to previous accounting periods, which led to an increase in depreciation expense in the first half of 2005 and 2004 by US$3.7 million and US$1.1 million respectively.

The effect of the doubling of the average number of vessels in the Group's owned fleet, between the first half of 2004 and the first half of 2005 is also reflected in the increase in vessel operating costs, including crew expenses, insurance, repairs and maintenance and other miscellaneous running costs of US$7.2 million.

General and administrative expenses were US$6.4 million in the first half of 2005 as compared with US$2.4 million in the same period in 2004. The increase was largely due to the Group's reorganisation effective 31 March 2004 which resulted in the acquisition of the management companies and which gave rise to a full six months of costs (2004: three months). These expenses include Directors, senior management and administrative staff costs of US$4.7 million (2004: US$1.4 million) and other administrative and office expenses of US$1.7 million (2004: US$0.6 million), reflecting the expansion of the Group's business after listing. With the adoption of HKFRS 3 "Business Combinations", there was no amortisation of goodwill in the first half of 2005 (2004: US$0.4 million).

Finance costs of US$2.4 million consist of interest payments and other finance charges of US$8.2 million but are offset by significant gains arising from the mark-to-market value of financial instruments of US$5.8 million in respect of bunker swap and forward contracts and interest-rate swaps, the recognition of which is in accordance with the New HKFRS and detailed in Note 2 to the unaudited condensed interim accounts in this Interim Report. Interest payments on bank borrowings used to finance the Group's vessels in the first half of 2005 were US$8.0 million as compared to US$2.4 million in the same period of 2004, in part attributable to the higher average balance of debts outstanding which increased to US$348.6 million in the first half of 2005 from US$173.2 million in the same period of 2004. In addition, average interest rates on bank borrowings also rose by approximately 69%. Bank borrowings carried interest rates, excluding the effect of fair values of interest-rate swaps, which ranged from approximately 3.3% to 4.9% in the first half of 2005, as compared to approximately 2.5% to 3.4% in the first half of 2004.

Liquidity, Financial Resources and Capital Structure

Net cash generated from operating activities during the six months ended 30 June 2005 amounted to US$90.4 million (2004: US$62.9 million).

Net cash generated from investing activities was US$23.2 million in the first half of 2005, primarily as a result of the proceeds from the sale of vessels of US$103.1 million, offset by the purchase of vessels of US$77.6 million. Net cash used in investing activities was US$22.9 million in the first half of 2004, mainly representing the payments for the purchase of vessels, offset by the bank balances and cash of US$12.2 million acquired from the purchase of subsidiaries.

Net cash used in financing activities was US$126.7 million in the first half of 2005, primarily as a result of the repayment and voluntary prepayment of bank borrowings of US$125.2 million, the payment of dividends of US$13.0 million in January 2005 and US$26.0 million in May 2005, partially offset by the draw down of additional bank loans for the acquisition of vessels of US$49.0 million. Net cash generated from financing activities in the first half of 2004 was US$1.2 million, which mainly represented the bank loans drawn down pursuant to the acquisition of three vessels and delivery of two newbuildings during the first half of 2004, partly offset by the payment of dividends by companies now comprising the Group to the then shareholders prior to the Group's reorganisation in March 2004 and the repayment of bank borrowings.

As at 30 June 2005, the Group had working capital of US$21.8 million excluding long-term bank loans repayable within one year of US$12.2 million. The primary sources of liquidity comprised bank balances and cash of US$28.6 million and unutilised committed bank borrowing facilities of US$95.4 million. The Group's primary liquidity needs are to fund general working capital requirements (including lease commitments), fleet expansion and other capital expenditure. The Group's current policy is to borrow from banks approximately 60% of the fair market value of the vessels acquired.

The indebtedness of the Group solely comprises bank borrowings which decreased from US$370.1 million at 31 December 2004 to US$293.3 million at 30 June 2005. The decrease is primarily because the Group voluntarily prepaid bank borrowings of approximately US$58.0 million and repaid bank borrowings of US$67.2 million. The repayment of bank borrowings includes the repayment of US$50.1 million in respect of vessels which were sold and chartered back, partially offset by the draw down of additional bank borrowings to finance the acquisition of four vessels during the six months ended 30 June 2005. As at 30 June 2005, all outstanding secured bank borrowings of the Group expire through year 2012 to year 2013, US$12.2 million of which represents the current portion that is repayable within one year from the balance sheet date.

The Group hedges its exposure to interest rate fluctuations by way of interest-rate swaps and cap arrangement with banks which are detailed in Note 5 to the unaudited condensed interim accounts in this Interim Report.

At 30 June 2005, the Group's banking facilities were secured by mortgages over 32 vessels with a total net book value of US$507.3 million and fixed deposits of approximately US$3.3 million, assignment of earnings and insurances in respect of the vessels and charges over the shares of certain vessel-owning subsidiaries.

At 30 June 2005, the Group had unutilised committed bank borrowing facilities of US$95.4 million. These facilities are available to finance the Group's newbuilding commitments and other vessel acquisitions to which the Group may be committed in the future.

At 30 June 2005, the Group's gearing ratio expressed as net borrowings (calculated as total bank borrowings net of cash) as a percentage of fixed assets (based on net book values) was 50.0% (31 December 2004: 59.1%).

The Group's lease commitments as at 30 June 2005 stood at US$125.5 million as opposed to US$37.0 million at 31 December 2004. The increase was primarily due to the sale and charter back of certain vessels during the Period.

Capital Expenditure

In the first half of 2005, capital expenditure on vessel additions, including instalments on newbuildings, was US$77.6 million.

As at 30 June 2005, the Group had non-cancellable commitments for the construction of three handysize vessels for delivery to the Group from August 2005 to August 2007, with an aggregate unpaid cost of approximately US$64.5 million. Unpaid costs are net of progress payments and prepayments. Finance for such vessel commitments will come from cash generated from the Group's operations, existing unutilised bank facilities and additional long-term borrowings to be arranged, as required.

Directors' Opinion on the Working Capital Available to the Group

The Directors are of the opinion that, taking into consideration the financial resources available to the Group, including internally generated funds and the available bank facilities, the Group has sufficient working capital to satisfy its present requirements.

Staff

As at 30 June 2005, the Group employed a total of 231 full-time shore-based staff in offices in Hong Kong, London, Melbourne, Seoul, Shanghai, Singapore, Tokyo and Vancouver.

The Group incurred total staff costs of approximately US$11.9 million for the six months ended 30 June 2005, representing 6.2% of the Group's turnover for the Period.

Remuneration of the Group's employees includes basic salaries, bonuses and long term incentives. Employees are remunerated on a fixed-salary basis and are eligible for a discretionary bonus (based on both the Group and individual performance for the year) and performance-related bonuses if certain financial and other targets, which are set annually by the Board, are achieved.

The Group's principal retirement benefit scheme is the Mandatory Provident Fund Scheme (the "MPF Scheme") provided under the Hong Kong Mandatory Provident Fund Schemes Ordinance for those staff employed under the jurisdiction of the Hong Kong Employment Ordinance. The MPF Scheme is a defined contribution scheme under which the employer and its employees are each required to make contributions to the scheme of 5% to 10% of the employees' relevant income, with the employees' contributions subject to a cap of monthly relevant income of HK$20,000. The Group's contributions to the scheme are expensed as incurred. Where employees leave the scheme prior to the full vesting of the employer's contributions, the amount of forfeited contributions is used to reduce the contributions payable by the Group.

Following the approval of shareholders at a special general meeting convened on 8 June 2005, the Company's share option scheme (now called the "Long Term Incentive Scheme") was amended to allow the Company to award restricted shares and restricted units as an alternative or in addition to granting share options.

Details of share options and restricted share awards granted under the Long Term Incentive Scheme are set out in Other Information section in this Interim Report.