Management Discussion and Analysis

INCOME

The Group is principally engaged in the provision of dry bulk shipping services through the operation of vessels. During the six months ended 30 June 2006, turnover was US$239.4 million as compared with the corresponding period last year of US$228.9 million. Time charter equivalent earnings and shipping management income were US$140.4 million as compared with the corresponding period last year of US$140.9 million. Net profit attributable to shareholders decreased to US$36.4 million from US$85.5 million in the corresponding period last year.

Turnover included US$199.3 million revenues earned from all the handysize vessels in the IHC Pool, including the managed vessels, and US$33.5 million from the handymax vessels. These were shown gross of voyage-related expenses. Approximately 97.2% of turnover was generated from the employment of the Group's owned and chartered fleet and the remaining 2.8% was generated from the provision of commercial and technical management services for third party vessels and revenues from marine services businesses. Voyage-related expenses related primarily to commissions, ships' bunkers, port-related costs and short term hire expenses of chartered vessels. The IHC Pool paid to other pool members freight and charter-hire net of voyage-related expenses which were calculated based on the number of pool points attributable to the vessels participated in the pool owned by the other pool members. The total amount of voyage-related expenses, including the change in fair value of bunker swap and forward contracts, and the amounts payable to other pool members deducted from turnover was US$99.0 million (2005: US$88.0 million), resulting in time charter equivalent earnings for the Group of US$140.4 million (2005: US$140.9 million).

The average daily charter rates on a time charter equivalent basis and the number of revenue days from the fleet of owned, finance leased and chartered vessels in the first half of the year, as compared to prior period, can be analysed as follows:

		Six months ended 30 June	
		2006	2005
Handysize			
Daily charter rates		**US$14,400**	US$18,600
Revenue days	Owned	**2,580**	5,500
	Finance leased	**3,060**	–
	Chartered (operating lease)	**1,930**	1,250
Total		**7,570**	6,750
Handymax			
Daily charter rates		**US$14,150**	US$8,460
Revenue days	Owned	**–**	200
	Chartered (operating lease)	**1,680**	150
Total		**1,680**	350

DIRECT COSTS, OTHER OPERATING INCOME AND OTHER OPERATING EXPENSES

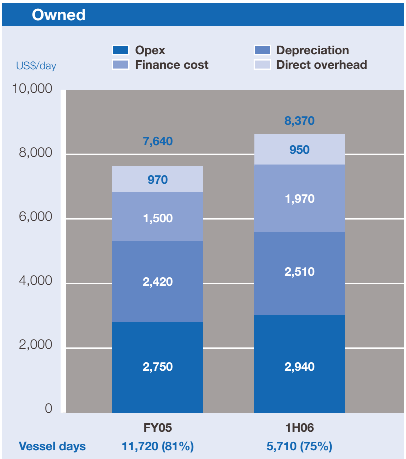
Direct costs in the first half of 2006 were US$84.9 million (2005: US$53.4 million). Direct costs included charter-hire expenses of vessels held under operating leases, vessel operating costs for owned and finance leased vessels, cost of marine products sold, cost of marine services, and an overhead allocation of US$10.7 million (2005: US$10.1 million) representing shore-based costs of staff, office and related expenses directly attributable to both the employment and operation of the owned and chartered fleet and the generation of marine services businesses.

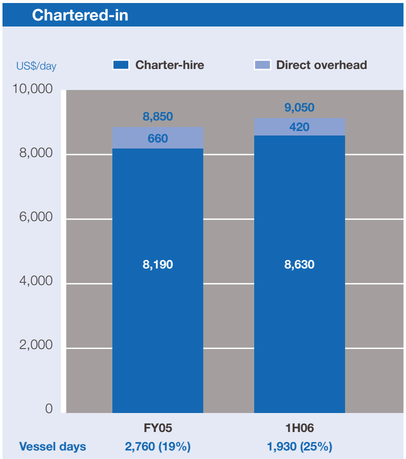
Vessel charter-hire expenses increased to US$42.2 million in the first half of 2006 from US$11.9 million in the first half of 2005. This reflected the increase in the average number of vessels chartered under operating leases, the increase in the average daily charter rate of handysize vessels and the higher average daily charter rate for our handymax vessels compared to that of our short and long term handysize vessels.

Depreciation expenses decreased to US$14.3 million in the first half of 2006 from US$15.4 million in the first half of 2005 primarily due to differences in the drydocking schedules between the two periods.

Vessel operating costs increased to US$16.8 million in the first half of 2006 from US$14.2 million in the first half of 2005. This was due to the increase in crew expenses, insurance, repairs and maintenance and other miscellaneous running costs.

Handysize vessel operating costs as a blend of owned and chartered vessel costs amounted to US$8,540 per day in the first half of 2006 (2005 full year: US$7,870 per day). This can be broken down between owned and chartered costs as follows:





Handymax vessel operating costs in the first half of 2006 consisted of charter-hire paid for 1,680 vessel days at US$15,130 per day.

The difference between the number of revenue days and vessel days for the owned fleet in the period was represented by technical off-hire. There was no technical off-hire for the vessels time chartered into the fleet. The total fleet of owned vessels incurred approximately 70 technical off-hire days in the first half of 2006 representing 1.3 per 100 operating days, compared to 270 technical off-hire days in the first half of 2005 representing 4.7 per 100 operating days.

Other operating income of US$6.5 million represented US$4.7 million (2005: Nil) of movements in the fair value of receipts in relation to forward freight agreements, and US$1.8 million (2005: US$0.1 million) of interest income.

Other operating expenses of US$8.8 million (2005: Nil) represented movements in the fair value of payments in relation to forward freight agreements.

GENERAL AND ADMINISTRATIVE EXPENSES

The Group's total administrative expenses of US$16.9 million (2005: US$16.5 million) consisted of shore-based overhead costs of US$10.7 million (2005: US$10.1 million) included as part of direct expenses, and general and administrative expenses of US$6.2 million (2005: US$6.4 million). The change in composition was due to the increase in the number of staff directly involved in the management of the expanded fleet. General and administrative expenses included Directors, senior management, key staff and administrative staff costs of US$4.0 million (2005: US$4.7 million) and other administrative and office expenses of US$2.2 million (2005: US$1.7 million).

SHARE OF PROFITS LESS LOSSES OF JOINTLY CONTROLLED ENTITIES

The Group's share of profits less losses of jointly controlled entities mainly represented the share of results of a jointly controlled vessel, "Captain Corelli" and a jointly controlled business of shipping aggregates in the Middle East.

FINANCING

Finance costs of US$11.6 million (2005: US$7.8 million) included interest payments of US$0.5 million (2005: US$7.3 million) in relation to bank borrowings used to finance the Group's owned vessels and finance charges of US$10.6 million (2005: Nil).

Interest payments on bank borrowings

The decrease in interest payments on bank borrowings in the first half of 2006 was due to the decrease in the average bank borrowings outstanding to US$16.6 million in the first half of 2006 from US$348.6 million in the first half of 2005. The bank borrowings' interest cost amounted to approximately US$190 per day for the owned vessels. Average interest rates on bank borrowings were approximately 5.9% in the first half of 2006 (2005: 4.2%).

Finance charges

Finance charges of US$10.6 million (2005: Nil) represented interest payments on finance lease liabilities used to finance the Group's finance leased vessels. During the second half of 2005, the Group sold and bareboat leased back 17 of its vessels for periods of 10 to 12 years. Finance lease accounting has been adopted for these transactions, which means that the balance sheet shows the net carrying value of these vessels, and the current and long term liabilities in aggregate include finance lease liabilities of US$309.5 million. The fixed equal quarterly charter-hire payments are accounted for as a combination of repayments of finance lease liabilities in the balance sheet and finance charges in the income statement. The finance charges amounted to approximately US$3,450 per day in the first half of 2006. This daily charge will reduce each year as the finance lease liabilities in the balance sheet are repaid. Finance charges can be expressed as interest rates, fixed for the period of the leases. The average interest rate on finance leases was approximately 6.7% in the first half of 2006 (2005: Nil).

CASH FLOW

US$ million	Six months ended 30 June 2006	2005
Net cash from operating activities	**57.3**	90.4
– Purchase of vessels	**(97.5)**	(77.6)
– Sale of vessels	**–**	103.1
– Others	**6.1**	(2.3)
Net cash (used in)/from investing activities	**(91.4)**	23.2
– Net drawdown/(repayment) of bank loans	**71.0**	(76.2)
– Repayment of finance lease liabilities	**(7.4)**	–
– Payment of interest and other finance charges	**(11.2)**	(8.2)
– Payment of dividends	**(58.1)**	(39.0)
– Others	**0.2**	(3.3)
Net cash used in financing activities	**(5.5)**	(126.7)
Bank balances and cash at 30 June	**42.6**	28.6

At 30 June 2006, the Group had net working capital of US$32.4 million excluding long term finance lease liabilities and bank loans repayable within one year of US$15.4 million and US$9.6 million respectively. The primary sources of liquidity comprised bank balances and cash of US$42.6 million and unutilised committed and secured bank borrowing facilities of US$42.6 million. The Group's primary liquidity needs are to fund general working capital requirements (including lease commitments), fleet expansion and other capital expenditure.

INDEBTEDNESS

The indebtedness of the Group comprised finance lease liabilities of US$309.5 million and bank borrowings of US$70.8 million, of which US$15.4 million and US$9.6 million respectively represented the current portion that were repayable within one year from the balance sheet date. Finance lease liabilities decreased to US$309.5 million at 30 June 2006 from US$316.9 million at 31 December 2005 as a result of repayments during the period.

Bank borrowings increased to US$70.8 million at 30 June 2006 from nil at 31 December 2005. The increase was the result of re-drawn existing pre-paid bank facilities to finance the delivery and acquisition of vessels. At 30 June 2006, all outstanding finance lease liabilities will expire between 2015 and 2017 and all outstanding secured bank borrowings will expire in 2012.

At 30 June 2006, the Group's bank borrowings were secured by mortgages over 11 vessels with a total net book value of US$146.3 million, assignment of earnings and insurances in respect of the vessels and charges over the shares of certain vessel-owning subsidiaries.

At 30 June 2006, the Group had unutilised committed bank borrowing facilities of US$42.6 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 2006, the Group's gearing ratio expressed as borrowings and finance lease liabilities, net of cash, as a percentage of property, plant and equipment (based on net book values) and vessel finance lease receivables was 57.0% (31 December 2005: 46.2%).

FINANCIAL INSTRUMENTS

The Group is exposed to fluctuations in interest rates, bunker prices, freight rates and foreign currencies in relation to contracts designated in foreign currencies. The Group manages these exposures by way of interest rate swap contracts, bunker swap and forward contracts, forward freight agreements and forward foreign exchange contracts respectively which are detailed in Note 5 and Note 11 to the unaudited condensed consolidated interim financial statements in this Interim Report. Hedge accounting has not been adopted for the aforesaid contracts unless they satisfy the conditions set out in HKAS 39 "Financial Instruments: Recognition and Measurement". The forward foreign exchange contracts and one of the interest rate swap contracts qualified for hedge accounting. Accordingly, the change in the fair value was recognised directly in other reserves, under hedging reserve. Gains or losses arising from a change in the fair value of the other contracts were recognised in the income statement under i) finance costs for interest rate swap contracts, ii) bunkers, port disbursements and other charges for bunker swap and forward contracts and iii) other operating income and other operating expenses for forward freight agreements. The adoption of HKAS 39 has the effect of shifting the estimated results of these contracts into the current period. The cashflows of these contracts remain in the future reporting period.

In the first half of 2006, the Group recognised net realised gains of US$2.0 million and net unrealised losses of US$2.9 million in the income statement. These are analysed as follows:

			Six months ended 30 June	
US$ million	Realised	Unrealised	**2006**	2005
Gains				
– Interest rate swap contracts	0.2	0.3	**0.5**	0.4
– Bunker swap and forward contracts	3.8	1.4	**5.2**	6.6
– Forward freight agreements	0.6	4.0	**4.6**	–
	4.6	5.7	**10.3**	7.0
Losses				
– Interest rate swap contracts	(0.1)	(0.7)	**(0.8)**	(0.7)
– Bunker swap and forward contracts	(1.3)	(0.4)	**(1.7)**	(0.1)
– Forward freight agreements	(1.2)	(7.5)	**(8.7)**	–
	(2.6)	(8.6)	**(11.2)**	(0.8)
Net				
– Interest rate swap contracts	0.1	(0.4)	**(0.3)**	(0.3)
– Bunker swap and forward contracts	2.5	1.0	**3.5**	6.5
– Forward freight agreements	(0.6)	(3.5)	**(4.1)**	–
	2.0	(2.9)	**(0.9)**	6.2

LEASE COMMITMENTS

Lease commitments included vessels chartered by the Group directly and by the IHC Pool. Charter in commitments under operating leases as at 30 June 2006 stood at US$280.2 million as compared with US$223.1 million at 31 December 2005. The increase was mainly due to an average increase of eight chartered vessels during the period. Of these commitments, US$206.3 million related to handysize vessels and US$73.9 million related to handymax vessels.

The average daily charter rates and total number of vessel days of our handysize and handymax vessels under operating leases and finance leases in each year, assuming the purchase options will not be exercised until the expiry of the charter-hire agreements, are as follows:

	Handysize Operating leases		**Handysize Finance leases**		**Handymax Operating leases**	
Year	**Average daily rates** *(in US$)*	**Total number of vessel days**	**Average daily rates** *(in US$)*	**Total number of vessel days**	**Average daily rates** *(in US$)*	**Total number of vessel days**
2006	9,800	2,210	5,800	3,210	17,100	2,260
2007	9,600	4,580	5,800	6,210	13,900	1,560
2008	9,200	4,410	5,800	6,220	9,800	850
2009	9,000	3,240	5,800	6,210	8,500	620
2010	8,900	2,680	5,800	6,210	8,500	10
2011	8,800	1,820	5,800	6,210	–	–
2012	8,800	1,330	5,800	6,220	–	–
2013	8,800	790	5,800	6,210	–	–
2014	8,400	370	5,800	6,210	–	–
2015	8,400	290	5,800	5,410	–	–
2016	–	–	5,900	1,830	–	–
2017	–	–	6,000	1,520	–	–

Certain lease agreements provide the Group with the option to purchase the related vessel at a pre-determined time and exercise price during the lease period. The average exercise prices of the existing purchase options for both handysize vessels and handymax vessels in the earliest years in which these options may be exercised, along with the number of vessels and the average age of such vessels in that year, are as follows:

Earliest year in which options may be exercised	Vessel type	Number of vessels: Finance leases	Number of vessels: Operating leases	Average age of such vessels	Average option exercise price *(in US$ million)*
2006	Handysize	17	–	5	18.9
2007	Handysize	–	2	3	15.8
2008	Handysize	–	4	6	21.1
2009	Handysize	–	3	3	23.4
	Handymax	–	1	5	17.7
2010	Handysize	–	1	3	22.5
	Handymax	–	1	5	17.7

CAPITAL EXPENDITURE

In the first half of 2006, capital expenditure, mainly comprised vessel acquisitions and instalments on newbuildings, amounted to US$97.5 million. This included capitalised expenditure on drydocking of US$0.9 million.

At 30 June 2006, the Group had property, plant and equipment of US$590.2 million, of which US$541.9 million related to 34 delivered vessels. In addition, the Group had non-cancellable commitments for the construction of nine handysize vessels, three second hand handysize vessels and two second hand handymax vessels for delivery to the Group between August 2006 and September 2009, with aggregate amount paid of US$45.4 million and aggregate amount unpaid of approximately US$283.2 million. Finance for such vessel commitments will come from cash generated from the Group's operations, existing unutilised bank borrowing 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

At 30 June 2006, the Group employed a total of 232 full time shore-based staff in offices in Hong Kong, Shanghai, Beijing, Dalian, Tokyo, Seoul, Singapore, Mumbai, Karachi, Dubai, Fujairah, London, Bad Essen, Houston, Vancouver and Melbourne.

The Group incurred total staff costs of approximately US$12.7 million in the first half of 2006, representing 5.3% 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's and individual's performance for the year).

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' mandatory contributions subject to a cap of 5% of monthly relevant income of HK$20,000. The Group's contributions to the scheme are expensed as incurred. When 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.

The Company's Long Term Incentive Scheme allows the Company to award eligible participants share options, restricted shares and restricted units.

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