CATHAY PACIFIC AIRWAYS LIMITED

CATHAY PACIFIC

ANNUAL REPORT 1998

Contents

A Chinese translation of this Annual Report is available upon request from the Company's Registrars.

本年報中文譯本，於本公司之股票註冊處備索。

Cathay Pacific Airways, based in Hong Kong, is an international airline offering scheduled passenger and cargo services to 48 cities in five continents.

Cathay Pacific Airways has a 75 percent shareholding in the all-freight carrier AHK Air Hong Kong Limited, which operates scheduled cargo services to Japan, Europe and the Middle East. In association with Hong Kong Dragon Airlines Limited, our global network is extended to a further 27 destinations in China and around the region.

The airline is a founder member of the global alliance **one**world which has networks that serve over 600 destinations in more than 140 countries. Other founder members are American Airlines, British Airways, Canadian Airlines and Qantas Airways. Finnair and Iberia will join the alliance in the second half of 1999.

As a strong, diversified aviation group, we maintain equity interests in a number of subsidiary and associated companies which provide aviation related services in Hong Kong and overseas.

Cathay Pacific Airways is a member of the Swire Group and is listed on The Stock Exchange of Hong Kong Limited.

Hong Kong:

PHOTOGRAPH BY SAMUEL LO

The world's aviation Super Hub

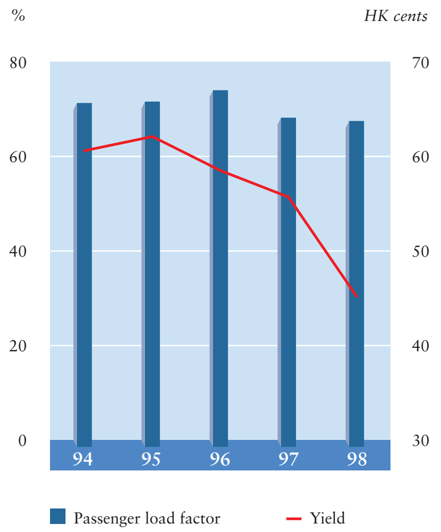
The opening of the new Hong Kong International Airport launched a new era for Hong Kong aviation and strengthened its position as Asia's premier aviation hub. Cathay Pacific's new Super Hub offers a superior passenger experience that includes preferred check-in facilities and boarding gates, as well as Business and First Class lounges that are setting standards for style, comfort and convenience.

Financial and Operating Highlights

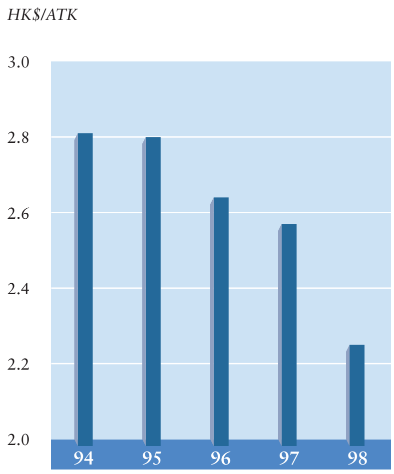
Financial (Group)		**1998**	**1997**	**Change**
Results	*HK$*			
Turnover	*million*	26,695	30,647	-12.9%
(Loss)/profit attributable to shareholders	*million*	(542)	1,694	-132.0%
(Loss)/earnings per share		(0.16)	0.49	-132.7%
Dividend per share		0.10	0.29	-65.5%
Balance Sheet	*HK$*			
Shareholders' funds	*million*	24,696	25,606	-3.6%
Net borrowings	*million*	14,958	8,795	+70.1%
Shareholders' funds per share		7.30	7.56	-3.4%
Key ratios				
(Loss)/profit margin	*%*	(2.0)	5.5	-7.5%pt
Net debt equity ratio	*Times*	0.61	0.34	+0.27 times
Operating (Company)				
Available tonne kilometres ("ATK")	*Million*	10,857	10,399	+4.4%
Passenger load factor	*%*	67.5	68.2	-0.7%pt
Passenger yield	*HK cents*	45.2	55.7	-18.9%
Cargo and mail load factor	*%*	65.2	72.9	-7.7%pt
Cargo and mail yield	*HK$*	1.7	1.8	-5.6%
Cost per ATK	*HK$*	2.25	2.57	-12.5%
Aircraft utilisation (average)	*Hours per day*	12.2	11.8	+3.4%
On-time performance	*%*	80.3	81.8	-1.5%pt

Confidence in our Industry

Passenger load factor and yield



Cost per ATK



Chairman's Letter

The Cathay Pacific Group's attributable loss for 1998 was HK$542 million, as compared with a profit of HK$1,694 million in 1997. Turnover was HK$26,695 million, down by 12.9 percent compared to the previous year.

The results for 1998 reflect the extreme difficulties facing Cathay Pacific due to the Asian economic downturn. The regional crisis, which first became apparent in the middle of 1997, worsened significantly during 1998 and its effect began to be felt in other economies. Faltering economic growth and rising unemployment dampened demand for both tourism and business travel across the region and had an adverse impact on our revenues. At the same time, the comparatively higher costs of operating in Hong Kong due to the devaluation of regional currencies reduced our competitiveness.

From the middle of the year, there was some recovery in passenger loads, but at the expense of yields. Management has taken a number of steps to increase efficiency and productivity across all our activities. These actions, combined with external factors such as favourable fuel prices, helped to reduce unit operating costs to their lowest level in more than a decade. This will benefit Cathay Pacific when the economy turns around.

Apart from focussing on costs, we have also taken the initiative in launching a series of promotions to boost demand in various markets to and from Hong Kong. The largest was our highly successful "Hong Kong Super Offer", which ran through January and February 1998, and involved two-for-one airfares to Hong Kong and in October and November we ran our "Fly to Win" promotion with further attractive incentives.

While taking steps to ensure our short-term competitiveness, our fundamental confidence in Hong Kong's long-term prosperity remains firm. We have no doubt that Hong Kong will recover economically and that it has the potential to become Asia's premier aviation hub. Cathay Pacific, as Hong Kong's largest and longest established carrier, is proud to be an important part of Hong Kong and, despite the current economic difficulties, we have continued our extensive investment programme to prepare us for the anticipated market recovery. The past year saw several elements of that programme come to fruition.

The completion of our new headquarters and associated facilities at the new Hong Kong International Airport at Chek Lap Kok, represents an overall investment of more than HK$7,300 million. Our new headquarters, Cathay Pacific City, is now home to over 3,000 staff and the Cathay Pacific Catering Services new flight kitchen is one of the largest flight kitchens in the world.

Our other major investment at the airport, the hangar complex of Hong Kong Aircraft Engineering Company Limited, is able to accommodate three wide-body aircraft side-by-side. We have also made substantial investments to upgrade our passenger services at the new airport, including new check-in facilities and our new airport lounges known as The Wing.

The opening of the new airport was marred by a series of teething problems, a number of which cost us dearly. The difficulties involving the airport's new cargo terminal resulted in substantial lost revenue for Cathay Pacific, compounding what was already a difficult year. However, with the opening difficulties now behind us, the airport has already established a reputation as being one of the most impressive in the world. The ability to offer improved customer service and increased capacity for expansion will serve Cathay Pacific well in the years ahead.

Despite the difficult market conditions we have continued to invest in our fleet, taking delivery of ten new aircraft during the year. These included the world's first Boeing 777-300, the longest commercial aircraft in service. A further three new aircraft will be delivered in 1999. However, in view of current weak demand and reduced growth forecasts, a decision was taken to remove seven B747-200 aircraft from the fleet. In addition a further six B747-300 aircraft will be phased out in 1999. As a result, we have incorporated in the 1998 accounts a provision of HK$607 million which recognises the current market value of this fleet.

Another step we have taken to ensure our future has been to review our network in the light of changing market demand. We have reduced frequencies to some regional destinations, and increased services on key long-haul routes. We have also added two exciting new destinations, Istanbul and San Francisco. The initial response to both services has been encouraging.

In addition to investing in our product we also took a major strategic initiative during the year by becoming a founder member in a new global alliance **one**world. The alliance links five key airlines – Cathay Pacific, American Airlines, British Airways, Canadian Airlines and Qantas Airways. We are firmly of the view that the alliance route is the way of the future for the airline industry, and becoming a member of **one**world is an important step in positioning ourselves for future global competition. The alliance will enhance our presence in key global business markets and will strengthen our competitive position and that of Hong Kong's new international airport.

Consistent with our alliance plans we also unveiled a new frequent flyer programme. The new programme, known as Asia Miles, replaced our previous programme *Passages*, which was amicably ended by the three partner airlines involved. Asia Miles is linked with our **one**world partners and allows us to offer accrual of passenger miles in all classes and brings on board a wide range of non-aviation service partners. We are confident the new programme will grow into a highly visible and successful way of delivering greater benefits to our passengers and thereby will help to foster greater loyalty.

Following difficulties experienced by Philippine Airlines in September, we responded to an invitation from Philippines President Joseph Estrada to provide a temporary domestic charter service for the country. For ten days in October we provided air links between Manila, Cebu and Davao, adding a new chapter to our history in a market we have served continuously since we were founded in 1946. We decided, however, not to pursue the opportunity to invest in and help manage Philippine Airlines.

We realise that the Year 2000 or millennium date change is a significant business issue and we are addressing it as a matter of priority. Further details are covered later in this report.

The year ahead is shaping up to be another difficult one for Cathay Pacific. All signs suggest the operating environment will remain challenging and no significant improvement is expected in 1999. Nevertheless, the measures we have put in place during 1998 will deliver increasing benefits as the year progresses and I believe we have every reason to look to the future with some confidence.

Peter Sutch
Chairman
10th March 1999

As the launch customer of the B777-300, Cathay Pacific leads the industry in product and service innovations. From comfortable seats to personal televisions in every seat, offering entertainment in several languages, to menus designed to match international tastes, our customers enjoy a world-class inflight product.

1998 In Review

The Asian economic downturn made 1998 an extremely difficult year for Cathay Pacific with passenger loads and yields remaining weak. The trying conditions however did not deter the Company from pressing ahead with its long-term investment programme. Investments were made in upgrading the fleet and enhancing our products and services. Cathay Pacific remains committed to nurturing its unique style of "Service Straight From the Heart" and continues to support the Hong Kong community and the underprivileged through a range of charitable activities.

The Customers and the Product

Advances in Cathay Pacific's award-winning services include the entry into a new global alliance **one**world, our new frequent flyer programme Asia Miles, and the introduction of electronic ticketing.

- Cathay Pacific joined with four other international airlines to announce a new global alliance, **one**world, in September 1998. The alliance links Cathay Pacific, American Airlines, British Airways, Canadian Airlines and Qantas Airways. The alliance, which focuses on providing enhanced customer benefits, aims to provide travellers with improved levels of service worldwide. With the joining of Finnair and Iberia in the second half of 1999, the combined **one**world network will cover 682 destinations worldwide in 143 countries.
- Details of Cathay Pacific's new frequent flyer programme Asia Miles were announced in October 1998. The programme came into effect last month, as did the **one**world alliance, and provides enhanced customer benefits including economy class passenger miles accrual.
- Cathay Pacific introduced electronic ticketing in early 1998. The service is now available on flights to Manchester, Melbourne, Singapore and Sydney, with other destinations being added progressively.
- Cathay Pacific won a number of awards for its high quality service and product during 1998, including Best Airline Business Class from *Travel Trade Gazette Asia*, Best Airline Intercontinental Routes from Germany's *Capital Magazine* and Best Passenger Service from *Air Transport World*.

Quality in our Product

The New Airport

Cathay Pacific's investment in the new Hong Kong International Airport and related facilities amounts to more than HK$7,300 million, making it the largest single private investor in the project. This investment includes a corporate headquarters, a flight kitchen facility, airport lounges and check-in facilities. Cathay Pacific has secured an exclusive area of the new Passenger Terminal Building for its use, including dedicated check-in facilities and preferred departure gates.

- The first commercial flight to land at the new airport was Cathay Pacific's ground-breaking non-stop flight from New York, known as Polar One, which flew directly over the North Pole.
- Check-in for Cathay Pacific passengers is noticeably more efficient at the new airport with the introduction of revolutionary MobileCheck, Single Line Queuing and In-Town Check-In. First Class passengers enjoy a totally new check-in procedure modelled on a concierge service.
- Cathay Pacific City, located at the Southeast corner of the airport, is nearing completion. Three 10-storey office blocks and a 23-storey staff hotel provide a pleasant, modern environment for over 3,000 staff now working there.
- Cathay Pacific's Flight Training Centre, constructed next to Cathay Pacific City, will open shortly and contain 14 simulator bays.
- Cathay Pacific Catering Services' new catering facility began operating on 6th July 1998, the same day as the new airport. It currently produces 40,000 meals a day with a future capacity of up to 80,000 meals.
- Cathay Pacific's new airport lounges, known as The Wing, were opened in September 1998. The lounges were created by renowned international designer John Pawson.
- Hong Kong Aircraft Engineering Company Limited, in which Cathay Pacific has a 25 percent interest, opened its new line and base maintenance facilities in July 1998, constructed at a total cost of HK$1,750 million.
- Hong Kong Air Cargo Terminals Limited, 10 percent-owned by Cathay Pacific, started operations at its new SuperTerminal One at the airport from July 1998. The new facility is the largest of its kind in the world.

The Fleet

Cathay Pacific has endeavoured to improve the quality of its fleet by continuing to invest in new aircraft, and retiring a number of its older aircraft. The changes have resulted in a younger and more efficient fleet with an average age of 6.5 years.

- During 1998, ten new aircraft joined the fleet. These included four B777-300s, one Airbus Industrie A330-300, and five A340-300s. Seven B747-200s were retired.
- In May 1998 , Cathay Pacific took delivery of its first B777-300, the longest commercial aircraft in the world. Cathay Pacific operated four of these aircraft by the end of 1998, and will take delivery of a further three this year.
- It has also been decided to remove from service the six B747-300 aircraft during 1999.

Fleet Profile

Aircraft Type	Number per fleet as at 31st December 1998				Firm Orders		Expiry of operating leases		Options (delivery date)				
		Leased											
	Owned	Finance	Operating	Total	'99	Total	'02	'03	'01	'02	'03	'04	Total
B747-400	1	16	2	19			1	1	3	3			6
B747-300	1	5		6									
B747-200	7*			7									
B747-200F	3	4**		7									
B747-400F	1	1		2									
B777-200	1	3		4									
B777-300	1	3		4	3	3			2	3	2	3	10
A330-300		12		12					3	3	3		9#
A340-300		11		11									
Total	15	55	2	72	3	3	1	1	8	9	5	3	25

* *Includes aircraft which have been leased out or taken out of service.*
** *Includes three freighters leased to AHK Air Hong Kong.*
# *Options are interchangeable between A330/A340.*

The Network

The Company has continued to review its network to best match changing passenger demands. Frequencies to some regional destinations most affected by the regional downturn have been reduced, while those to some key long-haul routes have been increased.

- Frequencies to key long-haul destinations London, Los Angeles, and Sydney were increased to double-daily services in July 1998, thereby strengthening our trunk network.
- The service to Sapporo was suspended in November due to weak demand. Frequencies to some other Asian destinations experiencing low passenger loads were also reduced.
- Two new destinations were added to the network during 1998: Istanbul on 8th August, and San Francisco on 1st December. Both services were launched successfully with encouraging market response.
- Cathay Pacific entered into a codeshare agreement with Swissair on the Hong Kong-Zurich route in order to maintain frequency of services to passengers on the route.

Information Technology

Cathay Pacific continues to invest in new information technology systems to streamline business processes.

- Cathay Pacific introduced an integrated communications network to better link its staff and offices in 80 countries. Called GalaCXy, the new network enhances the airline's efficiency and customer service.
- The Company has been undertaking a comprehensive programme to achieve Year 2000 compliance for its business-critical systems.

The People

Staff at Cathay Pacific have benefited from the Company's move to a brand-new headquarters complex which provides an improved working environment. Transportation to the new complex has been assisted through travel subsidies and the introduction of more company bus services.

- The phased move of Cathay Pacific staff to our new headquarters at Chek Lap Kok began in June 1998 and will soon be completed.
- Recruitment and training of Hong Kong cadet pilots continue with almost 100 now flying as First or Second Officers.
- Efforts to involve staff in making Cathay Pacific more efficient include a "Your Ideas Scheme", with each winner being given a prize equivalent to the market value of 1,000 Cathay Pacific shares.

The Community and the Environment

Cathay Pacific's community assistance programme has been maintained despite the pressure on cost management throughout the Company. The focus has again been on youth and the environment.

- An open day was held in May 1998 to give the people of Hong Kong the opportunity to view Cathay Pacific's first B777-300.
- 50 underprivileged children participated in the airport opening with a trip to Manila CX907 on the first commercial flight out of the airport.
- The annual Change for Good programme ran from July until the end of 1998. More than HK$3.6 million was raised for the United Nations Children's Fund (UNICEF). Change for Good encourages passengers to donate small change in the foreign currency they bring back from their travels.
- Cathay Pacific continued its contribution in the fight against drug abuse through the Life Education Activity Programme ("LEAP"), targeted at children and adolescents. The airline donated HK$2.2 million to LEAP during 1998.
- Cathay Pacific's Environmental Pioneer Programme began in January 1998. More than 500 youngsters have participated in the first two years of the programme.
- The International Lapalala Wilderness Experience Programme was conducted for the fifth year with children from nine countries sponsored to attend a week-long course at South Africa's Lapalala Wilderness School.
- Cathay Pacific staff in Hong Kong contributed more than HK$82,500 during the 1998 Dress Casual Day in support of The Community Chest.
- For the 13th year, Cathay Pacific was the major sponsor of the Hong Kong Squash Open, which attracted many of the world's best squash players.

Service Straight from the Heart is a key element of our business strategy and our corporate culture. Cathay Pacific staff take pride in adding that extra dimension of warmth and friendliness to the helpful, efficient and courteous service our customers expect.

Review of Operations

Passenger Services

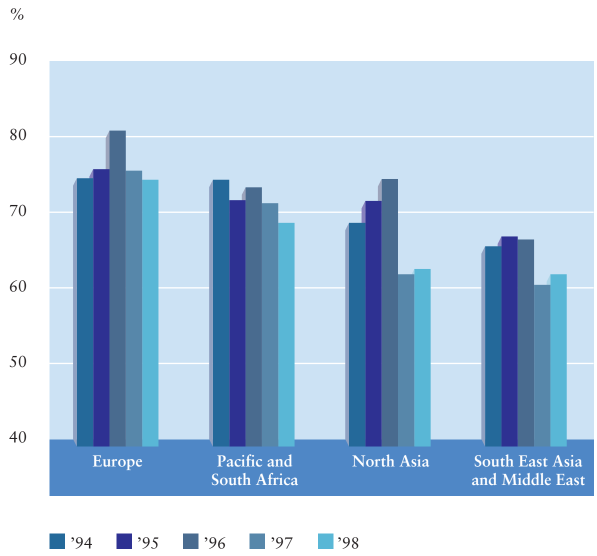
In January 1998, as part of Cathay Pacific's restructuring exercise, the individual route groups were combined into one Network Management team, in order to optimise the increasing amount of "sixth-freedom" business (i.e. passengers transiting through Hong Kong) which the airline carries. This revenue stream has been particularly important in the past year as the number of passengers travelling to Hong Kong, as a final destination, declined sharply. Although sixth-freedom traffic has resulted in lower yields, it has enabled load factors to be maintained at close to 1997 levels.

Available seat kilometres ("ASK"), load factor and yield:

	ASK (million)			*Load Factor (%)*			*Yield*
	1998	1997	**Change**	**1998**	1997	**Change**	**Change**
Europe	13,927	13,656	+2.0%	74.3	75.5	-1.2%pt	-14.5%
Pacific and South Africa	23,862	20,865	+14.4%	68.6	71.2	-2.6%pt	-15.5%
North Asia	10,423	10,869	-4.1%	62.5	61.8	+0.7%pt	-20.8%
South East Asia and Middle East	12,083	11,714	+3.2%	61.8	60.4	+1.4%pt	-19.6%
Overall	60,295	57,104	+5.6%	67.5	68.2	-0.7%pt	-18.9%

Pride in our Service

Load factor by region



Highlights by major routes are as follows:

Europe

- After a very difficult start to the year, loads on the European services improved towards winter, as the Hong Kong market improved. A codeshare arrangement with Swissair to Zurich started successfully in July and this helped to improve the results on the route. The second service to London also became daily in July, while the Frankfurt, Paris and Rome services performed satisfactorily for the year as a whole. The twice-weekly operation to Istanbul, inaugurated in August, generated a positive contribution.

Pacific and South Africa

- In order to develop more Europe-Australia business an additional daily frequency to Sydney was introduced into a generally tough market and as a result the South Pacific routes made a lower contribution in 1998. Load factors of the Australia and New Zealand routes were low and yields suffered, especially on the Auckland service. Improvements are anticipated in 1999. **one**world alliance benefits are also anticipated in the region.
- Capacity to North America grew significantly with the additional service to Los Angeles and the inauguration of services to San Francisco on 1st December. However falling yields across the Pacific adversely affected results and consequently the service to Los Angeles has been reduced to ten times a week. The Vancouver and New York services benefited from strikes suffered by competitors, whilst the Toronto flights caused concern due to falling yields.
- Prospects for 1999 depend on increasing yields from the 1998 lows, whilst maintaining or improving load factors. There is some evidence of a small recovery in long-haul tourist markets to Hong Kong, but significant growth is unlikely. Uncertainty remains over the key Taiwanese and Japanese markets and in Hong Kong the reduction in “front-end” business, an inevitable sign of the economic difficulties, is a further cause of concern.

North Asia

- For the first time in many years, the performance of direct services to Japan was poor and in certain months loss-making. Sapporo, in particular, suffered from a dramatic drop in business to and from Hong Kong and consequently the service was suspended effective from November. Yields to and from Japan fell severely, due to the weak yen and the general economic environment.
- As a result of a relatively buoyant Taiwanese economy, the first six months produced good results. Intense competition affected yields later in the year although volumes held up reasonably well.
- Strong demand from the Hong Kong market and better-than-expected front-end demand sustained revenues on our Korean services, albeit well below historic levels.

South East Asia and Middle East

- Routes to South East Asia were most severely impacted by the regional economic crisis – yields fell by more than 20% due to weak currencies and excess capacity, leading to intense price-cutting. The Philippine routes benefited from the intermittent stoppages of the major competitor and as a result these were some of the strongest performing routes in the network. Operations to Indonesia and Malaysia were affected by political problems as well as the economic downturn.
- Services to India and the Middle East performed satisfactorily, additional flights being mounted to Bahrain and Dubai early in the year. Additional capacity into India is being sought by the Company, since there has been no effective increase for a decade.

Cargo Services

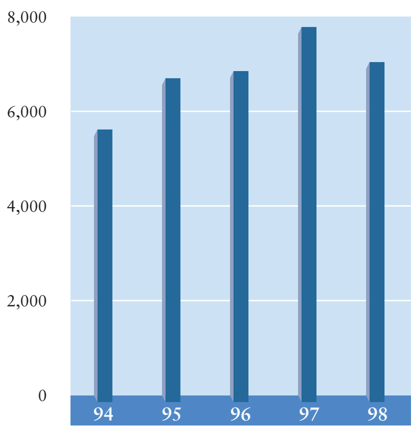
	ATK (million)			Cargo and mail Load Factor (%)			Yield
	1998	**1997**	**Change**	**1998**	**1997**	**Change**	**Change**
Cathay Pacific	5,119	4,965	+3.1%	65.2	72.9	-7.7%pt	-5.6%
AHK Air Hong Kong	1,114	978	+13.9%	74.9	78.7	-3.8%pt	-5.8%

Cathay Pacific Airways Limited ("CPA")

- Cathay Pacific Cargo operates a fleet of two B747-400 freighters and four B747-200 freighters, and serves 16 destinations.
- Worldwide cargo markets were weaker than expected in 1998, resulting in a disappointing performance for Cathay Pacific Cargo services with turnover declining by 12.8% over 1997.
- Approximately 61.3% of cargo was carried in the holds of our passenger aircraft.
- ATKs declined 2.9% for freighter aircraft and grew 9.1% for passenger aircraft cargo.
- Load factors on the freighters averaged 76.9% during 1998. Cargo load factors on passenger aircraft averaged 54.8%. Market conditions are not expected to improve during 1999.
- Problems associated with Hong Kong Air Cargo Terminals Limited following the opening of the new airport had a significant negative impact on Cathay Pacific Cargo revenue. However the enhanced facilities should strengthen Hong Kong's position as an international transhipment hub.
- Cargo shipments from Hong Kong to all major markets were weak, putting pressure on yields as supply outpaced demand.
- Most outports saw substantial negative growth with only Korea, Southeast Asia and Taiwan showing encouraging results. Loads out of Europe and North America were particularly weak.
- Cathay Pacific Cargo entered its seventeenth year of cooperation with Lufthansa on the Hong Kong-Frankfurt route. This relationship has not been impacted by the launch of the **one**world alliance which does not extend to cargo services.
- Cathay Pacific Cargo again targeted unit costs as an essential factor in its overall competitiveness. Significant unit cost reductions in both handling and trucking were achieved in 1998 and further savings in these areas will be aggressively pursued in 1999.

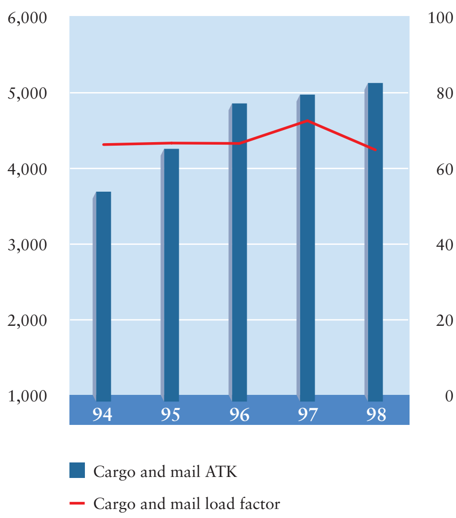
Turnover

HK$ million



Capacity and load factor

Million tonne kilometres %



AHK Air Hong Kong Limited ("AHK")

- AHK, a 75% owned subsidiary, is an all-cargo carrier with scheduled services to Brussels, Dubai, Manchester and Osaka.
- Its fleet consists of three B747-200Fs leased from Cathay Pacific.
- AHK achieved a better profit than that of 1997.
- Overall capacity as measured in ATKs increased by 13.9%.
- Efficiency as measured by cost per ATK improved by 10.7%.

Review of Affiliated Businesses and Associated Companies

Cathay Pacific Catering Services (H.K.) Limited

- This wholly-owned subsidiary is the principal flight kitchen in Hong Kong, serving 35 scheduled carriers.
- With the downturn in Hong Kong traffic, there was no growth in the production of meals which remained at 15 million in 1998.
- The company had a successful start up of the new facility at Hong Kong International Airport on 6th July.
- The company's profit was lower than that of the previous year.

Hong Kong Airport Services Limited ("HAS")

- HAS, in which Cathay Pacific holds a 70% interest, is one of the three ramp handling companies at the new Hong Kong International Airport providing aircraft loading, aerobridge and passenger step operations, and mail, cargo and baggage delivery services.
- The company was awarded a ten-year exclusive contract to operate passenger bus, staff bus and other bus services for the whole airport.
- It is the largest ramp handling operator accounting for over 50% of the market in Hong Kong. Major customers include Cathay Pacific, Air Hong Kong, All Nippon Air, Dragonair, Japan Airlines, Korean Airlines, Singapore Airlines and Thai Airways. Over 3,000 flights are handled monthly.
- The company commenced operations in July 1998 following the opening of the new Hong Kong International Airport. Although the Asian crisis affected the business volume, the company managed to be profitable in its half year of operation.

Hong Kong Dragon Airlines Limited ("Dragonair")

	ASK (million)			*Passenger Load Factor (%)*			*Passenger Yield*
	1998	1997	**Change**	**1998**	1997	**Change**	**Change**
All routes	4,066	3,729	+9.0%	59.6	68.5	-8.9%pt	-8.0%

- Dragonair, in which Cathay Pacific holds a 19% interest, is a Hong Kong-based airline operating scheduled and charter services to 27 destinations in Asia, 18 of which are in Mainland China.
- In February 1998, a thrice weekly service to Fuzhou commenced operation while the frequency to Shanghai was increased during the year.

- Despite the impact of the Asian economic turmoil, the performance of Dragonair remains satisfactory as the China market, the backbone of the company's operation, has been affected to a smaller extent than other markets in the region. Dragonair has also been very successful in reducing its operating costs.
- As a result of the disruption at the new Hong Kong International Airport in both July and August 1998, the company experienced loss in revenue, in particular cargo revenue.
- The company carried 2.1 million passengers and uplifted 43,600 tonnes of cargo in 1998, a decrease of 2.9% and an increase of 11.0% respectively over 1997.
- Passenger yield reduced by 8.0% from 1997 level and cargo yield maintained at 1997 level.
- The company took delivery of one A320 and one A330 in June and October 1998 respectively.
- Fleet profile as at 31st December 1998 is as follows:

Aircraft type	In service at 31st December 1998	Firm orders 2000
A320	7	1
A330	6	–
Fleet total	13#	1

 # All are on operating leases, except for one A320 and two A330s which are under finance leases.

- The company has replaced four A320s with new A320 aircraft powered by International Aero A5 engines in 1998. One A320 was returned to lessor in November 1998 and the replacement aircraft was delivered in January 1999. Two remaining A320s under operating lease will be replaced with the new A321s in 1999.
- Dragonair is constructing its own headquarters building at the new Hong Kong International Airport which is expected to be completed by the end of 1999. The simulator and the flight training school is expected to be operational in 2000.
- Demand for air services between Hong Kong and Mainland China is expected to increase in line with the development of China's economy.
- Dragonair will resume the Kathmandu service in 1999 which will be tagged on the existing Dhaka operation to form a triangular pattern, twice a week, using A330 aircraft.
- 1998 was a difficult year but the management remains optimistic about the future of the airline.

Hong Kong Aircraft Engineering Company Limited ("HAECO")

- HAECO, in which Cathay Pacific holds a 25% interest, provides aircraft maintenance and overhaul services at the new Hong Kong International Airport.
- Profit after tax for the year was HK$146 million, lower than that of the previous year.
- Line maintenance revenues were down, as a result of both the reduction in air traffic through Hong Kong and the increase in competition at the new Hong Kong International Airport.
- Airframe maintenance facilities were well utilised during 1998. Global rates for airframe maintenance have been stable throughout the year.
- Hong Kong Aero Engine Services Limited (HAESL), HAECO's 50:50 joint venture with Rolls-Royce plc, had a satisfactory year and is now fully operational in its new premises at Tseung Kwan O.
- Taikoo (Xiamen) Aircraft Engineering Company Limited (TAECO), 42% owned by HAECO and 9% by Cathay Pacific, had a successful year. It will shortly complete the construction of a second hangar.

We continue to invest in the future of our industry, our product and our staff to serve our customers. Cathay Pacific City, our new home, provides an efficient working environment for our staff with a range of support services including retail outlets and a new hotel.

Financial Review

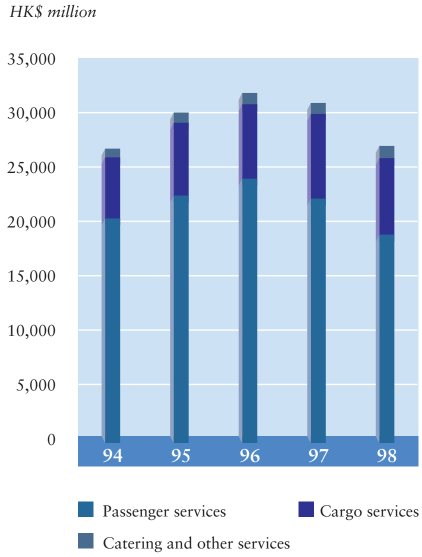
The Group's attributable loss was HK$542 million as compared with a profit of HK$1,694 million in 1997. This reduction stems from the continued deterioration in passenger load factors and yields following the downturn in the Asian economies.

Turnover

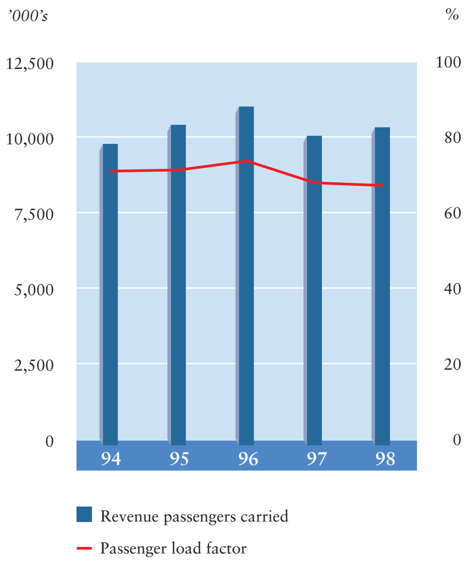
	Group		Cathay Pacific	
	1998 HK$M	1997 HK$M	1998 HK$M	1997 HK$M
Passenger services	18,532	21,851	18,532	21,851
Cargo services	7,040	7,782	5,738	6,584
Catering and other services	1,123	1,014	–	–
Turnover	26,695	30,647	24,270	28,435

Investment in our Future

Consolidated turnover



Passengers carried and load factor

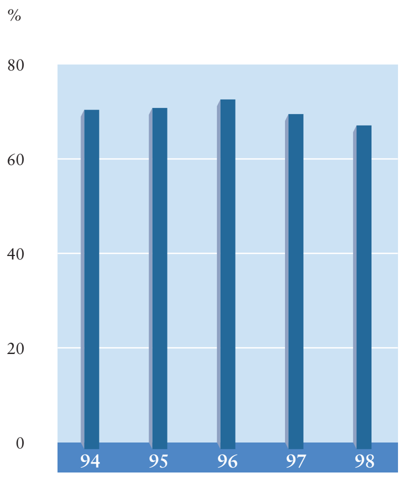


- The regional economic recession has caused passenger turnover to continue to decline in 1998, with a drop of 15.2%.
- The number of passengers carried increased by 2.8% to 10.3 million.

- Revenue passenger kilometres increased by 4.4% against a 5.6% increase in available seat kilometres which resulted in a deterioration in passenger load factor from 68.2% to 67.5%.
- Passenger yield continued to be under pressure and dropped by 18.9% to HK45.2¢ primarily as a result of weak currencies, tough competition, the reduction in "front-end" passengers and the increase in "sixth freedom" business.
- Cathay Pacific's cargo and mail turnover, as a result of the tough competition and the problems at HACTL's SuperTerminal One, dropped by 12.8%. AHK Air Hong Kong's turnover increased by 3.3%.
- Cathay Pacific's cargo and mail load factor reduced by 7.7 percentage points to 65.2% as cargo and mail tonne kilometres dropped by 7.8% against an increase of 3.1% in cargo and mail capacity. AHK Air Hong Kong's load factor decreased by 3.8 percentage points to 74.9%.
- At the Cathay Pacific company level, the decrease in turnover by HK$4,165 million was a result of:

		HK$M
4.4%	capacity growth	1,408
0.7%pt.	decrease in passenger load factor	(256)
7.7%pt.	decrease in cargo and mail load factor	(717)
18.9%	decrease in passenger yield	(4,266)
5.6%	decrease in cargo and mail yield	(334)
		(4,165)

Revenue load factor



- The weak traffic market in 1998 resulted in the Company's revenue load factor falling by 2.4 percentage points to 67.1%.
- Cathay Pacific's traffic turnover sensitivity is set out below:

Annual effects of:	HK$M
One percentage point change in passenger load factor at 1998 passenger yield	273
One percentage point change in cargo and mail load factor at 1998 cargo and mail yield	88
One Hong Kong cent change in passenger yield per revenue passenger kilometre at 1998 passenger load factor	407
One Hong Kong cent change in cargo and mail yield per cargo and mail tonne kilometre at 1998 cargo and mail load factor	33

Operating costs

	Group			Cathay Pacific		
	1998 HK$M	1997 HK$M	Change	1998 HK$M	1997 HK$M	Change
Staff	7,569	7,712	-1.9%	6,865	7,192	-4.5%
Route	6,429	6,677	-3.7%	6,181	6,406	-3.5%
Fuel	3,612	4,709	-23.3%	3,377	4,420	-23.6%
Aircraft maintenance	2,661	3,100	-14.2%	2,440	2,902	-15.9%
Aircraft depreciation and operating leases	2,743	2,330	+17.7%	2,733	2,325	+17.5%
Other depreciation and operating leases	941	1,017	-7.5%	813	958	-15.1%
Exchange losses	88	451	-80.5%	89	442	-79.9%
Commissions	717	872	-17.8%	673	849	-20.7%
Others	1,538	1,378	+11.6%	980	850	+15.3%
Total operating costs	26,298	28,246	-6.9%	24,151	26,344	-8.3%

- Staff costs decreased by HK$143 million, as a result of reduced headcounts.
- Route costs, which include costs such as meal costs, landing and parking charges, decreased primarily due to cost efficiencies and the effect of weaker foreign currencies.
- Fuel costs fell by HK$1,097 million as a result of lower fuel prices and the increased use of more fuel efficient aircraft.
- Aircraft maintenance costs reduced significantly as a result of the retirement of the B747-200 aircraft.
- Aircraft depreciation and operating lease costs increased, reflecting deliveries during the year.
- Exchange losses realised on repayment of borrowings reduced as the Japanese Yen was weaker than in 1997.
- Commissions paid to agents decreased due to lower turnover.
- The increase in other operating costs was mainly due to higher provision for doubtful debts and the costs associated with the airport move.
- Cathay Pacific's cost per ATK fell by 12.5% to HK$2.25 reflecting successful cost management.

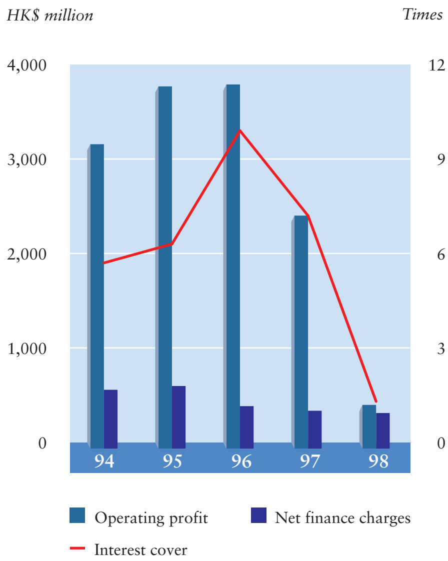
Net finance charges

- Decreased by 7.2% to HK$311 million.
- The decrease reflects movements of exchange and interest rates.
- Interest cover fell from 7.2 times to 1.3 times due to lower operating profit.

Share of profits of associated companies

- The share of profits after tax of associated companies decreased significantly by 42.9% to HK$149 million.
- The reduction of profits is mainly due to the adverse performance of two major associated companies, Dragonair and HAECO, as compared with last year.

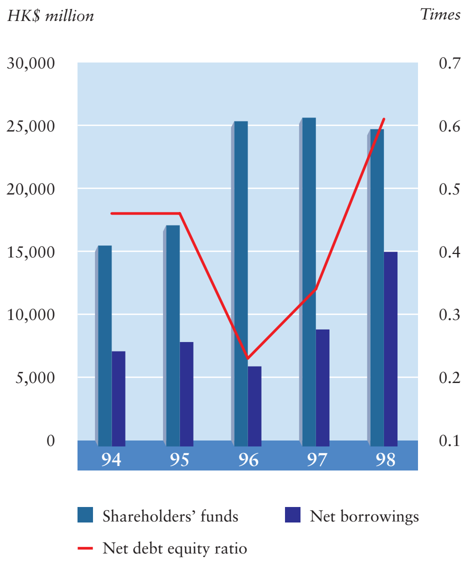
Interest cover



Taxation

- The taxation charge decreased by HK$395 million to a credit of HK$104 million as a result of the loss this year and the write-back of overseas provisions.

Net debt and equity



Dividends

- Total amount paid and proposed for 1998 is HK$339 million.

Financial position

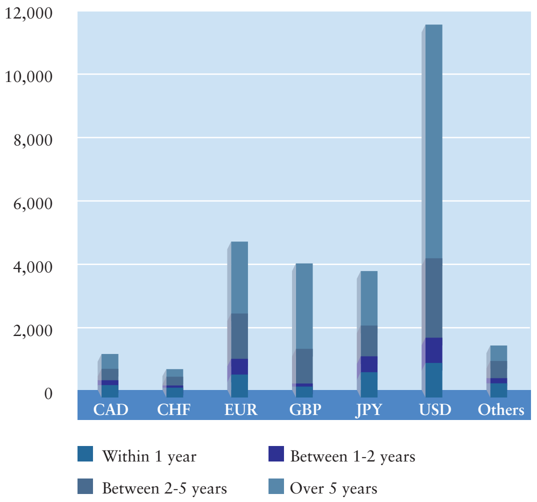
- Total assets as at 31st December 1998 amounted to HK$68,114 million.
- Additions to fixed assets amounted to HK$10,042 million, comprising HK$7,452 million for aircraft purchases including advance payments, HK$1,902 million for expenditure at the Hong Kong International Airport, and HK$688 million for properties and other equipment.
- Funds with investment managers comprise government and corporate bonds, other fixed and floating rate instruments and bank balances.
- During the year a decision was taken to mark-to-market the securities previously classified as other liquid investments and recorded at amortised cost. As a result, other liquid funds have been reclassified as current assets. Any gain or loss arising from the revaluation of these securities is taken to the profit and loss account.
- Gross borrowings increased by 17.5% to HK$27,284 million but net borrowings increased by 70.1% to HK$14,958 million.
- The Group's shareholders' funds decreased by 3.6% to HK$24,696 million.
- Net debt equity ratio increased to 0.61 times.

Financial Risk Management Policy

- In the normal course of business, the Group is exposed to fluctuations in foreign currencies, interest rates and jet fuel prices.
- These exposures are managed, sometimes with the use of derivative financial instruments, by the Treasury Department of Cathay Pacific in accordance with the Group's approved policies and parameters.
- Derivative financial instruments are used solely for financial risk management purposes and the Group does not hold or issue derivative financial instruments for trading purposes.

Maturity profile by currency: gross borrowings

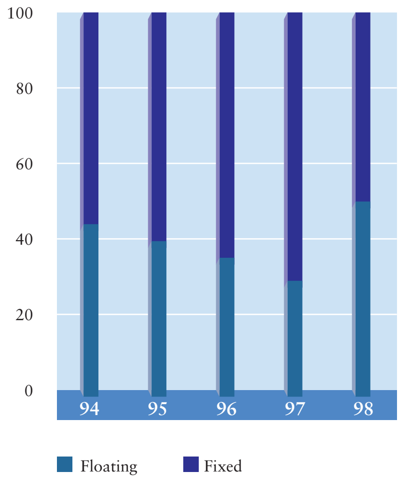
HK$ million



Others include AUD, BHD, HKD, IDR, KRW, NOK, NZD, PGK, PHP, SEK, TWD, ZAR.

Interest rate profile: gross borrowings

%



- Derivative financial instruments which constitute a hedge do not expose the Group to market risk since any change in their market value will be offset by an opposite change in the market value of the asset, liability or transaction being hedged.
- Exposure to foreign currencies, interest rates and jet fuel price movements are regularly reviewed and positions are amended in compliance with internal guidelines and limits.
- To manage credit risk, transactions are only carried out with financial institutions of high repute and all counterparties are subject to prescribed trading limits which are regularly reviewed. Risk exposures are monitored regularly by reference to market values.

Management of Currency and Interest Rate Exposures

- As an international airline, the Group's revenue streams are denominated in a number of foreign currencies resulting in exposure to foreign exchange fluctuations.
- To manage this exposure, where possible, assets are financed in those foreign currencies in which net operating surpluses are anticipated, thus establishing a natural hedge. In addition, the Group uses cross currency swaps to reduce such foreign currency surpluses.
- The use of foreign currency borrowings and cross currency swaps to hedge future operating revenues is a key component of the financial risk management process as exchange differences realised on the repayment of financial commitments are effectively matched by the change in value of the foreign currency earnings used to make those repayments.
- Derivative financial instruments are used to manage the interest rate profile of the foreign currency commitments.

Value added

The following table summarises the distribution of the Group's value added in 1997 and 1998.

	1998 HK$M	1997 HK$M
Total revenue	26,695	30,647
Less: Purchases of goods and services	(15,039)	(16,800)
Other costs	(1,460)	(1,750)
Value added by the Group	10,196	12,097
Add: Surplus/(deficit) on sale of aircraft and spares	18	(2)
Net investment income	28	43
Surplus on sales of associated companies	–	11
Share of profits of associated companies	149	261
Total value added available for distribution	10,391	12,410
Applied as follows:		
To employees		
– Salaries and other staff costs	7,569	7,712
To government		
– Corporation taxes	133	218
To providers of capital		
– Dividends	339	986
– Minority interests	35	40
– Net finance charges	311	335
Retained for re-investment and future growth		
– Depreciation	2,885	2,411
– (Loss)/retained profit for the year	(881)	708
Total value added	10,391	12,410

Directors and Advisers

Executive Directors

Peter Sutch, CBE, aged 53, has been a Director of the Company since May 1983, and was Managing Director from January 1984 to June 1989 when he was appointed Deputy Chairman. He was appointed Chairman of the Board in June 1992. He is also the Chairman of Swire Pacific Limited, Swire Properties Limited and John Swire & Sons (H.K.) Limited. He joined the Swire Group in 1966.

Robert Atkinson, aged 45, has been Finance Director of the Company since June 1997. He joined the Swire Group in 1979 and in addition to Hong Kong has also worked for the Group in Japan, the United Kingdom and the United States of America.

Ken Barley, aged 54, has been Director Flight Operations since December 1996. He joined the Company as an aircrew member in 1979 and was previously employed by Air New Zealand after serving as an officer in the Royal Air Force.

Philip Chen, aged 43, has been Director and Chief Operating Officer since 1st July 1998 and was previously Deputy Managing Director. He was previously Director and Chief Operating Officer of Hong Kong Dragon Airlines Limited. He joined the Swire Group in 1977.

Derek Cridland, aged 53, has been Engineering Director since April 1998. He joined the Company in 1982 and was previously employed by International Civil Aviation Organisation and British Airways. He is also a Director of Hong Kong Aircraft Engineering Company Limited, AHK Air Hong Kong Limited and Associated Engineers Limited.

David Turnbull, aged 43, has been a Director of the Company since January 1994. He was appointed Deputy Chairman and Chief Executive effective 1st July 1998 and was previously Managing Director. He is also Chairman of Hong Kong Aircraft Engineering Company Limited, and a Director of Swire Pacific Limited and John Swire & Sons (H.K.) Limited. He joined the Swire Group in 1976.

Tony Tyler, aged 43, has been Director Corporate Development since December 1996 and was previously Director Service Delivery. He is also a Director of Hong Kong Aircraft Engineering Company Limited and Hong Kong Dragon Airlines Limited. He joined the Swire Group in 1977 and has worked in Australia, the Philippines, Canada, Japan and Europe.

Non-Executive Directors

Robert Adams, aged 55, has been a Director of the Company since July 1996. He is an Executive Director of CITIC Pacific Limited.

Martin Cubbon, aged 41, has been a Director of the Company since September 1998. He is also a Director of Swire Pacific Limited and is Group Finance Director of John Swire & Sons (H.K.) Limited. He joined the Swire Group in 1986.

Henry Fan, aged 50, was a Director of the Company from October 1992 to March 1996. He rejoined the Board in June 1996 and was appointed Deputy Chairman in January 1997. He is Managing Director of CITIC Pacific Limited.

James Hughes-Hallett, aged 49, has been a Director of the Company since July 1998. He joined the Swire Group in April 1976 and in addition to Hong Kong he has worked for the Group in Japan and Australia. He is the Executive Director of the Trading and the Marine Services Divisions of Swire Pacific Limited.

Christopher Langley*, OBE, aged 54, has been a Director of the Company since February 1996. He is an Executive Director of The Hongkong and Shanghai Banking Corporation Limited.

Lee Hon Chiu*, aged 70, has been a Director of the Company since January 1989. He is Chairman of Hysan Development Company Limited, Chairman of the Council of The Stock Exchange of Hong Kong Limited, President of the International Federation of Stock Exchanges, a Director of Hang Seng Bank Limited, The Hong Kong & China Gas Company Limited, Sime Darby Hong Kong Limited and Imperial Chemical Industries plc of the United Kingdom and Chairman of the Council of The Chinese University of Hong Kong.

Vernon Moore*, aged 52, has been a Director of the Company since June 1996. He is Deputy Managing Director of CITIC Pacific Limited.

Edward Scott, aged 60, has been a Director of the Company since July 1976. He is also Chairman of John Swire & Sons Limited and a Director of Swire Pacific Limited. He joined the Swire Group in 1960.

Sir Adrian Swire, aged 67, was Chairman of John Swire & Sons Limited from July 1987 to December 1997 and currently is a Director and Honorary President of that Company. He has been a Director of the Company since June 1965, and is also a Director of Swire Pacific Limited, John Swire & Sons (H.K.) Limited and HSBC Holdings plc.

Raymond Yuen, aged 53, has been a Director of the Company since September 1998. He is a Director of John Swire & Sons (China) Limited. He joined the Swire Group in 1982.

Carl Yung, aged 30, is a General Manager of CITIC Pacific Limited and is also a Director of Shanghai Huang Pu River Tunnel and Bridges Development Company Limited and other companies concerned with infrastructure projects in the PRC. He joined CITIC Pacific Limited in 1993.

Zhang Xianlin, aged 45, has been a Director of the Company since August 1997. He is a Director of China National Aviation Corporation Group Limited.

* Member of the Audit Committee

Executive Officers

Robert Cutler, aged 45, has been Director Service Delivery since December 1996. He joined the Swire Group in 1975.

William Chau, aged 45, has been General Manager Personnel since November 1997. He joined the Swire Group in 1973.

Peter Buecking, aged 53, has been Director Sales and Marketing since November 1997. He joined the Swire Group in 1982.

Secretary

Paul Moore, aged 41, has been Company Secretary since October 1997. He joined the Swire Group in 1989 and has worked with the Group in Hong Kong and Japan.

Advisers to the Board

Baroness Dunn, DBE, aged 59, was a Director of the Company from December 1985 to March 1997. She is a Director of John Swire & Sons Limited, John Swire & Sons (H.K.) Limited, Swire Pacific Limited and The General Electric Company Plc. She is also Deputy Chairman of HSBC Holdings plc.

Yao Kang, OBE, aged 73, was a Director of the Company from July 1984 to June 1997. He is a Director of John Swire & Sons (H.K.) Limited, Sing Tao Holdings Limited and Hsin Chong Construction Group Limited. He joined the Swire Group in 1948.

Directors' Report

We submit our report and the audited accounts for the year ended 31st December 1998, which are on pages 33 to 61.

Activities

The Cathay Pacific Group ("the Group") is managed and controlled in Hong Kong. As well as operating scheduled airline services, the Group is engaged in other related areas, including aircraft engineering and airline catering. The airline operations are principally to and from Hong Kong, which is where most of the Group's other activities are also carried out.

Details of principal subsidiary companies, their main areas of operation and particulars of their issued capital, and details of principal associated companies are listed on pages 60 and 61.

Accounts

The loss of the Group for the year ended 31st December 1998 and the state of affairs of the Company and the Group at that date are set out in the accounts on pages 37 to 61.

Dividends

We recommend the payment of a final dividend of HK7¢ per share for the year ended 31st December 1998. Together with the interim dividend of HK3¢ per share paid on 5th September 1998, this makes a total dividend for the year of HK10¢ per share. This represents a total distribution for the year of HK$339 million. Subject to shareholders' approval of the final dividend at the annual general meeting on 12th May 1999, payment of the dividend will be on 28th May 1999 to shareholders registered on 12th May 1999. The shareholders' register will be closed from 4th May 1999 to 12th May 1999, both dates inclusive.

Reserves

Movements in the reserves of the Company and the Group during the year are set out in note 18 to the accounts.

Accounting policies

The principal accounting policies of the Group are set out on pages 33 to 36. A statement of the reasons for a departure from the standard accounting practices laid down by the Hong Kong Society of Accountants is set out in principal accounting policy note 4.

Donations

During the year, the Company and its subsidiary companies made charitable donations amounting to HK$5.1 million in direct payments and a further HK$6.6 million in the form of discounts on airline travel. In addition, the Swire Educational Trust, of which the Company is a founding contributor, funded scholarships of HK$7.7 million.

Fixed assets

Significant movements of fixed assets include aircraft acquisitions, properties in the new airport and a provision for the impairment of aircraft value. Details are set out on page 10.

Bank and other borrowings

The net bank loans, overdrafts and other borrowings, including obligations under finance leases, of the Company and its subsidiary companies are shown in notes 14, 19 and 20 to the accounts.

Share capital

During the year under review, the Company made the following purchases of its shares on the Hong Kong Stock Exchange. These purchases were made as a result of a fall in the price of the shares. All the shares purchased were cancelled.

Month	*Number Purchased*	*Highest Price Paid* **HK$**	*Lowest Price Paid* **HK$**	*Total Paid* **HK$**
January	3,600,000	5.50	4.98	19,350,631

Agreement for services

Under an agreement between the two parties, the Company reimburses costs and pays fees to John Swire & Sons Limited in exchange for services provided. This agreement can be terminated by either party giving not less than 12 months' notice to take effect on 31st December 2000 or 31st December in any subsequent year. As directors and shareholders of John Swire & Sons Limited, Edward Scott and Sir Adrian Swire are interested in this agreement. Duncan Bluck was also interested in this agreement as a director and shareholder of John Swire & Sons Limited.

Significant contracts

Contracts between the Company and HAECO for the maintenance and overhaul of aircraft and related equipment accounted for approximately 3.4% of the airline's operating costs in 1998. Like the Company, HAECO is an associated company of Swire Pacific Limited; all contracts have been concluded on normal commercial terms in the ordinary course of the business of both parties.

Connected transaction

On 5th March 1999, the Company acquired from Furama Hotel Enterprises Limited ("Furama") their 35% interest in Vogue Laundry Service Limited ("Vogue") for an aggregate consideration of HK$31,986,500. Vogue operates a laundry and drycleaning plant providing services mainly to large institutions. After the transaction, Vogue became a wholly-owned subsidiary of the Company.

The Directors of the Company, including the independent non-executive Directors, confirmed that the consideration and the terms of the Agreement were fair and reasonable and were of the best interests for the Shareholders.

The above was a connected transaction under the Listing Rules of The Stock Exchange of Hong Kong Limited because of Furama's 35% interest in Vogue.

Major customers and suppliers

5.8% of sales and 17.2% of purchases during the year were attributable to the Group's five largest customers and suppliers respectively. 1.9% of sales were made to the Group's largest customer while 5.5% of purchases were made from the Group's largest supplier. HAECO is one of the Group's largest suppliers.

Directors

All the present Directors of Cathay Pacific Airways Limited whose names are listed on pages 25 and 26 served throughout the year with the exception of:

Zhu Youjun	(resigned 14th January 1998)
Roland Fairfield	(resigned 17th April 1998)
Derek Cridland	(appointed 18th April 1998)
Patrick Tsai	(resigned 30th June 1998)
Duncan Bluck	(resigned 30th June 1998)
James Hughes-Hallett	(appointed 1st July 1998)
Raymond Yuen	(appointed 1st September 1998)
Peter Johansen	(resigned 16th September 1998)
Martin Cubbon	(appointed 16th September 1998)

At various times during the year, Peter Lee and Tony Tyler served as alternate directors.

Article 93 of the Company's Articles of Association provides for all the Directors to retire at the third annual general meeting following their election by ordinary resolution. In accordance therewith, Edward Scott, Sir Adrian Swire and Christopher Langley retire this year and being eligible, offer themselves for re-election.

James Hughes-Hallett, Raymond Yuen and Martin Cubbon having been appointed to the Board under Article 91 since the last annual general meeting, also retire and, being eligible, offer themselves for election.

No Director has a service contract that is not determinable by the employer within one year without payment of compensation (other than statutory compensation).

Directors' fees paid to the independent non-executive Directors during the year totalled HK$100,000; they received no other emoluments from the Company or any of its subsidiaries.

Year 2000

The Year 2000 ("Y2K") or millennium date change issue has arisen because many computer systems and electronic devices which store date information based on a two-digit year sequence are unable to accurately process dates for the Year 2000 and beyond. The problem affects IT and all other systems and equipment that rely on embedded electronic chip technology. It has the potential to impact on any business that does not take adequate steps to upgrade or replace non-compliant systems, guard against third-party risk from critical suppliers or customers, and manage its risk-exposure through the development of comprehensive contingency plans.

Recognising that this is first and foremost a business problem, the Cathay Pacific Group is addressing the millennium date change issue as a matter of priority. Sponsored by the Chairman of Swire Pacific and Cathay Pacific, and reporting to a central steering committee, the Swire Group Y2K Programme Office is working with external consultants to monitor progress towards Y2K readiness on a Group-wide basis. A separate Aviation Division subcommittee is co-ordinating the progress of Y2K projects within the Cathay Pacific Group. The airline's Y2K project team began work on the modification of its systems and programmes in 1996.

Cathay Pacific's Year 2000 Programme Office has been formed as a separate department headed by a senior manager reporting directly to the Director Corporate Development, who is the executive sponsor of the programme. The Programme Office also has direct access to the Chief Executive Officer who is briefed fortnightly by the Programme Manager. The role of the Year 2000 Programme Office includes the formulation of policies on Year 2000 compliance, development of a standard approach for the assessment of critical suppliers, Business Continuity Planning development and the overall coordination as well as management of the project. The Programme Office currently has a staff of 19 people and a budget in 1999 of HK$32 million.

Cathay Pacific aims to achieve Y2K readiness for its business-critical systems by March 1999 and compliance by June 1999 with the objective that neither the performance nor function of the Group's key business assets will be materially affected by the date change.

Y2K readiness will have been achieved when an inventory of all relevant equipment and systems (that is all business-critical IT systems and equipment relying on embedded chips which could be disrupted by the series of date changes associated with the Y2K issue, and therefore could have a material adverse effect on the business or operations of the Group) has been made; such equipment and systems have been assessed and tested for potential Y2K problems identified by the relevant project team and a course of action relating to any identified problems has been decided upon and the equipment or services required to implement this have been ordered or arranged. The Cathay Pacific Group of companies will have business contingency plans in place to apply in the event of disruptions caused by system or equipment failure or third party non-compliance.

Year 2000 *(continued)*

Having achieved readiness, Cathay Pacific aims to achieve Y2K compliance by June 1999. By this we mean, in relation to our own relevant equipment and systems, the modification or replacement of all such equipment and systems that fail our Y2K compliance test and, in respect of suppliers of such equipment and systems, we mean that all critical suppliers will have passed our Y2K compliance audit, or have been replaced where possible by those that have.

Cathay Pacific began to address Y2K issues at a relatively early stage. As part of regular and budgeted enhancements to its business systems, the Company has worked closely with vendors on systematic upgrade programmes to deal with the Y2K problem.

Cathay Pacific's transfer in July to the new Hong Kong International Airport, has also seen the planned upgrade of a number of potentially Y2K-sensitive systems and equipment, including the introduction of a new IT infrastructure as part of its investment in its new headquarters at Chek Lap Kok. The Company has spent HK$303 million in replacing systems, with upgraded versions the vendors of which have represented as being Y2K compliant, and as a consequence has avoided expensive remedial work. The cost of these new assets has been capitalised in the accounts. The aggregate of the costs to achieve Y2K compliance has not yet been ascertained. Costs of the Y2K programme are expensed in the accounts as and when incurred. As at 31st December 1998 a total of HK$144 million has been contracted for of which HK$90 million has been provided for in the accounts for the year ended 31st December 1998.

Cathay Pacific is supporting International Air Transport Association's ("IATA") initiative to monitor and assist Y2K readiness among airports and other industry suppliers. IATA has launched a global programme to audit international airports and air traffic control systems for Y2K readiness and plans to provide a report to its members by mid-1999.

Cathay Pacific believes that it has taken, or has identified and will take, all reasonable steps necessary to ensure that its internal systems and equipment will enable it to be Y2K compliant in a timely manner. In addition, Cathay Pacific believes that it has taken, or has identified and will take, all reasonable steps necessary to identify and mitigate the material adverse effects which might result from any third parties on which Cathay Pacific is or will be reliant, failing to be Y2K compliant. However, there can be no assurance that equipment or services used by third parties on which Cathay Pacific does or will rely, will be Y2K compliant in a timely manner. The failure of the systems or equipment or services used by third parties and on which Cathay Pacific does or will rely, could have a material adverse effect on its business.

Cathay Pacific is presently taking all reasonable steps to identify Y2K related system disruptions which may impact on part or all of our operations, and will have business continuity plans established to reduce the potential impact of any such disruptions.

Corporate governance

The Company has complied throughout the year with the Code of Best Practice as set out in the Listing Rules of The Stock Exchange of Hong Kong Limited.

In compliance with the additional requirement of The Stock Exchange of Hong Kong Limited to its Code of Best Practice, the Company has on 30th October 1998 established an Audit Committee with written terms of reference.

Directors' interests

At 31st December 1998, the register maintained under Section 29 of the Securities (Disclosures of Interests) Ordinance ("SDI") showed that Directors held the following beneficial interests in the shares of Cathay Pacific Airways Limited:

	Shares			
	Personal	Family	Other	Total
Philip Chen	9,000	–	–	9,000
Lee Hon Chiu	10,000	–	–	10,000
Peter Sutch	20,000	–	–	20,000
Tony Tyler	5,000	–	–	5,000

Neither during nor prior to the year under review, has any right been granted to, or exercised by, any Director of Cathay Pacific Airways Limited, or to or by the spouse or minor children of any Director, to subscribe for shares, warrants or debentures of Cathay Pacific Airways Limited.

Other than as stated above, no Director of Cathay Pacific Airways Limited held any interest, whether beneficial or non-beneficial, in the share capital or warrants of Cathay Pacific Airways Limited or any of its associated corporations (within the meaning of the SDI).

At no time during the year did any Director, other than as stated above, have a beneficial interest, whether directly or indirectly, in a contract to which Cathay Pacific Airways Limited, or any of its associated corporations, was a party which was of significance and in which the Director's interest was material.

At no time during the year was Cathay Pacific Airways Limited or any of its associated corporations, a party to any arrangements to enable the Directors of the Company to acquire benefits by means of the acquisition of shares in or debentures of the Company or any other body corporate.

Substantial shareholders

The register of substantial shareholders maintained under section 16(1) of the SDI shows that at 31st December 1998 the Company had been notified of the following interests, being 10% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors.

			Remarks
1. John Swire & Sons Limited	1,526,606,246		
2. Swire Pacific Limited	1,526,606,246	)	Duplications of John Swire
3. John Swire & Sons (H.K.) Limited	1,526,606,246	)	& Sons Limited's holding
4. CITIC Pacific Limited	859,353,462		
5. Super Supreme Company Limited	787,753,462	)	Duplication of CITIC Pacific
	6,226,925,662		Limited's holding
Less: Duplications	3,840,965,954		
	2,385,959,708		

Auditors

On 19th November 1998, the Company's Auditors changed the name under which they practise to KPMG and, accordingly, have signed their report in their new name. A resolution for the reappointment of KPMG as Auditors of the Company is to be proposed at the forthcoming annual general meeting.

By order of the Board

Peter Sutch
Chairman
Hong Kong, 10th March 1999

Auditors' Report

To the shareholders of Cathay Pacific Airways Limited (Incorporated in Hong Kong with limited liability)

We have audited the accounts on pages 33 to 61 which have been prepared in accordance with accounting principles generally accepted in Hong Kong, save as explained in accounting policy 4 on pages 33 and 34.

Respective responsibilities of directors and auditors

The Companies Ordinance requires the Directors to prepare accounts which give a true and fair view. In preparing accounts which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently, that judgements and estimates are made which are prudent and reasonable and that the reasons for any significant departure from applicable accounting standards are stated.

It is our responsibility to form an independent opinion, based on our audit, on those accounts and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Statements of Auditing Standards issued by the Hong Kong Society of Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the Company's and the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the accounts are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts. We believe that our audit provides a reasonable basis for our opinion.

Opinion

In our opinion the accounts give a true and fair view, in all material respects, of the state of the Company's and the Group's affairs as at 31st December 1998 and of the Group's loss and cash flows for the year then ended and have been properly prepared in accordance with the Companies Ordinance.

KPMG
Certified Public Accountants
Hong Kong, 10th March 1999

Principal Accounting Policies

1. Basis of accounting

The accounts have been prepared in accordance with the Hong Kong Society of Accountants' Statements of Standard Accounting Practice (HK SSAPs) with the exception of the recognition of exchange differences on certain long-term liabilities which is explained in full in accounting policy 4 below.

2. Basis of consolidation

The consolidated accounts of the Group incorporate the accounts of the Company and its subsidiary companies made up to 31st December, together with the Group's share of the results and retained post acquisition reserves of its associated companies.

The results of subsidiary companies are included in the consolidated profit and loss account, and the share attributable to minority interests is deducted from consolidated profit after taxation. Where interests have been bought or sold during the year, only those results relating to the period of ownership are included in the accounts.

Goodwill arising on consolidation, representing the excess of the cost of subsidiary and associated companies over the fair value of the Group's share of the separable net assets at the date of acquisition, is written off to reserves in the year in which it arises.

On the sale of a subsidiary or associated company, goodwill previously eliminated against reserves is written back.

Minority interests in the consolidated balance sheet comprise the outside shareholders' proportion of the net assets of subsidiary companies.

3. Associated companies

Associated companies are those companies, not being subsidiary companies, in which the Group holds a substantial long-term interest in the equity share capital and over which the Group is in a position to exercise significant management influence.

The consolidated profit and loss account includes the Group's share of results of associated companies as reported in their accounts made up to 31st December. In the consolidated balance sheet, investment in associated companies represents the Group's share of net assets other than goodwill.

In the Company's balance sheet, investment in associated companies is stated at cost less provision for permanent diminution in value, and loans to those companies.

4. Foreign currencies

Foreign currencies are translated into Hong Kong dollars on the following basis:

(a) for foreign currency denominated monetary assets and liabilities (including currency swaps), and the balance sheets of subsidiary and associated companies, at the rates ruling at the balance sheet date; and

(b) for foreign currency transactions entered into during the year, at the market rates ruling at the relevant transaction dates.

4. Foreign currencies *(continued)*

Exchange differences arising on the translation of foreign currencies into Hong Kong dollars are reflected in the profit and loss account except that:-

(i) To reduce its exposure to exchange rate fluctuations on future operating cash flows, the Group arranges its borrowings and leasing obligations in foreign currencies such that repayments can be met by these anticipated operating cash flows. In addition the Group takes out currency swaps to hedge anticipated cash flows. Any unrealised exchange differences on these borrowings, leasing obligations and currency swaps and on related security deposits are deferred and carried forward in the balance sheet as deferred items. These exchange differences are recognised in the profit and loss account as repayments under the original loan or leasing obligation fall due or on the settlement date of the relevant currency swaps.

This treatment does not comply with HK SSAP11 which requires that all such unrealised exchange differences are charged to the profit and loss account. The effect of this departure from HK SSAP11 is set out in note 16(a) to the accounts.

(ii) Unrealised differences on net investments in foreign subsidiary and associated companies (including intra-Group balances of an equity nature) and related long-term liabilities are taken directly to reserves.

In the opinion of the Directors, the deferral of unrealised exchange differences on foreign currency borrowings and lease obligations fairly reflects the effects of the Group's long-term foreign currency financing arrangements. The matching of foreign currency debt repayments against surplus operating cash flows in the same currencies is a key foreign exchange risk management tool for the Group's airline operations, which involve multi-currency cash flows. The appropriateness of continuing to defer these exchange differences is assessed regularly, taking into consideration the latest operating cash flow projections of each currency in which the Group has long-term liabilities. The Directors consider that the immediate recognition of all such exchange fluctuations in the profit and loss account could materially distort year on year results and would not give a true and fair view.

5. Fixed assets and depreciation

Fixed assets are stated at cost less depreciation.

Depreciation of fixed assets is calculated on a straight line basis to write down their cost over their anticipated useful lives to estimated residual values as follows:

Aircraft and related equipment	over 15 to 20 years to residual value of between 10% to 20% of cost
Other equipment	over 3 to 7 years to nil residual value
Leasehold land and buildings	over the period of the lease to nil residual value

Major modifications to aircraft and reconfiguration costs are capitalised as part of aircraft cost and are depreciated over periods of up to ten years.

The Group's aircraft depreciation policy is reviewed regularly, taking into consideration factors such as changes in fleet composition, current and forecast market prices, and technical factors which affect the life expectancy of the fleet. Where decisions have been made to take aircraft out of service, any impairment in value is recognised by writing down their carrying value to estimated net recoverable amount.

All costs incurred by the Group in the construction of facilities at Chek Lap Kok are initially recorded as properties under construction. No depreciation is provided on these costs until construction is complete and the assets are put into effective use.

6. Leased assets

Fixed assets held under lease agreements that give rights equivalent to ownership are treated as if they had been purchased outright at fair market value, and the corresponding liabilities to the lessor, net of interest charges, are included as obligations under finance leases. Any profits or losses under sale and leaseback arrangements are included as part of the cost of the leased assets.

Amounts payable in respect of finance leases are apportioned between interest charges and reductions of obligations based on the interest rates implicit in the leases.

Operating lease payments are charged to the profit and loss account on a straight line basis over the life of the related lease.

7. Long-term investments

Long-term investments are stated at cost less provision, where applicable, for any permanent diminution in value.

8. Stocks

Stocks held for consumption are valued at weighted average cost, less any applicable allowance for obsolescence. Stocks held for disposal are stated at the lower of cost and net realisable value. Net realisable value represents estimated resale price.

9. Funds with investment managers and other liquid investments

Funds with investment managers and other liquid investments are marked to market and any gain or loss arising from their revaluation is taken to the profit and loss account.

10. Defeasance of long-term liabilities

Where long-term liabilities have been defeased by the placement of security deposits, those liabilities and deposits (and income and charges arising therefrom) are netted off, in order to reflect the overall commercial effect of the arrangements. Such netting off has been effected where a right is held to insist on net settlement of the liability and deposit at any time and where no significant risk is borne in respect of the gross amounts.

11. Security deposits, notes and zero coupon bonds

Cash deposits and notes placed in respect of certain leasing and financing arrangements are stated at cost and set off against the relevant liabilities or obligations in the balance sheet. Interest income arising thereon is similarly set off against the interest charges on the related liabilities or obligations.

Zero coupon bonds purchased to meet future leasing obligation repayments are stated at maturity value and are set off against the principal amounts outstanding under the relevant obligations in the balance sheet. The discount or premium thereon is included in other deferred items and is amortised over the period to maturity. Amounts amortised in the year are included in net finance charges in the profit and loss account.

12. Currency and interest rate swaps and fuel price derivatives

The Group has entered into currency and interest rate transactions to effectively convert certain lease payments and loan repayments, including both principal and interest, into requisite currencies and interest bases. As a result, long-term borrowings reflect the ultimate repayable currencies and interest bases. Amounts receivable or payable under interest rate derivative transactions are accrued as an adjustment to interest expense.

12. Currency and interest rate swaps and fuel price derivatives *(continued)*

The Group uses fuel price caps, collars and swap agreements to reduce its exposure to fluctuating fuel costs. Gains and losses on these instruments are recognised as a component of fuel expense during the period the related fuel is used. Premiums paid on the fuel cap agreements are deferred and amortised to the profit and loss account over the term of the related agreement.

13. Deferred taxation

Provision is made for deferred taxation using the liability method for all material timing differences except where it is considered probable that no liability will arise in the foreseeable future.

In addition, where initial cash benefits have been received in respect of certain lease arrangements, provision is made for the future obligation to make taxation payments on behalf of the lessors.

14. Maintenance and overhaul costs

Replacement spares and labour costs for maintenance and overhaul of aircraft are charged to operating profit on consumption and as incurred respectively.

15. Revenue recognition

Passenger and cargo ticket sales are recognised as revenue when the transportation service is provided. The value of unflown passenger and cargo sales is recorded as unearned transportation revenue.

16. Retirement benefits

Arrangements for staff retirement benefits vary from country to country and are made in accordance with local regulations and customs. The significant plans are defined retirement benefit plans and are valued every year. Profits are charged with actuarially determined contributions using the accrued benefit valuation method.

17. Frequent flyer programme

During the year, the Company participated in certain frequent flyer programmes, the most significant of which was *Passages*, a frequent flyer programme administered by Asian Frequent Flyer Pte Limited ("AFFP") in which the Company holds 33% of the equity share capital. This programme has stopped mileage accrual in February 1999.

Under this frequent flyer programme, as points are earned by passengers, payments are made to AFFP which records the liabilities for future transportation services. AFFP in turn makes payments to the Company when *Passages* members redeem their accumulated points for passenger tickets. Payments made to and received from AFFP are recorded as expenses and revenue respectively in the Company's profit and loss account.

18. Related parties

For the purposes of these accounts, parties are considered to be related to the Group if the Group has the ability, directly or indirectly, to control the party or exercise significant influence over the party in making financial and operating decisions, or vice versa, or where the Group and the party are subject to common control or common significant influence. Related parties may be individuals or entities.

Consolidated Profit and Loss Account

for the year ended 31st December 1998

	Note	1998 HK$M	1997 HK$M	1998 US$M	1997 US$M
Turnover	1	**26,695**	30,647	**3,422**	3,929
Operating profit	2	**397**	2,401	**51**	308
Exceptional items	3	**(869)**	(347)	**(111)**	(44)
Net finance charges	4	**(311)**	(335)	**(40)**	(43)
Net operating (loss)/profit		**(783)**	1,719	**(100)**	221
Share of profits of associated companies	12	**172**	306	**22**	39
(Loss)/profit before taxation		**(611)**	2,025	**(78)**	260
Taxation	5	**104**	(291)	**13**	(38)
(Loss)/profit after taxation		**(507)**	1,734	**(65)**	222
Minority interests		**(35)**	(40)	**(4)**	(5)
(Loss)/profit attributable to shareholders	6	**(542)**	1,694	**(69)**	217
Dividends	7	**(339)**	(986)	**(44)**	(126)
(Loss)/retained profit for the year	8	**(881)**	708	**(113)**	91
(Loss)/earnings per share	9	**(16.0¢)**	49.5¢	**(2.1¢)**	6.3¢

The US$ figures are for information only and are translated at HK$7.8.

The notes on pages 41 to 61 form part of these accounts.

Consolidated Balance Sheet

at 31st December 1998

	Note	1998 HK$M	1997 HK$M	1998 US$M	1997 US$M
Aircraft and related equipment		41,754	37,580	5,353	4,818
Properties and other equipment		5,775	1,384	741	178
Properties under construction		1,672	3,863	214	495
Fixed assets	10	49,201	42,827	6,308	5,491
Associated companies	12	1,325	1,145	170	147
Other long-term receivables and investments	13	1,277	1,445	164	185
Long-term receivables and investments		2,602	2,590	334	332
Current assets	14	16,311	19,245	2,091	2,467
Current liabilities	14	(10,200)	(9,383)	(1,308)	(1,203)
Current assets less current liabilities		6,111	9,862	783	1,264
Total assets less current liabilities		57,914	55,279	7,425	7,087
Deferred taxation	15	(6,359)	(5,802)	(815)	(744)
Deferred exchange differences and other items	16	(1,893)	(2,296)	(243)	(294)
Total assets less current liabilities and deferred items		49,662	47,181	6,367	6,049
FINANCED BY:					
Share capital	17	676	677	87	87
Reserves	18	24,020	24,929	3,079	3,196
Shareholders' funds		24,696	25,606	3,166	3,283
Minority interests		108	104	14	13
Long-term loans, bonds and other liabilities	19	4,223	3,940	541	505
Obligations under finance leases	20	20,635	17,531	2,646	2,248
Long-term liabilities		24,966	21,575	3,201	2,766
Total equity and long-term liabilities		49,662	47,181	6,367	6,049

The US$ figures are for information only and are translated at HK$7.8.

Peter Sutch
Director
Hong Kong, 10th March 1999

Henry Fan
Director

The notes on pages 41 to 61 form part of these accounts.

Company Balance Sheet

at 31st December 1998

	Note	1998 HK$M	1997 HK$M	1998 US$M	1997 US$M
Aircraft and related equipment		38,360	31,798	4,918	4,077
Properties and other equipment		1,328	1,186	170	152
Fixed assets	10	39,688	32,984	5,088	4,229
Subsidiary companies	11	30,548	30,561	3,916	3,918
Associated companies	12	85	82	11	10
Other long-term receivables and investments	13	1,031	1,112	132	142
Long-term receivables and investments		31,664	31,755	4,059	4,070
Current assets	14	5,568	6,018	714	772
Current liabilities	14	(12,462)	(10,365)	(1,598)	(1,329)
Current assets less current liabilities		(6,894)	(4,347)	(884)	(557)
Total assets less current liabilities		64,458	60,392	8,263	7,742
Deferred taxation	15	(6,232)	(5,699)	(799)	(731)
Deferred exchange differences and other items	16	(1,673)	(2,086)	(214)	(267)
Total assets less current liabilities and deferred items		56,553	52,607	7,250	6,744
FINANCED BY:					
Share capital	17	676	677	87	87
Reserves	18	21,245	22,265	2,723	2,854
Shareholders' funds		21,921	22,942	2,810	2,941
Long-term loans, bonds and other liabilities	19	4,640	4,386	595	562
Obligations under finance leases	20	29,992	25,279	3,845	3,241
Long-term liabilities		34,632	29,665	4,440	3,803
Total equity and long-term liabilities		56,553	52,607	7,250	6,744

The US$ figures are for information only and are translated at HK$7.8.

Peter Sutch
Director

Henry Fan
Director

Hong Kong, 10th March 1999

The notes on pages 41 to 61 form part of these accounts.

Consolidated Cash Flow Statement

for the year ended 31st December 1998

	Note	1998 HK$M	1997 HK$M	1998 US$M	1997 US$M
Net cash flow from operating activities	21	4,066	4,722	521	605
Returns on investments and servicing of finance					
Interest received		387	497	50	64
Dividends received from associated companies		89	110	12	14
Net interest paid on finance leases		(1,190)	(1,385)	(153)	(178)
Other interest paid		(217)	(206)	(28)	(26)
Dividends paid – to shareholders		(694)	(1,817)	(89)	(233)
– to minority interests		(31)	(11)	(4)	(1)
Net cash outflow from returns on investments and servicing of finance		(1,656)	(2,812)	(212)	(360)
Tax paid		(75)	(475)	(10)	(61)
Investing activities					
Sales of fixed assets		52	11	7	1
Payments for fixed assets	22	(5,074)	(5,389)	(650)	(691)
Purchases of long-term investments		–	(114)	–	(15)
Net decrease/(increase) in long-term receivables		124	(111)	16	(14)
Transfer of funds from investment managers		1,354	6,130	174	786
Purchase of other liquid investments		(660)	(470)	(85)	(60)
Receipts from sale of investments		229	–	29	–
Net increase in short-term deposits maturing beyond three months		(85)	(1)	(11)	–
Investment in associated companies		–	(4)	–	(1)
Loans to associated companies		(121)	–	(15)	–
Proceeds from sale of interest in associated company		–	21	–	3
Net cash (outflow)/inflow from investing activities		(4,181)	73	(535)	9
Net cash (outflow)/inflow before financing		(1,846)	1,508	(236)	193
Financing					
New financing	23	2,917	80	374	10
Purchases of bonds and security deposits placed	23	(2,391)	(789)	(307)	(101)
Loan and finance lease repayments	23	(1,690)	(2,901)	(217)	(372)
Net cash benefit from financing arrangements		749	733	96	94
Redemption of minority interests' preference shares		–	(3)	–	–
Purchase of Company's shares		(19)	(438)	(2)	(56)
Net cash outflow from financing		(434)	(3,318)	(56)	(425)
Decrease in cash and cash equivalents		(2,280)	(1,810)	(292)	(232)
Cash and cash equivalents at beginning of the year	24	4,381	6,223	562	798
Effect of exchange differences		18	(32)	2	(4)
Cash and cash equivalents at end of the year	24	2,119	4,381	272	562

The US$ figures are for information only and are translated at HK$7.8.

The notes on pages 41 to 61 form part of these accounts.

Notes to the Accounts – Profit and Loss Account

1. Turnover

Turnover comprises revenue from transportation services, airline catering and other services provided to third parties. Turnover is analysed as follows:

	1998 HK$M	1997 HK$M
Passenger services	18,532	21,851
Cargo services	7,040	7,782
Catering and other services	1,123	1,014
Turnover	26,695	30,647

2. Operating profit

	1998 HK$M	1997 HK$M
Operating profit has been arrived at after charging/(crediting):		
Depreciation of fixed assets:		
Leased	1,660	1,456
Owned	1,225	955
Operating lease rentals:		
Land and buildings	555	624
Aircraft and related equipment	205	219
Others	39	93
Exchange differences:		
Realised on long-term loans and leasing obligations	64	275
Others	24	176
Auditors' remuneration	6	6
Income from unlisted investments	(28)	(43)

3. Exceptional items

	1998 HK$M	1997 HK$M
The exceptional items consist of the following:		
Net profit arising from the sale of investments	(185)	–
Provision for severance payments arising from staff retrenchments	217	347
Provision for the impairment in value of the B747-200 and B747-300 aircraft and related equipment arising from decisions to remove them from service	607	–
Provision to write down the B747-200 and B747-300 aircraft spare parts to net realisable value	230	–
	869	347

The net profit arising from the sale of investments mainly relates to the sale of a 4.5% shareholding in a company operating a computerised reservation system business in Asia. The Group still maintains an 8.4% shareholding in this business.

3. Exceptional items *(continued)*

The provision for severance payments arising from staff retrenchments in 1998 is in connection with staff redundancies undertaken or to be undertaken as a result of the decisions to remove the B747-200 and B747-300 aircraft from service.

The provision for the impairment in value of the B747-200 and B747-300 aircraft and related equipment arises from decisions to remove these aircraft from service. The carrying value of these aircraft and related equipment has been written down to estimated net recoverable amount. Provision has also been made to write down the related aircraft spare parts to net realisable value. The net realisable value of the spare parts has been determined based on market resale price.

4. Net finance charges

	1998 HK$M	1997 HK$M
Net interest charged on:		
Obligations under finance leases	2,047	2,058
Interest income on related security deposits, notes and bonds	(933)	(942)
	1,114	1,116
Bank loans and overdrafts	518	519
Interest income on related security deposits	(290)	(303)
	228	216
Other loans and bonds		
– wholly repayable within five years	40	36
– not wholly repayable within five years	–	1
	40	37
Interest income on bank short-term deposits and loans	(256)	(309)
Other finance income	(245)	(153)
	(501)	(462)
	881	907
Income from funds with investment managers	(570)	(572)
	311	335

Finance income and expenses relating to defeasance arrangements have been netted off in the above figures.

5. Taxation

The taxation (credit)/charge comprises:

	1998 HK$M	1997 HK$M
The Company and its subsidiary companies:		
Hong Kong profits tax	5	57
Overseas taxation	128	161
Deferred taxation (note 15)	(97)	161
Overprovision for prior years	(163)	(133)
	(127)	246
Associated companies:		
Hong Kong profits tax	22	44
Overseas taxation	1	1
	(104)	291

Hong Kong profits tax is calculated at 16% (1997: 16.5%) on the estimated assessable profits for the year. Overseas taxation is calculated at rates of tax applicable in countries in which the Group is assessable for tax. Tax provisions are reviewed regularly to take into account changes in legislation, practice and status of negotiations.

6. (Loss)/profit attributable to shareholders

Of the loss attributable to the shareholders, HK$663 million (1997: profit HK$1,517 million) has been dealt with in the accounts of the Company.

7. Dividends

	1998 HK$M	1997 HK$M
Interim dividend paid on 5th October 1998 of 3¢ per share (1997: 11.5¢)	102	394
Proposed final dividend of 7¢ per share (1997: 17.5¢)	237	592
	339	986

8. (Loss)/retained profit for the year

	1998 HK$M	1997 HK$M
(Loss)/retained profit for the year attributed by:		
The Company	(1,002)	531
Subsidiary companies	61	26
Associated companies	60	151
	(881)	708

9. (Loss)/earnings per share

Loss per share is calculated by dividing loss attributable to shareholders of HK$542 million (1997: profit HK$1,694 million) by the daily weighted average of 3,384,278,752 (1997: 3,423,428,308) shares in issue throughout the year.

10. Fixed assets

	Aircraft and related equipment		Other equipment			Properties under	
	Owned	Leased	Owned	Leased	Properties	construction	Total
	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M	HK$M
GROUP							
Cost							
At beginning of the year	14,525	34,023	2,958	7	929	3,863	56,305
Exchange differences	–	–	(6)	(2)	(7)	–	(15)
Additions	2,484	4,968	425	–	263	1,902	10,042
Disposals	(209)	–	(424)	–	(41)	–	(674)
Transfers	(2,550)	2,550	311	102	3,680	(4,093)	–
At end of the year	14,250	41,541	3,264	107	4,824	1,672	65,658
Depreciation							
At beginning of the year	3,910	7,058	2,000	3	507	–	13,478
Exchange differences	–	–	(5)	–	(3)	–	(8)
Charge for the year	878	1,659	207	1	140	–	2,885
Provision for impairment	220	387	–	–	–	–	607
Disposals	(75)	–	(389)	–	(41)	–	(505)
Transfers	164	(164)	(6)	6	–	–	–
At end of the year	5,097	8,940	1,807	10	603	–	16,457
Net book value							
At end of the year	9,153	32,601	1,457	97	4,221	1,672	49,201
At beginning of the year	10,615	26,965	958	4	422	3,863	42,827
COMPANY							
Cost							
At beginning of the year	4,295	36,141	2,545	–	743	–	43,724
Additions	1,745	7,970	183	–	202	–	10,100
Disposals	(548)	–	(280)	–	–	–	(828)
Transfers	526	(526)	(102)	102	–	–	–
At end of the year	6,018	43,585	2,346	102	945	–	52,996
Depreciation							
At beginning of the year	1,251	7,387	1,671	–	431	–	10,740
Charge for the year	638	1,743	158	–	70	–	2,609
Provision for impairment	173	387	–	–	–	–	560
Disposals	(336)	–	(265)	–	–	–	(601)
Transfers	231	(231)	(6)	6	–	–	–
At end of the year	1,957	9,286	1,558	6	501	–	13,308
Net book value							
At end of the year	4,061	34,299	788	96	444	–	39,688
At beginning of the year	3,044	28,754	874	–	312	–	32,984

10. Fixed assets *(continued)*

(a) Certain support equipment is subject to pooling agreements with other airlines.

(b) Security, including charges over the assets concerned and relevant insurance policies, is provided to the leasing companies or other parties that provide the underlying finance.

(c) Properties held at 31st December 1998 comprised land held under medium-term lease in Hong Kong with a net book value of HK$1,061 million (1997: nil) and freehold land held outside Hong Kong with a net book value of HK$19 million (1997: HK$20 million).

(d) Advance payments are made to manufacturers for aircraft and related equipment to be delivered in future years. Advance payments included in owned aircraft and related equipment amount to HK$1,194 million (1997: HK$3,292 million) for the Group and HK$60 million (1997: HK$131 million) for the Company. No depreciation is provided on these advance payments.

(e) During 1998, it was decided to phase out the B747-200 and B747-300 aircraft. As a result, the net recoverable amount of these aircraft was re-assessed and an exceptional loss of HK$607 million has been incorporated.

(f) Properties under construction comprise:

	Group	
	1998 HK$M	**1997 HK$M**
Headquarters and hotel	905	2,257
Training facilities	562	296
Stores building	205	77
Catering facilities	–	1,233
Total	1,672	3,863

Included in the cost of the properties under construction is land held under medium-term lease in Hong Kong with a net book value of HK$708 million (1997: HK$1,761 million).

(g) Capitalised value of operating leased aircraft

At 31st December 1998, the estimated capitalised value of the rental obligations for the two B747-400s held under operating leases was HK$723 million. The estimated capitalised value represents the present value of the aggregate future payments for operating lease commitments.

11. Subsidiary companies

	Company	
	1998	1997
	HK$M	HK$M
Investments at cost	**31,921**	25,945
Net amounts due (to)/from subsidiary companies:		
Loan accounts	**(8,698)**	(6,110)
Current accounts	**7,325**	10,726
	30,548	30,561

Principal subsidiary companies are listed on page 60.

12. Associated companies

	Group		Company	
	1998	1997	**1998**	1997
	HK$M	HK$M	**HK$M**	HK$M
Hong Kong listed shares at cost (Market value: $484 million, 1997: $890 million)	**–**	–	**52**	52
Unlisted shares at cost	**–**	–	**56**	56
Share of net assets other than goodwill				
– listed in Hong Kong	**616**	602	**–**	–
– unlisted	**584**	539	**–**	–
	1,200	1,141	**108**	108
Less: Provision	**–**	–	**(26)**	(26)
Loans to associated companies	**125**	4	**3**	–
	1,325	1,145	**85**	82
Share of profits of associated companies				
– listed	**40**	91	**–**	–
– unlisted	**132**	215	**–**	–
	172	306	**–**	–
Dividends received and receivable by the Company and its subsidiary companies from associated companies	**89**	110	**24**	45

Principal associated companies are listed on page 61.

13. Other long-term receivables and investments

	Group		Company	
	1998	1997	**1998**	1997
	HK$M	HK$M	**HK$M**	HK$M
Staff housing loans and other receivables	**887**	1,011	**746**	783
Investments at cost				
– listed in Hong Kong (Market value: $38 million, 1997: $106 million)	**105**	105	**–**	–
– unlisted	**285**	329	**285**	329
	1,277	1,445	**1,031**	1,112

14. Current assets less current liabilities

	Group		Company	
	1998	1997	**1998**	1997
	HK$M	HK$M	**HK$M**	HK$M
Current assets:				
Stocks	**694**	1,074	**678**	1,055
Debtors	**3,268**	3,748	**2,821**	3,295
Due from associated companies	**21**	4	**13**	1
Due from other related companies	**2**	–	**1**	–
Short-term deposits and bank balances	**2,291**	4,474	**1,730**	1,667
Funds with investment managers				
– debt securities listed outside Hong Kong	**7,091**	7,666	**–**	–
– cash and deposits	**225**	434	**–**	–
Other liquid investments				
– debt securities listed outside Hong Kong	**1,746**	1,475	**325**	–
– cash and bank deposits	**973**	370	**–**	–
Total current assets	**16,311**	19,245	**5,568**	6,018
Current liabilities:				
Creditors	**(4,879)**	(4,240)	**(6,142)**	(5,230)
Due to associated companies	**(165)**	(127)	**(150)**	(112)
Due to related companies	**(176)**	(10)	**(166)**	–
Unearned transportation revenue	**(1,644)**	(1,905)	**(1,644)**	(1,905)
Taxation	**(673)**	(766)	**(653)**	(734)
Bank overdrafts and short-term loans				
– secured	**–**	(29)	**–**	(29)
– unsecured	**(86)**	(63)	**(83)**	(63)
Long-term loans and liabilities				
– due within one year (note 19)	**(980)**	(735)	**(909)**	(498)
Obligations under finance leases				
– due within one year (note 20)	**(1,360)**	(916)	**(2,478)**	(1,202)
Proposed final dividend	**(237)**	(592)	**(237)**	(592)
Total current liabilities	**(10,200)**	(9,383)	**(12,462)**	(10,365)
Current assets less current liabilities	**6,111**	9,862	**(6,894)**	(4,347)

Included in other liquid investments are short-term bank deposits of HK$973 million (1997: HK$370 million) and debt securities of HK$706 million (1997: nil) which are pledged to lessors as part of long-term financing arrangements. The arrangements provide that the Group must maintain these deposits and debt securities at specified levels for the duration of the financing.

15. Deferred taxation

Movements on deferred taxation comprise:

	Group		Company	
	1998 HK$M	1997 HK$M	1998 HK$M	1997 HK$M
At beginning of the year	5,802	5,359	5,699	5,299
Movements for the year				
– transfer from profit and loss account				
– tax provision (note 5)	(97)	161	(121)	121
– operating expenses	81	46	81	43
– initial cash benefit from lease arrangements	666	317	666	317
Amount due within one year included under current liabilities – taxation (note 14)	(93)	(81)	(93)	(81)
At end of the year	6,359	5,802	6,232	5,699

The deferred taxation provision comprises the taxation effects of:

	Group		Company	
	1998 HK$M	1997 HK$M	1998 HK$M	1997 HK$M
Timing differences arising from:				
– different taxation and accounting treatments of fixed assets net of unutilised tax losses	541	634	412	529
– certain lease arrangements	5,831	5,177	5,833	5,178
– other timing differences	(13)	(9)	(13)	(8)
	6,359	5,802	6,232	5,699

Provision has been made for all significant deferred taxation liabilities.

The provision in respect of certain lease arrangements equates to payments which are expected to be made during the years 2000 to 2011 as follows:

	1998 HK$M	1997 HK$M
Within two to five years	666	463
Within five to ten years	4,395	3,939
Over ten years	770	775
	5,831	5,177

16. Deferred exchange differences and other items

	Group		Company	
	1998 HK$M	1997 HK$M	1998 HK$M	1997 HK$M
Deferred exchange differences	(66)	(619)	35	(752)
Other items	(1,827)	(1,677)	(1,708)	(1,334)
	(1,893)	(2,296)	(1,673)	(2,086)

(a) Deferred exchange differences

Deferred exchange differences are expected to be charged/(credited) to operating profit as noted below, based on exchange rates ruling at 31st December 1998.

	1st half HK$M	*2nd half* HK$M	*Total* HK$M
1999	53	51	104
2000	41	30	71
2001	17	(3)	14
2002	(46)	(74)	(120)
2003	(16)	(31)	(47)
Beyond 2003			(88)
			(66)

The actual exchange differences ultimately recognised in operating profit will depend upon exchange rates ruling on the repayment dates of the relevant long-term liabilities and lease obligations.

Had HK SSAP 11 been adopted, reserves brought forward from 1997 would have been HK$619 million higher and the reserves carried forward from 1998 would increase by HK$66 million. The effect on (loss)/profit attributable to shareholders and (loss)/earnings per share would be:

	1998 HK$M	1997 HK$M
(Loss)/profit attributable to shareholders	(542)	1,694
HK SSAP 11 adjustment	(553)	1,520
Adjusted (loss)/profit with adoption of HK SSAP 11	(1,095)	3,214
Adjusted (loss)/earnings per share with adoption of HK SSAP 11	(32.4¢)	93.9¢
(Loss)/earnings per share	(16.0¢)	49.5¢

(b) Other items

Other items principally consist of the unamortised discount arising on the purchase of zero coupon bonds and securities for the purpose of meeting certain of the Group's future finance lease obligations.

17. Share capital

	1998		1997	
	Number of shares	HK$M	Number of shares	HK$M
Authorised (HK$0.20 each):	3,900,000,000	780	3,900,000,000	780
Issued and fully paid (HK$0.20 each):				
At beginning of the year	3,387,799,848	677	3,437,413,848	687
Shares purchased and cancelled	(3,600,000)	(1)	(49,614,000)	(10)
At end of the year	3,384,199,848	676	3,387,799,848	677

Details of shares purchased in 1998 are included in the Directors' Report.

18. Reserves

		Non-distributable				
	Retained profit HK$M	*Share premium* HK$M	*Capital redemption reserve* HK$M	*Capital reserve* HK$M	*Other reserves* HK$M	*Total* HK$M
Group						
At beginning of the year	17,730	7,158	10	36	(5)	24,929
Loss for the year	(881)	–	–	–	–	(881)
Purchase of Company's shares:						
– premium paid on purchase	(18)	–	–	–	–	(18)
– transfer between reserves	(1)	–	1	–	–	–
Share of goodwill of associated companies	(1)	–	–	–	–	(1)
Exchange differences	–	–	–	–	(9)	(9)
At end of the year	16,829	7,158	11	36	(14)	24,020

Included in retained profit is an amount of HK$724 million (1997: HK$665 million) relating to retained profit attributable to associated companies.

Company						
At beginning of the year	15,097	7,158	10	–	–	22,265
Loss for the year	(1,002)	–	–	–	–	(1,002)
Purchase of Company's shares:						
– premium paid on purchase	(18)	–	–	–	–	(18)
– transfer between reserves	(1)	–	1	–	–	–
At end of the year	14,076	7,158	11	–	–	21,245

19. Long-term loans, bonds and other liabilities

	Group		Company	
	1998	1997	**1998**	1997
	HK$M	HK$M	**HK$M**	HK$M
Bank loans				
– secured	**5,522**	4,692	**4,303**	2,682
– unsecured	**1,039**	1,320	**899**	983
Other loans				
– secured	**228**	283	**126**	833
– unsecured	**92**	70	**221**	386
Bonds				
– unsecured	**346**	433	**–**	–
	7,227	6,798	**5,549**	4,884
Security deposits	**(2,024)**	(2,123)	**–**	–
Amount due within one year included under current liabilities (note 14)	**(980)**	(735)	**(909)**	(498)
	4,223	3,940	**4,640**	4,386

Repayable as follows:				
Bank loans				
– within one year	**931**	610	**712**	238
– between one and two years	**605**	810	**424**	559
– between two and five years	**2,184**	1,918	**1,710**	1,284
– after five years	**2,841**	2,674	**2,356**	1,584
	6,561	6,012	**5,202**	3,665
Other loans				
– within one year	**43**	115	**197**	260
– between one and two years	**43**	45	**71**	221
– between two and five years	**110**	133	**66**	269
– after five years	**124**	60	**13**	469
	320	353	**347**	1,219
Bonds				
– within one year	**115**	108	**–**	–
– between one and two years	**115**	108	**–**	–
– between two and five years	**116**	217	**–**	–
– after five years	**–**	–	**–**	–
	346	433	**–**	–
	7,227	6,798	**5,549**	4,884
Security deposits	**(2,024)**	(2,123)	**–**	–
Amount due within one year included under current liabilities (note 14)	**(980)**	(735)	**(909)**	(498)
	4,223	3,940	**4,640**	4,386

19. Long-term loans, bonds and other liabilities *(continued)*

Borrowings other than bank loans are repayable on various dates up to 2005 at interest rates between 3.75% and 10.2% per annum.

Long-term loans, bonds and other liabilities of the Group not wholly repayable within five years amounted to HK$3,218 million (1997: HK$2,257 million).

As at 31st December 1998, the Company and the Group had long-term liabilities which were defeased by funds and other investments totalling HK$32,847 million (1997: HK$28,719 million). Accordingly, these liabilities and the related funds, as well as related expenditure and income, have not been included in the consolidated accounts.

20. Obligations under finance leases

The Group has commitments under finance lease agreements in respect of aircraft and related equipment expiring during the years 1999 to 2016. The future payments under these finance leases are as follows:

	Group		*Company*	
	1998 HK$M	1997 HK$M	**1998 HK$M**	1997 HK$M
Within one year	**4,985**	3,147	**4,914**	3,363
After one year but within two years	**4,490**	3,888	**4,527**	4,111
After two years but within five years	**13,877**	10,178	**14,903**	10,907
After five years	**30,564**	26,229	**31,124**	27,674
	53,916	43,442	**55,468**	46,055
Interest charges relating to future periods	**(17,846)**	(13,874)	**(17,829)**	(14,776)
	36,070	29,568	**37,639**	31,279
Security deposits, notes and zero coupon bonds	**(14,075)**	(11,121)	**(5,168)**	(4,798)
Amounts due within one year included under current liabilities (note 14)	**(1,360)**	(916)	**(2,479)**	(1,202)
	20,635	17,531	**29,992**	25,279

As at 31st December 1998, the Company and the Group had obligations under finance leases which were defeased by funds and other investments amounting to HK$2,117 million and HK$3,382 million respectively (1997: HK$1,415 million and HK$1,601 million). Accordingly, these liabilities and the related funds, as well as related expenditure and income, have not been included in the consolidated accounts.

The Company's obligations under finance leases exceeded the Group's by HK$1,569 million (1997: HK$1,711 million) as a result of net amounts owing to subsidiary companies on certain aircraft financing arrangements, which have been eliminated on consolidation.

21. Reconciliation of operating profit to net cash flow from operating activities

	1998 HK$M	1997 HK$M
Operating (loss)/profit after exceptional items	(472)	2,054
Depreciation	2,885	2,411
Provision for impairment	607	–
Profit on sale of interest in associated company	–	(11)
Loss on disposal of fixed assets	117	104
Profit on sale of investments	(185)	–
Exchange differences on long-term loans and leasing obligations	64	275
Currency adjustments and other items not involving cash flows	87	(81)
Decrease/(increase) in stocks	380	(216)
Decrease in debtors	480	605
Increase in net amounts due to related and associated companies	185	26
Increase in creditors	639	59
Decrease in unearned transportation revenue	(261)	(449)
Non-operating movements in debtors and creditors	(460)	(55)
Net cash flow from operating activities	4,066	4,722

22. Analysis of payments for fixed assets

	1998		1997	
	HK$M	HK$M	HK$M	HK$M
Additions to fixed assets		(10,042)		(6,243)
Finance raised (note 23):				
– assets acquired under finance leases (note 10)	4,968		1,065	
– payments for assets acquired under finance leases	–	4,968	(211)	854
Payments for fixed assets		(5,074)		(5,389)

23. Analysis of changes in financing

	Long-term loans, bonds and other liabilities HK$M	*Obligations under finance leases* HK$M	*Minority interests* HK$M	*Total* HK$M
At beginning of the year	4,675	18,447	104	23,226
Finance raised on leased assets	–	4,968	–	4,968
Loan and finance lease repayments	(764)	(926)	–	(1,690)
New financing	1,161	1,756	–	2,917
Purchases of bonds and security deposits placed	–	(2,391)	–	(2,391)
Transfer of deposits placed to managed fund	–	9	–	9
Dividends paid to minority interests	–	–	(31)	(31)
Minority interests' share of subsidiaries' capital and revenue reserves	–	–	35	35
Non-cash movements	131	132	–	263
At end of the year	5,203	21,995	108	27,306

24. Analysis of cash and cash equivalents and net liquid funds

	1998 HK$M	1997 HK$M
Analysis of cash and cash equivalents		
Short-term deposits and bank balances	2,205	4,473
Bank overdrafts and short-term loans	(86)	(92)
Cash and cash equivalents at end of the year	2,119	4,381
Analysis of net liquid funds		
Cash and cash equivalents	2,119	4,381
Funds with investment managers	7,316	8,100
Other liquid investments	2,719	1,845
Short-term deposits maturing beyond three months when placed	86	1
Net liquid funds at end of the year	12,240	14,327

25. Directors' emoluments

Directors' emoluments comprise the following:

	1998 HK$M	1997 HK$M
Fees	–	–
Remuneration:		
Salaries, allowances and benefits in kind	36	38
Contributions to retirement schemes	2	3
	38	41

Housing costs accounted for 28% (1997: 27%) of emoluments.

26. Employee information

The five highest paid individuals of the Company included four (1997: four) directors, whose total emoluments are included in the amounts set out in note 25 above, and one (1997: one) other whose emoluments comprised:

	1998 HK$M	1997 HK$M
Remuneration:		
Salaries, allowances and benefits in kind	4	4
Contributions to retirement schemes	1	1
	5	5

The table below sets out the number of individuals, including those who have retired or resigned during the year, in each employment category whose total remuneration for the year fell into the following ranges:

	1998			1997		
HK$'000's	Director	Flight staff	Other staff	Director	Flight staff	Other staff
0 – 1,000	15	6,027	8,632	17	6,228	9,677
1,000 – 1,500	–	300	154	1	205	126
1,500 – 2,000	1	145	86	–	140	96
2,000 – 2,500	1	240	18	–	217	31
2,500 – 3,000	1	200	12	1	221	11
3,000 – 3,500	1	89	7	1	146	6
3,500 – 4,000	–	15	3	2	32	4
4,000 – 4,500	1	1	3	–	5	1
4,500 – 5,000	–	2	–	1	1	2
5,000 – 5,500	1	–	–	3	1	–
5,500 – 6,000	2	–	–	1	–	–
6,000 – 6,500	1	–	–	–	–	–
	24	7,019	8,915	27	7,196	9,954

27. Loans to directors

Loans made by the Company to directors disclosed pursuant to Section 161B of the Companies Ordinance are as follows:

	Balance at 1st January 1998 HK$M	*Balance at 31st December 1998* HK$M	*Maximum balance outstanding during the year* HK$M
Ken Barley	0.3	0.2	0.3

The loan is repayable on demand, secured on the borrower's retirement scheme entitlements, and bears interest at Hong Kong prime rate. There was no interest due but unpaid nor any provision made against this loan at 31st December 1998.

28. Retirement benefits

The Group operates various defined benefit and defined contribution retirement schemes for its employees in Hong Kong and in some overseas locations. The assets of these schemes are held in funds administered by independent trustees. The retirement schemes in Hong Kong are registered under and comply with the Occupational Retirement Schemes Ordinance. Most of the employees engaged outside Hong Kong are covered by appropriate local arrangements.

Retirement benefit costs for the year were:

	1998 HK$M	1997 HK$M
Swire Group Retirement Benefit Scheme	243	270
Cathay Pacific Airways Limited Retirement Scheme	112	137
CPA Provident Fund 1993	49	43
Other schemes	199	197
	603	647

The Group operates the following principal schemes:

(a) Defined benefit retirement schemes

The Swire Group Retirement Benefit Scheme ("SGRBS") in Hong Kong, in which the Company and Cathay Pacific Catering Services (Hong Kong) Limited ("CPCS") are participating employers, provides resignation and retirement benefits to its members, which include the Company's cabin attendants and other locally engaged employees, upon their cessation of service. The Company and CPCS meet the full cost of all benefits due by SGRBS to their employee members, who are not required to contribute to the scheme.

Staff employed by the Company in Hong Kong on expatriate terms before 1st April 1993 were eligible to join another scheme, the Cathay Pacific Airways Limited Retirement Scheme ("CPALRS"). Both members and the Company contribute to CPALRS.

The cost of the schemes to the Group is calculated based upon funding recommendations arising from actuarial valuations. Details of the latest actuarial valuations of CPALRS and of the portion of SGRBS funds specifically designated for the purposes of the actuarial valuation for the Group's employees are:

	SGRBS	*CPALRS*
Latest actuarial valuation	31st December 1997	31st December 1997
Actuaries	Watson Wyatt Hong Kong Limited	Watson Wyatt Hong Kong Limited
Actuarial valuation method	Attained age	Attained age
Assumed long-term average return on investment	1% higher than assumed average salary increase	1.5% higher than assumed average salary increase
Market value at date of valuation	HK$2,622 million	HK$1,775 million
Asset market valuation as a percentage of the present value of past service liabilities	98%	100%

28. Retirement benefits *(continued)*

The differences between the market values of the schemes' assets and the present value of the accrued past services liabilities at the date of an actuarial valuation are taken into consideration when determining future funding levels in order to ensure that the schemes will be able to meet these liabilities as they become due.

Differences in assumed long-term average return on investments arise as a result of variances in past performances of the individual funds.

(b) Defined contribution retirement scheme

Staff employed by the Company in Hong Kong on expatriate terms after 31st March 1993 are eligible to join a defined contribution retirement scheme, the CPA Provident Fund 1993. Under the terms of this scheme, only the Company is required to make contributions. During the year, the benefits forfeited in accordance with the scheme's rules amounted to HK$1.5 million (1997: HK$2.5 million) which have been applied towards the contributions payable by the Company.

29. Related party transactions

Material transactions between the Group and associated companies and other related parties which were carried out in the normal course of business on commercial terms are summarised below:

	1998		1997	
	Associated Companies	*Other Related Parties*	*Associated Companies*	*Other Related Parties*
	HK$M	**HK$M**	HK$M	HK$M
Aircraft maintenance costs	854	361	1,006	248
Route operating costs	224	623	253	741
Dividends received	(89)	(22)	(110)	(43)

a) Other transactions with related parties.

i) Under an agreement between the two parties, the Company pays fees and reimburses costs to John Swire & Sons Limited in exchange for services provided. Management services fees, calculated at 2.5% of the Group's profit before tax, results of associated companies, minority interests, and any profits and losses on disposal of fixed assets and investments will be paid annually. No such service fee was paid for the year ended 31st December 1998 (1997: HK$43 million) and expenses of HK$185 million (1997: HK$191 million) were reimbursed at cost.

ii) During the year, a loan of HK$120 million was made to Hong Kong Aircraft Engineering Company Limited which is unsecured, interest-bearing and repayable over 20 years. The interest rate was negotiated at arm's length after taking account of prevailing market conditions. The outstanding amount at the end of the year was HK$119 million.

iii) A loan of HK$89 million was also made to Hong Kong Air Cargo Terminals Limited during the year. It is unsecured and interest-bearing. The outstanding amount at the end of the year was HK$279 million.

iv) The Company received agency commission and services fees from Hong Kong Dragon Airlines Limited ("Dragonair"). The services fees were received in respect of computer support, engineering, station and ground services provided to Dragonair. All these transactions were conducted in the ordinary course of business and on normal commercial terms. During the year, the Company entered into a novation agreement with Dragonair under which Dragonair had the right to purchase one A330 aircraft from Airbus Industrie. A total of HK$110 million was received from Dragonair for these transactions in 1998.

29. Related party transactions *(continued)*

b) Amounts due to and due from associated companies and other related companies at 31st December 1998 are disclosed in note 14. These balances arise in the normal course of business, are non-interest bearing and have no fixed repayment terms.

c) At 31st December 1998, the Company has given guarantees relating to long-term loan facilities of HK$691 million (1997: HK$686 million) held by associated and other related companies.

d) There were no material transactions with Directors, except for those relating to remuneration (note 25) and shareholdings (Directors' Report).

30. Waiver from compliance with Listing Rules

Pursuant to Rule 14.04 (8) of the Listing Rules of The Stock Exchange of Hong Kong Limited, that exchange has granted to the Company a waiver from full compliance with the provisions of Chapter 14 of the Listing Rules, which relates to notifiable transactions, in relation to the acquisition or disposal of aircraft. As a result of the waiver, instead of the normal tests under Chapter 14, the test for the Company will be made by reference to Available Tonne Kilometres (ATKs). The test will be a calculation based on ATKs for aircraft being acquired or disposed of compared to the aggregate fleet ATKs. ATKs are calculated for each sector by multiplying the capacity, measured in tonnes available for the carriage of passengers, excess baggage, cargo and mail on that sector, by the sector distance.

	1998	1997
Fleet ATKs (in million tonne kilometres)	10,857	10,399

31. Commitments and contingencies

(a) Outstanding payment commitments in respect of capital items and investments authorised at the end of the year but not provided for in the accounts amounted to:

	Group		*Company*	
	1998 HK$M	1997 HK$M	1998 HK$M	1997 HK$M
Authorised and contracted for				
– aircraft and related equipment	3,476	12,042	3,476	12,042
– investments at Hong Kong International Airport	725	2,218	–	71
– others	18	25	–	15
	4,219	14,285	3,476	12,128
Authorised but not contracted for				
– aircraft and related equipment	–	–	–	–
– investments at Hong Kong International Airport	9	587	–	–
– others	–	244	–	216
	9	831	–	216
Grand Total	4,228	15,116	3,476	12,344

31. Commitments and contingencies *(continued)*

These commitments are expected to be paid as follows:

	HK$M
1999	3,325
2000	180
Beyond 2000	723
	4,228

Commitments include amounts for the acquisition of three B777s.

(b) At the end of the year, the Group had commitments to make annual payments under operating leases as follows, analysed by expiry dates:

	1998		1997	
	HK$M	HK$M	HK$M	HK$M
Land and buildings				
– within one year	122		261	
– between two and five years	250		247	
– after five years	81	453	18	526
Aircraft and related equipment				
– within one year	–		–	
– between two and five years	200		104	
– after five years	–	200	99	203
Others				
– within one year	2		53	
– between two and five years	21		4	
– after five years	16	39	178	235
		692		964

(c) Under some of the Group's leasing arrangements for aircraft and related equipment, the Company has undertaken to indemnify the lessors so as to maintain a specified rate of return on each of the lessors' investments as agreed at the inception of the lease. The Directors do not consider that an estimate of the potential financial effect of these contingencies can practically be made.

(d) At 31st December 1998, contingent liabilities existed in respect of guarantees given by the Company relating to long-term loan facilities of up to HK$700 million (1997: HK$800 million).

32. Comparative amounts

Certain comparative amounts have been reclassified to conform with the current year's presentation.

Principal Subsidiary and Associated Companies

at 31st December 1998

Subsidiary Companies

	Place of incorporation and operation	Principal activities	Percentage of issued capital owned	Issued and paid up share capital
Abacus Distribution Systems (Hong Kong) Limited	Hong Kong	Computerised reservation systems and related services	53	15,600,000 shares of HK$1
AHK Air Hong Kong Limited	Hong Kong	Cargo airline	75*	90,666,816 shares of HK$1
Aircrew Services Limited	Hong Kong	Provision of aircrew services	67	9 shares of HK$10
Airline Property Limited	Hong Kong	Property investment	100	2 shares of HK$10
Airline Stores Property Limited	Hong Kong	Property investment	100	2 shares of HK$10
Airline Training Property Limited	Hong Kong	Property investment	100	2 shares of HK$10
Cathay Pacific Catering (Holdings) Pty Limited	Australia	Airline catering	100*	2,100,519 shares of A$2
Cathay Pacific Catering Services (H.K.) Limited	Hong Kong	Airline catering	100	600 shares of HK$1,000
Cathay Holidays Limited	Hong Kong	Travel tour operator	100	5,000 shares of HK$100
Cathay Pacific Leasing Limited	Isle of Man	Aircraft leasing/ acquisition facilitator	100	5,000,000 shares of US$1
Cathay Pacific Loyalty Programmes Limited	Hong Kong	Airline frequent flyer programme	100	2 shares of HK$1
CLS Catering Services Limited	Canada	Airline catering	60*	330,081 shares of no par value
Guangzhou Guo Tai Information Processing Company Limited	Mainland China	Information processing	80*	7,000,000 shares of no par value
Hong Kong Airport Services Limited	Hong Kong	Provision of ground and ramp handling services	70	100 shares of HK$1
Prestwick Aviation Limited	Bermuda	Aircraft leasing	100*	12,000 shares of US$1
Snowdon Limited	Isle of Man	Financial services	100*	2 shares of GBP$1
Swansea Limited	Isle of Man	Financial services	100*	2,000 shares of US$1
Troon Limited	Bermuda	Financial services	100	12,000 shares of US$1
Vogue Laundry Service Limited	Hong Kong	Laundry and dry cleaning	65	3,700 shares of HK$500

Principal subsidiary and associated companies are those which materially affect the results or assets of the Group.

* *Shareholding held through subsidiary companies.*

Principal Subsidiary and Associated Companies

Associated Companies

	Place of incorporation and operation	Principal activities	Percentage of issued capital owned
Associated Engineers Limited	Hong Kong	Airport ground support and general engineering	36
Cathay Kansai Terminal Services Company Limited	Japan	Ground handling	33
Cebu Pacific Catering Services Inc	Philippines	Airline catering	40*
Hong Kong Aircraft Engineering Company Limited	Hong Kong	Aircraft overhaul and maintenance	25
Hong Kong Airport Restaurant Caterers Company Limited	Hong Kong	Airport catering	33
Hong Kong Dragon Airlines Limited	Hong Kong	Airline	19*
Securair Limited	Hong Kong	Airport security	50
VN/CX Catering Services Limited	Vietnam	Airline catering	40*

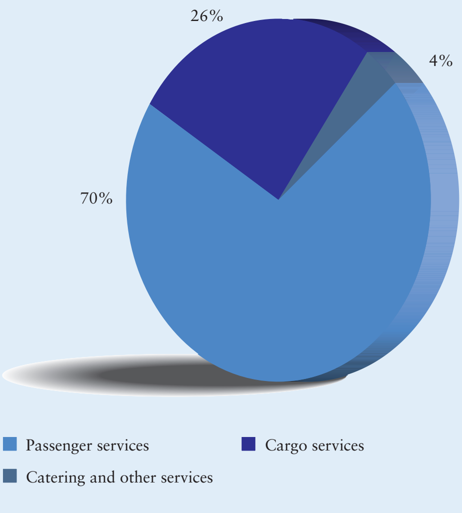
** Shareholding held through subsidiary companies.*

Statistics

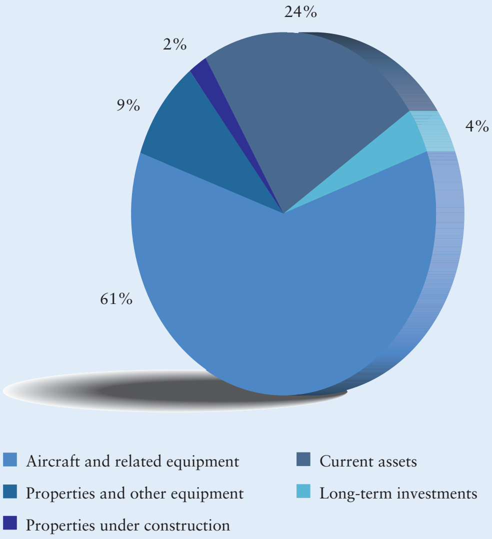
		1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Consolidated Balance Sheet											
Fixed assets	HK$M	49,201	42,827	39,126	29,650	24,539	22,756	20,639	17,192	14,229	11,549
Long-term receivables and investments	HK$M	2,602	2,590	2,139	1,960	1,789	1,459	1,319	1,015	1,049	488
Current assets less current liabilities	HK$M	6,111	9,862	13,488	8,182	8,385	9,408	9,233	5,867	4,546	2,537
Deferred taxation	HK$M	(6,359)	(5,802)	(5,359)	(3,954)	(3,006)	(1,951)	(962)	(355)	(807)	(659)
Deferred exchange differences and other items	HK$M	(1,893)	(2,296)	(674)	981	2,264	1,723	1,496	2,394	2,862	2,802
Total assets less current liabilities and deferred items	HK$M	49,662	47,181	48,720	36,819	33,971	33,395	31,725	26,113	21,879	16,717
Financed by:											
Shareholders' funds	HK$M	24,696	25,606	25,325	17,064	15,454	14,410	13,320	11,525	9,792	8,176
Long-term financing	HK$M	24,966	21,575	23,395	19,755	18,517	18,985	18,405	14,588	12,087	8,541
Total long-term liabilities and equity	HK$M	49,662	47,181	48,720	36,819	33,971	33,395	31,725	26,113	21,879	16,717
Gross borrowings	HK$M	27,284	23,214	26,181	21,917	22,079	21,192	20,167	16,828	13,560	11,167
Net borrowings	HK$M	14,958	8,795	5,865	7,796	7,061	6,799	6,165	5,412	4,454	2,919
Consolidated Profit and Loss Summary											
Passenger services	HK$M	18,532	21,851	23,680	22,128	20,027	18,321	18,284	16,459	15,823	13,952
Cargo services	HK$M	7,040	7,782	6,850	6,699	5,616	4,277	3,974	3,671	3,332	2,899
Traffic turnover	HK$M	25,572	29,633	30,530	28,827	25,643	22,598	22,258	20,130	19,155	16,851
Catering and other services	HK$M	1,123	1,014	1,037	941	800	738	585	377	354	268
Total turnover	HK$M	26,695	30,647	31,567	29,768	26,443	23,336	22,843	20,507	19,509	17,119
Operating profit	HK$M	397	2,401	3,790	3,769	3,157	2,577	3,621	3,653	3,618	3,937
Exceptional items	HK$M	(869)	(347)	541	–	–	–	–	–	–	–
Net finance charges	HK$M	(311)	(335)	(384)	(597)	(557)	(280)	(319)	(238)	(161)	(146)
Net operating (loss)/profit	HK$M	(783)	1,719	3,947	3,172	2,600	2,297	3,302	3,415	3,457	3,791
Share of profits of associated companies	HK$M	172	306	363	379	381	316	233	176	136	114
(Loss)/profit before taxation	HK$M	(611)	2,025	4,310	3,551	2,981	2,613	3,535	3,591	3,593	3,905
Taxation	HK$M	104	(291)	(484)	(516)	(560)	(288)	(505)	(622)	(582)	(570)
(Loss)/profit after taxation	HK$M	(507)	1,734	3,826	3,035	2,421	2,325	3,030	2,969	3,011	3,335
Minority interests	HK$M	(35)	(40)	(17)	(57)	(33)	(32)	(22)	(19)	(16)	(14)
(Loss)/profit attributable to shareholders	HK$M	(542)	1,694	3,809	2,978	2,388	2,293	3,008	2,950	2,995	3,321
Dividends	HK$M	(339)	(986)	(1,821)	(1,375)	(1,203)	(1,203)	(1,203)	(1,203)	(1,203)	(1,203)
(Loss)/retained profit for the year	HK$M	(881)	708	1,988	1,603	1,185	1,090	1,805	1,747	1,792	2,118
Per Share											
Shareholders' funds	HK$	7.30	7.56	7.37	5.96	5.39	5.03	4.65	4.02	3.42	2.85
Cash flow	HK$	1.2	1.4	2.0	2.4	2.1	1.5	1.9	1.8	1.7	1.9
(Loss)/earnings	HK cents	(16.0)	49.5	119.6	104.0	83.4	80.0	105.0	103.0	104.6	115.9
Dividend	HK cents	10.0	29.0	53.0	48.0	42.0	42.0	42.0	42.0	42.0	42.0
Share price											
High	HK$	8.9	16.4	14.9	12.8	15.7	15.3	12.4	10.2	10.7	10.4
Low	HK$	4.7	5.4	10.6	10.0	10.2	8.5	8.0	7.0	6.8	7.3
Year-end	HK$	7.7	6.3	12.2	11.8	11.3	15.0	9.5	10.0	7.0	8.3
Ratios *(Note a)*											
Dividend cover	Times	(1.6)	1.7	2.1	2.2	2.0	1.9	2.5	2.5	2.5	2.8
Gross debt equity ratio	Times	1.10	0.91	1.03	1.28	1.43	1.47	1.51	1.46	1.38	1.37
Net debt equity ratio	Times	0.61	0.34	0.23	0.46	0.46	0.47	0.46	0.47	0.45	0.36
Price/Earnings	Times	(48.1)	12.7	10.2	11.3	13.5	18.8	9.0	9.7	6.7	7.2
Price/Shareholders' funds	Times	1.1	0.8	1.7	2.0	2.1	3.0	2.0	2.5	2.0	2.9
Price/Cash flow	Times	6.4	4.5	6.1	4.9	5.4	10.0	5.0	5.6	4.1	4.4
Cost per ATK	HK$	2.25	2.57	2.64	2.80	2.81	2.84	2.97	3.00	2.92	2.80

Note a: Based on year end share prices, where applicable.

Total turnover

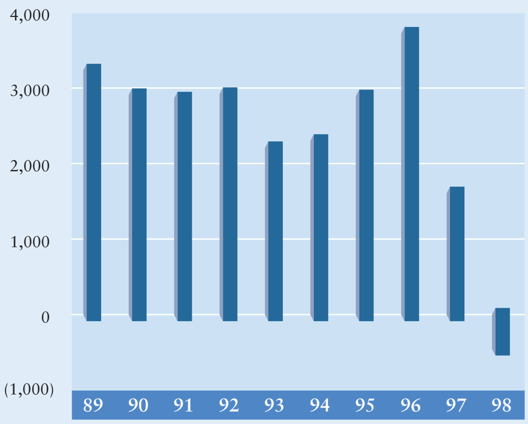


Total assets



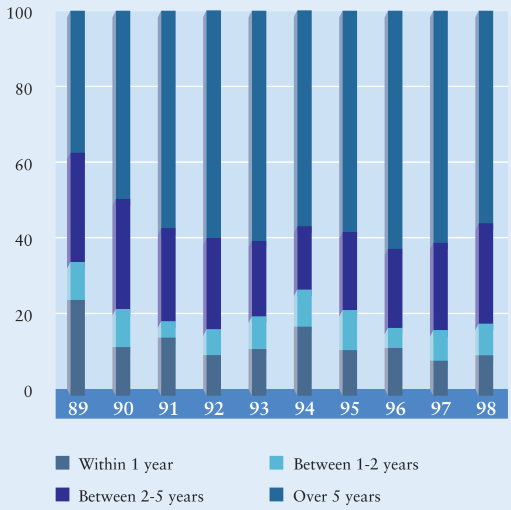
Profit/(loss) attributable to shareholders

HK$ million



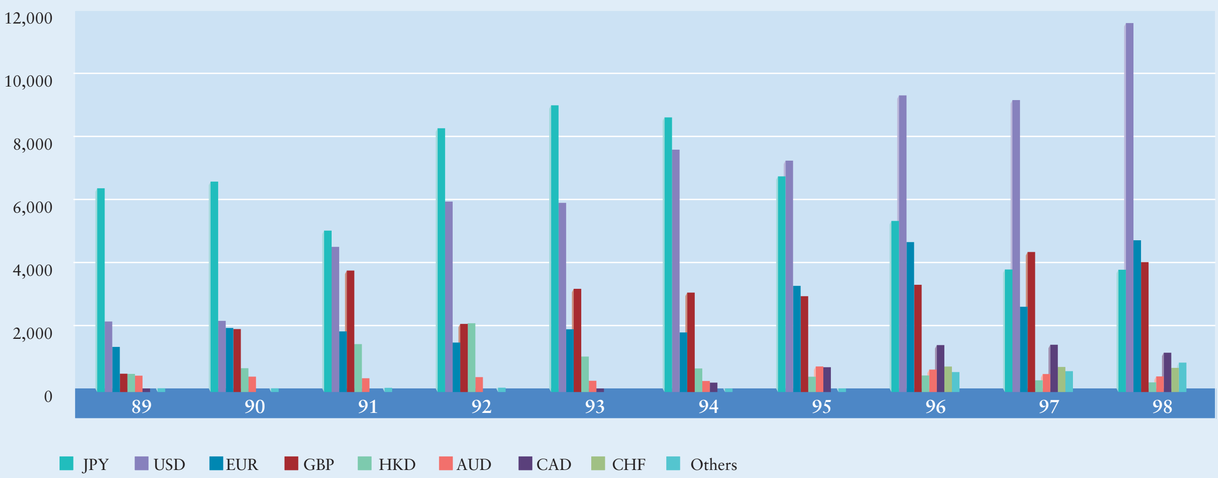
Maturity profile: Gross borrowings

%



Currency analysis of long-term gross borrowings

HK$ million



Statistics

Operating summary (Company)		1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Kilometres flown	*Million*	**202**	193	182	162	146	135	119	105	101	90
Block hours	*'000 Hours*	**271**	254	244	217	193	175	165	147	141	123
Aircraft departures	*000's*	**59**	56	55	52	49	46	41	38	38	34
Available tonne kilometres	*Million*	**10,857**	10,399	10,018	8,946	8,052	7,212	6,466	5,621	5,429	4,753
Revenue tonne kilometres	*Million*	**7,213**	7,331	7,072	6,214	5,553	4,834	4,366	3,854	3,843	3,434
Available seat kilometres	*Million*	**60,295**	57,104	54,306	49,334	45,892	41,552	37,428	33,186	32,214	28,477
Revenue passengers carried	*000's*	**10,299**	10,018	10,985	10,381	9,750	8,867	8,363	7,391	7,731	7,058
Revenue passenger kilometres	*Million*	**40,679**	38,962	40,185	35,341	32,727	29,097	27,527	24,433	24,461	22,088
Revenue load factor	*%*	**67.1**	69.5	72.6	70.8	70.4	68.9	70.4	71.0	74.3	75.6
Passenger load factor	*%*	**67.5**	68.2	74.0	71.6	71.3	70.0	73.5	73.6	75.9	77.6
Cargo carried	*'000 Tonnes*	**580**	635	568	531	463	395	349	314	315	281
Cargo and mail tonne kilometres	*Million*	**3,339**	3,621	3,244	2,847	2,434	2,060	1,739	1,524	1,510	1,332
Cargo and mail load factor	*%*	**65.2**	72.9	66.9	67.0	66.1	63.3	60.0	62.0	64.0	65.0
Excess baggage carried	*Tonnes*	**3,375**	3,301	4,133	4,632	4,807	5,068	6,049	4,107	4,105	4,112
Mail carried	*Tonnes*	**6,775**	10,831	13,719	13,112	12,697	13,071	13,569	13,322	12,838	11,423
Length of scheduled route network	*'000 Kilometres*	**338**	309	296	279	275	276	243	199	199	207
Destinations at year end	*Number*	**48**	48	45	44	42	42	41	39	38	37
Staff number at year end	*Number*	**13,971**	15,747	15,757	14,744	14,469	14,098	13,240	12,747	12,764	11,728
ATK per staff (average)	*000's*	**739**	663	651	619	574	534	501	443	444	435
ATK per HK$'000 staff cost	*Unit*	**1,582**	1,446	1,403	1,327	1,316	1,326	1,286	1,263	1,336	1,444

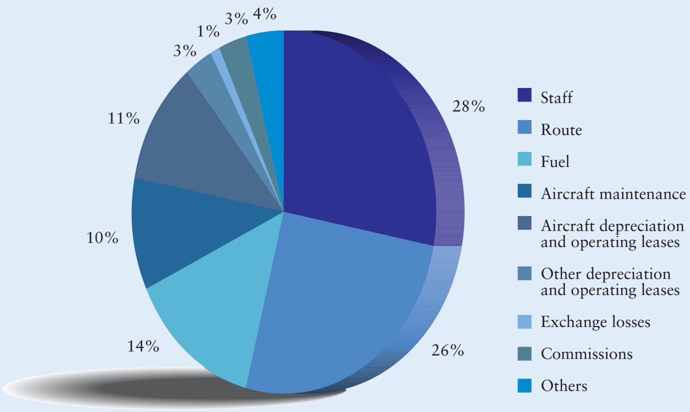
On-time performance *(Note)*		1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Departure (within 15 minutes)	*%*	**80.3**	81.8	78.0	77.3	79.0	74.0	69.1	70.2	71.5	–

Operating fleet	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
Daily average utilisation (hours)										
A330-300	**9.5**	8.5	8.9	7.4	–	–	–	–	–	–
A340-200	**–**	12.8	14.7	12.3	10.3	–	–	–	–	–
A340-300	**15.8**	15.9	16.4	–	–	–	–	–	–	–
B747-200/300	**7.0**	7.1	7.6	8.5	8.8	8.8	11.5	11.2	12.7	13.9
B747-400	**15.3**	15.4	15.3	14.5	14.7	14.4	13.0	15.1	13.4	12.6
B747-200F	**13.6**	14.2	13.8	13.8	14.0	13.9	13.4	13.6	13.2	14.6
B747-400F	**15.6**	15.3	15.2	14.7	13.9	–	–	–	–	–
B777-200/300	**8.9**	7.9	7.0	–	–	–	–	–	–	–
L1011	**–**	–	4.8	6.1	5.6	5.7	6.0	5.7	6.3	6.8
Fleet daily average utilisation	**12.2**	11.8	11.4	10.8	10.2	9.8	10.0	9.8	10.0	10.5

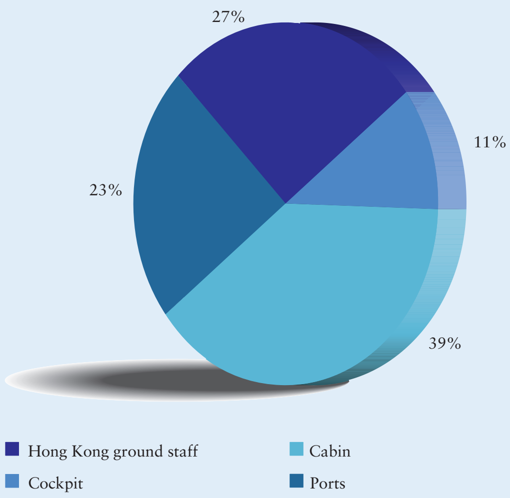
Number per fleet at year end:	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
A330-300	**12**	11	10	7	–	–	–	–	–	–
A340-200	**–**	–	2	4	2	–	–	–	–	–
A340-300	**11**	6	5	–	–	–	–	–	–	–
B747-200/300	**13**	13	13	13	13	13	13	14	15	15
B747-400	**19**	19	19	19	18	17	14	10	5	2
B747-200F	**7**	7	7	4	4	4	4	3	3	2
B747-400F	**2**	2	2	2	1	–	–	–	–	–
B777-200	**4**	4	4	–	–	–	–	–	–	–
B777-300	**4**	–	–	–	–	–	–	–	–	–
L1011	**–**	–	–	8	17	19	18	18	18	17
Total number of aircraft	**72**	62	62	57	55	53	49	45	41	36

Note : On-time performance information is not available for the period before 1990.

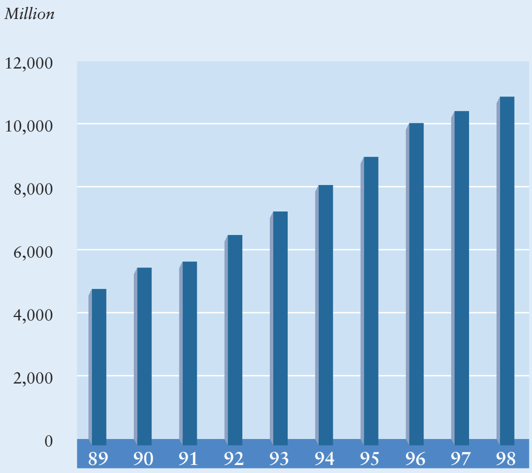
Airline operating costs



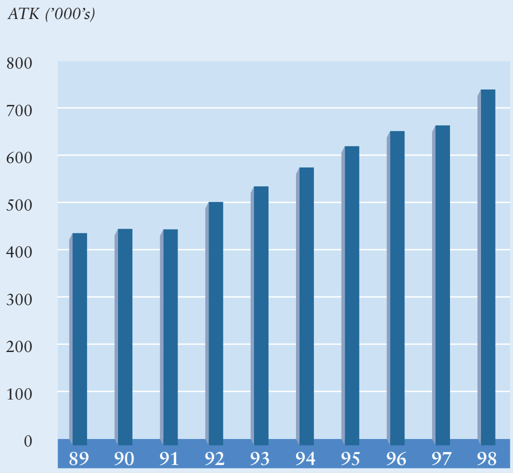
Staff Composition



Available tonne kilometres

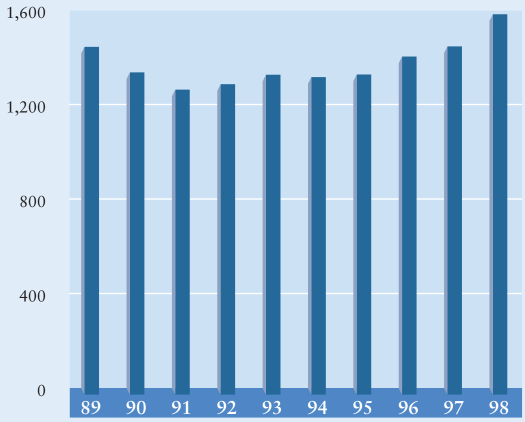


ATK per staff



Number of staff

ATK per HK$'000 staff cost



Glossary

Terms:

Net borrowings	Gross borrowings less other liquid funds, short-term deposits and bank balances.
Gross borrowings	Total borrowings (loans, lease obligations and bank overdrafts) less security deposits, notes and zero coupon bonds.
Available tonne kilometres ("ATK")	Capacity, measured in tonnes available for the carriage of passengers, excess baggage, cargo and mail on each sector multiplied by the sector distance.
On-time performance	Departure within 15 minutes of scheduled departure time.

Ratios:

$$\text{(Loss)/earnings per share} = \frac{\text{(Loss)/profit attributable to shareholders}}{\text{Weighted average number of shares (by days) in issue for the year}}$$

$$\text{Shareholders' funds per share} = \frac{\text{Shareholders' funds}}{\text{Total issued and fully paid shares at end of the year}}$$

$$\text{(Loss)/profit margin} = \frac{\text{(Loss)/profit attributable to shareholders}}{\text{Turnover}}$$

$$\text{Net debt equity ratio} = \frac{\text{Net borrowings}}{\text{Shareholders' funds}}$$

$$\text{Passenger/Cargo and mail load factor} = \frac{\text{Revenue passenger kilometres/Cargo and mail tonne kilometres}}{\text{Available seat kilometres/Available cargo and mail tonne kilometres}}$$

$$\text{Passenger/Cargo and mail yield} = \frac{\text{Passenger revenue/Cargo and mail revenue}}{\text{Revenue passenger kilometres/Cargo and mail tonne kilometres}}$$

$$\text{Cost per ATK} = \frac{\text{Operating costs and net finance charges of Cathay Pacific Airways}}{\text{ATK of Cathay Pacific Airways}}$$

Corporate and Shareholder Information

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Financial Calendar

Year ended 31st December 1998	
Annual General Meeting	12th May 1999
1998 final dividend payable	28th May 1999
Six months ending 30th June 1999	
Interim results announcement	August 1999
Interim dividend payable	October 1999

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