P&O Group

Annual Report 2004

P&O

International strength, local focus

P&O will use its brand, global presence and management skills to achieve world class operational and financial performance in logistics and transport.

Ports

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Highlights

P&O Group

These results reflect a substantial improvement in trading performance and considerable strategic progress during 2004.

- Pre-exceptional profit before tax up 65% to £170.2 million (2003 £103.2 million).
- Ports' trading profit up 24% and container throughput up 22%.
- Good progress made in implementing conclusions of Ferries' fundamental business review.
- Net property disposals of £371 million against a target of £250 million.
- Strong cash inflow with net debt reduced to £1,029.6 million (2003 £1,502.7 million).
- Recommended final dividend of 6.0p (full year 9.0p), in line with previous announcements.

£170.2m
Pre-exceptional profit before tax
2003 £103.2m

24%
Increase in Ports' trading profit
2003 14%

£371m
Net property disposals achieved
Against £250m target

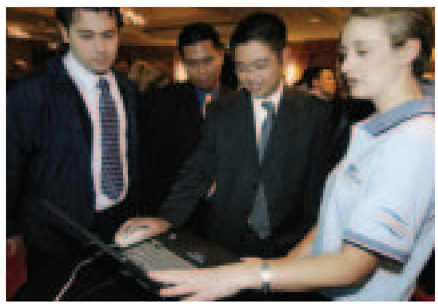
Note: Exceptional items are primarily impairment charges, reorganisation costs and profits and losses on sale of businesses. Trading profit/(loss) is operating profit/(loss) before exceptional items.

Company overview

The Group

P&O is a global transport operator. It is one of the world's foremost port companies and one of the UK's leading ferry operators. With the widely recognised house flag and brand name, P&O's businesses are focused on achieving world class operational and financial performance and on delivering first class service to customers.

Local focus



Strategy

P&O is committed to focusing its capital on those businesses where it is a market leader and which offer strong growth and value creation opportunities.

International strength

Container terminal locations

Ports

Activity

One of the world's pre-eminent container terminal operators and stevedores, with 27 container terminals and logistics operations in over 100 ports, P&O Ports operates in 18 countries across the world. Its main service is containerised cargo handling in ports which offer strong growth opportunities. Other services include general cargo, bulk cargo, roll on-roll off facilities and cruise passenger terminal management, as well as a range of maritime services.

Strategy

Ports is committed to achieving profit growth by increasing scale organically through local trade growth and market share gain at existing locations, by expanding current capacity and by developing or acquiring new terminals and by improving the efficiency of its container terminal operations through sharing best practice.

Container volumes (P&O equity share)
13.8m teu
Capacity available (January 05 – P&O equity share)
15m teu
Total potential capacity (P&O equity share)
31m teu
(excludes new projects under consideration)

www.poports.com

teu = 20 foot equivalent unit. This is the standard size of a container and is a common measure of capacity in the container business.

Ferries

Activity

P&O is a household name in the UK for ferry travel. P&O Ferries carries freight and tourist traffic between the UK and France, Spain, Belgium and Holland. P&O Irish Sea operates routes for freight and tourist traffic between the UK and Ireland. P&O has a fleet of 26 ships. P&O Ferrymasters, the European road haulage and freight management business, is part of the Ferries division.

Strategy

In 2004, a fundamental business review was undertaken to reshape the direction of the business. Extensive research with customers was the foundation for developing a strategy focused on delivering what freight and tourist customers really value.

Ferries aims to deliver a simplified customer focused product operated on fewer routes with fewer ships and a substantially lower, more flexible cost base.

Passengers carried 2004
12.8m
Fleet
26 ships
Routes
Dover – Calais
Portsmouth – Bilbao
Portsmouth – Le Havre*
Hull – Rotterdam
Hull – Zeebrugge
Teesport – Rotterdam (freight only)
Teesport – Zeebrugge (freight only)
Dublin – Liverpool
Larne – Cairnryan
Larne – Troon
* expected to be closed in 2005

www.poferries.com

Other activities

Cold Logistics

P&O Cold Logistics provides a full range of logistics services, ranging from refrigerated warehousing to complex retail supply chain management for temperature controlled products. It is one of the world's few international temperature controlled logistics companies and has strong competitive positions in the US, Australasia and Argentina.

www.pocoldlogistics.com

Container Shipping

P&O Nedlloyd is one of the world's leading providers of point to point container shipping services. To support this core business, it also offers a range of value added logistics services, from relatively simple freight management to sophisticated supply chain management. The company is wholly owned by Royal P&O Nedlloyd N.V., which is listed on the Amsterdam Stock Exchange, and in which P&O has a 25% stake.

www.ponl.com

Property

P&O Properties has most of its assets in the US but with some developments in the UK and Continental Europe. It is continuing its programme of sales within the portfolio, with a target of £250m net sales set for 2005.

www.poproperties.com
www.podevelopments.com

Chairman's statement

The Lord Sterling of Plaistow GCVO CBE
Chairman

Results

The Group results reflect a substantial improvement in trading performance. Operating profit from continuing operations before exceptional items increased to £268.3 million (2003 £202.7 million) despite adverse currency movements of approximately £20 million. Strong profit growth was achieved in our major business, Ports, while the cyclical upturn continued to benefit Container Shipping. Ferries experienced difficult trading conditions which led to a fundamental business review, the results of which are now being successfully implemented.

Pre-exceptional profit before tax increased 65% to £170.2 million (2003 £103.2 million). There were significant exceptional items (primarily impairment and reorganisation charges and profits and losses on sale of businesses) totalling £380.2 million (2003 £23.2 million) before tax, of which £267.1 million related to the restructuring of Ferries announced in September and £65.4 million to the restructuring of the Group's interest in P&O Nedlloyd. After exceptional items, interest and tax, the Group recorded a loss of £235.4 million (2003 profit £59.2 million).

Earnings per share and dividend

Before exceptional items and goodwill amortisation, the earnings per £1 nominal of deferred stock were 19.4p (2003 12.4p). The basic and diluted loss per £1 nominal of deferred stock was 34.7p (2003 earnings 6.5p). In line with the announcement of future dividend policy on 2 February 2004, the Board recommends a final dividend of 6.0p per £1 nominal of deferred stock which, together with the interim dividend of 3.0p, would give a total dividend of 9.0p for 2004. The dividend will be paid on 1 June 2005 to deferred stockholders on the register at the close of business on 29 March 2005.

Strategic progress

2004 was an important year in P&O's strategic development. A major objective was achieved with the restructuring of the Group's interest in Container Shipping. P&O now holds a 25% interest in the listed Royal P&O Nedlloyd N.V. Capital expenditure of £140 million was invested in expanding our Ports portfolio and in September we announced proposals to change fundamentally the way we run our Ferries business in response to difficult industry conditions. We also achieved net property sales of £371 million in 2004.

Outlook

2005 has seen a good start for our Ports business. World containerised trade is growing strongly and many of our ports benefit from a favourable local competitive environment. We expect to allocate approximately £1 billion of capital to the portfolio over the next five years. At the end of 2004, our total capacity was over 15 million teu, with expansion rights which could increase this to 31 million teu. By the end of 2005, we expect total capacity to be approximately 17 million teu. Over and above this we are examining a range of possible opportunities around the world that could, over time, add up to a further 10 million teu.

The market for Ferries remains challenging, particularly for the tourist business. However, freight continues to grow strongly and the enhanced freight service that we are offering following the fundamental business review has been well received. With a new management team now in place, we are on target to achieve the forecast cost savings from the review.

Royal P&O Nedlloyd is continuing to benefit from strong volumes and freight rates. Assuming that current industry and market conditions continue, they expect a significant improvement in operating profit this year.

We intend to make further net property sales of £250 million in 2005. We announced in March 2005 the £47 million sale of a significant part of our King's Cross development which already brings the total of net property sales so far for 2005 to £157 million. By the end of the year we expect Property to account for less than 10% of our net operating assets. The reduced size of the portfolio, together with our having sold the resorts and other assets which were significant contributors to earnings, means that Property is likely to make a smaller profit contribution in 2005.

For the Group as a whole, excluding Property, operating profit is anticipated to improve further in 2005.

Employees

The strength of our operating result is a credit to our employees. 2004 saw the Group undergo considerable change once more and as a result it has been a period of uncertainty for some colleagues. Employees within our Ferries and Properties businesses have been working in challenging markets as we have restructured those businesses. I would like to pay tribute to all employees for their dedication and achievements during the year.

Board

Rodney Galpin will be retiring from the Board as senior non-executive director after this year's annual general meeting. Rodney joined the Board in 1996. We have benefited greatly from his counsel over the years and I would like to record my own gratitude, as well as that of my fellow directors, for his commitment to P&O.

I was delighted to welcome Sir John Parker to the Board in February 2005 as Deputy Chairman and Chairman designate. Sir John is Chairman of National Grid Transco plc, senior non-executive director of the Bank of England and a non-executive director of Carnival. His considerable experience, particularly in maritime industries, will be invaluable to P&O as it moves forward.

We also welcomed David Williams to the Board as a non-executive director in January 2005. David is Finance Director of Bunzl plc. His extensive financial experience across a broad range of industries will be a great asset to the Group.

This is my final annual statement to stockholders. I have been Executive Chairman for 22 years and a Board member for 25 years. In one sense the connection goes back much further, to Sterling Guarantee Trust, the company I founded in 1969 which played a "white knight" role in defending P&O against a hostile takeover bid in 1983. I still meet many people at our annual general meetings who were stockholders in those days. I know that Sir Bruce MacPhail, my colleague and close friend from the very beginning, who stood down only last year as Managing Director, would agree that it has been a remarkable period.

I have no doubt that a further notable chapter of the Company's history will be written as P&O moves forward in the capable hands of Sir John Parker, Robert Woods and the rest of the management team. It is with great pride that I have served the Company and I would like to thank all those at sea, ashore and retired for the loyalty and support they have given the Company and me personally during these years.

The Lord Sterling of Plaistow
GCVO CBE
Chairman

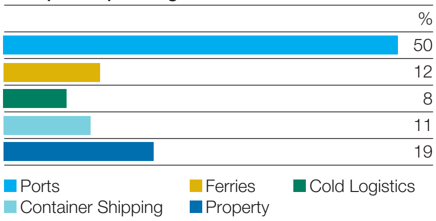
Operating and financial review

Strategic progress

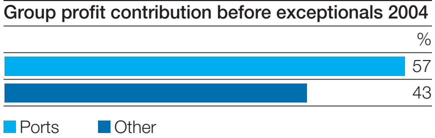
Robert Woods CBE
Chief Executive

Objectives for 2005
- Secure further benefits of volume growth in Ports
- Expand Ports' container terminal capacity, particularly at congested locations
- Implement proposals of Ferries' fundamental business review
- Achieve net property sales of a further £250 million

Group net operating assets 2004



Group profit contribution before exceptionals 2004



Last year I commented on our sharpened investment strategy and indicated that, although progress had been made, there was more to do in reallocating capital within the Group. I also commented that a fundamental business review of Ferries had commenced in response to the tough trading conditions in that industry.

Significant strategic progress was achieved in both of these areas in 2004:

- Capital reallocation – we achieved £371 million net property disposals in the year and realised €215 million cash from the P&O Nedlloyd transaction. £140 million was reinvested into our Ports business and we reduced net debt by £473 million.
- Ferries – the results of the fundamental business review were announced in September 2004. Far reaching proposals are being implemented to produce an increased focus on freight and a simplified tourist product operated on fewer routes with fewer ships and a substantially lower and more flexible cost base.

Ports

Ports now comprises half of the net operating assets of the Group and contributed 57% of operating profit (before exceptional items) in 2004.

Ports is a highly attractive business because of our competitive strength in local markets and the high levels of international trade growth. This has been further supported by the relocation of manufacturing to Asia, particularly China, and the resulting trade imbalances around the globe.

We have approximately 50% of our Ports asset base in Asia. This was one of the reasons the business grew so strongly in 2004. We also have strategic advantages specific to our business:

- Origin and destination cargo – unlike transhipment ports, our focus on ports which service the regional or local economy means there is less risk that cargo can be relocated to another port;
- Common user terminals – we service a wide range of liner companies and do not have capacity dedicated to any particular customer; and
- Expansion opportunities – our current container terminal capacity is 15 million teu, but this can ultimately be expanded to 31 million teu through adding equipment and exercising expansion rights that we hold at existing locations. This will enable us to alleviate congestion at specific locations and to continue to grow the business.

Given the long term – typically 30 year – nature of our port concessions, new investments take time to reach optimum utilisation and can dilute returns for the overall portfolio in the short term. However, our established operations, i.e. those which we have operated for more than five years, reported a return on average capital employed of 18% in 2004. This further underlines the long term potential of our business.

Ferries

The far reaching proposals of our fundamental business review are being implemented quickly. Agreement has been reached with trade unions and the benefits are starting to be seen.

The freight market continues to grow and more emphasis has been placed on that business. Customer links have been improved and tariff structures simplified. Despite capacity reductions in our overall fleet we have retained freight capacity at peak times via vessel rescheduling.

Our tourist product on the important Short Sea sector is focused on 'short break' and 'long stay' customers, where volumes have been stable, rather than on 'day trip' traffic, which has been in decline. We are introducing an affordable, hassle free tourist experience which will be delivered in a simple, more focused and flexible way. This includes improvements to our website and booking processes together with an on-board product more closely tailored to our customers' requirements.

The cost base is anticipated to be reduced by over £100 million and involves the closure of four routes and a reduction in the fleet from 31 to 23 ships. Regrettably this could result in a headcount reduction of approximately 1,550 employees. Three routes have already closed. Following the decision by Brittany Ferries not to take on the Portsmouth – Le Havre route this will be operated until the end of September 2005 when it is intended, subject to employee consultation, to be closed.

These proposals led to restructuring and impairment charges of £267 million in 2004 but were necessary to put the business right. Profit improvements of £55 million per annum have been targeted and are anticipated to be fully delivered by 2006.

We are confident that we can improve Ferries' financial performance. However, looking forward, we are mindful that over-capacity persists within the industry.

Container Shipping

Early in 2004, a major strategic objective was achieved in reducing the Group's interest in Container Shipping. P&O now holds a 25% interest in the listed Royal P&O Nedlloyd N.V. Whilst we would not rule out a sale of some or all of our shares at a price that recognises the full potential of the company, we remain comfortable with our shareholding. We recognise that the industry remains cyclical but we believe that the prospects for the company are highly positive. The relationship with Ports continues to develop and this will be a key factor in any future decisions.

Property

Net property sales of £371 million were achieved in 2004. A further £250 million of net property sales are targeted for 2005 and, since 1 January 2005, £157 million in sales has already been achieved. This means P&O's net operating assets are now approximately £314 million compared to £808 million at 31 December 2003 and £466 million at 31 December 2004. Obviously, the much reduced asset base is likely to lead to a reduced operating profit contribution from Property.

Looking ahead

As a result of these achievements in 2004, the Group is now more focused. Together, Ports and Ferries make up almost two thirds of the Group's net operating assets. Good progress is being made in improving Ferries and hence P&O is in good shape to move forward in 2005.

Lord Sterling

Before turning to our operating companies, I should like to record the Company's gratitude to Lord Sterling who will be standing down from the Board after our annual general meeting in May. He led the Company through turbulent times in the 1980s and subsequently restored P&O to its place as one of the world's leading shipping companies.

P&O has now changed again and we have a clear strategy supported by our name and house flag which are recognised around the world. We have all played a part in this but it has been achieved under Lord Sterling's chairmanship.

My Board colleagues and I wish him well for the future and for the further challenges he will undoubtedly wish to undertake!

Key announcements

February 04
- Restructuring of P&O's Container Shipping interests to give a 25% holding in Royal P&O Nedlloyd N.V. announced.
- Target of £250 million of net sales of property assets announced for 2004.

March 04
- Agreement signed to further invest and expand Centerm Container Terminal in Vancouver, Canada.

April 04
- Ferries sells part of its Irish Sea operations and related assets to Stena AB.
- Concession signed to invest in major new container terminal in Antwerp, Belgium.
- Royal P&O Nedlloyd N.V. lists on Euronext, the Amsterdam Stock Exchange.

July 04
- Sales of Australian resorts and office development in Germany, plus major property disposals in US.

August 04
- Agreement signed to invest in potential port project in Kulpi, India.
- Luxury resort, La Manga Club, in Spain announced for sale.

September 04
- Conclusions of Ferries' fundamental business review announced.

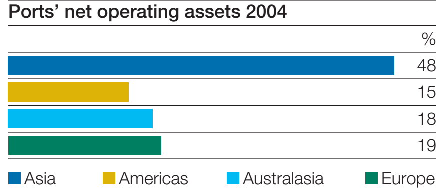
October 04
- Agreement signed to expand port operations in Le Havre, France.

December 04
- Appointments of Sir John Parker as Chairman designate and David Williams as a non-executive director announced.
- Major property disposals completed in US and the sale of La Manga Club in Spain completed. Net property sales target of £250 million for 2004 exceeded.

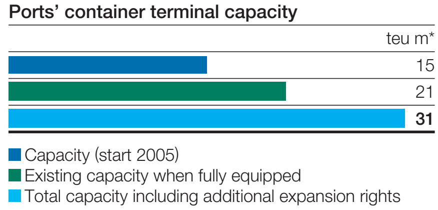
January 05
- Property sales in UK and Germany announced.
- Target of £250 million net property sales set for 2005.

March 05
- Sale of part of Regent Quarter development, London.

Ports' net operating assets 2004



Ports' container terminal capacity



* Data presented is capacity attributable to P&O and excludes new projects under consideration

Operating and financial review

Ports

Performance review 2004

- Container throughput increased by 22% to 13.8 million teu with 15% attributable to organic growth
- Trading profit grew to £153.8 million in 2004 (2003 £129.1 million)
- Approximately £140 million invested in developing existing operations
- New capacity introduced in Thailand, India, China and France

Objectives for 2005

- Continue to expand capacity as required to service trade growth
- Complete the major expansions in Antwerp and Vancouver
- Continue to increase efficiency in all areas of operations and thereby improve operating returns
- Continue development of new enterprise operating systems
- Continue to improve safety performance
- Ensure all facilities comply with increasingly demanding port security requirements
- Pursue new opportunities which offer attractive returns to stockholders

Ports' trading profit

	£m
04	**153.8**
03	129.1
02	116.8
01	115.1
00	102.5

www.poports.com

Market review

Global container traffic during 2004 is estimated to have grown by 12% to 100 million teu. There continues to be strong growth of container traffic originating from Asia, particularly China where GDP growth in 2004 is estimated at 19%. This reflects the competitive strengths of the Asian economies. P&O Ports has benefited from this growth, not only through its investments in Asia, but also at ports servicing the Asia trade lanes.

Customers

P&O Ports operates common user terminals with the objective of providing the same high level of service to all customers. Customers include all of the major container shipping lines as well as break bulk, passenger and car carriers. We also perform logistics activities dealing directly with transport companies and the ultimate cargo owners such as manufacturers, traders and importers. We aim to provide excellent value to our customers, with a commitment to delivering industry leading levels of service in all locations.

Financial review

Ports' total trading profit increased to £153.8 million (2003 £129.1 million) with the strong growth reported in the first half continuing throughout the year. Total operating profit increased to £158.1million (2003 £129.1 million) including a net benefit of £4.3 million (2003 £nil) for exceptional items.

Excluding the Maritime Services business, part of which was sold in 2003, Ports' trading profit increased by 24% to £146.9 million (2003 £118.5 million). Adverse currency movements held back earnings by £12 million. On a constant currency basis, trading profit increased by 34%.

Total container throughput grew 22% to a record 13.8 million teu. Organic volume growth was 15%. Net operating assets increased to £1,202.2 million (2003 £1,170.6 million). Return on average capital employed at ports which we have operated for more than five years increased further to 18% (2003 16%), a particularly strong result.

Asia

Our Asian terminals increased trading profit by 23% to £84.6 million (2003 £69.0 million) with strong organic volume growth of 18%.

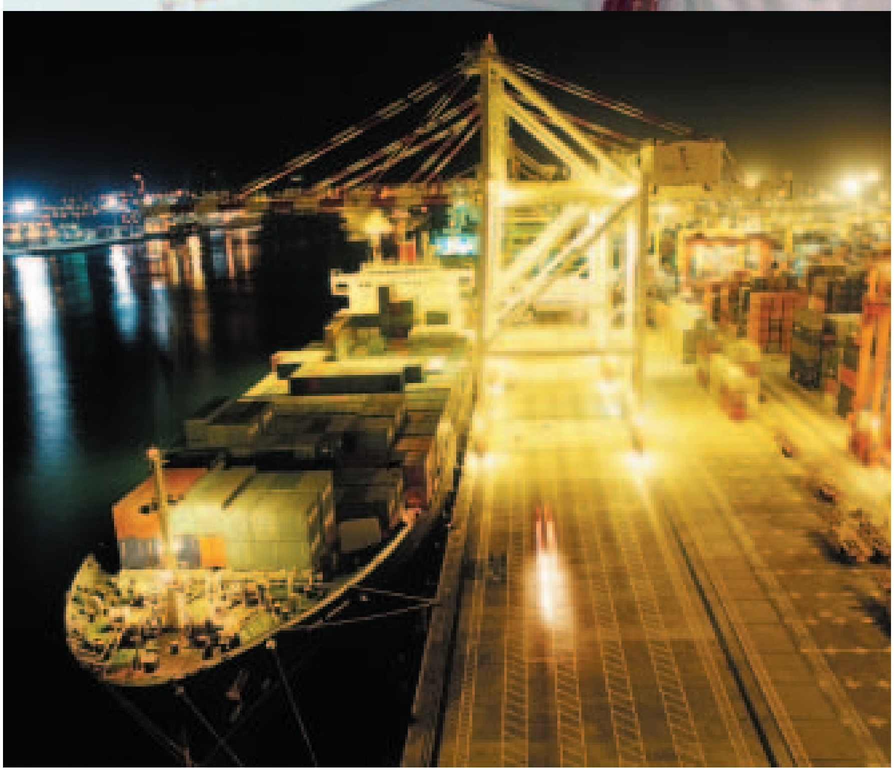
In China, significant volume and profit growth was achieved at Qingdao following the handover of an additional four berths, making a total of eight berths with a potential throughput of over 4 million teu. Shekou also grew strongly with a new facility becoming fully operational in February 2004.

In India, Nhava Sheva (Mumbai) again performed well although it is now at capacity. Chennai continued to grow strongly and the recent start-up terminal at Mundra moved into operating profit. In Pakistan, growth in volumes and a high contribution from ancillary services such as container storage led to strong profit growth at Port Qasim.

The difficult economic environment in the Philippines led to static container volumes at ATI and weak non-containerised cargo volumes. In Indonesia, slower economic growth also resulted in disappointing international container volumes at Surabaya.

Americas

Our ports in the Americas significantly improved trading profits to £16.2 million (2003 £13.2 million) with organic volume growth of 17%. This reflected some improvement at Port Newark (New York) where reconstruction of the core terminal was completed during 2004 leading to customer gains, improved volumes and better utilisation. TRP in Argentina achieved good volume growth, particularly in the first half of the year. The terminal in Vancouver progressed well and increased tariffs were achieved. Agreement has been reached to double the size of the existing container terminal under a new 51 year lease from the port authority. Non-containerised business in the Americas was mixed with certain sites experiencing local competitive pressure.



Best practice

Training and development

P&O Ports continually seeks to improve its operational efficiency through investment in people, systems, assets and the sharing of best practice. Training and development of all employees is fundamental to achieving this.

From issues such as safety procedures to information technology, people at all levels of P&O Ports have the opportunity to develop skills and knowledge through formal training, development initiatives and on-line distance education programmes.

In 2004, P&O Ports launched its Operational Management Diploma. This 10 week residential programme is designed to produce our expert terminal operators and managers of the future.

Setting new standards

Laem Chabang International Terminal ("LCIT"), Thailand set new standards in 2004.

The terminal handled in excess of one million teu whilst experiencing no 'lost time' safety incidents.

In achieving this excellent result LCIT averaged 30 crane moves per hour and on an annualised basis moved 63,000 teu per yard hectare.

Operating and financial review

Expansion

Growing the business

P&O Ports is increasing stockholder value by increasing its scale of operations organically through local trade growth and market share at existing terminals, by expanding current capacity and by developing or acquiring new terminals.

In April 2004, we signed a 40 year concession with the Port of Antwerp Authority to build the superstructure, equip and operate a new terminal as the lead in a consortium – Antwerp Gateway. The new project will add over 3.5 million teu to our existing operational capacity of 1.4 million teu in Belgium.

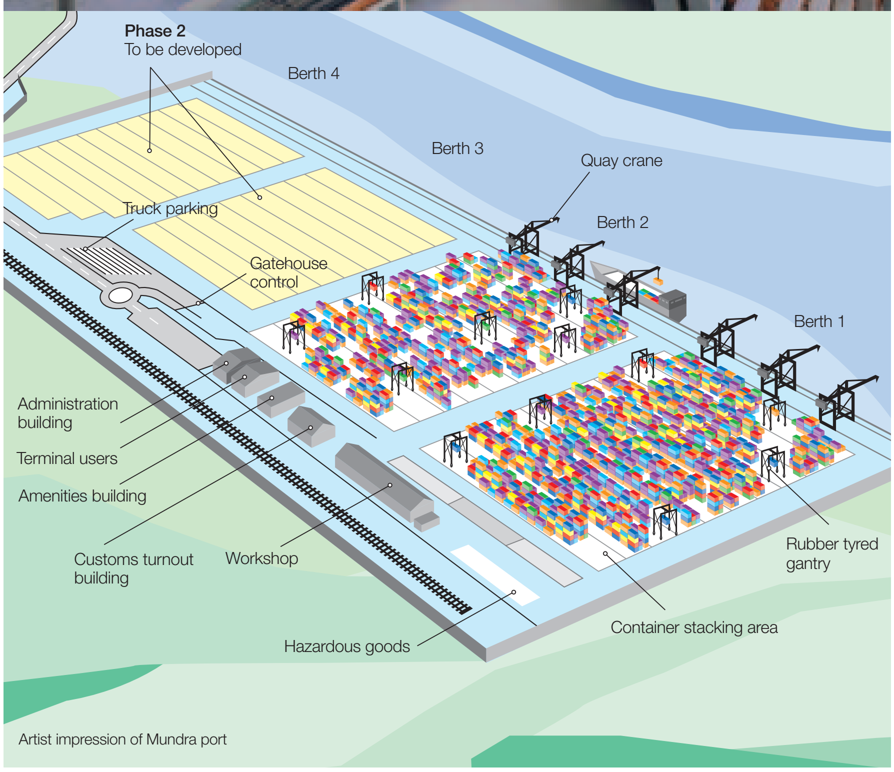
The first phase, with an estimated capacity of 1.4 million teu, will be operational in mid 2005 with development of the second phase expected from 2008.

Developing new terminals

In 2003, we invested £120 million in a major new deep water port development in Mundra, North West India. The port handles cargo from and to the principal trade regions in and around New Delhi.

Operations commenced in July 2003 with two berths and four cranes, with an initial capacity of 0.6 million teu. The terminal is being further equipped with cranes and yard gantries to a capacity of 1.3 million teu.

P&O also has the right to lease and operate a further two berths and associated yard area which will create a total capacity of 2.5 million teu.



Artist impression of Mundra port

Port operations		
Asia – Total throughput teu		**5,793,000**
Location	Country	Shareholding
Manila	Philippines	84%
Laem Chabang	Thailand	35%
Qingdao	China	29%
Shekou, Shenzhen	China	22%
Surabaya	Indonesia	49%
Vostochny	Russia	25%
Chennai	India	75%
Mundra	India	100%
Nhava Sheva	India	100%
Karachi	Pakistan	55%
Colombo	Sri Lanka	16%
Americas – Total throughput teu		**2,178,000**
Location	Country	Shareholding
New York	USA	50%
Vancouver	Canada	100%
New Orleans	USA	100%
Miami	USA	50%
Baltimore	USA	100%
Buenos Aires	Argentina	53%
Various locations	USA	
Europe – Total throughput teu		**3,913,000**
Location	Country	Shareholding
Le Havre	France	37%
Marseilles	France	20%
Antwerp	Belgium	100%
Antwerp Gateway	Belgium *(from July 2005)*	43%
Southampton	UK	51%
Tilbury	UK	34%
Maputo	Mozambique	67%
Australasia – Total throughput teu		**1,917,000**
Location	Country	Shareholding
Sydney	Australia	90%
Melbourne	Australia	100%
Brisbane	Australia	100%
Fremantle	Australia	100%
Total		**13,801,000**

Australia
Trading profit increased to £26.9 million (2003 £17.7 million) with organic volume growth of 14%. There was a significant improvement in logistics and transport, and also in the non-containerised business which benefited from the easing of the drought experienced in 2003. There were strong trade flows with Asia for both containerised and non-containerised cargo. Increased container productivity was achieved, particularly in Sydney and Melbourne.

Europe
Trading profit increased to £19.2 million (2003 £18.6 million) with organic volume growth of 10%. Profit growth was held back at Southampton due to increased labour costs in order to support increases in capacity. Expansion is under way to increase capacity from 1.5 million to 1.9 million teu. Our operation at Antwerp suffered from congestion as did the terminal at Le Havre. Major expansion is under way at Antwerp, to benefit from the continuing good growth in demand, and the Le Havre 2000 project is due to commence operations in 2006.

Maritime Services
Trading profit was £6.9 million (2003 £10.6 million) reflecting the impact of the disposal of our 50% interest in the International Offshore Services business in June 2003. The remaining parts of the business made a sound contribution, and the outlook for 2005 is positive.

Outlook
We are continuing to experience good growth in volume at the start of 2005 although there are capacity constraints at some locations. Capacity is being expanded at several locations such as Southampton, Le Havre and Vancouver to alleviate congestion and to support growth. New equipment has also been commissioned at Chennai and Mundra in India and at Port Qasim in Pakistan. The large development at Antwerp Gateway is on track to commence operations in the second half of the year. In the UK, a decision by the Secretary of State for Transport is awaited on the proposed port development at London Gateway.

Operating and financial review

Ferries

Performance review 2004

- Fundamental business review, the most thorough review of our Ferries business ever undertaken, successfully completed
- Irish Sea operations restructured
- Difficult market conditions led to pressure on earnings

Objectives for 2005

Implement conclusions of fundamental business review:

Freight:
- Maintain efficient loading and minimal waiting times
- Improve customer relationships and links
- Simplify pricing structure

Tourist:
- Provide clear and consistent pricing via improved website and booking process
- Enhance on-board experience – 'hassle free', less crowded ships that are peaceful and comfortable
- Refine on-board restaurant and retail facilities to better meet customer requirements

By end of 2005, close 4 routes and reduce fleet by 8 ships

Deliver profit improvement initiatives: £55 million per annum by 2006

Routes

- Dover – Calais
- Portsmouth – Bilbao
- Portsmouth – Le Havre*
- Hull – Rotterdam
- Hull – Zeebrugge
- Teesport – Rotterdam (freight only)
- Teesport – Zeebrugge (freight only)
- Dublin – Liverpool
- Larne – Cairnryan
- Larne – Troon

* expected to close in 2005

Carryings 2004

	All routes
Freight units	1.9m
Tourist vehicles	2.3m
Passengers	12.8m

Ferries' trading (loss)/profit

	£m
04	(15.4)
03	(0.2)
02	30.2
01	(1.2)
00	18.1

www.poferries.com

Market review

P&O is one of the leading ferry operators in the UK. 2004 was a difficult year for the Anglo-Continental ferry industry which continued to see a downturn particularly in the tourist business. In the important Short Sea market, carryings of 'short break' and 'long stay' customers were stable whereas 'day trip' traffic continued to decline due to factors such as the euro exchange rate and changes in French duty on retail goods. Increased competition from low cost airlines had an impact across all sectors of the market. Freight continued to see steady growth in carryings. There was severe pressure on rates at the start of the year but they subsequently stabilised for much of 2004. Capacity remained unchanged compared to 2003.

Customers

P&O is committed to offering a timely, frequent and competitively priced freight service and an enhanced on-board tourist experience with clear and consistent pricing. As a result of the fundamental business review we are focusing on freight, which is growing strongly, and we are introducing a simplified tourist product targeting premium traffic but with lower volumes. Safety, as always, remains paramount. We can now service the premium segment of the ferry tourist market but also satisfy 'low cost' customer needs via a lower cost product at off-peak periods on the Short Sea. Our customers want quality services but at value for money prices.

A new management structure is in place, customer links improved and tariff structures simplified. Despite capacity reductions in our overall fleet in 2005, we have retained freight capacity at peak times via vessel rescheduling. We are introducing an affordable, hassle free tourist experience. This includes improvements to our website and booking processes and rationalisation of restaurant and retail outlets and services on-board.

Financial review

Ferries reported a trading loss of £15.4 million (2003 £0.2 million). The result includes the Ferrymasters business which reported a loss of £1.9 million (2003 £0.1 million). After reorganisation and impairment charges of £266.0 million (2003 £39.8 million), the operating loss was £281.4 million (2003 £40.0 million).

On a like for like basis, net revenue (turnover less direct variable costs) declined by £34.0 million compared to 2003. Freight volumes grew by 5% despite reduced capacity on the Short Sea but average net freight rates declined by 8%. Tourist vehicle volumes were down 5% year on year, mainly attributable to the Short Sea, but average net tourist vehicle rates were up 3% despite significant price competition over the summer period. Passenger numbers decreased 3% and the net on-board spend per passenger fell sharply because of the impact of the rise in cigarette prices following the increases in French tobacco duty. As a result, net revenue generated from on-board sales was down by 23%. The decline in total net revenue was only partially offset by cost reductions, hence the trading result was £15.2 million lower than 2003.

These adverse trading conditions led to a fundamental business review, the conclusions of which were announced on 28 September 2004. We are now operating on fewer routes with fewer ships and a cost base that is becoming substantially lower and more flexible. Total profit improvements of £55 million per annum are on schedule and we are confident that they will be fully delivered, as planned, by 2006. Following the decision by Brittany Ferries not to take on our Portsmouth – Le Havre route, total implementation costs are estimated at £83.9 million. The review included a reassessment of the carrying value of assets, resulting in an impairment charge of £182.1 million and a £1.1 million write down of investments.

Outlook

The start of 2005 has continued to see growth in the freight market and on most sectors, rates are similar or slightly ahead compared to the end of 2004. As anticipated, tourist carryings remain under pressure, although at this early stage of the year, yields are encouraging. Operational difficulties at Calais following the failure of a link span in February 2005 will have a negative impact on results in the short term. Approximately two thirds of the targeted profit improvements of £55 million per annum will benefit 2005, but the requirement to continue operating the loss making Portsmouth – Le Havre route is likely to erode these benefits by approximately £5 million.

Customer focused

Reviewing the business

Future commercial emphasis for all routes will be on the growing freight market and on premium long stay car and coach passengers.

The vision is based on market trends and analysis undertaken during the fundamental business review. The research indicated that while customers want affordable travel, they are not looking for a no-frills style of service.

Customers value the quality experience they associate with the P&O Ferries name but they want their travelling costs to be lower.

Turning proposals into actions

As a result of the review, a number of proposals have already been implemented including:

- a wide range of lower fares in response to customer demand;
- simplified restaurant and bar offer on board the ships;
- a non-smoking policy in most of the public spaces on board, in response to customer research; and
- projects to make the booking process easier for customers.

Operating and financial review

Other activities

Cold Logistics	
Capacity	Cubic m
Australasia	1,559,117
USA	3,267,775
Argentina	191,635
Total	**5,018,527**
www.pocoldlogistics.com	

Container Shipping	
P&O shareholding in Royal P&O Nedlloyd	25%
Number of ships in P&O Nedlloyd fleet	156
Ship calls at 217 ports in 99 countries	
Total fleet capacity	428,459 teu
www.ponl.com	

Property	
Target set in 2004 for net property sales	£250m
Book value sold 2004	£m
Office development, Boston Wharf, US	75
Technology Park, Atlanta, US	54
Hanseatic Trade Center, Germany	36
Australian resorts	51
La Manga Club, Spain	87
Manchester Arena, UK	49
Other	92
	444
Net gain	56
Gross sales for 2004	500
Development expenditure	(129)
Net sales 2004	**371**
www.poproperties.com	
www.podevelopments.com	

Cold Logistics

Cold Logistics reported a trading profit of £17.4 million (2003 £16.4 million). After an impairment charge of £10.0 million (2003 £nil), the operating profit was £7.4 million (2003 £16.4 million). Net operating assets are now £189.5 million (2003 £218.9 million).

The US had a good year with 4% revenue growth in local currency despite the sale of two small facilities which reduced capacity by 4%. Improved operating performance and productivity gains led to higher profit. In Australia revenue also grew 4% in local currency but a tight labour market and new contract start-up costs resulted in profits remaining similar to 2003.

Following a change in approach to supply chain management by some major retailers in Australia, it is unlikely that some contracts, which expire in 2006 and 2008, will be renewed in their current form. We believe that the surplus capacity that may result at some sites can be managed effectively. However, the carrying value of the relevant facilities has been reviewed in the light of this anticipated change, resulting in the impairment charge of £10.0 million.

Container Shipping

P&O's share of the results of its Container Shipping interests was an operating profit of £55.5 million (2003 £17.6 million).

On 16 April 2004, P&O Nedlloyd effectively became an independently listed company, Royal P&O Nedlloyd N.V. ("Royal PONL"). P&O sold its previous 50% share of P&O Nedlloyd to Royal PONL, in which it now holds a 25% interest, which is accounted for as an associate.

Royal PONL reported its full year results on 3 March 2005 (see www.ponl.com). P&O Nedlloyd's full year operating profit was US$401.0 million (2003 US$77.0 million). The strong upturn was due to a 13% average freight rate increase, and 10% underlying volume growth.

Property

The Property trading result was £57.0 million (2003 £39.8 million) before impairment charges of £31.0 million (2003 £nil). Operating profit was £26.0 million (2003 £39.8 million).

Total gross sale proceeds were £500 million (book value of property plus net gain over book value) with net proceeds of £371 million. This was considerably above the target of £250 million of net sales set at the beginning of the year. Significant sales were made in the US. The Australian resorts and La Manga Club were sold together with part of the Hanseatic Trade Center ("HTC") joint development in Germany and the Manchester Arena in the UK. Offsetting these gross sales was development spend of £129 million, largely in the UK.

In January, it was announced that the remainder of HTC had been sold and this resulted in an impairment charge of £60.2 million. Of this, £31.0 million is included in operating profit as noted above and a further £29.2 million as a write down to the investment.

We intend to make further net property sales of £250 million in 2005 of which £157 million has already been announced. By the end of the year we expect Property to account for less than 10% of our net operating assets. The reduced size of the portfolio, together with our having sold the resorts and other assets which were significant contributors to earnings, means that Property is likely to make a smaller profit contribution in 2005.

Adding value

Reallocating capital

Within our other activities we achieved two major strategic objectives.

At the start of 2004 we set a target of £250 million net property sales. Our property teams exceeded this goal by over £120 million with disposals completed in Germany, Australia, the US, Spain and the UK.

A similar net sales target has been set for 2005 with over £150 million achieved by March 2005. This includes the disposal of part of Regent Quarter, our mixed use scheme, in King's Cross, London.

Achieving objectives

We also achieved another key strategic objective of taking capital out of Container Shipping.

On 16 April 2004, P&O Nedlloyd effectively became an independently listed company, Royal P&O Nedlloyd N.V., on the Amsterdam Stock Exchange (Euronext).

P&O sold its previous 50% share of P&O Nedlloyd to Royal P&O Nedlloyd, in which it now holds a 25% interest.

Operating and financial review

Supporting projects

Tsunami tragedy

P&O has operations in many of those countries which were worst affected by the devastating tsunami disaster in December 2004.

Whilst none of our operations were directly affected, many of our staff have been touched by this tragedy. Our local operations and contacts in Sri Lanka, India, Thailand and Indonesia were able to provide immediate practical and financial assistance through donating food, clothes and medicines and supplying shelter and transport.

This was later supported by a Group donation of £200,000 channelled via our ports in the region.

Reducing ship emissions

In 2003, P&O and BP Marine embarked on an ambitious project with the potential to reduce ships' exhaust emissions dramatically.

At the beginning of 2004 we trialled a new technology, the 'Eco-Silencer', on board the Pride of Kent. The technology uses seawater to scrub out harmful emissions from the funnel before they are released into the atmosphere.

The tests have proven the viability of exhaust gas scrubbing and we look forward to further developments next year.

Even without the Eco-Silencer fully optimised, the system is delivering a high percentage of reductions in exhaust emissions.

Photograph taken by David Graham

Community

Highlights for 2004

- P&O published its 6th biennial report on the environmental performance of the Group, 'People, Environment and Community'. This report was expanded to cover a wide range of social responsibility data.
- All of P&O's port and marine operations have achieved compliance with the requirements of the International Ship and Port Facility Security Code.
- P&O has commenced a programme of dedicated social responsibility audits.
- P&O is listed on both the FTSE4Good and Dow Jones Sustainability indices.
- A wide range of Divisional and Group safety initiatives have been introduced including the establishment of four year targets to reduce accidents by 80%.
- The P&O Sharesave Plan was offered globally for a second year.
- The external assurance programme for global warming emissions has been enhanced.
- P&O has established and issued a Group 'Whistle-blowing' policy.
- Working trials of the 'Eco-Silencer' technology to reduce ships' exhaust emissions have progressed well.

Social responsibility

P&O's policy on social responsibility has been in place since January 2002 and the Group remains committed to the values established within it. Key to our approach is a belief that our activities should be conducted in a way which is economically, environmentally and socially sustainable. We endeavour to apply these values in all of our operations, from the services we provide to the public and business customers to the development of new projects.

In May 2004 we published our 6th biennial report, 'People, Environment and Community'. A large number of people have been good enough to respond to our request for feedback on this report, with 95% rating the report as either good or very good. A copy of this report is available at www.pogroup.com.

Environment

P&O first adopted an environmental policy in 1990. Seeking to minimise any adverse impacts arising from our activities remains a priority.

During 2004 we have extended the range of our operations which have formal environmental management systems. As part of these systems, all locations are required to set environmental improvement targets. Of the 129 targets which we previously set ourselves, 101 have now been achieved.

Workplace

Creating and maintaining a working environment in which the capabilities of all employees are developed are core values within P&O.

P&O is committed to achieving the highest standards of safety. During the year P&O Ports established a range of initiatives targeting accidents and injuries which result from human error or behaviour. Pilot programmes have been introduced at certain sites in consultation with the workforce. This includes continuous training and the positive reinforcement of safe behaviour. Senior management are leading this approach as well as visiting other companies, who have achieved outstanding safety levels.

In 2004 our global Sharesave Plan which offers all eligible employees the opportunity to participate in the value we are creating, was extended. Some 30% of all eligible staff have now joined the plan.

Community

Traditionally we have contributed to society through the creation of jobs, through charitable donations and by providing practical help. As our business has moved forward so has our understanding of our impact on the communities where we work and what needs to be done to maintain and strengthen those relationships. Whilst we continue to give priority to requests for help with educational and environmental projects, we actively seek long term programmes and links within the communities in which we operate.

Assurance

In addition to the internal procedures and contracts in place within operating companies, the P&O Group Safety and Environmental Directorate conducts a series of annual audits on behalf of the Board. During 2004 these audits were enhanced to include a wide range of social responsibility issues.

As a result of increasing numbers of locations adopting formal, certified environmental and safety management systems, the number of sites and assessments subject to external audit and verification has increased.

Robert Woods CBE
Chief Executive

Operating and financial review

Group financial review

Nick Luff
Chief Financial Officer

2004 was a year of significant change. Underlying trading profits were good although the overall profits were impacted by exceptional items, while strong cash flows from trading and disposals reduced borrowings.

Earnings per share

The earnings per share before reorganisation and impairment charges, exceptional items and goodwill amortisation improved from 12.4p per share to 19.4p per share. This reflected the strong performance from Ports, the improved result from Container Shipping and high Property profits, offset by the operating loss from Ferries. After exceptional items, which totalled £378.7 million (2003 £23.3 million), the basic loss per share was 34.7p (2003 earnings 6.5p). The main exceptional items came from the Ferries reorganisation and impairment charges (£267.1 million), the loss on the partial sale of P&O Nedlloyd (£65.4 million) and the impairment charge relating to the Hanseatic Trade Center ("HTC") development in Hamburg (£60.2 million).

Cash flow and financial position

Net cash inflow from operating activities was £417.0 million (2003 £247.8 million) reflecting the improved underlying trading and the significant number of development property sales in the year. The net cash inflow before capital expenditure was £315.1 million (2003 £200.8 million). Net capital expenditure was an inflow of £220.8 million (2003 £411.1 million outflow). This reflected £224.5 million (2003 £527.0 million) expenditure on assets and business acquisitions which was more than offset by cash inflows from the partial sale of P&O Nedlloyd, disposal of Australian resorts and La Manga Club, disposal of part of the Irish Sea ferry business and other asset disposals which totalled £445.3 million (2003 £115.9 million). Consequently, after dividend payments, there was a net cash inflow of £448.1 million (2003 £304.0 million outflow).

Given the high cash inflows from property, asset and business disposals, net borrowings decreased from £1,502.7 million to £1,029.6 million. Stockholders' funds reduced to £976.3 million from £1,310.1 million mainly due to the significant exceptional items incurred in the year. The debt to capital ratio at the year end was 50.2% (2003 52.8%).

Acquisitions and disposals

A number of significant strategic disposals occurred during the year together with further significant investments in the Ports portfolio.

On 2 February 2004, the Group announced that it had signed a conditional agreement for the disposal of its 50% stake in P&O Nedlloyd for a consideration of €215 million cash and a 25% shareholding in Royal Nedlloyd, which has been renamed Royal P&O Nedlloyd N.V. This transaction completed on 16 April 2004.

The Group disposed of a number of development properties during the year with gross proceeds totalling £500 million including a significant part of the Boston Wharf property portfolio, the entire Atlanta property portfolio and one phase of the HTC office development.

In the first half of the year part of the Irish Sea ferry operation was sold (£50 million) and during the second half of the year the Australian resorts (£81 million) and La Manga Club (£102 million) businesses were sold.

A total of £140 million has been invested in the Ports division during the year. This included £31 million spent equipping the new terminal in Mundra, India, and £26 million on expansion of the terminal in Qingdao, China.

Since the year end the Group has announced further property disposals of the remainder of the HTC office development (£66 million), the shopping centre development in Plymouth (£55 million) and part of the King's Cross development (£47 million) which make us well placed to achieve our target of £250 million net property sales in 2005.

Tax charge

The tax charge in 2004 was £26.9 million (2003 £20.7 million), excluding the impact of exceptional items. This represents an effective tax rate of 16% on the pre-exceptional profit of the Group. However, this includes some benefit from one-off credits following the finalisation of overseas tax audits. An ongoing average tax rate around 30% is anticipated. We do not pay any significant tax on profits from our shipping businesses as these fall mainly in tonnage tax regimes. We also benefit from favourable tax regimes that apply to a number of Ports' businesses, although the benefit of these is offset by interest and overhead costs in the UK for which we do not receive a tax deduction.

Pensions

The two pension schemes of most relevance to the Group's financial position are the P&O UK scheme and the New Section of the industry wide Merchant Navy Officer's Pension Fund ("MNOPF").

The P&O UK scheme is a joint scheme for both P&O and P&O Nedlloyd employees.

As at 31 December 2004, P&O's share of the deficit in the scheme on an FRS 17 basis was £221 million (2003 £197 million). P&O Nedlloyd has now formed its own scheme and 25% of the assets and liabilities of the P&O UK scheme are in the process of being transferred into the P&O Nedlloyd Scheme. In addition, P&O Nedlloyd is making an exit payment of £70 million into the remaining P&O UK scheme. As a result of this transfer, on a pro forma basis (using 31 December 2004 data), the deficit in the P&O UK scheme has reduced to £200 million. Group cash payments into the remaining P&O UK scheme are being increased to approximately £30 million a year, from £12.5 million, but this has no effect on the profit and loss account.

For the MNOPF, the last actuarial valuation also reported a deficit. A court case commenced in March to resolve how deficit payments will be allocated amongst employers. The outcome is likely to be known later in 2005. P&O's share of the deficit under FRS 17 is estimated at either £125 million or £30 million, depending on the outcome of the court case, with these amounts potentially increasing if payments from other employers are not forthcoming. Currently, a multi-employer exemption applies and hence the deficit does not impact P&O's reported financial position.

International Financial Reporting Standards

All quoted companies in the UK will be required to adopt International Financial Reporting Standards ("IFRS") for their consolidated accounts for periods commencing on or after 1 January 2005. The 2004 accounts have been prepared under UK Generally Accepted Accounting Principles and our Interim Report for 2005 will be our first financial statement prepared under IFRS. A detailed announcement providing restatement of these 2004 results under IFRS will be published during the second quarter of 2005. We expect the most significant changes to the Group's ongoing reported figures to be in the following areas (estimates are based on these 2004 results):

- IAS 19 'Employee Benefits' is broadly consistent with the UK standard, FRS 17 'Retirement Benefits', in terms of measurement of the pension assets and liabilities, assuming that the amendments to IAS 19 will be endorsed by the European Union. A liability of approximately £250 million (based on our FRS 17 valuation) will be reported in the balance sheet with a consequential reduction in Group reserves to reflect P&O's exposure to pension scheme deficits. This excludes the MNOPF scheme, due to the multi-employer exemption noted above, and the Group's share of P&O Nedlloyd's pension schemes. There will be a benefit to operating profit in 2004 of £4 million as the 'deficit' charges applied under SSAP 24 will no longer be applicable, although changes in mortality and other assumptions could offset this gain for subsequent years.
- IFRS 3 'Business Combinations' prohibits the amortisation of goodwill arising on a business combination and instead requires such goodwill to be tested for impairment annually. There will be an ongoing benefit of approximately £8 million to the income statement as a result of this change. However, in future, the annual impairment tests may increase the volatility of results.

Turnover

	£m
04	**2,397.5**
03	2,291.0
02	1,882.8
01	1,730.5
00	1,790.8

Turnover includes Group turnover for all continuing operations and excludes joint venture turnover

Operating profit

	£m
04	**268.3**
03	202.7
02	126.3
01	249.4
00	334.6

Operating profit includes our share of joint ventures and associates and all continuing operations before exceptional items

EBITDA

	£m
04	**464.1**
03	427.4
02	352.9
01	482.9
00	530.8

EBITDA includes earnings from our share of joint ventures and associates and all continuing operations before interest, depreciation, amortisation, tax and exceptional items

The figures for 2000 used in these graphs are pro forma figures, the basis of which is explained on pages 26 and 27.

Operating and financial review

Group financial review

Net capital expenditure

	£m
04	**(220.8)**
03	411.1
02	229.6
01	119.4
00	(299.9)

Net capital expenditure of all continuing and discontinued operations, excluding joint ventures and associates

(Loss)/profit before tax

	£m
04	**(210.0)**
03	80.0
02	(135.7)
01	173.0
00	162.7

(Loss)/profit before tax includes all continuing and discontinued operations and our share of joint ventures and associates

The figures for 2000 used in these graphs are pro forma figures, the basis of which is explained on pages 26 and 27.

- IFRS 2 'Share Based Payments' requires the fair value of stock option grants and employee/executive matching awards to be recognised as a cost in the income statement over the vesting period. This is estimated to result in an additional cost of approximately £2 million per annum.
- IAS 27 'Consolidated Financial Statements' requires P&O's interest in the partnership that owned the HTC property development in Hamburg to be accounted for as a subsidiary. Consequently, P&O's Group debt as at 31 December 2004 will increase by approximately £146 million. P&O's share of joint venture and associate debt will reduce by £69 million and net operating assets will increase by approximately £75 million as at 31 December 2004. The property has subsequently been sold and consequently Group debt will reduce by £146 million, with net operating assets reducing by the same amount, upon completion of the sale in 2005.
- IAS 12 'Income Taxes', is similar to the UK standard, FRS 19 'Deferred tax', in respect of deferred tax provisioning. However there are some differences in which timing/temporary differences are recognised. Notably, under IAS 12, deferred tax will need to be recognised on revalued assets and fair valuation adjustments, and also on the unremitted reserves of certain joint ventures and associates in overseas tax jurisdictions.
- The presentation of the primary financial statements will differ under IFRS. In particular, the treatment of joint ventures and associates will differ in the income statement, with the Group's share of the post-tax results of such entities reported as a single line item.

Other impacts will include possible adjustments to leases, the non accrual of dividends and, from 2005, the marking to market of certain financial instruments under IAS 39, the impact of which is subject to movements in the financial markets.

Financial risk

The financial instruments held by the Group to finance its operations include cash, overdrafts, loans, a limited amount of interest bearing and non-interest bearing investments and non-equity stockholders' funds. Derivative financial instruments are used to manage the interest rate and currency risks arising from its operations and its sources of finance. The derivatives employed for this purpose are principally interest rate swaps and forward foreign currency contracts.

The Group has in place established treasury policies. The purpose of these is to ensure that adequate cost effective funding is available to the Group at all times and that exposure to financial risk is minimised.

The main financial risks to which the Group is exposed are foreign currency risk, interest rate risk and liquidity risk as summarised below. No transactions of a speculative nature are undertaken. The Board receives regular reports which monitor these risks in accordance with agreed policies. None of these policies have been altered during the year.

Foreign currency risk

The Group has extensive overseas and international business operations and operates in a number of foreign currencies. The most important foreign currency to the Group is the US dollar, followed by the Australian dollar and the Indian rupee. In general, the Group's profits and stockholders' funds benefit if these currencies are strong against sterling. The year end rate for the US dollar was \$1.920=£1 (2003 \$1.790=£1), for the Australian dollar it was \$2.449=£1 (2003 \$2.376=£1) and for the Indian rupee it was INR83.458=£1 (2003 INR81.676=£1).

The proportion of the Group's net operating assets denominated in foreign currencies is 75% with the result that the Group's sterling consolidated balance sheet, and in particular stockholders' funds, can be significantly affected by currency movements. The Group mitigates the effect of such movements by borrowing in the same currencies as those in which

Net cash flow

	£m
04	**448.1**
03	(304.0)
02	(139.4)
01	(8.3)
00	369.8

Net cash flow before management of liquid resources and financing

Interest cover (before exceptional items)

04	**2.7**
03	1.9
02	1.2
01	2.4
00	3.8

Operating profit before exceptional items for all operations, including our share of joint ventures and associates, divided by net interest and similar items

Headline earnings per share

	pence
04	**19.4**
03	12.4
02	(1.0)
01	17.9
00	28.7

Headline earnings/(loss) is calculated by reference to profit attributable to stockholders before exceptional items and goodwill amortisation

The figures for 2000 used in these graphs are pro forma figures, the basis of which is explained on pages 26 and 27.

the assets are denominated. In addition the majority of the Group's operating profit in 2004 was generated by businesses with functional currencies other than sterling. The results of these businesses are translated into sterling at average exchange rates for the purposes of consolidation. The impact of currency movements on operating profit is mitigated partially by interest costs being incurred in foreign currencies.

A portion of the Group's businesses generates part of their revenue and incurs some costs outside their main functional currency. In particular P&O Nedlloyd, in common with other operators in the container shipping industry, has US dollar based revenues with costs incurred in a range of currencies including US dollars, sterling, euros, and Japanese yen. Some hedging, generally up to 12 months using forward contracts, is undertaken to reduce the short term effect of currency movements. Also P&O Ferries has US dollar based fuel costs which naturally offset some of the Group's US dollar income.

When the Group's businesses enter into capital expenditure or lease commitments in currencies other than their main functional currency, these commitments are hedged in most instances using forward contracts and currency swaps in order to fix the cost when converted to the functional currency. The main exposure of the Group's foreign currency commitments of this nature is in respect of ferry operating lease commitments. Forward contracts match the expected cash flows of capital and lease commitments.

As well as the direct effect on cash flows, exchange rates also affect the Group's businesses because of their overall economic influence. In particular, exchange rates affect international trade flows which impact on the activities of the Group.

Interest rate risk

A small proportion of the Group's underlying borrowings are at fixed rates of interest. In addition, the Group uses interest rate swaps and other instruments to fix the interest cost on its floating rate borrowings in order to limit the impact of increases in interest rates. In the medium term, the Group's policy is to maintain between 50% and 75% of borrowings at a fixed rate of interest. In the short term, the level of fixed rate borrowings may move out of the 50% to 75% range, in which case a plan is put in place to move back within this range. Interest rate swaps have been taken out for periods of between 2 and 13 years with an average life of 3.5 years at 31 December 2004. £686.0 million of borrowings were at fixed rates of interest as at 31 December 2004, either directly or indirectly through swap arrangements. This represents 67% of net borrowings, with 62% at rates fixed for more than one year.

Liquidity risk

The Group is currently funded mainly through bilateral bank borrowings which are largely repayable within five years, together with ship related finance which increases the average term of the Group's borrowings. The Group has cash balances and undrawn committed facilities, to provide additional liquidity if required. It remains the objective of the Group to put in place long term debt to finance its long term assets.

Fuel hedging

During 2004 no fuel price swaps or options were used by Group companies. Royal P&O Nedlloyd, which has a high proportion of its costs attributable to fuel, uses derivatives to hedge its fuel consumption in accordance with its fuel hedging policy.

Nick Luff
Chief Financial Officer

Board of directors












1	2	3
4	5	6
7	8	9
10	11	12

Members of the audit committee
Chairman: Rodney Galpin
Sir David Brown
Sir John Collins
Michael Everard
David Williams

Members of the remuneration committee
Chairman: Sir John Collins
Sir David Brown
Michael Everard
Rodney Galpin
David Williams

Members of the nomination committee
Chairman: The Lord Sterling of Plaistow
Sir David Brown
Sir John Collins
Michael Everard
Rodney Galpin
Robert Woods

Senior non-executive director
Rodney Galpin

1 **The Lord Sterling of Plaistow GCVO CBE**
70; Appointed to the Board on 6 February 1980; Chairman since 1983; Chairman of P&O Princess Cruises plc 2000 to 2003; prior to his involvement in P&O, Lord Sterling founded Sterling Guarantee Trust and was a Special Adviser to successive Secretaries of State for Trade and Industry.

2 **Robert Woods CBE**
58; Appointed to the Board on 18 January 1996; Chief Executive since 1 January 2004 and Executive Chairman of P&O Ports since May 2002; Group Managing Director of P&O Nedlloyd Container Line Ltd from 2000 to 2003; joined P&O in 1971; Past President of the Chamber of Shipping; Non-executive director of John Swire & Sons and Royal P&O Nedlloyd N.V.

3 **Sir David Brown**
54; Non-executive director since 16 January 2002; Chairman of Motorola Limited; Fellow of the Royal Academy of Engineering and Past President of the Institution of Electrical Engineers.

4 **Sir John Collins**
63; Non-executive director since 10 June 1998; Chairman of Dixons Group plc; Non-executive director of N M Rothschild & Sons; Chairman and Chief Executive of Shell UK Ltd 1990 to 1993.

5 **Michael Everard**
56; Non-executive director since 1 January 2001; Chairman of F T Everard & Sons Limited; Immediate Past President of BIMCO; Vice-Chairman of The Mission to Seafarers; Member of Lloyd's Register General Committee.

6 **Rodney Galpin**
73; Non-executive director since 18 January 1996; Senior non-executive director; Executive director of the Bank of England 1984 to 1988; Chairman and Group Chief Executive of Standard Chartered plc 1988 to 1996.

7 **Michael Gradon**
45; Appointed to the Board on 10 June 1998; Executive Director, Commercial and Legal Affairs, and Company Secretary; joined the Company in 1986 becoming Group Legal Director in 1994 and Company Secretary in 1996.

8 **Nick Luff**
37; Re-appointed to the Board as Chief Financial Officer on 14 May 2003; Chief Financial Officer, P&O Princess Cruises plc 2000 to 2003; Finance Director, P&O and Board Member 1999 to 2000; joined the Company in 1991; appointed Group Treasurer in 1994 and Head of Corporate Finance in 1996; Non-executive director of QinetiQ Group plc and Royal P&O Nedlloyd N.V.

9 **Sir John Parker**
62; Non-executive director and Deputy Chairman since 1 February 2005; Chairman of National Grid Transco plc; Senior non-executive director of the Bank of England; Non-executive director of Carnival Corporation and Carnival plc. Chairman of RMC Group 2001 to 2005; Chief Executive of Babcock International Group plc 1993 to 2000 and Chairman 1994 to 2000; Chairman and Chief Executive of Harland and Wolff Plc 1983 to 1993; Fellow of the Royal Academy of Engineering and Past President of the Royal Institution of Naval Architects.

10 **Russ Peters**
56; Appointed to the Board on 11 June 2003; Chief Executive Officer of the Ferries division; joined P&O in 1987 becoming Managing Director of P&O European Ferries (Dover) in 1994 and Managing Director of P&O Stena Line when it was formed in 1998.

11 **Peter Smith**
53; Appointed to the Board on 1 January 2000; Executive Director, Communications and Strategy; joined P&O in 1994; formerly Principal Private Secretary to the Secretary of State for Trade and Industry.

12 **David Williams**
59; Non-executive director since 1 January 2005; Finance Director of Bunzl plc; Non-executive director and Chairman of the Audit Committee of George Wimpey plc; Group Finance Director of Tootal Group plc 1991.

Financial calendar and addresses

2005

08 March
Announcement of 2004 final results

23 March
Ex-dividend date for 2004 final dividend

29 March
Registration qualifying date for 2004 final dividend

13 May
Annual General Meeting

01 June
2004 final dividend payable

11 August*
Announcement of unaudited 2005 interim results and 2005 interim dividend

24 August*
Ex-dividend date for 2005 interim dividend

26 August*
Registration qualifying date for 2005 interim dividend

11 November*
2005 interim dividend payable

* Provisional

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Sharehandling agent
UFJ Trust Bank Limited
Corporate Agency Planning Dept
5-3 Nihombashi
1-chome, Chuo-ku
Tokyo 103-0027

USA
ADR depositary
JP Morgan Chase Bank
JP Morgan Service Center
PO Box 43013, Providence,
RI 02940-3013

Financial contents

Five year financial record

Certain 2000 figures are pro forma. They have been prepared to illustrate the results and cash flows of the Group excluding the results and cash flows of the companies and businesses transferred to P&O Princess Cruises plc as a result of the demerger of the Group's cruise business on 23 October 2000. The basis of preparation is set out in the note at the end of page 27.

Group profit and loss summary for the years ended 31 December

	Actual 2004 £m	Actual 2003 £m	Actual 2002 £m	Actual 2001 £m	Pro forma 2000 £m
Turnover: Group and share of joint ventures					
Continuing operations	3,057.4	4,137.9	3,725.9	3,753.6	3,607.5
Discontinued operations	–	–	793.3	745.5	786.0
	3,057.4	4,137.9	4,519.2	4,499.1	4,393.5
Total operating (loss)/profit					
Continuing operations	(34.4)	162.9	109.8	249.4	334.6
Discontinued operations	–	11.8	11.2	24.2	30.7
	(34.4)	174.7	121.0	273.6	365.3
Continuing operations					
(Loss)/profit on sale of fixed assets and businesses	(44.1)	23.1	(41.6)	0.3	(53.1)
Discontinued operations					
(Loss)/profit on sale of fixed assets and businesses	(3.1)	(6.5)	(103.3)	12.7	(53.3)
Amounts written off investments	(30.3)	–	–	–	–
(Loss)/profit before interest and taxation	(111.9)	191.3	(23.9)	286.6	258.9
Net interest payable and similar items	(98.1)	(111.3)	(111.8)	(113.6)	(96.2)
(Loss)/profit on ordinary activities before taxation	(210.0)	80.0	(135.7)	173.0	162.7
Taxation	(25.4)	(20.8)	(35.5)	(44.8)	(83.7)
Equity minority interests	(14.9)	(9.2)	(8.5)	(8.9)	(14.1)
(Loss)/profit for the financial year	(250.3)	50.0	(179.7)	119.3	64.9
Dividend per £1 nominal of deferred stock	9.0p	13.5p	13.5p	13.5p	22.5p
Basic (loss)/earnings per £1 nominal of deferred stock	(34.7)p	6.5p	(27.1)p	17.0p	9.1p
Headline earnings/(loss) per £1 nominal of deferred stock	19.4p	12.4p	(1.0)p	17.9p	28.7p

Headline earnings for the years ended 31 December

	Actual 2004 £m	Actual 2003 £m	Actual 2002 £m	Actual 2001 £m	Pro forma 2000 £m
Operating (loss)/profit	(34.4)	174.7	121.0	273.6	365.3
Add back: Amortisation of goodwill	17.2	18.4	14.9	14.1	9.5
Exceptional items (within operating (loss)/profit)	302.7	39.8	16.5	–	–
Net interest payable and similar items	(98.1)	(111.3)	(111.8)	(113.6)	(96.2)
Headline profit	187.4	121.6	40.6	174.1	278.6
Taxation	(26.9)	(20.7)	(35.1)	(40.0)	(67.3)
Equity minority interests	(14.9)	(9.2)	(8.5)	(8.9)	(14.1)
Non-equity dividends	(3.8)	(3.8)	(3.8)	(3.8)	(3.8)
Headline earnings/(loss)	141.8	87.9	(6.8)	121.4	193.4

Reconciliation of earnings per £1 nominal of deferred stock

	pence	pence	pence	pence	pence
Headline earnings/(loss) per £1 nominal of deferred stock	19.4	12.4	(1.0)	17.9	28.7
Amortisation of goodwill	(2.3)	(2.6)	(2.2)	(2.1)	(1.3)
Exceptional items	(52.0)	(3.3)	(23.8)	1.9	(15.8)
Taxation on exceptional items	0.2	–	(0.1)	(0.7)	(2.5)
Basic (loss)/earnings per £1 nominal of deferred stock	(34.7)	6.5	(27.1)	17.0	9.1

Headline profit is calculated as total operating profit before amortisation of goodwill (including the Group's share of goodwill amortisation within joint ventures and associates) and exceptional items, less net interest payable and similar charges. Headline earnings is calculated as headline profit less taxation (excluding taxation on exceptional items), equity minority interests and non-equity dividends. The directors consider that headline earnings give a useful indication of underlying performance.

Group balance sheet summary at 31 December

	Actual 2004 £m	Actual 2003 £m	Actual 2002 £m	Actual 2001 £m	Actual 2000 £m
Goodwill	**105.2**	237.3	246.2	181.8	171.3
Land and buildings	**447.6**	585.3	446.4	485.5	484.4
Ships and other fixed assets	**903.1**	1,092.7	1,023.7	827.7	796.2
Investments including joint ventures and associates	**569.6**	761.6	814.8	1,102.8	1,062.1
Current assets excluding cash and short term investments	**832.0**	1,006.0	968.7	1,107.8	1,239.2
	2,857.5	3,682.9	3,499.8	3,705.6	3,753.2
Net borrowings	**(1,029.6)**	(1,502.7)	(1,346.8)	(1,096.7)	(1,025.4)
Other long term liabilities	**(275.4)**	(235.9)	(207.9)	(213.9)	(181.6)
Other creditors	**(531.1)**	(598.8)	(621.0)	(709.0)	(806.7)
Equity minority interests	**(45.1)**	(35.4)	(34.3)	(52.9)	(71.1)
Stockholders' funds	**976.3**	1,310.1	1,289.8	1,633.1	1,668.4

Group cash flow summary for the years ended 31 December

	Actual 2004 £m	Actual 2003 £m	Actual 2002 £m	Actual 2001 £m	Pro forma 2000 £m
Net cash inflow from operating activities	**417.0**	247.8	281.4	287.3	389.2
Dividends from joint ventures and associates	**22.1**	62.9	29.5	27.8	5.6
Returns on investments and servicing of finance	**(87.0)**	(96.3)	(94.5)	(84.5)	(58.2)
Taxation	**(37.0)**	(13.6)	(34.6)	(27.4)	(44.3)
Capital expenditure, acquisitions and disposals	**220.8**	(411.1)	(229.6)	(119.4)	299.9
	535.9	(210.3)	(47.8)	83.8	592.2
Equity dividends paid	**(87.8)**	(93.7)	(91.6)	(92.1)	(222.4)
Net cash flow before financing	**448.1**	(304.0)	(139.4)	(8.3)	369.8

Financial data

	Actual 2004 £m	Actual 2003 £m	Actual 2002 £m	Actual 2001 £m	Actual 2000 £m
Net operating assets	**2,404.8**	3,320.4	3,280.0	3,474.9	3,439.9
Debt to capital ratio Net borrowings (loans, short term borrowings and overdrafts less short term investments and cash) as a percentage of the sum of stockholders' funds, net borrowings and minority interests	**50.2%**	52.8%	50.4%	39.4%	37.1%
Net assets per £1 nominal of deferred stock Stockholders' funds less convertible, concessionary and preferred stock divided by deferred stock in issue at the end of the year	**£1.22**	£1.68	£1.79	£2.29	£2.35
Interest cover Operating profit before exceptional items divided by net interest and similar items (*pro forma)	**2.7**	1.9	1.2	2.4	3.8*

Note

Certain companies and businesses which were previously consolidated in the Group accounts were transferred to P&O Princess Cruises plc on 23 October 2000 as a result of the demerger of the Group's cruise business. Certain pro forma figures for 2000 exclude the results and cash flows of these companies and businesses (as well as demerger costs) and reflect the financial structure that was put in place on demerger. In addition certain pro forma 2000 figures exclude an element of the Group's overhead costs, which was allocated to P&O Princess Cruises plc consistently throughout the period based on its share of the turnover and staff numbers of the Group prior to the demerger.

Results in summary

Turnover (Group and share of joint ventures) and total operating (loss)/profit

	Turnover: Group and share of joint ventures			Total operating (loss)/profit		
	2004 £m	2003 £m	2002 £m	2004 £m	2003 £m	2002 £m
Continuing operations						
Before exceptional items						
Ports	**1,019.3**	944.8	797.2	**153.8**	129.1	116.8
Ferries	**984.0**	1,081.0	1,042.3	**(15.4)**	(0.2)	30.2
Cold Logistics	**205.6**	210.5	153.1	**17.4**	16.4	12.5
Container Shipping	**478.9**	1,685.1	1,549.7	**55.5**	17.6	(85.6)
Property	**369.6**	216.5	183.6	**57.0**	39.8	52.4
	3,057.4	4,137.9	3,725.9	**268.3**	202.7	126.3
Exceptional items						
Ports	**–**	–	–	**4.3**	–	–
Ferries	**–**	–	–	**(266.0)**	(39.8)	(16.5)
Cold Logistics	**–**	–	–	**(10.0)**	–	–
Container Shipping	**–**	–	–	**–**	–	–
Property	**–**	–	–	**(31.0)**	–	–
	–	–	–	**(302.7)**	(39.8)	(16.5)
Total						
Ports	**1,019.3**	944.8	797.2	**158.1**	129.1	116.8
Ferries	**984.0**	1,081.0	1,042.3	**(281.4)**	(40.0)	13.7
Cold Logistics	**205.6**	210.5	153.1	**7.4**	16.4	12.5
Container Shipping	**478.9**	1,685.1	1,549.7	**55.5**	17.6	(85.6)
Property	**369.6**	216.5	183.6	**26.0**	39.8	52.4
	3,057.4	4,137.9	3,725.9	**(34.4)**	162.9	109.8
Discontinued operations						
Contract Logistics	**–**	–	793.3	**–**	–	12.0
Bulk Shipping	**–**	–	–	**–**	11.8	(0.8)
	3,057.4	4,137.9	4,519.2	**(34.4)**	174.7	121.0

Group profit and loss summary by half year

	Six months to 30 June		Six months to 31 December		Twelve months to 31 December	
	2004 £m	2003 £m	2004 £m	2003 £m	2004 £m	2003 £m
Total operating (loss)/profit						
Continuing operations						
Ports	**71.4**	58.4	**86.7**	70.7	**158.1**	129.1
Ferries	**(25.1)**	(19.9)	**(256.3)**	(20.1)	**(281.4)**	(40.0)
Cold Logistics	**8.5**	7.6	**(1.1)**	8.8	**7.4**	16.4
Container Shipping	**20.6**	(19.9)	**34.9**	37.5	**55.5**	17.6
Property	**37.7**	13.1	**(11.7)**	26.7	**26.0**	39.8
	113.1	39.3	**(147.5)**	123.6	**(34.4)**	162.9
Discontinued operations						
Bulk Shipping	**–**	5.8	**–**	6.0	**–**	11.8
Total operating (loss)/profit	**113.1**	45.1	**(147.5)**	129.6	**(34.4)**	174.7
(Loss)/profit on sale of fixed assets and businesses	**(72.1)**	13.2	**24.9**	3.4	**(47.2)**	16.6
Amounts written off investments	**–**	–	**(30.3)**	–	**(30.3)**	–
(Loss)/profit before interest and taxation	**41.0**	58.3	**(152.9)**	133.0	**(111.9)**	191.3
Net interest payable and similar items	**(47.1)**	(55.0)	**(51.0)**	(56.3)	**(98.1)**	(111.3)
(Loss)/profit on ordinary activities before taxation	**(6.1)**	3.3	**(203.9)**	76.7	**(210.0)**	80.0
Taxation	**(20.7)**	(8.8)	**(4.7)**	(12.0)	**(25.4)**	(20.8)
Equity minority interests	**(6.5)**	(3.5)	**(8.4)**	(5.7)	**(14.9)**	(9.2)
(Loss)/profit for the financial period	**(33.3)**	(9.0)	**(217.0)**	59.0	**(250.3)**	50.0
Basic (loss)/earnings per £1 nominal of deferred stock	**(4.8)p**	(1.6)p	**(29.9)p**	7.8p	**(34.7)p**	6.5p

Further information on the above reporting divisions is given in the Chairman's statement on pages 4 and 5 and in the operating and financial review on pages 6 to 21.

Net operating assets and operating profit before depreciation, amortisation and exceptional items

	Net operating assets			Operating profit before depreciation, amortisation and exceptional items		
	2004 £m	2003 £m	2002 £m	2004 £m	2003 £m	2002 £m
Continuing operations						
Ports	**1,202.2**	1,170.6	962.4	**238.7**	208.5	184.3
Ferries	**287.8**	629.5	625.0	**35.9**	57.1	86.2
Cold Logistics	**189.5**	218.9	223.1	**28.0**	26.9	21.0
Container Shipping	**259.4**	493.4	605.5	**98.2**	87.8	0.4
Property	**465.9**	808.0	767.8	**63.3**	47.1	61.0
	2,404.8	3,320.4	3,183.8	**464.1**	427.4	352.9
Discontinued operations						
Contract Logistics	**–**	–	–	**–**	–	27.2
Bulk Shipping	**–**	–	96.2	**–**	16.2	7.2
	2,404.8	3,320.4	3,280.0	**464.1**	443.6	387.3

Net operating assets include port assets under construction of £39.2m (2003 £144.0m, 2002 £23.2m) within Ports.

The Group's goodwill amortisation charge relating to continuing operations was £14.1m (2003 £13.8m, 2002 £9.6m). The Group's share of amortisation of goodwill within joint ventures and associates was £3.1m (2003 £4.6m, 2002 £4.1m).

Report of the directors

The directors present their report and accounts for the year ended 31 December 2004.

Principal group activities, review of operations and results

The operating and financial review on pages 6 to 21 describes the principal activities, operations, performance and financial position of the Group. The results of the Group are set out in detail on pages 48 to 51 and in the accompanying notes. Further information is given in the Chairman's statement on pages 4 and 5. The principal subsidiaries, joint ventures and associates are listed on page 87.

Principal changes in the Group

On 2 February 2004, the Group announced that it had signed a conditional agreement for the disposal of its 50 per cent stake in P&O Nedlloyd Container Line Limited for a consideration of €215 million cash and a 25 per cent shareholding in Royal Nedlloyd N.V., which would be renamed Royal P&O Nedlloyd N.V. This transaction was approved by P&O Stockholders at an extraordinary general meeting held on 29 March 2004 and the transaction completed on 16 April 2004.

On 1 March 2004, the Group announced an agreement to sell to Stena AB part of P&O's Irish Sea ferry operation, including the Fleetwood-Larne route and five ferries, for a cash consideration of approximately £50 million. This transaction was completed on 20 April 2004.

On 24 March 2004, the Group announced that it had signed a 51 year agreement with the Vancouver port authority to operate the Centerm Container Terminal in Vancouver Harbour, and would invest C$130 million (£53 million) by the end of 2005 in expanding the terminal.

On 21 April 2004, the Group announced that it had signed a 40 year concession with the Antwerp port authority to equip and operate the Deurganckdok container terminal as part of the Antwerp Gateway consortium. P&O originally had a 67.5 per cent stake in the consortium (of which 25 per cent was subsequently sold to COSCO Pacific Ltd. in November) and will manage the terminal, for which the total development cost is estimated at €450 million spread over several years, with the first phase expected to be operational by the middle of 2005.

On 1 July 2004, the Group announced that it had sold buildings comprising 380,000 sq ft of office space in the Boston Wharf development for US$92 million (£51 million) in cash to HDGM Holdings, Inc. At the same time the HTC Hanseatic Trade Center GmbH & Co. Grundbesitz partnership (in which the Group holds a 47.5 per cent interest) sold a major phase of its office development in Hamburg to Crédit Suisse Asset Management for €96 million in cash.

On 7 July 2004, the Group announced that it had sold its Australian resorts business for approximately A$210 million (£81 million) in cash to General Property Trust and Voyages Hotels & Resorts Pty Ltd.

On 11 August 2004, the Group announced that it had secured the rights to become an investor in Bengal Port Ltd., which is to develop and operate a port and property development at Kulpi, near Kolkata (Calcutta, in India). P&O will have rights to acquire 69 per cent of Kulpi Port Company, which will have a 50 year concession to develop, operate and maintain the port.

On 28 September 2004, the Group announced the conclusions of its fundamental review of its ferry operations, including (subject to employee consultation) a reduction in the number of ships from 31 to 23 and the closure of four out of 13 routes. These proposals initially included the sub-charter of two ships to Brittany Ferries which was subject to the approval of the UK competition authorities. The Office of Fair Trading referred this transaction to the Competition Commission on 7 December 2004. On 28 February 2005, it was announced that Brittany Ferries had withdrawn from the proposed transaction.

On 29 October 2004, the Group and the French container shipping group CMA CGM announced that they had signed a 36 year concession with the Le Havre port authority to equip and operate two berths at Terminal de France. Under this agreement a subsidiary of P&O will invest about €100 million in the terminal.

On 21 December 2004, the Group announced that it had sold 995,000 sq ft of offices and covered garage parking in Boston for US$97 million (£51 million) in cash to Berkeley Investments Inc.

On 23 December 2004, the Group announced that it had sold its sport and leisure resort La Manga Club for €146 million (£102 million) in cash to the Spanish leisure and property company MedGroup.

On 31 December 2004, the Group announced that it had sold its property portfolio in Atlanta for US$93 million (£48 million) in cash in four separate transactions.

On 24 January 2005, the Group announced that the HTC Hanseatic Trade Center GmbH & Co. Grundbesitz partnership had sold the remaining four buildings of its office development in Hamburg for €200 million (£140 million) in cash to a consortium comprising affiliates of Lehman Brothers Real Estate Partners, L.P., Tishman Speyer Properties and Quantum Immobilien AG.

On 31 January 2005, the Group announced that it had realised £55 million in cash from its 600,000 sq ft shopping centre development in Plymouth through a sale to Morgan Stanley Real Estate Fund.

On 8 March 2005, the Group announced that it had sold one of the main blocks of the Regent Quarter development at King's Cross to La Salle London Office Fund for £47 million.

Directors

A list of the directors of the Company is given on page 23, including the dates of their appointment. David Williams and Sir John Parker were appointed to the Board with effect from 1 January and 1 February 2005 respectively and will offer themselves for re-election at the forthcoming annual general meeting. In accordance with the regulations of the Company, Robert Woods, Michael Gradon and Nick Luff will retire by rotation at the forthcoming annual general meeting and being eligible will also offer themselves for re-election. Lord Sterling and Rodney Galpin will retire from the Board at the annual general meeting and will not seek re-election. The unexpired term of the letters of appointment of the non-executive directors, Sir David Brown, Sir John Collins, Michael Everard, Sir John Parker and David Williams are given within the directors' remuneration report on page 40.

Details of the directors' remuneration and their interests in the shares of the Company are set out in the directors' remuneration report on pages 37 to 45.

Dividends

The directors recommend a final dividend in respect of the year ended 31 December 2004 of 6p per £1 nominal of deferred stock. This would bring the total cash dividend for the year to 9p per £1 nominal of deferred stock. If approved, the final dividend will be paid on 1 June 2005 to deferred stockholders on the register at the close of business on 29 March 2005.

Employees

The Company is committed to keeping employees throughout the Group informed of performance, development and progress through its established system of briefings by management, the Group's bi-monthly newspaper, Wavelength, and widely distributed news and information bulletins. There is a European Works Council, known as the P&O European Forum, the purpose of which is to inform and consult with employee representatives on transnational issues. Members are elected in the UK and Ireland and either elected or appointed, in accordance with national laws, in other countries. The P&O European Forum meets twice a year with several additional meetings during 2004 in connection with the Ferries review.

The Company's aim is to meet the objectives of the code of good practice on the employment of disabled people. Full and fair consideration is given to disabled applicants for employment and training, and career development is encouraged on the basis of aptitude and abilities. It remains Company policy to retain employees who become disabled whilst in its service and to provide specialised training where appropriate.

Employees are able to share in the Group's results through performance related bonus schemes which are widely applied in the Group.

The P&O 2004 UK Sharesave plan (the ''2004 Plan'') was approved by stockholders on 14 May 2004 and will expire on 14 May 2014. Under this plan, which is a UK Inland Revenue approved plan, eligible employees may be invited to apply for options during the six weeks after announcement of the interim or final results or at such other times as the directors consider are warranted by special circumstances. The option granted to each individual is related to the monthly sum the individual agrees to save under a contract, not exceeding £250 per month for a period of three or five years, with a financial institution nominated by the directors. Options can be granted with an exercise price which is discounted by up to 20 per cent by reference to the market value of the deferred stock at the time the options are offered to eligible employees. Options are normally exercisable within six months following the end of the related savings contract, but earlier exercise is permitted in certain circumstances, for example, if an individual leaves employment for specific ''good leaver'' reasons or if there is a change in control of the Company.

In view of the global nature of the P&O Group and the benefits of encouraging wide employee share ownership, the Company operates plans, based on the 2004 Plan, for the benefit of overseas employees. All such plans operate within the individual and plan limits applicable to the 2004 Plan. The overseas plans are also due to expire on 14 May 2014.

The P&O 2000 Executive Stock Option Plan (the ''P&O Option Plan'') was approved by stockholders on 20 October 2000. Under the P&O Option Plan, options may be granted twice a year, during the six weeks after the release of the interim or final results. The life of options is ten years and the price at which options can be granted is governed by the market price of deferred stock at the time of grant. There are restrictions on the total number of options that can be granted in normal circumstances to any one executive and the scheme also contains limits on the total amount of stock over which options may be granted.

The rules of the P&O Option Plan reflect current institutional investor guidelines by requiring that options granted under the plan can normally be exercised only if a performance target has been met. Options granted under this scheme will not normally be exercisable unless the growth in P&O's headline earnings per £1 nominal of deferred stock (''EPS'') over a period of at least three years from grant exceeds the percentage increase in the UK Index of Retail Prices by an average of at least three per cent per annum. The rules permit the adoption of a different basis if at the time of a grant of options it is thought appropriate to do so, provided that the replacement conditions are no less demanding. The Company reported negative EPS for 2002 and accordingly application of the formula for EPS growth would result in a less stretching hurdle. Therefore, the remuneration committee resolved that options granted during 2003 will not normally be exercisable unless the growth in P&O's pre-tax and exceptional items profit per £1 nominal of deferred stock over a period of at least three years from grant exceeds the percentage increase in the UK Index of Retail Prices by an average of at least three per cent per annum. In 2004 the remuneration committee decided to revert to the earlier, EPS, performance target.

On 14 May 2004 the stockholders approved an amendment to the rules of the P&O Option Plan to enable the Company to satisfy the exercise of both existing and future options by the issue of only that amount of stock which has a value, at the time of exercise, equal to the net gain resulting from the exercise, that is, the difference between the market price on the day of exercise of the amount of stock under the option and the total exercise price payable.

Pursuant to the changes in Board and senior executive remuneration structures set out in detail on page 39, it is not intended that any further grants of options will be made under the P&O Option Plan except in exceptional circumstances (e.g. recruitment). No general grant was made in 2004.

Corporate responsibility, safety and the environment

There are Group policies for health, safety, welfare, the environment and social responsibility, which are communicated to all staff. More information on these policies is given on page 17. Each operating company is required to produce its own policies and management systems to reflect Group policies and best industry practice in its sector of business. The Company also encourages the adoption of similar policies by its significant joint ventures and associates.

Monitoring of compliance with Group policies is maintained by periodic assessment under the direction of the Head of Group Safety and Environment. Reports are reviewed by Peter Smith, the Board director responsible for safety, environmental and social responsibility issues. In addition, a monthly report on these matters is submitted to the Board.

A separate report details the measures taken to minimise the environmental impact of Group businesses. It is available on the internet at www.pogroup.com or by request to the Head of Group Safety and Environment.

Share capital

There may be occasions when it would be advantageous for the Company to issue stock for cash without a pre-emptive offer to existing stockholders, and since 1989 stockholders in general meeting have extended the authority for such issues originally given at the annual general meeting held on 6 May 1988, which authority also permits new limits to be prescribed. Stockholders' consent is therefore sought to resolution 11 set out in the notice of meeting authorising the directors to issue a specified amount of stock for cash, not exceeding £37 million nominal in aggregate (2004 £36 million), without first being required to offer such stock to existing stockholders. £37 million is approximately 5 per cent of the deferred stock currently in issue. The authority will expire at the conclusion of the annual general meeting in 2006 or on 13 August 2006, whichever is the earlier. Stockholders' approval of resolution 11 set out in the notice of meeting, which will be proposed as special business, will also enable the directors, pursuant to resolution 8 passed at the annual general meeting held on 6 May 1988, to issue redeemable securities and convertible securities and to make technical provision for the manner of conversion.

There may be circumstances when, having regard to gearing levels, other investment opportunities and the effect on earnings per £1 nominal of deferred stock, it would be advantageous for the Company to purchase its own stock. Any stock purchased by the Company would be cancelled and the amount of stock in issue reduced accordingly. The existing authority for the Company to purchase its own stock, given at the annual general meeting held on 14 May 2004, expires at the conclusion of the annual general meeting to be held on 13 May 2005. Stockholders' consent is therefore sought to resolution 12 set out in the notice of meeting to enable the directors to purchase up to £37 million nominal of deferred stock (approximately 5 per cent of the deferred stock currently in issue), subject to the limits expressed in the resolution. The authority will expire at the conclusion of the annual general meeting in 2006, and it will be exercised only if there is a resultant increase in earnings per £1 nominal of deferred stock and if implementation of the proposal is for the benefit of stockholders generally.

Holders of the 5.5 per cent concessionary stock (''concessionary stock'') should note that a purchase by the Company of deferred stock gives them the right to repayment of their stock at par together with accrued interest and dividends (whether earned or declared or not) calculated at the date of such purchase. This should not, however, be construed as a recommendation to such holders to exercise their right to repayment. Holders of concessionary stock should note that it may not be in their best interests to exercise the right of repayment and should seek their own personal financial advice in deciding whether or not to do so. If any concessionary stockholder wishes to exercise the right of repayment in the event of a buy-back of deferred stock by the Company pursuant to the authority being sought at the 2005 annual general meeting, then they should write to the Company Secretary at the head office of the Company.

Substantial stockholdings

As at the date of this report, the Company has been notified that the following have an interest in the Company's stock amounting to 3 per cent or more of the relevant class of the called up capital:

	Class	Holding £	Percentage of class
HBOS plc and subsidiaries	deferred	36,037,819	4.84
Legal & General Investment Management	deferred	26,361,361	3.54
Prudential plc and subsidiaries	deferred	47,192,761	6.34
Schroder Investment Management Ltd	deferred	72,289,291	9.70
Threadneedle Investment Management Ltd	deferred	34,769,901	4.67
Cleaning Tokens Ltd	preferred	102,731	3.07
Deutsche Equity Income Trust plc	preferred	300,000	8.97
Ecclesiastical Insurance Group	preferred	800,000	23.92
P S Allen	preferred	145,577	4.35

Going concern

The directors, having made enquiries, consider that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future and therefore they consider it appropriate to adopt the going concern basis in preparing the accounts.

Creditor payment policy

The Company's policy is to pay suppliers in accordance with terms and conditions agreed when the orders are placed. Although the Company does not follow any code or standard on payment policy, where payment terms have not been specifically agreed invoices dated in one calendar month are paid close to the end of the following month. These policies are understood by the purchasing and finance departments. The Company has procedures for dealing promptly with complaints and disputes. The Company had 27 days' (2003 33 days) purchases outstanding at 31 December 2004.

Donations

During the year ended 31 December 2004 the Group contributed £141,000 (2003 £380,000) for UK charitable purposes. Further significant charitable donations were made in 2004 and in previous years to overseas causes. An additional £200,000 is being given, via the Company's ports in South Asia, to support relief operations following the tsunami disaster on 26 December 2004. The Group made no contributions to political parties during the year (2003 £nil).

Indemnity

All directors are entitled to contractual indemnification from the Company to the extent permitted by law against claims and legal expenses incurred in the course of their duties.

Auditors

Stockholders' consent is sought to resolutions 9 and 10 set out in the notice of meeting proposing to re-appoint KPMG Audit Plc as independent auditors of the Company and to authorise the directors to determine the auditors' remuneration.

By order of the Board
R M Gradon
Director and Secretary
8 March 2005

Corporate governance

The revised Combined Code on corporate governance (''the Combined Code''), which implements the recommendations made in the ''Higgs Review of the role and effectiveness of non-executive directors'' and Sir Robert Smith's guidance for audit committees, came into effect for the Company for the financial year commencing 1 January 2004. During 2004 the Company complied in all material respects with the Combined Code apart from the balance between the non-executive and executive directors. During 2004 non-executive directors constituted less than half of the Board, excluding the Chairman. However, in light of the high calibre and wide experience of the four non-executive directors, this is not considered a significant departure from the principles of the Combined Code. Additionally, David Williams was appointed as a new non-executive director on 1 January 2005 and, since that date, non-executive directors have constituted at least half of the Board, excluding the Chairman.

The following is an explanation of the Company's corporate governance policies in the light of the Combined Code.

Directors

The full Board meets at least nine times each year. Although there is a prescribed pattern of presentation to the Board, including matters specifically reserved for the Board's decision (which include strategy; the annual budget; major transactions; key appointments and divisional structure; personnel, health, safety and environmental policies; insurance and risk management; and internal controls), all Board meetings tend to have further subjects for discussion and decision taking. Board papers, including an agenda, are sent out in advance of the meetings. Board meetings are discursive in style and directors are encouraged to offer their opinions.

The Board has delegated the following responsibilities to the management: the development and recommendation of strategic plans for consideration by the Board that reflect the longer term objectives and priorities established by the Board; implementation of the strategies and policies of the Group as determined by the Board; monitoring of the operating and financial results against plans and budgets; monitoring the quality of the investment process against objectives, prioritising the allocation of capital, technical and human resources; and developing and implementing risk management systems subject to the continuing oversight of the Board and the audit committee as set out below.

A list of the directors of the Company is given on page 23. There is a Chairman, a Chief Executive and a senior non-executive director. The non-executive directors are independent of management and have no relationship which could materially interfere with the exercise of their independent judgement. Sir John Collins is a director of N M Rothschild & Sons (''NMR'') which provides financial advice to the Company, but since Sir John's role is solely as a non-executive director of NMR on a fixed remuneration with no relationship to the income or profits of NMR, the Board continues to regard him as independent. Sir John Parker is a non-executive director of Carnival plc which benefits from a trade mark licence in respect of the P&O name and flag. The company receives no fee for this licence. The Company has various other business relationships with Carnival plc, but these are considered to be immaterial both individually and in aggregate. Given the limited nature of the contractual relationships between P&O and Carnival plc and Sir John's role solely as a non-executive director of Carnival plc, the Board regards him as independent. Non-executive directors have letters of appointment, but as with executive directors they must seek election at the first available annual general meeting after their appointment and thereafter stand for election at least every three years.

During the year the Board carried out a formal evaluation of its performance and that of its committees and individual directors. This was carried out with the assistance of external consultants. The procedure adopted was for each director to complete a detailed questionnaire, on a non-attributable basis, on his perception of the composition, operation and effectiveness of the Board (and any of its committees on which he served), and on the performance of the Chairman and each of his fellow directors. Each director was then interviewed by the consultants in order to achieve an overall assessment and identifying areas requiring improvement. It was decided by the non-executive directors that in view of the Chairman's impending retirement, it was not appropriate to conduct an individual evaluation of his performance. A final report from the consultants, setting out their findings and suggesting avenues for further work, was then presented to the Board towards the end of the year. The evaluation drew particular attention to the fact that the Board was in a transition phase reflecting changes in the Group's business. The Group is restructuring from a diversified conglomerate to a more focused business. Accordingly the Board is moving away from a holding company approach and is increasingly addressing issues at group level which were previously managed in divisions. The review identified key areas on which to focus, in respect of both process and topics for debate. Progress will in future be reviewed by the Board annually, with assistance from external consultants where appropriate.

All directors have access to the Company Secretary, who is also a director, and independent professional advice at the Company's expense if necessary.

The following table sets out the number of meetings of the Board, and of the principal committees of the Board, during 2004 together with details of attendance. Lord Sterling did not attend those meetings of the nomination committee that discussed the appointment of his successor.

	Board	Audit	Remuneration	Nomination
Number of meetings	12	4	6	3
Attendance:				
Lord Sterling	12	n/a	n/a	1
Robert Woods	12	n/a	n/a	3
Sir David Brown	10	4	6	2
Sir John Collins	9	3	6	2
Michael Everard	12	3	5	3
Rodney Galpin	12	4	6	3
Michael Gradon	12	n/a	n/a	n/a
Nick Luff	12	n/a	n/a	n/a
Russ Peters	11	n/a	n/a	n/a
Peter Smith	12	n/a	n/a	n/a

Directors' remuneration

The directors' remuneration report is set out on pages 37 to 45.

Relations with stockholders

The Company's practice is to send the notice of the annual general meeting and proxy voting forms to stockholders at least 20 working days before the meeting. The Chairman always sets aside a period of time for questions from the floor by eligible stockholders and the chairmen of the audit, remuneration and nomination committees are expected to attend. It is the practice of the Company to indicate the level of proxy voting at general meetings.

Feedback is obtained from major institutional stockholders through investor surveys, communication with the Company's brokers and in regular meetings with stockholders. This feedback is communicated to the Board through regular reports. When appropriate, the Chairman or the senior non-executive director takes soundings from major institutional stockholders on strategic and management issues. Major institutional stockholders were consulted on the appointment of Sir John Parker as Chairman designate prior to the announcement of his appointment.

All press releases and further stockholder information are available on the Group's website, www.pogroup.com. Results presentations and trading updates are made available via webcasts.

Accountability and audit

The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. The internal control system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The system of internal control described below has been in place throughout the year and up to the date of this report.

The Board has delegated certain powers and duties to Board committees, all of which operate within defined terms of reference.

Audit committee

The audit committee, the members of which are given on page 23, is made up entirely of independent non-executive directors. The audit committee is chaired by Rodney Galpin whom the Board considers has appropriate financial experience to fulfil this role. It is the Board's intention that David Williams should succeed Rodney Galpin as Chairman of the committee on 13 May 2005. David Williams is currently Finance Director of Bunzl plc. The Chief Executive, Chief Financial Officer, external auditors and internal auditors are invited to attend audit committee meetings, along with any other director or member of staff considered necessary by the committee to complete its work. The committee meets with external auditors and internal auditors without executive directors or members of staff present, as it considers appropriate (and at least once a year). During the year the committee assumed responsibility for reviewing the effectiveness of the Group's risk management processes. This was previously undertaken by the risk committee. The terms of reference of the audit committee are available from the Company's website.

The committee meets at least three times each year.

The committee's remit includes the following:

- to review the form and content of the financial statements to be presented to stockholders of the Company at the half year and at the year end, and, if necessary, to challenge the actions and judgements of management in relation to them;
- to keep under review the scope and results of the external audit and the independence, effectiveness, resources and objectivity of the auditors;
- to review the effectiveness of the system of risk management and at least annually to carry out a review of the effectiveness of the system of internal controls and the process of risk management;
- to review management and internal audit reports on the effectiveness of the system of internal financial control, including the year end financial reporting process and the Company's procedures for investigating concerns raised by members of staff, and to report its findings to the Board. A whistle-blowing policy was put in place during the year;
- to monitor the integrity of the Company's financial controls; and
- to receive reports from the internal audit department and to monitor the quality of the department's work, ensuring that it is adequately resourced.

Independence of external auditors

The audit committee is responsible for recommending a firm of auditors of appropriate independence and experience and for the approval of all audit fees and terms of engagement. The committee's policy is to undertake a formal assessment of the auditors' independence each year which includes:

- a review of non-audit services provided to the Group and related fees;
- discussion with the auditors of a written report detailing any relationships with the Company and any other parties that could affect independence or the perception of independence;
- a review of the auditors' own procedures for ensuring the independence of the audit firm and partners and staff involved in the audit, including the regular rotation of the audit partner; and
- obtaining written confirmation from the auditors that, in their professional judgement, they are independent.

The audit committee has implemented procedures relating to the provision of non-audit services by the Company's auditors. These include:

- the maintenance of a schedule of certain non-audit services, including consultancy, investment banking and legal services, which the Company is specifically prohibited from obtaining from the audit firm;
- requiring the selection of providers of permitted non-audit services to be subject to a tender process, where appropriate; and
- requiring non-audit work and the fees involved to be approved in advance by the audit committee.

An analysis of the fees payable to the external audit firm in respect of both audit and non-audit services during the year is set out in note 3 to the accounts.

Risk management process

The Group risk management process, on which the review of effectiveness of the system of internal control and risk management is based, has the following key features:

- Through a series of interviews, management discussions and risk assessment workshops, all major businesses within the Group determine the most significant risks to the achievement of their business objectives. Appropriate risk management activity is then determined and any required action plans are implemented. This is a continual process, and may be associated with a variety of financial, operational and compliance matters including organisation structures, business strategies, disruption in information technology systems, competition, natural catastrophe and regulatory requirements.
- The risks and associated controls are summarised in risk portfolios and are presented to the Board for review.
- At each year end, divisional management certify that the risk management process is in place and an assessment has been conducted throughout their businesses and that appropriate internal control procedures are in place or in hand to manage the risks identified. These self-certifications are made available to the audit committee.
- The self certification statements referred to above include a section where divisional management state that they are not aware of any irregularities involving actual or suspected fraud or breach of regulation, legislation or contract that may cause significant loss to the Company.
- Finance departments across the Group complete a control self-assessment questionnaire. The results of this questionnaire are subject to review by the internal audit department. Summarised results of this exercise are presented to the audit committee.
- The Group's principal associate has throughout 2004 convened a risk committee which has overseen the development of a risk management process covering all significant parts of the business.

The Board now considers that, with risk management well embedded in normal management processes, a separate risk committee is no longer necessary and its responsibilities can be assumed by the Board, audit committee and management.

Internal control

The Board has complied with the guidance of the Turnbull committee by establishing a strong control framework within which the Group operates and the audit committee has undertaken a review of the effectiveness of internal controls and process of risk management in accordance with its remit. The principal features and key high level control procedures include:

- An organisation structure which supports clear lines of communication and accountability and delegation of authority rules which specify responsibility.
- Business strategies are prepared at divisional level and are approved by the Board. In addition, there are annual budgeting and strategic planning processes. Financial forecasts are prepared every quarter. Actual performance is compared to budget, latest forecast and prior year on a monthly basis. Significant variances are investigated and explained through normal monthly reporting channels.
- Key performance indicators are produced to summarise and monitor business activity.
- Evaluation and approval procedures for major capital expenditure and significant treasury transactions.
- Regular reviews of the effectiveness of the Group's health, safety, welfare and environment processes.
- The internal audit department provides additional assurance to the Board and audit committee that key controls are operating as intended.

The risk management process and the system of internal control are subject to continuous improvement.

Nomination committee

The nomination committee, the members of which are given on page 23, keeps under review the structure, size and composition of the Board, giving consideration to succession planning. During 2004 the committee, with assistance from external search consultants, devised a candidate specification for an additional non-executive director that stipulated the individual should be appropriately qualified to be a future chairman of the audit committee. A full external search was then conducted which led to the appointment of David Williams as a non-executive director. He was selected for his record as a seasoned FTSE 100 Finance Director and for his previous non-executive experience. A separate sub committee, consisting of all the independent directors and also assisted by the consultants, agreed the specification and conducted a full external search for a new chairman which led to the appointment of Sir John Parker as Chairman designate. Sir John was selected for his strong credentials as a Chairman with a real understanding of the markets in which P&O operates. Lord Sterling took no part in the selection of the new chairman.

Remuneration committee

The remuneration committee, the members of which are given on page 23, determines and agrees with the Board the framework and broad policy for the remuneration of the Company's Chairman, Chief Executive, executive directors and other members of the executive management in the tier immediately below Board level. The remuneration of non-executive directors is a matter for the executive members of the Board. No director or executive is involved in any decisions as to their own remuneration. The remuneration committee:

- approves the design of, and determines the targets for, any performance-related pay schemes operated by the Company for the executive directors and other relevant executive management and approves the total annual payments made under such schemes;
- reviews the design of all share incentive plans for approval by the Board and stockholders and for any such plans determines each year whether awards will be made and, if so, the overall amount of such awards, the individual awards to executive directors and other senior executives and the performance targets to be used;
- determines the policy for, and scope of, pension arrangements for each executive director;
- determines, within the terms of the agreed policy and in consultation with the Chairman and/or Chief Executive as appropriate, the total individual remuneration package of each executive director and other relevant senior executives;
- ensures that contractual terms on termination, and any payments made, are fair to the individual and the Company;
- reviews and notes annually the remuneration trends across the P&O Group; and
- is responsible for appointing external remuneration consultants who advise the committee by providing reliable up to date information about remuneration in other companies.

Directors' remuneration report

This report complies with the Directors' Remuneration Report Regulations 2002 (the ''Regulations''), has been approved by the directors and will be put to stockholders for approval at the annual general meeting on 13 May 2005.

Remuneration committee

The remuneration committee consists entirely of independent non-executive directors and is chaired by Sir John Collins. The other members of the committee during 2004 were Rodney Galpin, Michael Everard and Sir David Brown. The consultants Deloitte were appointed by the committee to assist it in conducting a comprehensive review of executive directors' remuneration. During 2004, other parts of the Deloitte group carried out certain work for subsidiaries and associates of the Company including a review of information systems and the provision of tax calculation software, but in view of the limited scope and scale of this other work this is not considered to affect their independence. In addition, the committee consults with the Chairman and Chief Executive as appropriate with regard to its proposals relating to the remuneration of the executive directors.

Policy

The policy of the committee is to review executive directors' remuneration based on an independent assessment of market practice. The total remuneration package of the executive directors is structured to attract, retain and motivate executive directors. The committee has, in consultation with its advisers, conducted an annual review of executive directors' remuneration, including bonuses and long term incentives, to ensure consistency with market practice, local conditions and business objectives. The major proportion of the remuneration package for executive directors is performance-related assuming maximum performance in respect of the performance-related elements. This includes participation in the Company's long term incentive plans, which currently consist of a Deferred Bonus and Co-investment Matching Plan (the ''Matching Plan'') and an Executive Stock Option Plan (the ''P&O Option Plan''), which are described in more detail below, though no grants have been made to directors under the P&O Option Plan in 2004. The performance conditions and policies relating to long term incentives and directors' remuneration packages were approved by stockholders in October 2000 and have not been materially altered since that date. The total remuneration package is designed to align the interests of executive directors with those of stockholders. In 2004 the rules of the P&O Option Plan were amended, with stockholder approval, so as to allow the exercise of options to be satisfied by issuing or transferring a smaller amount of stock than that over which the option was originally granted. During 2004, the committee undertook a comprehensive review of directors' remuneration, in consequence of which new long-term incentive structures will be submitted to stockholders for approval at the annual general meeting. Details of these structures are set out below. The Company has also introduced a Directors' Shareholding Guideline as described on page 44.

This report sets out the Company's policy on executive remuneration for 2005 and, so far as practicable, for subsequent years. The inclusion in the report of remuneration policy in respect of years after 2005 is required by the Regulations. The committee cannot be certain that its remuneration policy will continue without amendment in 2005 or subsequent years. The committee considers that a successful remuneration policy needs to be sufficiently flexible to take account of future changes in the Company's business environment and in remuneration practice. In addition, where necessary, in order to recruit a director of sufficient calibre, the remuneration committee may consider it appropriate to enter into special arrangements for the benefit of that director. Any changes in policy will be described in future reports, which will continue to be subject to stockholder approval. All statements in this report in relation to remuneration policy for years after 2005 should be read in light of this paragraph.

Except as noted above, there are no current proposals to change this policy.

Components of remuneration

The remuneration package of executive directors comprises base salary, an annual bonus scheme, long term incentive plans, pension arrangements and certain benefits in kind (for example health cover, car benefits and accommodation where relevant to their role). In some cases directors take their pension and other benefits in the form of a cash equivalent payment. In addition executive directors are entitled to participate in any all-employee share scheme of the Company.

Base salary

Base salaries of executive directors are reviewed annually and are set at levels which reflect the level of responsibility of the executive directors concerned and ensure that they are competitive with pay for executive directors holding equivalent positions in comparable companies. The benchmark levels represent remuneration data across industries and reflect factors including company size, reporting level and international accountability.

Annual performance bonus

Executive directors participate in a non-pensionable bonus scheme which is linked to the achievement of demanding business and corporate objectives including profitability and other key performance indicators.

Bonus targets for 2004 were based on headline profit and other financial targets for the Group and the main operating divisions, and the requirement to achieve key strategic objectives. The Group elements of the 2004 targets (financial and strategic) were achieved in a range of 73 to 88 per cent of maximum. The business specific performance targets for Ferries were not met.

All incentive targets are set by the committee and are designed to be demanding. Financial targets are normally set above those for the prior year, but having regard to the anticipated trading environment.

The maximum annual bonus that can be earned is generally 75 per cent of salary. Two thirds of any bonus up to 75 per cent of salary is paid in cash with the balance awarded as a Stock Award under the Matching Plan, as described below. The committee has over-riding discretion in determining the payment of bonuses.

Long term incentives

As stated above, the Company's long term incentive plans currently comprise the Matching Plan and the P&O Option Plan.

The Matching Plan

The Matching Plan provides participants with the opportunity to receive matching awards of deferred stock depending upon the performance of the Company over a two year retention period following the year in which an original bonus-related award is earned.

As noted above, one third of any annual bonus awarded to directors and other executives who are participants in the Matching Plan is in the form of a Stock Award which is automatically invested in the Matching Plan. The Board believes that, in order to further align participants' interests with those of stockholders, participants should be invited to commit their own resources to the Matching Plan. Therefore participants also have a choice of investing their own funds in further deferred stock in the Company (described as Invested Stock) subject to an overall limit for directors on the amount invested in the Matching Plan in any one year of 75 per cent of base salary. Subject to the discretion of the Matching Plan Trustee, Matching Plan participants receive Matching Awards. Matching Awards entitle the participants to acquire a maximum amount of deferred stock which, at the date of grant, has a value equal to the aggregate value of the executive's Stock Award and Invested Stock (valuing Invested Stock on a gross of tax basis).

The amount of deferred stock over which a Matching Award may be exercised is dependent on the Company's total shareholder return (''TSR'') over the retention period compared to that of the other companies in the FTSE 350 index. TSR is used as a performance measure because it is considered to be effective in aligning the interests of executives and stockholders. If the Company achieves median performance a participant is entitled to exercise 25 per cent of his Matching Award and if the Company achieves upper quartile performance, a participant will be entitled to exercise 100 per cent of his Matching Award. For performance between median and upper quartile, entitlement is calculated on a straight line basis. These targets are subject to review by the committee.

Matching Awards are only exercisable if a secondary validating performance condition is also met. This requires earnings per share growth (after appropriate adjustments to ensure consistency throughout the period) over the retention period to exceed the growth in the UK Index of Retail Prices by an average of at least 3 per cent per annum. The rules of the Matching Plan permit the adoption of a different performance condition if at the time of a grant of awards under the Matching Plan it is thought appropriate to do so, provided that the replacement conditions are no less demanding. For 2002 and 2004, the Company reported a negative EPS and accordingly application of the formula for EPS growth would result in a less stretching hurdle. Therefore, the remuneration committee resolved that the secondary validating performance condition for the 2002 awards and 2004 awards under the Matching Plan would be that the growth in P&O's pre-tax and exceptional items profit per £1 nominal of deferred stock over the retention period must exceed the growth in the UK Index of Retail Prices by an average of at least 3 per cent per annum.

The TSR and EPS performance conditions were chosen since they were considered the most appropriate for determining the Company's performance. They were established after consultation with the Association of British Insurers and the Company's largest stockholders.

Other share related benefits

In 2004 no general grant of stock options was made to the executive directors or senior executives under the P&O Option Plan and it is intended that, except in exceptional circumstances (e.g. recruitment), no grants will be made in future years. Options under this plan are generally exercisable three years after the date of grant subject to the achievement of performance conditions and remain exercisable until the tenth anniversary of grant. Performance conditions are generally based on the achievement of EPS growth (after appropriate adjustments to ensure consistency throughout the period) of an average of at least 3 per cent per annum in excess of the growth in the UK Retail Prices Index over a period of at least three years from grant. This was considered to be an appropriate hurdle and consistent with market practice at the time the P&O Option Plan was adopted. The Company reported negative EPS for 2002 and accordingly application of the formula for EPS growth would result in a less stretching hurdle. Therefore, the remuneration committee resolved that options granted during 2003 will not normally be exercisable unless the growth in P&O's pre-tax and exceptional items profit per £1 nominal of deferred stock over a period of at least three years from grant exceeds the percentage increase in the UK Index of Retail Prices by an average of at least 3 per cent per annum.

There is a facility for the Company to require optionholders to assume the Company's liability for employer's national insurance contributions due on the exercise of unapproved stock options. The Company may grant additional options in recognition of the liability that optionholders assume.

At the 2004 annual general meeting the stockholders approved an amendment to the rules of the P&O Option Plan to enable the Company to satisfy the exercise of both existing and future options by the issue of only that amount of stock which has a value, at the time of exercise, equal to the net gain resulting from the exercise, that is, the difference between the market price on the day of exercise of the amount of stock under the option and the total exercise price payable.

Executive directors may participate, subject to the usual limits, in the P&O 2004 UK Sharesave Plan (the ''2004 Plan''), and previously the P&O Save As You Earn Stock Option Scheme (the ''P&O SAYE Scheme''), on the same terms as other employees. The 2004 Plan operates within specific tax legislation (including a requirement to finance the exercise of the option using the proceeds of a monthly savings contract) and exercise of the option is not subject to satisfaction of a performance target since this is an all-employee share scheme.

Proposed new incentive structures

As foreshadowed in the 2003 Annual Report, the remuneration committee has conducted a comprehensive review of Board and senior management remuneration structures. The aim of the review was to:

- increase the alignment between directors' incentive arrangements and stockholders' interests;
- ensure that the Company's remuneration structures support its continuing business objectives and strategy; and
- ensure that the arrangements are cost effective given the new accounting rules on the treatment of share-based payments.

Subject to stockholder approval of the proposed new Performance Share Plan and new Matching Share Plan at the 2005 annual general meeting, it is proposed that the remuneration structure for executive directors will consist of the following elements:

- Salary;
- Annual bonus;
- Performance Share Plan;
- Matching Share Plan;
- Pension contributions; and
- Non-cash benefits.

Further details on the incentive arrangements are set out below. The Company's largest stockholders have been consulted on these proposed new arrangements.

Annual bonus

Annual bonuses for executive directors will be payable in cash and will continue to be subject to a maximum award of 75 per cent of salary. The principal performance measures will continue to be based on achievement of a combination of demanding Group, individual and, where applicable, divisional targets.

New Performance Share Plan (''PSP'')

Under the PSP, executive directors and a limited number of other senior employees who have significant influence over the Group's ability to meet its strategic objectives will be eligible to receive annual awards, in the form of deferred stock, worth up to 120 per cent of salary for directors and a lesser amount for executives below Board level. In order to provide flexibility, the scheme rules will however allow annual awards of up to a maximum of 200 per cent of salary.

Awards will vest after three years subject to the Company's TSR performance against the constituents of the FTSE 350 (excluding investment trusts) at the date of award. 25 per cent of the award will vest if the Company is ranked at the median. The full award will vest if the Company is ranked at, or above, the upper quartile. Between these two points, the award will vest on a straight line basis. No portion of the award will vest if the Company is ranked below the median, and any unvested award at the end of the three year period will automatically lapse.

Awards will only vest subject to the remuneration committee determining that the TSR performance is a genuine reflection of the Company's underlying financial performance over the three year period.

Awards made to executives with responsibility solely for a specific business unit may vest based on the performance of their business unit, as opposed to relative TSR. However, executive directors with such business unit responsibility will have at least one third of the award subject to the TSR performance condition. Awards made to executive directors with Group-wide responsibility will be subject solely to the TSR performance condition.

Awards may be satisfied by the use of stock purchased in the market or newly issued stock and to the extent that new issue stock is used this will be subject to the normal dilution limits (i.e. options/awards over stock in the Company will not exceed 5 per cent of the Company's issued deferred stock in any rolling 10 year period in respect of executive schemes, or 10 per cent in any 10 year period in respect of all schemes).

In the event of a change of control, awards will vest based on the Company's performance to date and the time elapsed in the three year performance period. However, the remuneration committee will retain an overriding discretion to adjust any award above or below these amounts, based on the Company's financial performance to the date of change of control.

New Matching Share Plan (''MSP'')

Executive directors will also be able to invest their own cash resources up to a limit of 50 per cent of their maximum bonus opportunity into stock in the Company (''Invested Stock''). Participants who make such investment will receive a performance based matching award equal in value to the Invested Stock (valuing the Invested Stock on a pre-tax basis).

It is intended that the first awards under the revised MSP arrangements will be made in 2005 and will vest after three years, subject in normal circumstances to the participant continuing to hold the Invested Stock for the three year period and will vest based on the same TSR performance conditions as under the PSP.

Service contracts and Board changes

No executive director has a service contract of more than twelve months with the Company or any of its subsidiaries. All executive directors' service contracts are reissued with effect from 1 January in each year and are terminable upon twelve months' notice by either party, except that in the exceptional circumstance where an executive director will be or has been materially adversely affected by the pension taxation changes in the Finance Act 2004 (or any subsequent legislation) he will be entitled to give six months' notice. Lord Sterling will retire as Chairman, and Rodney Galpin will leave the Board, at the 2005 annual general meeting. The Chairman and the executive directors have service contracts which provide for payments in lieu of notice equivalent to 12 months' base salary and benefits, including bonus. Compensation payable upon early termination (other than under the payment in lieu of notice provisions) would be based on the contractual entitlement to salary and benefits subject to mitigation. Sir John Parker joined the Board as Deputy Chairman on 1 February 2005 on a salary of £200,000 p.a. and will become Chairman on 13 May 2005 on a salary of £400,000 p.a. He will not be entitled to participate in any of the Company's incentive or pension schemes. His contract is terminable on six months' notice but subject thereto is for a fixed term until 31 January 2008.

Robert Woods and Nick Luff are non-executive directors of Royal P&O Nedlloyd N.V., as representatives of the Company, which retains their fees for this service. Robert Woods is a non-executive director of John Swire & Sons, for which he receives an annual fee of £32,500. Nick Luff is a non-executive director of QinetiQ Group plc for which he receives an annual fee of £35,000.

Non-executive directors

The non-executive directors have letters of appointment.

The remuneration of non-executive directors is decided by the Board. Non-executive directors receive a base fee and they also receive fees for additional services such as being a member of, or chairing a Board committee. Non-executive directors are not eligible for incentive schemes or other benefits. At the 2004 annual general meeting the stockholders approved a proposal to increase to £0.5 million the aggregate annual limit on fees payable to non-executive directors other than the Chairman, and the Board adopted with effect from 1 July 2004 the following revised remuneration structure for non-executive directors, which will be subject to annual review by the Board:

Base fee — £30,000 per annum
Committee membership fee* — £5,000 per annum (per committee)
Committee chairmanship fee* — £5,000 per annum
Senior non-executive director — £5,000 per annum

*Remuneration and audit committees only

The unexpired term of service of the non-executive directors (subject to re-election by stockholders) is:

Sir David Brown: 15 January 2007
Sir John Collins: 31 December 2005
Michael Everard: 31 December 2005
Sir John Parker: 31 January 2008
David Williams: 31 December 2007

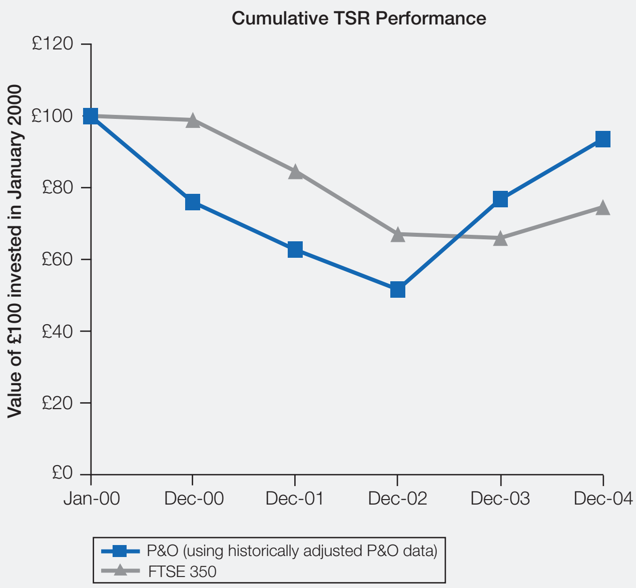
With the exception of Sir John Parker and David Williams, whose appointments are subject to six months' notice by either party, all letters of appointment in respect of the above are subject to twelve months' notice by either party.

Performance graph

In line with the Regulations, the following graph compares the performance of the Company's deferred stock on a TSR basis for the past five years against the FTSE 350 Index. This index has been selected as P&O is a constituent of the FTSE 350 and uses this index for its comparator group for the Matching Plan. However, the line representing the FTSE 350 on the graph is based on the market index weighted by market capitalisation whereas the Matching Plan is based on the performance of the companies comprising the FTSE 350 at the commencement of the relevant performance period. TSR is shown as the value of £100 invested in P&O and in the FTSE 350 index over the five year period.

P&O's TSR data has been adjusted to exclude the value attributable to P&O Princess Cruises by reference to the proportionate value of the two businesses at the demerger date.

TSR is calculated for each year relative to the base date of 1 January 2000 and taking the percentage change of the market price over the relevant period, reinvesting any dividends at the ex-dividend date.



Details of directors' remuneration

With the exception of the deferred stock and the total interests columns in the table of executive directors' interests in shares and the non-executive directors' interests in shares, the following sections of the remuneration report have been audited.

Directors' emoluments

	Salary and fees 2004 £000	Stock awards and bonus* 2004 £000	Benefits in kind 2004 £000	Cash in lieu of benefits 2004 £000	Total 2004 £000	Total 2003 £000
Executive directors						
Lord Sterling	359	216	85	–	660	551
Robert Woods	450	271	46	–	767	552
Michael Gradon	284	176	20	–	480	358
Nick Luff	359	222	7	105	693	356†
Russ Peters	256	47	17	–	320	162†
Peter Smith	236	146	40	–	422	316
Sir Bruce MacPhail	–	–	–	–	–	808#
Joanne Curin	–	–	–	–	–	320#
Charles Rice	–	–	–	–	–	364#
Non-executive directors						
Sir David Brown	33	–	–	–	33	25
Sir John Collins	39	–	–	–	39	33
Michael Everard	33	–	–	–	33	25
Rodney Galpin	44	–	–	–	44	33
	2,093	1,078	215	105	3,491	3,903

† from date of appointment # up to date of cessation of directorship
* The stock awards will be the subject of 2005 awards under the Matching Plan

Aggregate emoluments in respect of qualifying services amounted to £3,491,000 (2003 £3,436,000).

Nick Luff received a cash equivalent payment in place of certain benefits in kind and pension benefits.

Sir Bruce MacPhail who retired as a director of the Company on 31 December 2003 worked on a part-time basis for the Company throughout 2004 managing the disposal of the development property portfolio for which he received a salary of £250,000, benefits in kind of £59,026 and a bonus of £375,000.

Graeme Dunlop who ceased to be a director of the Company on 31 December 2002 worked as a special advisor to the Board and Company throughout 2004, receiving fees of £20,000 and benefits in kind of £18,400.

Richard Hein who retired as a director of the Company on 17 May 2002 was Chairman of P&O Australia Limited throughout 2004 for which he received a salary of £117,541, received benefits in kind of £12,857 and a bonus of £47,016.

Directors' interests in shares

The following is a table of the executive directors' deferred stock, long term incentive awards and option grants (in units of £1 nominal of deferred stock) under the Matching Plan, P&O SAYE Scheme and the P&O Option Plan. The terms of the P&O SAYE Scheme, P&O Option Plan and the Matching Plan are set out under the heading ''Long term incentives'' on page 38. Further details of the stock option grants are set out on pages 43 and 44.

Lord Sterling	Deferred stock (unaudited)	Matching Plan Stock Awards	Matching Plan Invested Stock	Maximum Matching Plan Matching Awards	Stock Options	Total interests (unaudited)
At 1 January 2004	1,757,604	5,914	141,062	240,394	1,320,817	3,465,791
Dividend stock*	218	807	–	–	–	1,025
Vested, exercised and sold#(1,2,4)	–	(5,914)	(49,702)	–	(195,578)	(251,194)
Own stock invested	–	–	63,278	–	–	63,278
Granted(8)	–	15,307	–	120,770	–	136,077
Lapsed	–	–	–	(88,128)	(15,214)	(103,342)
At 31 December 2004	1,757,822	16,114	154,638	273,036	1,110,025	3,311,635
Robert Woods						
At 1 January 2004	65,116	4,140	106,938	181,935	1,284,958	1,643,087
Dividend stock*	12	929	–	–	–	941
Vested, exercised and sold#(1,2,5)	6,872	(4,140)	(17,248)	–	(92,211)	(106,727)
Own stock invested	–	–	34,883	–	–	34,883
Granted(8)	–	17,604	–	75,742	–	93,346
Lapsed	–	–	–	(32,452)	–	(32,452)
At 31 December 2004	72,000	18,533	124,573	225,225	1,192,747	1,633,078
Michael Gradon						
At 1 January 2004	143,952	4,343	80,022	137,256	880,842	1,246,415
Dividend stock*	482	532	–	–	–	1,014
Vested, exercised and sold#(1,2,6)	–	(4,343)	(34,496)	–	(54,065)	(92,904)
Own stock invested	–	–	38,839	–	–	38,839
Granted(8)	–	10,103	–	74,835	–	84,938
Lapsed	–	–	–	(61,380)	(8,579)	(69,959)
At 31 December 2004	144,434	10,635	84,365	150,711	818,198	1,208,343
Nick Luff						
At 1 January 2004	5,358	–	135,000	225,000	689,660	1,055,018
Dividend stock*	305	525	–	–	–	830
Own stock invested	–	–	44,987	–	–	44,987
Granted(8)	–	9,950	–	84,928	–	94,878
At 31 December 2004	5,663	10,475	179,987	309,928	689,660	1,195,713
Russ Peters						
At 1 January 2004	5,472	–	–	–	386,858	392,330
Dividend stock*	286	100	–	–	–	386
Own stock invested	–	–	16,195	–	–	16,195
Granted(8)	–	1,913	–	28,905	–	30,818
At 31 December 2004	5,758	2,013	16,195	28,905	386,858	439,729
Peter Smith						
At 1 January 2004	79,357	3,561	89,145	151,761	766,274	1,090,098
Dividend stock*	–	444	–	–	–	444
Vested, exercised and sold#(1,3,7)	4,191	(3,561)	(29,935)	–	(94,644)	(123,949)
Own stock invested	–	–	32,020	–	–	32,020
Granted(8)	–	8,419	–	61,786	–	70,205
Lapsed	–	–	–	(53,078)	–	(53,078)
At 31 December 2004	83,548	8,863	91,230	160,469	671,630	1,015,740

#The figures for vested, exercised and sold include the exercise of Matching Plan awards and the release of Matching Plan Invested Stock and are stated to show the amount of stock retained (being the increase in the deferred stock column) and the amount sold (being the decrease in the total interests column) after exercise.

*Dividend stock includes stock purchased in lieu of dividends for the stock held in the Employee Benefit Trust and stock purchased with dividends for stock in PEPs and ISAs.

(1) The Matching Plan Stock Awards, which had been granted on 8 May 2002, vested on 4 March 2004. The market value of the deferred stock constituting these awards on the day of grant was 286p and on the day of vesting was 237p.

(2) The date of exercise of the Matching Plan Stock Award was 29 March 2004. The market value of the deferred stock constituting these awards on the day of exercise was 218p.

(3) The date of exercise of the Matching Plan Stock Award was 30 March 2004. The market value of the deferred stock constituting this award on the day of exercise was 220p.

(4) The date of exercise of the Stock Options was 12 October 2004. The market value of the deferred stock on the day of exercise was 270p and the exercise price 243p.

(5) The date of exercise of the Stock Options was 17 November 2004. The market value of the deferred stock on the day of exercise was 286p and the exercise price 243p.

(6) The date of exercise of the Stock Options was 11 November 2004. The market value of the deferred stock on the day of exercise was 283p and the exercise price 243p.

(7) The date of exercise of the Stock Options was 5 October 2004. The market value of the deferred stock on the day of exercise was 268p and the exercise price 243p.

(8) The 2004 Matching Plan Awards were granted on 29 March 2004 and the market value of the deferred stock constituting these awards on the day of the grant was 218p. The performance conditions and performance period for these awards are described on page 38.

The aggregate net value of assets received or receivable by directors during the year under long term incentive plans was £1,544,555 (2003 £1,438,000).

Lord Sterling had a non-beneficial interest in £174,595 nominal of deferred stock (2003 £174,595).

The remuneration committee agreed that within three months after the date of his appointment as Chief Financial Officer on 14 May 2003, Nick Luff could contribute two tranches of invested stock to the Matching Plan, being the 2004 Award and the 2005 Award. Accordingly on 18 June 2003, Nick Luff purchased a total of £135,000 nominal of deferred stock which was split equally between a 2004 Award and a 2005 Award. It was also agreed that a Matching Award of £112,500 nominal of deferred stock would be granted in relation to each of the 2004 Award and the 2005 Award. It was agreed that the performance period applicable to the 2004 Matching Award shall be the period starting on 1 January 2003 and ending on 31 December 2004 and the performance period applicable to the 2005 Matching Award shall be the period starting on 1 January 2003 and ending on 31 December 2005. The performance targets for these awards are the same as for other awards granted under the Matching Plan during 2003 and described above.

The Company's register of directors' interests (which is open to inspection at the Company's head office) contains full details of directors' holdings of stock and options.

No director had interests, whether beneficial or non-beneficial, in the Company's preferred stock or debenture stocks or in the share capital, loan stocks or debenture stocks of the Company's subsidiaries at the beginning or end of the year or at the date of this report. No director had a material interest in any contract of significance with the Company or any subsidiary, joint venture or associate during the year.

As potential beneficiaries of the P&O Employee Benefit Trust (the ''Trust''), the executive directors are technically deemed to be interested in deferred stock of the Company held by the Trust. At 31 December 2004, the Trust held £11,730,000 nominal of deferred stock.

The interests in the deferred stock of four executive directors have increased by a total of £990 nominal of deferred stock as a result of the reinvestment of dividends in their personal equity plans and individual savings accounts between 31 December 2004 and the date of this report.

Stock Awards

The Trustee waives its right to receive dividends on stock held in the Trust and the amount of stock to which Stock Awards relate increased during the year, due to additional P&O deferred stock purchased by the Trustee which had a value equivalent to the value of the dividend foregone. Stock Awards are eligible for Matching Awards in accordance with the rules of the Matching Plan as described above. The terms of the Matching Plan (including the performance conditions) are summarised on page 38. Stock Awards are subject to a retention period of two years from the date of grant. Stock Awards granted in 2002 became exercisable from 4 March 2004 (however no Matching Awards vested at that time as the performance conditions had not been met). Stock Awards granted in 2003 become exercisable from 8 March 2005 and Stock Awards granted in 2004 will become exercisable from the announcement of the 2005 preliminary results.

Non-executive directors' interests in shares (unaudited)

The non-executive directors and their families had the following beneficial interests in units of £1 nominal of deferred stock of the Company at 31 December 2004:

	2004	2003
Sir David Brown	1,000	1,000
Sir John Collins	4,414	4,414
Michael Everard	3,500	3,500
Rodney Galpin	12,504	12,197

Stock options

Further details of the stock options granted to directors under the P&O Option Plan and the P&O SAYE Scheme are set out below:

	Outstanding 1 January 2004	Lapsed	Exercised	Exercise Price	Market price at date of exercise	Outstanding 31 December 2004	Exercisable From	Exercisable To
Lord Sterling	15,214*	15,214	–	243p	–	–	23/10/00	14/4/04
	195,578*	–	195,578	243p	270p	–	23/10/00	22/12/04
	229,533			243p		229,533	23/10/03	23/10/10
	282,615			205p		282,615	17/9/04	17/9/11
	355,673			166p		355,673	24/9/05	24/9/12
	242,204			249p		242,204	29/9/06	29/9/13
	1,320,817	15,214	195,578			1,110,025		
Robert Woods	92,211*	–	92,211	243p	286p	–	23/10/00	22/12/04
	226,014			243p		226,014	23/10/03	23/10/10
	277,962			205p		277,962	17/9/04	17/9/11
	409,755			166p		409,755	24/9/05	24/9/12
	279,016			249p		279,016	29/9/06	29/9/13
	1,284,958	–	92,211			1,192,747		

	Outstanding 1 January 2004	Lapsed	Exercised	Exercise Price	Market price at date of exercise	Outstanding 31 December 2004	Exercisable From	Exercisable To
Michael Gradon	8,579*	8,579	–	243p	–	–	23/10/00	14/4/04
	54,065*	–	54,065	243p	283p	–	23/10/00	22/12/04
	162,908			243p		162,908	23/10/03	23/10/10
	207,592			205p		207,592	17/9/04	17/9/11
	261,228			166p		261,228	24/9/05	24/9/12
	186,470			249p		186,470	29/9/06	29/9/13
	880,842	8,579	54,065			818,198		
Nick Luff	447,915			223p		447,915	18/6/06	18/6/13
	241,745			249p		241,745	29/9/06	29/9/13
	689,660	–	–			689,660		
Russ Peters	206,768			166p		206,768	24/9/05	24/9/12
	7,382#			128p		7,382#	1/6/06	1/11/06
	172,708			249p		172,708	29/9/06	29/9/13
	386,858	–	–			386,858		
Peter Smith	94,644*	–	94,644	243p	268p	–	23/10/00	22/12/04
	124,432			243p		124,432	23/10/03	23/10/10
	170,250			205p		170,250	17/9/04	17/9/11
	214,175			166p		214,175	24/9/05	24/9/12
	7,382#			128p		7,382#	1/6/06	1/11/06
	155,391			249p		155,391	29/9/06	29/9/13
	766,274	–	94,644			671,630		

P&O SAYE Plan options

Options marked (*) are replacement options granted by the Company immediately following the demerger of the cruise business to replace those options which were released prior to the demerger. The period in which a replacement option is exercisable is identical to that of the option it replaced. The exercise of replacement options is not subject to performance conditions. The other options shown above were granted as part of general grants of options to a large number of executives, further details of which are provided above.

The performance conditions for each of the above stock options are described on page 38. The performance conditions for all options (other than replacement options) are based on EPS growth, except for the options exercisable from 29 September 2006.

The Company has introduced a Directors' Shareholding Guideline whereby executive directors are expected to build up over a three year period, and maintain thereafter, a holding of deferred stock in the Company (including Stock Awards and Invested Stock) with a value broadly equivalent to at least 100 per cent of salary. This guideline will be applied flexibly, where appropriate, for example to recognise the possibility of directors wishing to reduce their holding as they near retirement or to take account of other special circumstances.

The aggregate gains made by directors on the exercise of deferred stock under option were £137,743 (2003 £nil).

The mid-market price of the deferred stock at 31 December 2004 was 297.5p (2003 230p). The highest mid-market price during the year was 309.75p and the lowest mid-market price was 205.25p.

Pensions

	Current age	Increase in accrued pension (net of inflation/ revaluation) during the year (A) £000 p.a.	Transfer value of the increase in accrued pension (net of inflation/ revaluation) less director's contribution 31 December 2004 (B) £000	Accrued pension at 31 December 2004 (C) £000 p.a.	Increase in accrued pension during the year (D) £000 p.a.	Transfer value of accrued pension at 31 December 2004 (E) £000	Transfer value of accrued pension at 31 December 2003 (F) £000	Increase/ (decrease) in transfer value over the year, less director's contribution (G) £000
Lord Sterling	70	–	–	549	57	11,201	9,662	1,539
Robert Woods	58	9	183	300	31	6,828	5,861	943
Michael Gradon	45	8	54	109	11	920	756	149
Russ Peters	56	14	203	143	18	2,281	1,819	448
Peter Smith	53	1	5	65	3	795	688	102

Notes:

(a) All executive directors during the year, except Nick Luff, were members of the P&O Pension Scheme (the ''UK Scheme'').

(b) The accrued pensions indicated in column (C) are the pensions payable on reaching age 60, except for Lord Sterling and Robert Woods whose pensions could be payable immediately.

(c) Where applicable the rate of inflation used in columns (A) and (B) is 3.1 per cent.

(d) The pensions and transfer values indicated in columns (A) to (G) above, exclude the effect of any Additional Voluntary Contributions paid by the directors.

Lord Sterling has ceased to accrue further pension rights. The pension in columns (C) and (D) above, reflect the UK Scheme's late retirement provisions. The transfer values indicated in columns (E), (F) and (G) demonstrate the change in cost to the UK Scheme of providing the late retirement benefits, given prevailing market conditions. In accordance with Inland Revenue Regulations he is not entitled to transfer his benefits out of the UK Scheme.

Robert Woods' accrued pension in column (C) is the total pension earned, which could be paid immediately in the event of retirement. For the purpose of the UK Listing Authority's Listing Rules the figure in column (A) is consistent with him being entitled to an immediate pension last year.

Michael Gradon's pension rights in the event of early retirement would be affected by various historical provisions, which have not been available to new directors for some years. The actual pension payable would depend on his age and service and whether his retirement was voluntary or compulsory. The various provisions would start to apply from age 47 and begin to fall away gradually after age 55. The maximum effect of these provisions would be on retirement from service at age 55, where the value of the standard provisions reflected above could be enhanced by up to 40 per cent.

Peter Smith's pension rights are restricted by the current earnings cap, which was introduced by the government in 1989. The Company has therefore established a Funded Unapproved Retirement Benefits Scheme (''FURBS'') which operates on a defined contribution basis. The Company's contribution to the FURBS is paid quarterly in arrears and it amounted to £43,741 in 2004 (2003 £42,002).

Nick Luff receives no pension benefit from the Company. The Company provides life insurance for which an insurance policy is in place, the cost of which is included within the directors' emoluments table on page 41.

General provisions of the UK Scheme

The Normal Retirement Age for Senior Executives is 60. The maximum pension is normally two thirds of pensionable salary. Only basic salary is pensionable. Early retirement pensions are normally reduced to take account of the longer period over which they will be paid. However in certain circumstances the Scheme rules will allow unreduced pensions to be paid, providing they are funded by the employer at the time of retirement.

The UK Scheme's rules guarantee pension increases during retirement fully in line with RPI increases up to 3 per cent, subject to the minimum introduced in the Pensions Act 1995. Increases above 3 per cent are not guaranteed but the trustee has the power to grant them, if circumstances permit, without referring to the Company. Increases greater than 80 per cent of the increase in RPI may only be given with the agreement of the Company. The current policy of the Company and the trustee is to fund the UK Scheme for increases up to 80 per cent of the increase in RPI, subject to the above guarantees, allowance for which is made in transfer value calculations.

In the event of death before retirement, the UK Scheme provides a capital sum equal to four times basic salary (or four times the earnings cap for those joining after 1989) plus spouse pensions or, at the trustee's discretion, a dependents pension of up to 66 per cent of the member's pension. Children's allowances are also payable at the rate of 25 per cent of the spouse/dependents pension.

By order of the Board
R M Gradon
Director and Secretary
8 March 2005

Directors' responsibilities in respect of the preparation of the accounts

The following statement, which should be read in conjunction with the statement of auditors' responsibilities included in the report of the independent auditors on page 47, is made with a view to distinguishing for stockholders the respective responsibilities of the directors and of the auditors in relation to the accounts.

The directors are required by the Companies Act 1985 to prepare accounts for each financial year which give a true and fair view of the state of affairs of the Company and the Group as at the end of the financial year and of the profit or loss for the financial year.

In preparing the accounts, the directors are required to select appropriate accounting policies and then apply them consistently, make judgements and estimates that are reasonable and prudent and state whether all accounting standards which they consider to be applicable have been followed, subject to any material departures disclosed and explained in the financial statements. The directors are also required to use a going concern basis in preparing the accounts unless this is inappropriate.

The directors have responsibility for ensuring that the Company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the Company and which enable them to ensure that the accounts comply with the Companies Act 1985.

The directors have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Report of the independent auditors

Independent auditors' report to the members of The Peninsular and Oriental Steam Navigation Company

We have audited the accounts on pages 48 to 86. We have also audited the information on pages 41 to 45 of the directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors are responsible for preparing the Annual Report and the directors' remuneration report. As described on page 46, this includes responsibility for preparing the accounts in accordance with applicable United Kingdom law and accounting standards. Our responsibilities, as independent auditors, are established in the United Kingdom by statute, the Auditing Practices Board, the Listing Rules of the Financial Services Authority, and by our profession's ethical guidance.

We report to you our opinion as to whether the accounts give a true and fair view and whether the accounts and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the accounts, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions with the group is not disclosed.

We review whether the corporate governance statement on pages 33 to 36 reflects the Company's compliance with the nine provisions of the 2003 FRC Code specified for our review by the Listing Rules, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read the other information contained in the Annual Report, including the corporate governance statement and the unaudited part of the directors' remuneration report, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts and the part of the directors' remuneration report to be audited. 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 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 that the accounts and the part of the directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts and the part of the directors' remuneration report to be audited.

Opinion

In our opinion:

– the accounts give a true and fair view of the state of affairs of the Company and the Group as at 31 December 2004 and of the loss of the Group for the year then ended; and

– the accounts and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered Accountants
Registered Auditor

8 Salisbury Square
London
EC4Y 8BB
8 March 2005

Group profit and loss account

for the year ended 31 December 2004

	Note	Before exceptional items 2004 £m	Exceptional items* 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items* 2003 £m	Total 2003 £m
Turnover: Group and share of joint ventures	2(a)	3,057.4	–	3,057.4	4,137.9	–	4,137.9
Less: share of joint ventures' turnover		(659.9)	–	(659.9)	(1,846.9)	–	(1,846.9)
Group turnover	2(a)	2,397.5	–	2,397.5	2,291.0	–	2,291.0
Cost of sales	3	(2,017.7)	(60.7)	(2,078.4)	(1,916.8)	–	(1,916.8)
Gross profit		379.8	(60.7)	319.1	374.2	–	374.2
Other net operating costs	3	(221.5)	(211.6)	(433.1)	(235.5)	(39.8)	(275.3)
Group operating (loss)/profit		158.3	(272.3)	(114.0)	138.7	(39.8)	98.9
Share of operating results of: joint ventures		25.1	–	25.1	40.8	–	40.8
associates		84.9	(30.4)	54.5	35.0	–	35.0
Continuing operations							
Total operating profit before goodwill amortisation		285.5	(302.7)	(17.2)	221.1	(39.8)	181.3
Goodwill amortisation		(17.2)	–	(17.2)	(18.4)	–	(18.4)
		268.3	(302.7)	(34.4)	202.7	(39.8)	162.9
Discontinued operations		–	–	–	11.8	–	11.8
Total operating (loss)/profit: Group and share of joint ventures and associates	2(b)	268.3	(302.7)	(34.4)	214.5	(39.8)	174.7
Continuing operations							
Loss on sale of fixed assets	2(d)	–	(10.9)	(10.9)	–	(5.4)	(5.4)
(Loss)/profit on sale and termination of businesses	2(d)	–	(33.2)	(33.2)	–	28.5	28.5
Discontinued operations							
Profit on sale of fixed assets	2(d)	–	–	–	–	4.8	4.8
Loss on sale and termination of businesses	2(d)	–	(3.1)	(3.1)	–	(11.3)	(11.3)
Amounts written off investments		–	(30.3)	(30.3)	–	–	–
(Loss)/profit on ordinary activities before interest and taxation		268.3	(380.2)	(111.9)	214.5	(23.2)	191.3
Net interest payable and similar items	5	(98.1)	–	(98.1)	(111.3)	–	(111.3)
(Loss)/profit on ordinary activities before taxation		170.2	(380.2)	(210.0)	103.2	(23.2)	80.0
Taxation	6	(26.9)	1.5	(25.4)	(20.7)	(0.1)	(20.8)
(Loss)/profit on ordinary activities after taxation		143.3	(378.7)	(235.4)	82.5	(23.3)	59.2
Equity minority interests	23	(14.9)	–	(14.9)	(9.2)	–	(9.2)
(Loss)/profit for the financial year attributable to stockholders		128.4	(378.7)	(250.3)	73.3	(23.3)	50.0
Dividends on equity and non-equity share capital	7	(69.9)	–	(69.9)	(102.5)	–	(102.5)
Retained loss for the financial year	22	58.5	(378.7)	(320.2)	(29.2)	(23.3)	(52.5)

	Note	2004	2003
Dividend per £1 nominal of deferred stock	7	9.0p	13.5p
Basic (loss)/earnings per £1 nominal of deferred stock	9	(34.7)p	6.5p
Diluted (loss)/earnings per £1 nominal of deferred stock	9	(34.7)p	6.5p
Headline earnings per £1 nominal of deferred stock	9	19.4p	12.4p

*Exceptional items consist of impairment charges, reorganisation and closure costs, exceptional income, profits and losses on sale of fixed assets and businesses and amounts written off investments (note 4), including the consequential adjustments to taxation.

Balance sheets

at 31 December 2004

	Note	Group 2004 £m	Restated Group 2003 £m	Company 2004 £m	Restated Company 2003 £m
Assets					
Fixed assets					
Intangible assets: Goodwill	10	105.2	237.3	–	–
Tangible assets:					
Land and buildings	11	447.6	585.3	–	0.3
Ships and other fixed assets	12	903.1	1,092.7	20.7	22.5
Investments:					
Subsidiaries	13	–	–	3,292.2	3,983.4
Participating interests in joint ventures:				46.4	398.2
Share of gross assets		308.5	1,251.0		
Share of gross liabilities		(96.7)	(684.5)		
Share of net assets		211.8	566.5		
Participating interests in associates		346.6	182.5	206.9	6.7
Other investments		11.2	12.6	0.1	0.1
Total joint ventures, associates and other investments	14	569.6	761.6	253.4	405.0
		2,025.5	2,676.9	3,566.3	4,411.2
Current assets					
Properties held for development and sale	15	361.7	478.6	27.1	21.9
Stocks	16	43.2	60.1	–	–
Debtors:					
Amounts falling due within one year	17	419.9	427.2	45.7	100.4
Amounts falling due after more than one year	17	7.2	40.1	3.4	33.6
		427.1	467.3	49.1	134.0
Cash at bank and in hand		50.8	64.0	50.9	16.9
		882.8	1,070.0	127.1	172.8
Creditors: amounts falling due within one year					
Loans	18	(79.7)	(100.8)	(20.0)	(7.8)
Other creditors	19	(551.9)	(627.7)	(153.0)	(219.7)
		(631.6)	(728.5)	(173.0)	(227.5)
Net current assets/(liabilities)		251.2	341.5	(45.9)	(54.7)
Total assets less current liabilities		2,276.7	3,018.4	3,520.4	4,356.5
Creditors: amounts falling due in more than one year					
Loans	18	(979.9)	(1,437.0)	(538.8)	(836.6)
Other creditors	19	(55.1)	(55.7)	(1,138.2)	(1,793.0)
		(1,035.0)	(1,492.7)	(1,677.0)	(2,629.6)
Provisions for liabilities and charges	20	(220.3)	(180.2)	(2.2)	(9.4)
Net assets		1,021.4	1,345.5	1,841.2	1,717.5
Capital and reserves					
Called up share capital	21	813.5	807.6	813.5	807.6
Share premium account	22	782.9	778.3	782.9	778.3
Revaluation reserve	22	11.1	28.9	–	–
Other reserves	22	127.8	83.2	–	–
Profit and loss account	22	(759.0)	(387.9)	244.8	131.6
Equity stockholders' funds		906.4	1,240.2	1,771.3	1,647.6
Non-equity stockholders' funds	21	69.9	69.9	69.9	69.9
Stockholders' funds		976.3	1,310.1	1,841.2	1,717.5
Equity minority interests	23	45.1	35.4	–	–
		1,021.4	1,345.5	1,841.2	1,717.5

The accounts were approved by a duly authorised committee of the Board of directors and signed on its behalf on 8 March 2005 by:

Lord Sterling
Nick Luff

Group cash flow statement

for the year ended 31 December 2004

	Note	2004 £m	2004 £m	2003 £m	2003 £m
Net cash inflow from operating activities	29(a)		417.0		247.8
Dividends from joint ventures and associates			22.1		62.9
Returns on investments and servicing of finance					
Interest received		26.4		7.2	
Interest paid		(103.2)		(91.7)	
Finance lease interest paid		(1.8)		(4.2)	
Dividends paid to minority interests		(4.6)		(3.8)	
Dividends paid to non-equity stockholders		(3.8)		(3.8)	
Net cash outflow from returns on investments and servicing of financing			(87.0)		(96.3)
Taxation			(37.0)		(13.6)
Capital expenditure and financial investment					
Purchase of ships		(9.3)		(92.9)	
Purchase of land and buildings		(56.5)		(71.7)	
Purchase of investments and other fixed assets		(90.5)		(114.9)	
Sale of ships		47.8		5.0	
Sale of land and buildings		33.7		3.6	
Sale of investments and other fixed assets		21.5		8.7	
Net cash outflow for capital expenditure and financial investment			(53.3)		(262.2)
Acquisitions and disposals					
Purchase of subsidiaries and businesses	29(d)	1.6		(185.1)	
Purchase of joint ventures and associates		(69.8)		(62.4)	
Sale of subsidiaries and termination of businesses	29(e)	186.5		(7.0)	
Sale of joint ventures and associates		155.8		105.6	
Net cash inflow/(outflow) for acquisitions and disposals			274.1		(148.9)
Equity dividends paid			(87.8)		(93.7)
Net cash inflow/(outflow) before financing			448.1		(304.0)
Financing					
Issue of stock		12.6		119.6	
Purchase of own shares		(14.2)		–	
Short term borrowings		(7.1)		7.4	
Loan drawdowns		838.6		864.1	
Loan repayments		(1,261.4)		(675.2)	
Finance leases capital payments		(30.6)		(17.8)	
Net cash (outflow)/inflow from financing			(462.1)		298.1
Decrease in cash	29(b)		(14.0)		(5.9)

Group statement of total recognised gains and losses

for the year ended 31 December 2004

	2004 £m	2003 £m
(Loss)/profit for the financial year attributable to stockholders	(250.3)	50.0
Deficit on valuation of land and buildings	–	(0.1)
Taxation on disposal of previously revalued properties	(5.2)	–
Exchange movements on foreign currency net investments and revaluation reserves	(57.4)	(48.0)
UK taxation on exchange movements on foreign currency net investments: prior periods	3.5	–
Total recognised gains and losses for the financial year	(309.4)	1.9

Note of Group historical cost profits and losses

for the year ended 31 December 2004

	2004 £m	2003 £m
(Loss)/profit on ordinary activities before taxation	(210.0)	80.0
Realisation of revaluation movements of previous years	16.6	(41.0)
Difference between a historical cost amortisation charge and the actual amortisation charge of the year calculated at the revalued amount	–	(0.4)
Historical cost (loss)/profit on ordinary activities before taxation	(193.4)	38.6
Historical cost loss for the year retained after taxation, minority interests and dividends	(308.8)	(93.9)

Reconciliations of movements in stockholders' funds

for the year ended 31 December 2004

	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
Total recognised gains and losses for the financial year	(309.4)	1.9	192.7	131.5
Dividends on share capital	(69.9)	(102.5)	(69.9)	(102.5)
New stock issued	12.6	121.9	12.6	56.5
Issue costs of stock placing	–	(2.3)	–	(2.3)
Purchase of own stock	(14.2)	–	(14.2)	–
Other movements in own stock	2.5	1.3	2.5	1.3
Goodwill on disposals	44.6	–	–	–
Net change in stockholders' funds	(333.8)	20.3	123.7	84.5
Stockholders' funds at the beginning of the year (restated)	1,310.1	1,289.8	1,717.5	1,633.0
Stockholders' funds at the end of the year	976.3	1,310.1	1,841.2	1,717.5

Stockholders' funds for the Group and the Company at the beginning of the year, as previously reported, were £1,323.1m (2003 £1,304.1m) and £1,730.5m (2003 £1,647.3m) respectively, before the prior year adjustment for the adoption of UITF abstract 38 ''Accounting for ESOP Trusts'' of £13.0m (2003 £14.3m) (note 1).

Notes to the accounts

1 Accounting policies
The following accounting policies have been applied consistently in dealing with items which are considered material in relation to these accounts.

Basis of preparation of accounts
The accounts have been prepared on the historical cost basis, modified to include certain land and buildings at market value, and in accordance with the Companies Act 1985 except as stated under land and buildings and properties held for development and sale.

The accounts have been prepared in accordance with applicable United Kingdom accounting standards, and on a consistent basis except that the Group has adopted UITF abstract 38 ''Accounting for ESOP Trusts'' and its consequential changes to UITF abstract 17 ''Employee share schemes'' for the first time in its 2004 results. Shares purchased through Employee Share Option Plan (''ESOP'') trusts are taken as a deduction in arriving at stockholders' funds. Previously these were held within investments. The Group and Company balance sheets as at 31 December 2003 have been restated to reflect this change in accounting policy, resulting in a reduction in stockholders' funds of £13.0m at 31 December 2003, comprising a reduction in investments of £13.8m and a reduction in creditors of £0.8m. The impact on the profit and loss account in the current and prior year is immaterial. The Group has continued to follow the transitional arrangements of Financial Reporting Standard 17 ''Retirement benefits'' in these accounts.

Basis of consolidation
The Group accounts include the accounts of the Company and its subsidiary undertakings made up to 31 December each year. Unless otherwise stated, the acquisition method of accounting has been adopted. Under this method, the results of subsidiary undertakings acquired or disposed of in the year are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

An associate is an undertaking in which the Group has a long term interest, usually from 20 per cent to 50 per cent of the equity voting rights, and over which it exercises significant influence. The Group's share of the profits less losses of associates is included in the consolidated profit and loss account and its interest in their net assets is included in investments in the consolidated balance sheet.

A joint venture is an undertaking in which the Group has a long term interest and over which it exercises joint control. The Group's share of the turnover and profits less losses of joint ventures is included in the consolidated profit and loss account and its interest in their assets and liabilities is included in investments in the consolidated balance sheet.

Under section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account.

Goodwill arising on consolidation
Purchased goodwill represents the excess of the fair value of the consideration and associated costs over the fair value of the separable net assets of businesses acquired.

Goodwill arising on consolidation in respect of acquisitions before 1 January 1998, when Financial Reporting Standard 10 ''Goodwill and intangible assets'' was adopted, was deducted from reserves in the year of acquisition. When a subsequent disposal occurs any related goodwill previously deducted from reserves is written back through the profit and loss account as part of the profit or loss on disposal.

Goodwill arising on consolidation in respect of acquisitions since 1 January 1998 is capitalised. Goodwill is amortised to nil on a straight line basis over its estimated useful life, which can be up to 20 years.

Goodwill arising on the Group's acquisition of its joint ventures and associates less accumulated amortisation is included in the carrying amount for the joint ventures and associates.

On the subsequent disposal or termination of a business acquired since 1 January 1998, the profit or loss on disposal or termination is calculated after charging the unamortised amount of any related goodwill.

Investments
In the Company's accounts, investments in subsidiary undertakings, joint ventures and associates are stated at cost less any impairment in value. Where merger relief provisions of the Companies Act 1985 apply, investments of the Company are accounted for on the basis of the nominal value of shares issued as purchase consideration.

Other investments are stated at historical cost net of provisions for impairment.

Land and buildings
Land and buildings are included in fixed assets at their latest valuations plus subsequent additions at cost, and surpluses and deficits on valuation are included in the revaluation reserve. Land and buildings are valued at least every five years by external valuers. Profits and losses on sale of land and buildings are calculated by reference to their net carrying amounts.

In the case of freehold buildings and leasehold land and buildings annual depreciation is provided on a straight line basis. Freehold buildings are written off over 50 years and leasehold land and buildings are written off over the remainder of the lease period. No depreciation is provided on freehold land.

Provision for any impairment in value of land and buildings held as fixed assets is made in the profit and loss account, except in the case of land and buildings which have previously been revalued upwards, when the provision is made to the revaluation reserve to the extent of the previous revaluation.

Included in land and buildings are assets under construction, which are held at cost. These assets are depreciated from the date on which they come into use. Interest incurred in respect of assets under construction is capitalised into the cost of the asset concerned.

1 Accounting policies (continued)

Ships and other fixed assets

These assets are stated at cost less accumulated depreciation.

Assets acquired under finance leases are stated at cost less accumulated depreciation, the future capital payments being included in loans.

Depreciation is calculated to write off the cost of these assets to estimated residual value, on a straight line basis over the expected useful life of the asset concerned. Generally for ships this is between 10 and 35 years, and for other fixed assets (reported within plant and machinery, fixtures and fittings) various periods of up to 40 years, the most significant of which are cold storage facilities (up to 40 years), port equipment, such as cranes and straddle carriers (up to 25 years) and other port equipment, such as forklifts, tractors and trailers (5 to 10 years).

Provision for any impairment in value of ships and other fixed assets is made in the profit and loss account.

Assets constructed by the Group are depreciated from the date on which they come into use. Interest incurred in respect of assets under construction is capitalised into the cost of the asset concerned.

Properties held for development and sale

Properties held for development and sale are included in current assets at the lower of cost and net realisable value. For properties previously held for investment, which the directors have decided are to be developed or sold and which are reclassified as properties held for development and sale, cost is considered to be the latest valuation prior to their reclassification. This treatment is a departure from the Companies Act 1985 which would normally require current assets to be carried at the lower of cost or net realisable value. The directors consider that compliance with this requirement would fail to give a true and fair view of historical revaluation surpluses, which remain unrealised by the Group until disposal. Interest and other outgoings less income receivable are charged to the profit and loss account during development, except in respect of certain overseas properties where the development period is extensive, when such amounts are included in cost.

In certain subsidiaries, realised capital profits on the sale of properties are not ordinarily available for distribution and accordingly these capital profits are transferred to other reserves. These capital profits can be distributed by the passing of a special resolution by the subsidiary.

Stocks

Stocks and work in progress are stated at the lower of cost and net realisable value.

Liquid resources

Liquid resources comprise term deposits of less than one year.

Turnover

Turnover comprises amounts derived from the provision of goods and services to third parties (excluding VAT and similar sales taxes) and includes rent receivable from properties. Turnover from the provision of goods includes sales of properties held for development and sale, recognised when contracts become unconditional. Turnover from the provision of services is recognised on the delivery of those services, which for Ports is once the relevant throughput has taken place, for Ferries is on provision of carriage and for P&O Nedlloyd is on completion of the shipping or transport operation. For Cold Logistics storage revenue is recognised over the period during which storage is provided and for its handling and transport operations on completion of the service.

Leases

Ships, plant and machinery and land and buildings financed by leasing agreements giving rights approximating to ownership are capitalised as tangible fixed assets at cost less accumulated depreciation. The capital element of future lease payments is treated as a liability. The interest element is charged to the profit and loss account over the period of the finance lease in proportion to the balance of capital repayments outstanding.

All other leases are classified as operating leases with the lease rentals payable being charged to the profit and loss account on a straight line basis.

Pension schemes

Contributions for ongoing benefit accruals paid to schemes in respect of defined benefit pension schemes are calculated as a percentage, agreed on actuarial advice, of the pensionable salaries of employees. The cost of providing defined benefit pensions is charged to the profit and loss account on a systematic basis over the periods benefiting from the services of employees. Differences between the amounts charged to the profit and loss account and payments made to the pension schemes are treated as assets or liabilities.

Contributions including lump sum payments in respect of defined contribution pension schemes and multi employer defined benefit schemes, where it is not possible to identify the Group's share of the scheme, are charged to the profit and loss account when they are payable.

Deferred taxation

Deferred tax is recognised without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet dates except in respect of revalued fixed assets where there is no commitment to sell the asset, gains on sale of assets which are rolled over into replacement assets and the remittance of taxable subsidiary, associate or joint venture earnings where no commitment has been made to the remittance of those earnings.

1 Accounting policies (continued)

Derivatives and other financial instruments

Amounts payable or receivable in respect of interest rate swaps are recognised within the interest expense over the period of the contracts. Non-interest bearing amounts due after one year are discounted at a rate approximating to current interest rates.

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised.

Foreign currencies

Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction. Profits and losses of subsidiaries, branches, joint ventures and associates which have currencies of operation other than sterling are translated into sterling at average rates of exchange except for material exceptional items which are translated at the rate ruling on the date of transaction. Assets and liabilities denominated in foreign currencies are translated at the year end exchange rates.

Exchange differences arising from the retranslation of the opening net assets of subsidiaries, branches, joint ventures and associates which have currencies of operation other than sterling and any related loans are taken to reserves together with the differences arising when the profit and loss accounts are translated at average rates and compared with rates ruling at the year end. Other exchange differences are taken to the profit and loss account.

2 Analysis of results and net operating assets

(a) Turnover

By division:	Group 2004 £m	Joint ventures 2004 £m	Total 2004 £m	Group 2003 £m	Joint ventures 2003 £m	Total 2003 £m
Continuing operations						
Ports	844.4	174.9	1,019.3	791.6	153.2	944.8
Ferries	984.0	–	984.0	1,081.0	–	1,081.0
Cold Logistics	205.6	–	205.6	210.5	–	210.5
Container Shipping*	–	478.9	478.9	–	1,685.1	1,685.1
Property	363.5	6.1	369.6	207.9	8.6	216.5
	2,397.5	659.9	3,057.4	2,291.0	1,846.9	4,137.9

*Turnover for the Container Shipping business includes joint venture turnover for P&O Nedlloyd until 16 April 2004 only. On that date P&O disposed of its 50 per cent stake in P&O Nedlloyd for a consideration of €215m cash and a 25 per cent shareholding in Royal P&O Nedlloyd N.V. P&O's investment in Royal P&O Nedlloyd N.V. has been accounted for as an associate since that date.

By geographical area of origin:	Group 2004 £m	Joint ventures 2004 £m	Total 2004 £m	Group 2003 £m	Joint ventures 2003 £m	Total 2003 £m
Continuing operations						
Europe	1,255.6	202.5	1,458.1	1,335.3	707.1	2,042.4
Americas	616.4	158.5	774.9	459.3	237.8	697.1
Australasia	372.5	49.8	422.3	357.0	144.7	501.7
Asia	153.0	249.1	402.1	139.4	757.3	896.7
	2,397.5	659.9	3,057.4	2,291.0	1,846.9	4,137.9

Turnover by destination is not materially different from turnover by origin.

2 Analysis of results and net operating assets (continued)

(b) Operating (loss)/profit

By division:	Group 2004 £m	Joint ventures 2004 £m	Associates 2004 £m	Total 2004 £m	Group 2003 £m	Joint ventures 2003 £m	Associates 2003 £m	Total 2003 £m
Continuing operations								
Before exceptional items								
Ports	107.3	13.7	32.8	153.8	97.4	15.5	16.2	129.1
Ferries	(15.4)	–	–	(15.4)	(0.2)	–	–	(0.2)
Cold Logistics	17.4	–	–	17.4	17.0	(0.6)	–	16.4
Container Shipping	(4.2)	9.9	49.8	55.5	(5.9)	23.5	–	17.6
Property	53.2	1.5	2.3	57.0	32.7	2.4	4.7	39.8
	158.3	25.1	84.9	268.3	141.0	40.8	20.9	202.7
Exceptional items								
Ports	4.3	–	–	4.3	–	–	–	–
Ferries	(266.0)	–	–	(266.0)	(39.8)	–	–	(39.8)
Cold Logistics	(10.0)	–	–	(10.0)	–	–	–	–
Container Shipping	–	–	–	–	–	–	–	–
Property	(0.6)	–	(30.4)	(31.0)	–	–	–	–
	(272.3)	–	(30.4)	(302.7)	(39.8)	–	–	(39.8)
Total								
Ports	111.6	13.7	32.8	158.1	97.4	15.5	16.2	129.1
Ferries	(281.4)	–	–	(281.4)	(40.0)	–	–	(40.0)
Cold Logistics	7.4	–	–	7.4	17.0	(0.6)	–	16.4
Container Shipping	(4.2)	9.9	49.8	55.5	(5.9)	23.5	–	17.6
Property	52.6	1.5	(28.1)	26.0	32.7	2.4	4.7	39.8
	(114.0)	25.1	54.5	(34.4)	101.2	40.8	20.9	162.9
Discontinued operations								
Bulk Shipping	–	–	–	–	(2.3)	–	14.1	11.8
	(114.0)	25.1	54.5	(34.4)	98.9	40.8	35.0	174.7

By geographical area of origin:	Group 2004 £m	Joint ventures 2004 £m	Associates 2004 £m	Total 2004 £m	Group 2003 £m	Joint ventures 2003 £m	Associates 2003 £m	Total 2003 £m
Continuing operations								
Europe	(267.1)	5.4	(12.1)	(273.8)	(15.3)	10.5	6.9	2.1
Americas	72.4	3.2	8.6	84.2	42.1	(1.2)	0.3	41.2
Australasia	35.0	4.3	3.2	42.5	34.3	7.9	–	42.2
Asia	45.7	12.2	54.8	112.7	40.1	23.6	13.7	77.4
	(114.0)	25.1	54.5	(34.4)	101.2	40.8	20.9	162.9
Discontinued operations								
Europe	–	–	–	–	(2.3)	–	5.8	3.5
Americas	–	–	–	–	–	–	1.1	1.1
Asia	–	–	–	–	–	–	7.2	7.2
	(114.0)	25.1	54.5	(34.4)	98.9	40.8	35.0	174.7

2 Analysis of results and net operating assets (continued)

(c) Operating (loss)/profit before depreciation, amortisation and exceptional items

By division:	Operating (loss)/profit 2004 £m	Goodwill amortisation 2004 £m	Operating (loss)/profit before goodwill amortisation 2004 £m	Depreciation and exceptional items 2004 £m	Operating profit before depreciation, amortisation and exceptional items 2004 £m	Operating profit before depreciation, amortisation and exceptional items 2003 £m
Continuing operations						
Before exceptional items						
Ports	153.8	7.7	161.5	77.2	238.7	208.5
Ferries	(15.4)	6.3	(9.1)	45.0	35.9	57.1
Cold Logistics	17.4	0.9	18.3	9.7	28.0	26.9
Container Shipping	55.5	2.2	57.7	40.5	98.2	87.8
Property	57.0	0.1	57.1	6.2	63.3	47.1
	268.3	17.2	285.5	178.6	464.1	427.4
Exceptional items						
Ports	4.3	–	4.3	(4.3)	–	–
Ferries	(266.0)	–	(266.0)	266.0	–	–
Cold Logistics	(10.0)	–	(10.0)	10.0	–	–
Container Shipping	–	–	–	–	–	–
Property	(31.0)	–	(31.0)	31.0	–	–
	(302.7)	–	(302.7)	302.7	–	–
Total						
Ports	158.1	7.7	165.8	72.9	238.7	208.5
Ferries	(281.4)	6.3	(275.1)	311.0	35.9	57.1
Cold Logistics	7.4	0.9	8.3	19.7	28.0	26.9
Container Shipping	55.5	2.2	57.7	40.5	98.2	87.8
Property	26.0	0.1	26.1	37.2	63.3	47.1
	(34.4)	17.2	(17.2)	481.3	464.1	427.4
Discontinued operations						
Bulk Shipping	–	–	–	–	–	16.2
	(34.4)	17.2	(17.2)	481.3	464.1	443.6

In the above table, operating profit before depreciation, amortisation and exceptional items is stated after adding back to total operating profit the depreciation, amortisation and exceptional items of all Group subsidiaries, and the Group's share of the depreciation, amortisation and exceptional items of joint ventures and associates. The Group's goodwill amortisation charge relating to continuing operations was £14.1m (2003 £13.8m). The Group's share of amortisation of goodwill within joint ventures and associates was £3.1m (2003 £4.6m).

(d) (Loss)/profit on sale of fixed assets and sale and termination of businesses

(Loss)/profit on sale of fixed assets	Group 2004 £m	Joint ventures and associates 2004 £m	Total 2004 £m	Total 2003 £m
Continuing operations				
Ports	(1.6)	–	(1.6)	(0.2)
Ferries	(7.2)	–	(7.2)	(8.9)
Cold Logistics	0.8	–	0.8	–
Container Shipping	(0.4)	0.3	(0.1)	(0.3)
Property	(2.8)	–	(2.8)	4.0
	(11.2)	0.3	(10.9)	(5.4)
Discontinued operations				
Bulk Shipping	–	–	–	4.8

2 Analysis of results and net operating assets (continued)

(d) (Loss)/profit on sale of fixed assets and sale and termination of businesses (continued)

(Loss)/profit on sale and termination of businesses	Group 2004 £m	Joint ventures and associates 2004 £m	Total 2004 £m	Total 2003 £m
Continuing operations				
Ports	1.2	–	1.2	36.7
Ferries	(2.1)	–	(2.1)	–
Container Shipping	(65.4)	–	(65.4)	(8.2)
Property	33.1	–	33.1	–
	(33.2)	–	(33.2)	28.5
Discontinued operations				
Contract Logistics	(3.4)	–	(3.4)	(3.9)
Bulk Shipping	0.4	–	0.4	(7.4)
Other	(0.1)	–	(0.1)	–
	(3.1)	–	(3.1)	(11.3)

(e) Net operating assets

By division:	Net operating assets 2004 £m	Group share of joint ventures and associates: Loans 2004 £m	Group share of joint ventures and associates: Other non operating assets 2004 £m	Total 2004 £m	Net operating assets 2003 £m	Group share of joint ventures and associates: Loans 2003 £m	Group share of joint ventures and associates: Other non operating assets 2003 £m	Total 2003 £m
Continuing operations								
Ports	1,202.2	(59.7)	(6.2)	1,136.3	1,170.6	(46.8)	(3.5)	1,120.3
Ferries	287.8	0.1	(0.1)	287.8	629.5	0.1	(0.1)	629.5
Cold Logistics	189.5	–	0.4	189.9	218.9	0.4	0.5	219.8
Container Shipping	259.4	(44.0)	(4.9)	210.5	493.4	(139.7)	(7.8)	345.9
Property	465.9	(76.3)	0.5	390.1	808.0	(104.3)	0.2	703.9
	2,404.8	(179.9)	(10.3)	2,214.6	3,320.4	(290.3)	(10.7)	3,019.4

By geographical area of origin:	Net operating assets 2004 £m	Net operating assets 2003 £m
Continuing operations		
Europe	903.7	1,412.4
Americas	497.8	737.8
Australasia	297.0	413.4
Asia	706.3	756.8
	2,404.8	3,320.4

The net operating assets are reconciled to stockholders' funds as follows:	2004 £m	2003 £m
Net operating assets	2,404.8	3,320.4
Group share of joint venture and associate loans	(179.9)	(290.3)
Group share of joint venture and associate other net non operating liabilities	(10.3)	(10.7)
	2,214.6	3,019.4
Amounts receivable relating to previous corporate disposals	35.7	75.2
Interest bearing investments	10.2	11.3
Net borrowings	(1,029.6)	(1,502.7)
Corporation tax and deferred tax	(163.5)	(190.0)
Dividends payable	(46.0)	(67.7)
Minority interests	(45.1)	(35.4)
	976.3	1,310.1

2 Analysis of results and net operating assets (continued)

(f) Ports operating profit and net operating assets

	Operating profit				Net operating assets	
	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Total 2003 £m	2004 £m	2003 £m
Asia	84.6	–	84.6	69.0	573.7	550.2
Americas	16.2	–	16.2	13.2	185.7	199.4
Australasia	26.9	5.7	32.6	17.7	187.4	197.7
Europe	19.2	(1.4)	17.8	18.6	226.2	192.0
	146.9	4.3	151.2	118.5	1,173.0	1,139.3
Maritime Services	6.9	–	6.9	10.6	29.2	31.3
	153.8	4.3	158.1	129.1	1,202.2	1,170.6

Ports operating assets include assets under construction of £39.2m (2003 £144.0m).

3 Net operating costs

	Before exceptional items 2004 £m	Exceptional items 2004 £m	Total 2004 £m	Before exceptional items 2003 £m	Exceptional items 2003 £m	Total 2003 £m
Cost of sales	(2,017.7)	(60.7)	(2,078.4)	(1,916.8)	–	(1,916.8)
Administrative expenses	(240.5)	(219.8)	(460.3)	(249.9)	(39.8)	(289.7)
Other operating income	19.0	8.2	27.2	14.4	–	14.4
	(2,239.2)	(272.3)	(2,511.5)	(2,152.3)	(39.8)	(2,192.1)

Net operating costs include:	2004 £m	2003 £m
Depreciation and amortisation of tangible fixed assets	(115.2)	(117.8)
Impairment charge	(198.6)	(24.2)
Amortisation of goodwill	(14.1)	(13.8)
Audit fee	(2.3)	(2.2)
Rental of land and buildings	(100.2)	(98.6)
Hire of ships	(60.3)	(66.5)
Hire of plant and machinery	(35.5)	(35.4)

Fees paid to the Company's principal auditor (KPMG)	UK 2004 £m	Overseas 2004 £m	Total 2004 £m	Percentage of total fees 2004 %	UK 2003 £m	Overseas 2003 £m	Total 2003 £m	Percentage of total fees 2003 %
Audit services								
Statutory audit	1.2	1.0	2.2	42.3	1.1	1.0	2.1	51.2
Audit-related regulatory reporting	0.2	–	0.2	3.9	0.2	–	0.2	4.9
Total audit services	1.4	1.0	2.4	46.2	1.3	1.0	2.3	56.1
Further assurance services	1.1	0.1	1.2	23.0	0.4	–	0.4	9.7
Tax services								
Compliance services	–	0.4	0.4	7.7	–	0.5	0.5	12.2
Advisory services	0.4	0.5	0.9	17.3	0.1	0.6	0.7	17.1
	0.4	0.9	1.3	25.0	0.1	1.1	1.2	29.3
Other services	0.2	0.1	0.3	5.8	0.2	–	0.2	4.9
Total of non-audit services	1.7	1.1	2.8	53.8	0.7	1.1	1.8	43.9
Total of audit and non-audit services	3.1	2.1	5.2	100.0	2.0	2.1	4.1	100.0

Fees for further assurance services in 2004 principally relate to due diligence work in respect of the disposal of the Australian resorts and La Manga Club, and the P&O Nedlloyd transaction.

In addition to the above £0.1m (2003 £0.1m) was paid to secondary auditors in respect of audit fees bringing the statutory audit fee for the Group to £2.3m (2003 £2.2m). The Group's share of fees paid to KPMG by joint ventures and associates was £1.1m (2003 £0.9m), of which £0.6m (2003 £0.7m) was in respect of audit work and £0.5m (2003 £0.2m) was in respect of non-audit work. The audit fee of the Company was £0.5m (2003 £0.4m).

4 Exceptional items

	Impairments and write downs: Goodwill £m	Impairments and write downs: Tangible assets £m	Impairments and write downs: Investments £m	Reorganisation and closure costs £m	2004 Total £m	2003 Total £m
Ferries impairments	108.4	37.3	1.1	–	146.8	24.2
Ferries reorganisation	–	36.4	–	83.9	120.3	15.6
	108.4	73.7	1.1	83.9	267.1	39.8
HTC impairments and write downs	–	–	59.6	0.6	60.2	–
Cold Logistics impairments	–	10.0	–	–	10.0	–
Other impairments	1.4	5.1	–	–	6.5	–
	109.8	88.8	60.7	84.5	343.8	39.8
Exceptional income					(10.8)	–
Loss/(profit) on sale of fixed assets and businesses					47.2	(16.6)
					380.2	23.2
of which:						
Charged to operating profit					302.7	39.8
Other separately disclosable items					47.2	(16.6)
Amounts written off investments					30.3	–
					380.2	23.2

FRS 11 ''Impairment of fixed assets and goodwill'' requires that a review of fixed assets and goodwill should be carried out if events or changes in circumstances indicate that the carrying amount of the fixed asset or goodwill may not be recoverable.

During 2004, in view of the changed market conditions and the disappointing results for the Ferries division, the Group undertook a wide-ranging business review looking at the overall market and all aspects of the business.

On 28 September 2004 the Group announced the results of this fundamental business review, the central conclusion of which was that there would be a fundamental change in both the product offered to customers and the cost base of the business. The review proposed to reduce the number of ships that P&O Ferries operates from 31 to 23 and to close four of its 13 routes and could result in a reduction of up to 1,550 jobs. The outcome of the review indicated that the Group should perform an impairment review of the entire Ferries division.

The carrying values of the goodwill and fixed assets of each of the Ferries division's income generating units (''IGUs''), being the Short Sea, Western Channel, North Sea and Irish Sea routes and Ferrymasters, were compared to their respective net recoverable amounts (the higher of value in use to the Group and net realisable value).

The value in use for each IGU was calculated with reference to the net present value of the future cash flows projected to be derived from its assets, using cash flows to 31 December 2014 or shorter if the overall remaining life of the fleet in service on the routes in the IGU was less. These projection periods were used as management believes that the annual growth rate of the IGUs will be different from that of the average economic growth rates of the countries in which the business operates, which are within the European Union. For periods beyond these dates the projections use a long term rate of growth less than the average long term rate of growth for the countries in which the business operates. The discount rate applied to these projections was based on the estimated weighted average cost of capital for the division adjusted for the related underlying tax. The effective pre-tax discount rate used was 10 per cent.

The impairment review indicated that the goodwill and fixed assets of the Short Sea and North Sea routes and Ferrymasters were impaired resulting in an exceptional charge of £146.8m of which £145.7m has been charged to operating profit within the Ferries' exceptional items (see note 2(b)) and £1.1m shown as an amount written off investments.

As a result of the reorganisation arising from the Ferries' fundamental business review, other tangible assets which are no longer required to service the routes have been written down by £36.4m and reorganisation costs of £83.9m are being incurred. The reorganisation costs primarily comprise redundancies, costs relating to the lay up or sub charter of surplus ships and exit from port commitments. These have also been charged to operating profit within the Ferries exceptional items (see note 2(b)).

On 24 January 2005 the Group announced that The HTC Hanseatic Trade Center GmbH & Co. Grundbesitz partnership (''HTC'') has sold the remaining four buildings of its office development in Hamburg to a consortium comprising affiliates of Lehman Brothers Real Estate Partners, L.P., Tishman Speyer Properties and Quantum Immobilien AG. Contracts for the sale have been exchanged with completion expected to take place during the first half of 2005. The total net cash proceeds of sale, of approximately €200m (£140m) after costs, will be used to repay debt in the partnership. The Group holds a 47.5 per cent equity interest in HTC.

When this transaction completes the Group will have exited all of its property interests in Hamburg. Accordingly the Group has conducted an impairment review of its net investment in HTC, which indicated that the net investment in HTC should be written down to the net proceeds from the property sale. An impairment charge of £60.2m has been made of which £31.0m was charged to operating profit within the Property division's exceptional items (see note 2(b)) and £29.2m shown as an amount written off investments.

4 Exceptional items (continued)

Within the Cold Logistics division following a change in approach to supply chain management by certain retailers in Australia, the Group believes it is unlikely that some existing contracts which expire between 2006 and 2008 will be renewed in their current form. The Group considers that the surplus capacity that will result at some sites (IGUs) can be managed effectively, however in light of this anticipated change the carrying value of the relevant facilities has been compared to their respective net recoverable amounts (the higher of value in use to the Group and net realisable value).

The value in use for the affected sites was calculated with reference to the net present value of the future cash flows derived from the use of the site, using cash flows to 31 December 2029. The projections use a steady long term rate of growth which is less than the average long term rate of growth for Australia.

The discount rate applied to these projections was based on the estimated weighted average cost of capital for the division adjusted for the underlying tax. The effective pre-tax discount rate used was 10.8%.

The impairment review indicated that the fixed assets of the affected sites were impaired resulting in an exceptional charge of £10.0m which has been charged to operating profit within the Cold Logistics exceptional items (see note 2(b)).

During the course of the year certain other goodwill and tangible assets, principally within the Ports division, have been impaired totalling £6.5m.

Exceptional income of £10.8m was received in the year by the Australian operation of the Ports division.

Other separately discloseable items consist principally of the loss on sale of P&O Nedlloyd £65.4m (including £44.3m of recycled goodwill), the profit on sale of Australian resorts £25.2m, the profit on sale of La Manga Club £6.8m and losses arising on the sale of certain Irish Sea assets £6.5m.

5 Net interest payable and similar items

	2004 £m	2003 £m
Interest payable and similar items on:		
bank loans and overdrafts	(85.5)	(63.1)
breakage of swap contracts	(1.3)	(3.7)
other loans	(3.5)	(24.6)
debt redemption costs	(1.6)	–
amortisation of debt issue costs	(0.5)	(0.1)
finance leases	(3.7)	(5.8)
	(96.1)	(97.3)
Interest capitalised	5.3	2.6
Gain on refinancing	4.6	–
Interest receivable and similar items	12.0	13.0
	(74.2)	(81.7)
Unwinding of discounts on provisions	(2.7)	(2.5)
	(76.9)	(84.2)
Joint ventures	(8.0)	(17.7)
Associates	(13.2)	(9.4)
	(98.1)	(111.3)

Interest capitalised in the year comprises £1.4m (2003 £1.6m) in respect of ships and other fixed assets and £3.9m (2003 £1.0m) in respect of properties held for development and sale. At the year end the aggregate interest capitalised was £2.0m (2003 £5.8m) on ships and other fixed assets and £8.1m (2003 £7.7m) on properties held for development and sale in the Group, and there is no interest capitalised in the Company.

6 Taxation

(a) Analysis of taxation on (loss)/profit on ordinary activities

	2004 £m	2004 £m	2003 £m	2003 £m
UK corporation tax				
Current tax on income for the period		(18.6)		(6.1)
Adjustment in respect of prior periods		5.3		18.0
		(13.3)		11.9
Double taxation relief		17.1		4.5
		3.8		16.4
Overseas tax				
Current tax on income for the period	(65.5)		(10.0)	
Adjustment in respect of prior periods	39.8		(3.7)	
		(25.7)		(13.7)
Joint ventures and associates		(12.2)		(9.4)
Total current tax		(34.1)		(6.7)
Deferred tax				
Origination/reversal of timing differences	16.0		(24.4)	
Adjustment in respect of prior years	(7.3)		10.3	
		8.7		(14.1)
Tax on (loss)/profit on ordinary activities		(25.4)		(20.8)

The taxation charge is after a taxation credit of £1.5m (2003 £0.1m charge) in respect of exceptional items.

The adjustment in respect of prior periods for overseas tax includes amounts released as a result of the settlement of certain audits in overseas jurisdictions.

(b) Factors affecting the taxation charge for the current period

The current taxation charge is higher (2003 lower) than the (loss)/profit on ordinary activities multiplied by the standard rate of corporation tax in the UK, 30 per cent (2003 30 per cent). The differences are explained below:

	2004 £m	2003 £m
(Loss)/profit on ordinary activities before taxation	(210.0)	80.0
(Loss)/profit on ordinary activities before taxation multiplied by standard rate of corporation tax in the UK of 30 per cent (2003 30 per cent)	63.0	(24.0)
Effects of:		
Profits and losses on sale of fixed assets and businesses not subject to taxation	(22.2)	1.7
UK expenses not deductible and other UK permanent adjustments	(2.8)	(3.9)
Unutilised UK tax losses arising in the year	(6.4)	(9.6)
Timing differences taken up in deferred tax	(16.0)	24.4
Impairments	(89.5)	(4.9)
Write off of investments	(6.5)	–
Tonnage tax in UK Group	(9.6)	(6.5)
Variance from overseas tax rates	(3.7)	(3.4)
Variance on joint ventures and associates	14.5	5.2
Adjustments in respect of prior periods	45.1	14.3
Current taxation charge for the period	(34.1)	(6.7)

The Group's principal shipping businesses and P&O Nedlloyd operate under the UK tonnage tax regime, and comparable overseas tonnage tax regimes, under which the current year tax charge arising is calculated by reference to the net tonnage of the ships operated by the business rather than the tax adjusted profit or loss of the business.

The Group's overseas tax rates are typically a mixture of rates higher and lower than 30 per cent. They include the effect of overseas tonnage tax applicable to shipping operations, and overseas tax benefits available to some infrastructure projects.

The joint ventures and associates tax rates are typically a mixture of rates higher and lower than 30 per cent. They include the effect of P&O Nedlloyd operating under the UK and Dutch tonnage tax regimes, and overseas tax benefits available to some infrastructure projects.

6 Taxation (continued)

(c) Factors which may affect future tax charges

The UK tax losses not utilised can only be carried forward against certain categories of non shipping UK income, including receipt of overseas dividends.

The Group is subject to ongoing routine audits and enquiries from tax authorities around the world. The eventual outcome of these may result in further amounts of tax payable which are greater or less than the related provisions held in the balance sheet.

The UK tonnage tax regime referred to above includes provision whereby a proportion of capital allowances previously claimed by the Group may be subject to tax in the event of a significant number of ships owned at the time the Group entered tonnage tax being sold and not replaced. This contingent liability diminishes to nil over the period to 31 December 2008. At 31 December 2004, the Group's contingent liability in respect of this provision would be £7.4m (2003 £29.5m) on the assumption that all ships and related assets are sold at book value and not replaced.

In accordance with FRS 19, no deferred tax has been recognised on the unremitted earnings of overseas subsidiaries, joint ventures and associates. Also in accordance with FRS 19, no provision has been made for deferred tax on gains and losses recognised on revaluing property. The total amount unprovided in respect of property revaluations is £4.6m (2003 £8.0m).

7 Dividends on equity and non-equity share capital

Dividends paid, proposed and accrued are as follows:	2004 £m	2003 £m
Equity share capital		
Deferred stock		
Interim declared and paid at 3.0p (2003 4.5p)	**(21.9)**	(32.9)
Final proposed at 6.0p (2003 9.0p)	**(44.2)**	(65.8)
	(66.1)	(98.7)
Deferred stock outstanding at the end of the year	**743.6**	737.7
Dividend per £1 nominal of deferred stock	**9.0p**	13.5p
Non-equity share capital	**£m**	£m
Preferred stock	**(0.1)**	(0.1)
5.5% concessionary stock	**(3.7)**	(3.7)
	(3.8)	(3.8)
	(69.9)	(102.5)

8 Profit for the financial year attributable to stockholders

The profit for the financial year of the Company attributable to stockholders, being the profit on ordinary activities after taxation, was £197.5m (2003 £129.9m).

9 Earnings per £1 nominal of deferred stock

The calculations of the basic earnings per £1 nominal of deferred stock are based on the (loss)/profit for the financial year attributable to equity stockholders and the weighted average number of £1 nominal of deferred stock of £731.5m (2003 £706.2m).

	2004 £m	2003 £m
(Loss)/profit for the year attributable to stockholders	**(250.3)**	50.0
Less: dividends on non-equity share capital	**(3.8)**	(3.8)
Basic and diluted (loss)/earnings	**(254.1)**	46.2
Basic (loss)/earnings per £1 nominal of deferred stock	**(34.7)p**	6.5p
Diluted (loss)/earnings per £1 nominal of deferred stock	**(34.7)p**	6.5p
Headline earnings per £1 nominal of deferred stock	**19.4p**	12.4p

The diluted loss per £1 nominal of deferred stock is the same in 2004 as the basic loss per £1 nominal of deferred stock as the issue of additional deferred stock arising on exercise of options would reduce the loss per £1 nominal of deferred stock and therefore these are not dilutive under FRS 14. In 2003, dilution increased the weighted average deferred stock in issue by £3.7m to £709.9m.

9 Earnings per £1 nominal of deferred stock (continued)

Reconciliation of earnings per £1 nominal of deferred stock:

	2004 pence	2003 pence
Headline earnings per £1 nominal of deferred stock	19.4	12.4
Amortisation of goodwill	(2.3)	(2.6)
Exceptional items	(52.0)	(3.3)
Taxation on exceptional items	0.2	–
Basic (loss)/earnings per £1 nominal of deferred stock	(34.7)	6.5

Headline profit is calculated as total operating profit before amortisation of goodwill (including the Group's share of goodwill amortisation within joint ventures and associates) and exceptional items, less net interest payable and similar charges. Headline earnings is calculated as headline profit less taxation (excluding taxation on exceptional items), equity minority interest and non-equity dividends. The directors consider that headline earnings give a useful indication of underlying performance.

10 Goodwill

	£m
Cost at 1 January 2004	274.3
Exchange movements	(7.3)
Disposals	(2.9)
Cost at 31 December 2004	264.1
Amortisation at 1 January 2004	(37.0)
Exchange movements	1.4
Amortisation charge for the year	(14.1)
Impairments (note 4)	(109.8)
Disposals	0.6
Amortisation at 31 December 2004	(158.9)
At 31 December 2004	105.2
At 31 December 2003	237.3

11 Land and buildings

Group	Freehold £m	Leasehold £m	Total £m
Cost or valuation at 1 January 2004	174.5	486.4	660.9
Exchange movements	(6.6)	(11.1)	(17.7)
Additions	11.5	45.9	57.4
Reclassification (to)/from other fixed assets	(2.5)	0.7	(1.8)
Reclassification between categories	(0.1)	0.1	–
Disposals	(12.0)	(14.2)	(26.2)
On disposal of subsidiaries	(98.9)	(37.1)	(136.0)
Cost or valuation at 31 December 2004	65.9	470.7	536.6
Depreciation and amortisation at 1 January 2004	(6.0)	(69.6)	(75.6)
Exchange movements	0.3	1.3	1.6
Depreciation and amortisation charge for the year	(2.7)	(14.3)	(17.0)
Impairments (note 4)	–	(12.2)	(12.2)
Reclassification to/(from) other fixed assets	–	(0.7)	(0.7)
Reclassification between categories	0.1	(0.1)	–
Disposals	0.1	5.6	5.7
On disposal of subsidiaries	5.9	3.3	9.2
Depreciation and amortisation at 31 December 2004	(2.3)	(86.7)	(89.0)
At 31 December 2004	63.6	384.0	447.6
At 31 December 2003	168.5	416.8	585.3

11 Land and buildings (continued)

An analysis of the foregoing at 31 December 2004 is as follows:

	At valuation 2004 £m	At valuation 2003 £m	At valuation 2002 £m	At valuation 2001 £m	At cost £m	Depreciation and amortisation £m	2004 Total £m	2003 Total £m
Freehold	–	2.0	9.3	15.0	39.6	(2.3)	63.6	168.5
Leasehold: 50 years and over	–	–	–	2.4	2.0	(0.1)	4.3	24.0
under 50 years	–	–	47.9	67.8	350.6	(86.6)	379.7	392.8
	–	2.0	57.2	85.2	392.2	(89.0)	447.6	585.3

Company	Freehold £m
Cost at 1 January 2004	0.3
Disposals	(0.3)
Cost at 31 December 2004	–
Cost at 31 December 2003	0.3

(a) The valuations of land and buildings were carried out by external surveyors, normally Cushman & Wakefield Healey & Baker or its affiliates, except in Australia where valuations were carried out by Jones Lang LaSalle Advisory. They were made on the basis of existing use value which is in accordance with the RICS Appraisal and Valuation Manual published by the Royal Institution of Chartered Surveyors, or local equivalent. The directors are not aware of any material changes in the value of land and buildings since the date of the last reported valuation.

(b) Of the land and buildings included at cost over 85 per cent have been acquired by the Group since 1 January 2000.

(c) Included within land and buildings are buildings under construction of £17.5m (2003 £157.4m).

(d) The historical cost of land and buildings is £539.0m (2003 £668.4m) and the accumulated depreciation and amortisation based on the historical cost is £93.7m (2003 £80.6m) in the Group and £nil (2003 £0.3m) and £nil (2003 £nil) in the Company.

12 Ships and other fixed assets

Group	Ships Owned £m	Ships Leased £m	Plant and machinery, fixtures and fittings Owned £m	Plant and machinery, fixtures and fittings Leased £m	Total £m
Cost at 1 January 2004	540.0	140.5	1,029.3	20.7	1,730.5
Exchange movements	(0.4)	(0.8)	(36.8)	(0.9)	(38.9)
On acquisition of subsidiaries and businesses	–	–	0.6	–	0.6
Additions	7.7	1.9	86.5	9.2	105.3
Purchase of leased assets	32.1	(32.1)	8.5	(8.5)	–
Reclassification from/(to) land and buildings	–	–	2.5	(0.7)	1.8
Disposals	(178.7)	(34.0)	(70.6)	(0.8)	(284.1)
On disposal of subsidiaries	(3.8)	–	(39.6)	–	(43.4)
Cost at 31 December 2004	396.9	75.5	980.4	19.0	1,471.8
Depreciation at 1 January 2004	(175.9)	(29.5)	(419.0)	(13.4)	(637.8)
Exchange movements	0.1	0.4	11.7	0.4	12.6
Depreciation charge for the year	(28.6)	(4.2)	(64.4)	(1.0)	(98.2)
Impairments (note 4)	(40.8)	(7.4)	(28.4)	–	(76.6)
Purchase of leased assets	(4.6)	4.6	(7.9)	7.9	–
Reclassification (from)/to land and buildings	–	–	–	0.7	0.7
Disposals	155.8	7.2	46.5	0.8	210.3
On disposal of subsidiaries	1.1	–	19.2	–	20.3
Depreciation at 31 December 2004	(92.9)	(28.9)	(442.3)	(4.6)	(568.7)
At 31 December 2004	304.0	46.6	538.1	14.4	903.1
At 31 December 2003	364.1	111.0	610.3	7.3	1,092.7

Company	Leased ships £m	Owned plant and machinery, fixtures and fittings £m	Total £m
Cost at 1 January 2004	30.7	7.0	37.7
Additions	–	0.2	0.2
Disposals	–	(0.5)	(0.5)
Cost at 31 December 2004	30.7	6.7	37.4
Depreciation at 1 January 2004	(10.7)	(4.5)	(15.2)
Depreciation charge for the year	(1.2)	(0.6)	(1.8)
Disposals	–	0.3	0.3
Depreciation at 31 December 2004	(11.9)	(4.8)	(16.7)
At 31 December 2004	18.8	1.9	20.7
At 31 December 2003	20.0	2.5	22.5

Plant and machinery, fixtures and fittings in the above table includes assets under construction totalling £21.7m (2003 £8.4m) for the Group and £nil (2003 £nil) for the Company.

13 Investment in subsidiaries

	Shares at cost £m	Loans £m	Provisions against shares £m	Provisions against loans £m	Total £m
At 1 January 2004	2,302.7	2,087.4	(186.5)	(220.2)	3,983.4
Exchange movements	–	(25.5)	–	–	(25.5)
Additions/increases	22.9	255.0	(15.8)	(13.6)	248.5
Disposals/decreases	(312.5)	(702.3)	70.3	30.3	(914.2)
At 31 December 2004	2,013.1	1,614.6	(132.0)	(203.5)	3,292.2

The principal subsidiaries are shown on page 87.

14 Joint ventures, associates and other investments

Group	Investment in joint ventures £m	Investment in associates £m	Joint venture and associate loans £m	Other investments £m	Total £m
Cost at 1 January 2004	521.7	118.8	110.0	12.6	763.1
Exchange movements	(23.8)	(16.3)	(0.9)	(0.6)	(41.6)
Additions	11.6	13.3	37.6	2.3	64.8
Transfers between categories	(168.9)	169.8	–	(0.9)	–
Transfer on acquisitions as subsidiaries	(0.6)	–	(31.9)	–	(32.5)
On acquisition of subsidiaries	0.6	–	(1.0)	–	(0.4)
Share of retained profits/(losses) for the year before impairment	(0.8)	50.6	–	–	49.8
Share of impairment	–	(30.4)	–	–	(30.4)
Disposals/repayments	(171.4)	(1.1)	(4.0)	(1.1)	(177.6)
Transfer on sell down to associates	–	–	4.6	–	4.6
Cost at 31 December 2004	168.4	304.7	114.4	12.3	599.8
Provisions at 1 January 2004	–	–	(1.5)	–	(1.5)
Exchange movements	–	–	0.1	–	0.1
Transfers from profit and loss account	–	–	(29.2)	(1.1)	(30.3)
Transfer on acquisitions as subsidiaries	–	–	1.5	–	1.5
Provisions at 31 December 2004	–	–	(29.1)	(1.1)	(30.2)
At 31 December 2004	168.4	304.7	85.3	11.2	569.6
At 31 December 2003	521.7	118.8	108.5	12.6	761.6

Company	Investment in joint ventures £m	Investment in associates £m	Joint venture and associate loans £m	Other investments £m	Total £m
Cost at 1 January 2004	560.7	–	12.5	0.1	573.3
Exchange movements	–	–	0.2	–	0.2
Additions	–	206.9	28.7	–	235.6
Transfer on acquisitions as subsidiaries	(7.3)	–	(31.0)	–	(38.3)
Disposals/repayments	(499.9)	–	–	–	(499.9)
Cost at 31 December 2004	53.5	206.9	10.4	0.1	270.9
Provisions at 1 January 2004	(168.3)	–	–	–	(168.3)
Transfers from profit and loss account	–	–	(10.4)	–	(10.4)
Transfer on acquisitions as subsidiaries	7.3	–	–	–	7.3
Disposals	153.9	–	–	–	153.9
Provisions at 31 December 2004	(7.1)	–	(10.4)	–	(17.5)
At 31 December 2004	46.4	206.9	–	0.1	253.4
At 31 December 2003	392.4	–	12.5	0.1	405.0

14 Other investments (continued)

(a) The Group's loans to joint ventures totalled £43.4m (2003 £44.8m) and to associates totalled £41.9m (2003 £63.7m).

(b) The Group's investment in joint ventures totalled £211.8m (2003 £566.5m). This is made up of fixed assets of £183.7m (2003 £744.7m), current assets of £124.8m (2003 £506.3m), liabilities falling due within one year of £54.4m (2003 £489.2m) and liabilities falling due in more than one year of £42.3m (2003 £195.3m). Fixed assets includes goodwill arising on the Group's acquisition of joint ventures of £12.4m (2003 £10.5m) less accumulated amortisation of £1.2m (2003 £0.4m).

(c) The Group's investment in associates totalled £346.6m (2003 £182.5m). This is made up of fixed assets of £463.0m (2003 £129.8m), current assets of £302.3m (2003 £160.1m), liabilities falling due within one year of £373.7m (2003 £63.1m) and liabilities falling due in more than one year of £45.0m (2003 £44.3m). The Group's share of turnover from associates was £745.2m (2003 £77.9m).

(d) The Group's share of P&O Nedlloyd's turnover was £1,154.3m (2003 £1,685.1m) and P&O Nedlloyd has contributed a profit of £47.6m (2003 £9.4m) to the Group's loss before tax and £3.4m (2003 £4.0m) to the taxation charge, resulting in a total profit of £44.2m (2003 £5.4m) contributed to the Group's retained loss for the year. The Group's investment in P&O Nedlloyd of £210.5m (2003 £345.9m) consists of fixed assets of £290.5m (2003 £525.4m), current assets of £182.6m (2003 £416.7m), liabilities falling due within one year of £200.6m (2003 £398.2m) and liabilities falling due in more than one year of £62.0m (2003 £198.0m).

(e) During the year the Group's trading with joint ventures and associated undertakings included £57.2m received from P&O Nedlloyd. The Group's operating profit also includes £5.5m in respect of management and guarantee fees from joint ventures and associates during the year, in addition to the Group's share of joint venture and associates' results.

(f) The Group's share of the pre-tax results of joint ventures and associates was a profit of £58.7m (2003 £53.7m).

(g) On 16 April 2004 the Group disposed of its 50 per cent stake in P&O Nedlloyd Container Line Limited (''PONL'') for a consideration of €215m cash and a 25 per cent shareholding in Royal Nedlloyd N.V. (renamed Royal P&O Nedlloyd N.V.). The transaction has been accounted for as a disposal of half of the Group's interest in PONL, with the other half being reclassified as an investment in an associate, along with the deemed acquisition of a 25 per cent interest in the other net assets of Royal Nedlloyd N.V. Goodwill previously deducted from other reserves of £44.3m was realised in respect of this transaction, which generated a loss of £65.4m. The cash consideration receivable by the Group is subject to variation in respect of the value of an investment held by Royal P&O Nedlloyd N.V.

(h) The principal joint ventures and associates are shown on page 87. Joint ventures and associates are stated at the Group's share of underlying net assets plus any unamortised goodwill on acquisition, and include the Group's share of the valuation of property. The issued share capital of the principal joint ventures and associates at 31 December 2004 was as follows:

Joint ventures	Number in issue	Nominal value of each class of share capital and issued debt	Percentage held
PT Terminal Petikemas Surabaya	255,768,115	IR 1 ordinary shares	49
Port Newark Container Terminal LLC	–	Limited partnership	50
Portsynergy SAS	1,700,000	€10 ordinary shares	50
Associates			
Antwerp Gateway N.V.	50,000	€10 ordinary shares	42.5
HTC Hanseatic Trade Center GmbH & Co Grundbesitz KG	2,000,000	Limited partnership	47.5
Laem Chabang International Terminal Co Ltd	75,000,000	Bht 10 ordinary shares	34.5
Qingdao Qianwan Container Terminal	–	Equity partnership	29
Royal P&O Nedlloyd N.V.	40,635,752	€1 ordinary shares	25
Shekou Container Terminals Ltd	–	Equity partnership	22
South Asia Gateway Terminals Pte Ltd	378,848,590	Rs10 ordinary shares	16.2
Tilbury Container Services Ltd	51	£1 'P' shares	100
	50	£1 'T' shares	–
	49	£1 'A' shares	–

15 Properties held for development and sale

Group	USA £m	UK £m	Other £m	Total £m
At 1 January 2004	**288.8**	**164.2**	**25.6**	**478.6**
Exchange movements	**(12.7)**	**–**	**(0.2)**	**(12.9)**
On acquisition of subsidiaries and businesses	**–**	**43.7**	**–**	**43.7**
Additions	**13.4**	**82.5**	**0.2**	**96.1**
Disposals	**(160.7)**	**(73.3)**	**(0.1)**	**(234.1)**
Write down	**–**	**(4.6)**	**(5.1)**	**(9.7)**
At 31 December 2004	**128.8**	**212.5**	**20.4**	**361.7**

At 31 December 2004, the revaluation surplus attributable to properties held for development and sale previously classified as investment properties (within land and buildings) was £11.1m (2003 £31.7m).

Properties held for development and sale in the Company were £27.1m (2003 £21.9m).

Costs in respect of the separate London Gateway Port and Business Park proposals total £29.1m (2003 £21.8m). These costs included above are shown within the net operating assets (note 2) respectively of the Ports and Property divisions. The inspector's reports following the public inquiries into the applications to develop the Port and Business Park were submitted to the UK government in February 2004. Decisions are expected in 2005.

16 Stocks

	Group	
	2004 £m	2003 £m
Raw materials and consumables	**16.0**	20.2
Work in progress	**8.1**	19.1
Goods for resale	**19.1**	20.8
	43.2	60.1

17 Debtors

	2004 Falling due		2003 Falling due	
Group	within 1 year £m	in more than 1 year £m	within 1 year £m	in more than 1 year £m
Short term investments	**5.2**	**–**	–	–
Trade debtors	**253.3**	**1.4**	251.5	1.2
Overseas taxation	**0.8**	**–**	–	–
Amounts owed by associates	**0.9**	**–**	–	–
Other debtors	**93.7**	**3.5**	110.2	36.1
Prepayments and accrued income	**66.0**	**2.3**	65.5	2.8
	419.9	**7.2**	427.2	40.1
	427.1		467.3	

	2004 Falling due		2003 Falling due	
Company	within 1 year £m	in more than 1 year £m	within 1 year £m	in more than 1 year £m
Trade debtors	**1.3**	**–**	2.3	–
Amounts owed by joint ventures and subsidiaries	**–**	**–**	47.8	–
Other debtors	**41.6**	**3.4**	47.5	33.6
Prepayments and accrued income	**2.8**	**–**	2.8	–
	45.7	**3.4**	100.4	33.6
	49.1		134.0	

Other debtors include £35.7m (2003 £75.2m) relating to previous corporate disposals, net of provisions, of which £3.4m (2003 £33.6m) falls due in more than 1 year. Included within amounts receivable relating to previous corporate disposals is an amount outstanding of £32.2m (2003 £28.6m) net of relevant provisions arising following the sale of Bovis Group plc in 1999. Further information on this is set out on page 81.

18 Loans

	Group 2004 £m	Group 2003 £m	Company 2004 £m	Company 2003 £m
US dollar bonds and notes 2007 – 2027 (unsecured)	12.0	23.6	12.0	23.6
Term loans: secured	139.4	133.6	–	–
unsecured	850.8	1,259.4	545.4	819.4
Finance leases	52.7	116.5	–	–
Mortgage debenture stocks	1.4	1.4	1.4	1.4
Unsecured loan stock	3.3	3.3	–	–
	1,059.6	1,537.8	558.8	844.4

All the above loans are non-convertible.

Secured loans and other secured creditors are secured on ships, properties and other assets of the Group.

Group loans are denominated in the following currencies:

	Sterling £m	US dollars £m	Australian dollars £m	Euro £m	Indian rupees £m	Other £m	Total £m
At 31 December 2004	398.3	271.5	128.5	11.5	126.1	123.7	1,059.6
At 31 December 2003	572.3	450.5	190.7	67.8	122.2	134.3	1,537.8

An analysis of the maturity and interest rates of Group fixed rate loans is as follows:

The fixed rate bands below include the effect of interest rate swaps with net principal value totalling £496.3m (2003 £652.9m).

	Repayable						
Interest rate	Within one year £m	Between one and two years £m	Between two and five years £m	Between five and ten years £m	Over ten years £m	2004 Total £m	2003 Total £m
6% or less	34.2	54.2	125.5	72.4	2.5	288.8	356.9
Over 6% to 8%	4.7	4.0	296.5	30.7	7.4	343.3	416.7
Over 8%	4.6	9.9	30.1	7.3	2.0	53.9	60.5
At 31 December 2004	43.5	68.1	452.1	110.4	11.9	686.0	
At 31 December 2003	14.6	139.2	529.2	136.4	14.7		834.1

An analysis of the maturity of total Group loans is as follows:

At 31 December 2004	79.7	323.0	568.5	51.4	37.0	1,059.6	
At 31 December 2003	100.8	333.8	966.4	79.0	57.8		1,537.8

In the Company, all the term loans and finance leases totalling £545.4m (2003 £819.4m), are at variable rates of interest. £20.0m (2003 £7.8m) is repayable within one year, £276.1m (2003 £182.4m) in between one and two years, £249.3m (2003 £629.2m) in between two and five years and £nil (2003 £nil) thereafter. The US dollar bonds 2007 – 2027, of which £7.9m (2003 £8.5m) is repayable in 2007, incur fixed rate interest at between 6 and 8 per cent. The Company has £5.5m of loans repayable after more than five years (2003 £16.5m).

18 Loans (continued)

The maturity profile of the Group's financial liabilities, other than short term creditors (such as trade creditors and accruals) and non-equity stockholders' funds, at 31 December 2004 was as follows:

	2004 £m	2003 £m
In one year or less, or on demand	100.5	129.7
In more than one year, but not more than two years	323.0	333.8
In more than two years, but not more than five years	573.5	966.4
In more than five years	88.4	136.8
	1,085.4	1,566.7

The undrawn committed facilities available at 31 December 2004 in respect of which all conditions precedent had been met at that date were as follows:

	2004 £m	2003 £m
Expiring in one year or less	164.0	94.5
Expiring in more than one year, but not more than two years	306.0	130.5
Expiring in more than two years	190.6	228.1
	660.6	453.1

19 Other creditors

	2004 Falling due		2003 Falling due	
Group	within 1 year £m	in more than 1 year £m	within 1 year £m	in more than 1 year £m
Unsecured bank overdrafts	20.8	–	21.3	–
Short term borrowings	–	–	7.6	–
Payments received on account	8.8	–	1.6	–
Trade creditors	127.9	–	141.7	–
Amounts owed to joint ventures and associates	20.0	50.1	11.0	53.1
UK taxation	33.8	–	43.5	–
Overseas taxation	70.3	–	76.3	–
Social security and other taxation	17.8	–	34.9	–
Other creditors: secured	0.3	–	0.1	–
unsecured	65.0	3.3	83.0	0.1
Accruals and deferred income	141.2	1.7	139.0	2.5
Dividends payable	46.0	–	67.7	–
	551.9	55.1	627.7	55.7
	607.0		683.4	

	2004 Falling due		2003 Falling due	
Company	within 1 year £m	in more than 1 year £m	within 1 year £m	in more than 1 year £m
Unsecured bank overdrafts	64.8	–	91.2	–
Payments received on account	–	–	0.4	–
Trade creditors	0.1	–	–	–
Amounts owed to joint ventures and associates	8.7	–	11.0	–
Amounts owed to subsidiaries	5.9	1,137.8	–	1,793.0
Social security and other taxation	3.7	–	2.2	–
Other unsecured creditors	9.5	0.4	35.5	–
Accruals and deferred income	14.3	–	11.7	–
Dividends payable	46.0	–	67.7	–
	153.0	1,138.2	219.7	1,793.0
	1,291.2		2,012.7	

20 Provisions for liabilities and charges

Group	Employee benefits £m	Insurance £m	Deferred taxation £m	Other provisions £m	Total £m
At 1 January 2004	58.5	1.4	70.2	50.1	180.2
Exchange movements	(3.1)	–	(1.7)	(1.1)	(5.9)
Transfers from profit and loss account	30.5	–	27.9	89.4	147.8
Transfers to profit and loss account	–	(0.8)	(36.6)	(0.1)	(37.5)
Transfers to creditors	(0.2)	–	–	(2.2)	(2.4)
On disposal of subsidiaries	(0.8)	–	0.4	–	(0.4)
Applied during the year	(21.6)	–	–	(39.9)	(61.5)
At 31 December 2004	63.3	0.6	60.2	96.2	220.3

Deferred taxation comprises:	2004 £m	2003 £m
Accelerated capital allowances	49.1	45.9
Other	11.1	24.3
	60.2	70.2

Company	Deferred taxation £m	Other provisions £m	Total £m
At 1 January 2004	0.3	9.1	9.4
Transfers from profit and loss account	(0.3)	3.5	3.2
Intra group transfer	–	0.9	0.9
Applied during the year	–	(11.3)	(11.3)
At 31 December 2004	–	2.2	2.2

Deferred taxation comprises:	2004 £m	2003 £m
Accelerated capital allowances	0.1	0.4
Other	(0.1)	(0.1)
	–	0.3

Employee benefits provisions for the Group include provisions for various leave and compensation arrangements of £51.3m (2003 £46.5m) of which approximately £20.0m is expected to be utilised within the next 12 months. The remainder of the provisions will be utilised over the relevant employees' working life.

Other provisions in the Group include £73.5m (2003 £16.3m) relating to reorganisation and restructuring, and a provision for the repayment of state aid following an EC ruling of £4.1m (2003 £4.1m). The majority of the reorganisation and restructuring provisions are expected to be utilised within the next 12 months. Other provisions in the Group include £3.6m (2003 £9.1m) relating to outstanding disputes, warranties and indemnity claims arising on the previous disposal of subsidiaries and termination of businesses. Transfers from the profit and loss account for the year include a charge of £2.7m (2003 £2.5m) for the unwinding of discounts on provisions.

21 Share capital

The authorised share capital is £956.5m (2003 £956.5m) being the allotted capital together with £143.0m (2003 £148.9m) of unclassified stock. The nominal value of each class of stock unit is £1.

The allotted, called up and fully paid share capital is as follows:

	2004 £m	2003 £m
Equity share capital		
Deferred stock	**743.6**	737.7
Non-equity share capital		
Preferred stock	**3.3**	3.3
5.5% concessionary stock	**66.6**	66.6
	69.9	69.9
	813.5	807.6

The rights attached to each class of non-equity share capital at 31 December 2004 are summarised below:

Holders of preferred stock, which ranks before all other stock, receive a fixed cumulative dividend of 5 per cent per annum (net of tax credit). On a liquidation they are entitled to receive, subject to the rights of preferential creditors, a return of capital together with all unpaid dividend arrears and accruals and a premium based upon the average price of the stock in the six months preceding the liquidation. Holders are entitled to one vote for each unit of stock held, both on a show of hands and on a poll.

Holders of the 5.5 per cent concessionary stock, which ranks after the preferred stock, receive a fixed non-cumulative dividend of 5.5 per cent per annum (net of tax credit). Should the directors terminate the concessionary fare scheme, this dividend will be replaced by an annual fixed cumulative dividend equal to or exceeding 5.5 per cent (net of tax credit) so that the market price of the stock at the date of termination is at least 100p per £1 nominal of stock. In such circumstances the stock will be redeemed with a 20p premium within six months of the date of termination. On a liquidation they are entitled to receive, subject to the rights of preferential creditors, all unpaid dividends and the amount paid up on their stock. Holders are entitled to one vote on a show of hands and on a poll to one vote for every £4 nominal of stock held.

The movements in equity share capital in the year were as follows:

	Deferred stock £
At 1 January 2004	**737,682,252**
Exercise of options granted under stock option schemes	**5,875,737**
At 31 December 2004	**743,557,989**

The movements during the year in rights of subscription for, or rights of conversion into, deferred stock were as follows:

	At 1 January 2004 £	Granted £	Lapsed £	Exercised £	At 31 December 2004 £
Executive stock option schemes	**47,620,135**	**17,200**	**(6,690,334)**	**(5,699,900)**	**35,247,101**
1994 Save As You Earn Stock Option Scheme/ 2004 Sharesave Plan	**7,469,270**	**1,487,081**	**(718,218)**	**(175,837)**	**8,062,296**
	55,089,405	**1,504,281**	**(7,408,552)**	**(5,875,737)**	**43,309,397**

The executive stock options are generally exercisable not later than 15 April 2014 at prices between 166p and 266p per £1 nominal of deferred stock.

The Save As You Earn Stock Options and the Sharesave Plan options are exercisable not later than 17 April 2009 at prices between 128p and 205p per £1 nominal of deferred stock.

22 Reserves

Group	Share premium account £m	Revaluation reserve £m	Other reserves £m	Profit and loss account £m	Total £m
At 1 January 2004	778.3	28.9	83.2	(374.9)	515.5
Prior year adjustment (note 1)	–	–	–	(13.0)	(13.0)
	778.3	28.9	83.2	(387.9)	502.5
Exchange movements	–	(1.2)	–	(56.2)	(57.4)
UK taxation on exchange movements on foreign currency net investments	–	–	–	3.5	3.5
Issues of stock	6.7	–	–	–	6.7
Debt redemption costs	(1.6)	–	–	1.6	–
Amortisation of debt issue costs	(0.5)	–	–	0.5	–
Valuation movements on sale of land and buildings and subsidiaries	–	(16.6)	–	16.6	–
Taxation on disposal of previously revalued properties	–	–	–	(5.2)	(5.2)
Purchases of own stock	–	–	–	(14.2)	(14.2)
Other movements in own stock	–	–	–	2.5	2.5
Goodwill on disposals included in loss for the year	–	–	44.6	–	44.6
Retained loss for the financial year	–	–	–	(320.2)	(320.2)
At 31 December 2004	782.9	11.1	127.8	(759.0)	162.8

Company	Share premium account £m	Profit and loss account £m	Total £m
At 1 January 2004	778.3	144.6	922.9
Prior year adjustment	–	(13.0)	(13.0)
	778.3	131.6	909.9
Exchange movements	–	(4.8)	(4.8)
Issues of stock	6.7	–	6.7
Debt redemption costs	(1.6)	1.6	–
Amortisation of debt issue costs	(0.5)	0.5	–
Purchases of own stock	–	(14.2)	(14.2)
Other movements in own stock	–	2.5	2.5
Retained profit for the financial year	–	127.6	127.6
At 31 December 2004	782.9	244.8	1,027.7

At 31 December 2004 cumulative goodwill deducted from other reserves was £407.3m (2003 £451.9m). This relates to goodwill in respect of acquisitions prior to 1 January 1998 when Financial Reporting Standard 10 ''Goodwill and intangible assets'' was adopted and is stated after writing back through the profit and loss account the goodwill relating to subsequent disposals.

The P&O Group Employee Benefit Trust (the ''Trust'') is used in connection with the Group's Deferred Bonus and Co-investment Matching Plan (the ''Matching Plan''), the terms of which are set out in the directors' remuneration report on pages 37 to 45. The Trust may also be used in connection with the Group's other share based plans, including the Executive Stock Option Plan and the proposed new plans referred to on page 39. The Trustee of the Trust purchases the Company's stock in the open market, as required, on the basis of regular reviews of the anticipated liabilities of the Group, with financing provided by the Company. All expenses of the Trust are settled directly by the Company and charged in the financial statements as incurred.

The profit and loss account reserves for the Group and the Company are stated after the deduction of £24.7m (2003 £13.0m) in respect of £11,435,110 nominal of deferred stock of the Company (2003 £6,645,191 nominal) held by the Trust (excluding awards which have vested unconditionally), of which £402,032 nominal (2003 £257,164 nominal) has been conditionally awarded to participants in the Matching Plan. Further Matching Awards over £2,132,996 nominal (2003 £1,761,752 nominal) have been granted to participants under the Matching Plan, which will be met by the Trust to the extent that the performance conditions are met. The market value of the deferred stock held by the Trust as at 31 December 2004 was £34.0m.

Exchange movements in the Group profit and loss account reserve include a profit of £42.7m (2003 £40.8m) in respect of foreign currency net borrowings.

Non-equity stockholders' funds in the Group and Company comprise:	2004 £m	2003 £m
Preferred stock	3.3	3.3
5.5% concessionary stock	66.6	66.6
	69.9	69.9

23 Equity minority interests

	Group	
	£m	£m
At 1 January 2004		35.4
Exchange movements		(1.9)
Proportion of profit on ordinary activities after taxation	14.9	
less proportion of minority profits on ordinary activities after taxation from joint ventures and associates	(0.8)	
		14.1
Changes in composition and dividends		(2.5)
At 31 December 2004		45.1

24 Employees

The average number of people employed by the Group was:

	2004	2003
UK full time	2,899	3,231
UK part time	204	289
Overseas full time	12,018	12,084
Overseas part time	2,883	3,272
Sea staff	4,034	4,452
	22,038	23,328

The aggregate payroll costs, excluding directors' emoluments, were:	2004 £m	2003 £m
Wages and salaries	449.8	428.6
Social security costs	14.5	14.5
Pension charge	43.7	41.5
	508.0	484.6

Certain comparatives have been adjusted to make them consistent with current year classifications.

25 Pensions

The Group operates a number of pension schemes throughout the world. The principal scheme, The P&O Pension Scheme (the ''P&O UK Scheme''), is located in the UK and is a funded defined benefit scheme which was closed to routine new members on 1 January 2002. The assets of the scheme are managed on behalf of the trustee by independent fund managers.

The Group also operates a number of smaller defined benefit and defined contribution schemes and makes contributions to various industry schemes. These generally have assets held in separate trustee administered funds.

SSAP 24 ''Accounting for pension costs''

The pension charge for the year was:

	2004 £m	2003 £m
The P&O UK Scheme	15.2	14.9
Merchant navy pension schemes	8.2	6.2
Other defined benefit schemes	7.3	7.1
Defined contribution schemes	8.6	8.1
Other industry schemes	4.7	5.5
	44.0	41.8

In addition to the above a total of £0.5m (2003 £2.6m) has been charged in respect of ill health, early retirement and other pension augmentations.

For the principal scheme and certain other material schemes the pension charge for the year has been based on valuations in accordance with SSAP 24. Differences between the amounts charged and the amounts paid are included within prepayments or creditors as appropriate. As at 31 December 2004, the total prepayments amounted to £10.1m (2003 £2.8m) and total creditors amounted to £2.6m (2003 £6.5m), giving a net pension asset in the balance sheet of £7.5m (2003 net liability of £3.7m).

A summary of the main financial assumptions for the P&O UK Scheme for SSAP 24 purposes for 2004 is set out below:

	%
Discount rate	6.5
Rate of increase in salaries	4.2
Rate of increase in pensions	2.5
Inflation rate	2.7

Under these assumptions there is a deficit in the P&O UK Scheme which has resulted in a pension variation charge for the Group, excluding the Group's share of P&O Nedlloyd, of £7.3m.

25 Pensions (continued)

FRS 17 ''Retirement benefits''

For the purposes of the accounting disclosure requirements of FRS 17, the latest valuation of the P&O UK Scheme and those of other material defined benefit schemes have been updated to 31 December 2004 by qualified independent actuaries.

The principal assumptions are included in the table below. The less material defined benefit schemes have been aggregated and the assumptions are given in the form of weighted averages. These other schemes are principally in the UK, Australia, the USA and the Netherlands.

The assumptions used by the actuaries are the best estimates chosen from a range of possible actuarial assumptions, which, due to the timescale covered, may not necessarily be borne out in practice.

	The P&O UK Scheme			Other schemes		
	2004 %	2003 %	2002 %	2004 %	2003 %	2002 %
Discount rate applied to scheme liabilities	**5.3**	5.4	5.8	**5.6**	6.0	6.2
Rate of increase in salaries	**4.2**	4.2	3.8	**3.6**	4.0	3.8
Rate of increase in pensions	**2.5**	2.5	2.3	**2.7**	2.7	2.5
Inflation rate	**2.7**	2.7	2.3	**2.7**	2.9	2.7

Following the latest triennial valuation of the P&O UK Scheme, deficit payments were individually attributed by the trustee to all current contributing companies, including an allocation of 38.5 per cent to the Group's associate P&O Nedlloyd. As a result, for the purposes of the FRS 17 disclosure, the underlying assets and liabilities of the P&O UK Scheme were adjusted to reflect this allocation from 1 January 2003. This gives a net pension liability under FRS 17 that is consistent and reasonable with reference to the companies' deficit contributions. It should be noted that, if P&O Nedlloyd is not able to make payments due from it to the P&O UK Scheme, the trustee may seek additional payments from Group companies to make good the shortfall, thereby allocating more of the scheme's assets and liabilities back to the Group.

Subsequent to the year end, P&O Nedlloyd has formed its own UK scheme and 25 per cent of the assets and liabilities of the P&O UK Scheme are in the process of being transferred into the P&O Nedlloyd scheme. In addition, P&O Nedlloyd is making an exit payment of £70.0m into the remaining P&O UK Scheme. As a result of this transfer and the exit payment, on a pro forma basis (using 31 December 2004 data), the Group's share of the FRS 17 deficit in the P&O UK Scheme has reduced to £199.9m compared to £221.3m, as set out in the table below. Group cash deficit payments into the P&O UK Scheme will be increased to approximately £30.0m a year, from £12.5m, but there is no effect on the profit and loss account.

The allocation of the P&O UK Scheme deficit payments has principally been to shipping companies within the UK tonnage tax regime. These companies benefit from operating in the tonnage tax regime, and so will not receive tax relief for the payments and hence a related deferred tax asset is not recognised in respect of the FRS 17 deficit arising on the scheme.

The market value of the schemes' assets, which are not intended to be realised in the short term and may be subject to significant change before they are realised, and the present value of the schemes' liabilities, which are derived from cash flow projections over long periods and thus inherently uncertain are set out below:

	The P&O UK Scheme		Other schemes				
	Expected long term rate of return %	Market value £m	Expected long term rate of return %	Market value £m	Total Group schemes market value £m	Share of P&O Nedlloyd schemes market value £m	Total market value £m
2004							
Equities	**8.0**	**347.5**	**8.1**	**62.8**	**410.3**	**54.4**	**464.7**
Bonds	**4.7**	**393.8**	**4.7**	**39.6**	**433.4**	**61.6**	**495.0**
Other	**3.7**	**26.0**	**5.2**	**8.0**	**34.0**	**4.1**	**38.1**
	6.2	**767.3**	**6.6**	**110.4**	**877.7**	**120.1**	**997.8**
Present value of scheme liabilities		**(988.6)**		**(131.5)**	**(1,120.1)**	**(154.7)**	**(1,274.8)**
Deficit		**(221.3)**		**(21.1)**	**(242.4)**	**(34.6)**	**(277.0)**
Related deferred tax asset		**–**		**3.4**	**3.4**	**–**	**3.4**
Net pension liability		**(221.3)**		**(17.7)**	**(239.0)**	**(34.6)**	**(273.6)**
2003							
Equities	8.3	389.4	8.1	57.5	446.9	121.9	568.8
Bonds	5.0	301.2	5.0	37.3	338.5	94.3	432.8
Other	3.7	12.2	5.6	5.4	17.6	3.8	21.4
	6.8	702.8	6.8	100.2	803.0	220.0	1,023.0
Present value of scheme liabilities		(899.9)		(122.9)	(1,022.8)	(281.7)	(1,304.5)
Deficit		(197.1)		(22.7)	(219.8)	(61.7)	(281.5)
Related deferred tax asset		–		3.7	3.7	–	3.7
Net pension liability		(197.1)		(19.0)	(216.1)	(61.7)	(277.8)

25 Pensions (continued)

	The P&O UK Scheme Expected long term rate of return %	The P&O UK Scheme Market value £m	Other schemes Expected long term rate of return %	Other schemes Market value £m	Total Group schemes market value £m	Share of P&O Nedlloyd schemes market value £m	Total market value £m
2002							
Equities	8.4	568.6	8.1	43.1	611.7	–	611.7
Bonds	4.7	453.5	4.9	35.7	489.2	–	489.2
Other	3.8	12.3	5.9	5.5	17.8	–	17.8
	6.7	1,034.4	6.6	84.3	1,118.7	–	1,118.7
Present value of scheme liabilities		(1,286.0)		(105.6)	(1,391.6)	–	(1,391.6)
Deficit		(251.6)		(21.3)	(272.9)	–	(272.9)
Related deferred tax asset		62.9		5.4	68.3	–	68.3
Net pension liability		(188.7)		(15.9)	(204.6)	–	(204.6)
2001							
Equities	7.9	707.0	7.6	67.1	774.1	–	774.1
Bonds	5.2	478.0	5.4	50.7	528.7	–	528.7
Other	4.6	13.0	6.4	10.4	23.4	–	23.4
	6.8	1,198.0	6.6	128.2	1,326.2	–	1,326.2
Present value of scheme liabilities		(1,308.0)		(138.1)	(1,446.1)	–	(1,446.1)
Deficit		(110.0)		(9.9)	(119.9)	–	(119.9)
Related deferred tax asset		33.0		2.9	35.9	–	35.9
Net pension liability		(77.0)		(7.0)	(84.0)	–	(84.0)

If FRS 17 had been fully adopted in these accounts the pension costs for defined benefit schemes would have been as follows:

	The P&O UK Scheme £m	Other schemes £m	Total Group schemes £m	Share of P&O Nedlloyd schemes £m	Total £m
2004					
Operating profit					
Current service cost	(10.5)	(6.1)	(16.6)	(2.1)	(18.7)
Past service cost	(0.4)	(0.3)	(0.7)	(0.1)	(0.8)
Net gain on settlement and curtailments	2.6	0.3	2.9	0.4	3.3
Total charge to operating profit	(8.3)	(6.1)	(14.4)	(1.8)	(16.2)
Other finance income/(expense)					
Expected return on pension scheme assets	47.4	6.4	53.8	9.6	63.4
Interest on pension scheme liabilities	(47.4)	(6.6)	(54.0)	(9.6)	(63.6)
Net return	–	(0.2)	(0.2)	–	(0.2)
Group statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	28.9	3.2	32.1	4.9	37.0
Experience gains and losses on pension scheme liabilities	0.8	(1.5)	(0.7)	0.1	(0.6)
Changes in assumptions underlying the present value of scheme liabilities	(75.3)	(1.9)	(77.2)	(10.1)	(87.3)
Actuarial loss recognised in statement of total recognised gains and losses	(45.6)	(0.2)	(45.8)	(5.1)	(50.9)
Exchange movement	–	0.1	0.1	–	0.1

25 Pensions (continued)

	The P&O UK Scheme £m	Other schemes £m	Total Group schemes £m	Share of P&O Nedlloyd schemes £m	Total £m
2003					
Operating profit					
Current service cost	(9.8)	(6.1)	(15.9)	(3.1)	(19.0)
Past service cost	(2.1)	(0.8)	(2.9)	(0.7)	(3.6)
Net gain on settlement and curtailments	–	0.4	0.4	–	0.4
Total charge to operating profit	(11.9)	(6.5)	(18.4)	(3.8)	(22.2)
Other finance income/(expense)					
Expected return on pension scheme assets	41.9	5.6	47.5	13.1	60.6
Interest on pension scheme liabilities	(44.3)	(6.3)	(50.6)	(13.9)	(64.5)
Net return	(2.4)	(0.7)	(3.1)	(0.8)	(3.9)
Group statement of total recognised gains and losses					
Actual return less expected return on pension scheme assets	49.6	5.7	55.3	15.5	70.8
Experience gains and losses on pension scheme liabilities	2.2	(0.9)	1.3	0.7	2.0
Changes in assumptions underlying the present value of scheme liabilities	(91.4)	(8.2)	(99.6)	(28.6)	(128.2)
Actuarial loss recognised in statement of total recognised gains and losses	(39.6)	(3.4)	(43.0)	(12.4)	(55.4)
Exchange movement	–	0.1	0.1	–	0.1

As the P&O UK Scheme is closed to routine new entrants, under the Projected Unit valuation method, the current service cost as a percentage of relevant defined benefit pensionable payroll will increase as the members of the scheme approach retirement.

	The P&O UK Scheme %	Other schemes %
2004		
Difference between the expected and actual return on scheme assets, expressed as a percentage of the scheme assets	**3.8**	**2.9**
Experience gains and losses on pension scheme liabilities expressed as a percentage of the present value of the scheme liabilities	**0.1**	**(1.1)**
Total actuarial loss recognised in the consolidated statement of total recognised gains and losses expressed as a percentage of the present value of the scheme liabilities	**(4.6)**	**(0.2)**
2003		
Difference between the expected and actual return on scheme assets, expressed as a percentage of the scheme assets	7.1	5.7
Experience gains and losses on pension scheme liabilities expressed as a percentage of the present value of the scheme liabilities	0.2	(0.7)
Total actuarial loss recognised in the consolidated statement of total recognised gains and losses expressed as a percentage of the present value of the scheme liabilities	(4.4)	(2.8)

If FRS 17 had been adopted in these accounts, the Group's net assets and profit and loss reserve at 31 December 2004 would have been as follows:

	2004 £m	2003 £m
Group net assets		
Net assets per consolidated balance sheet	**1,021.4**	1,358.5
Reversal of SSAP 24 (prepayments)/liabilities	**(11.2)**	8.1
Net pension liabilities under FRS 17 (net of deferred tax)	**(273.6)**	(277.8)
Group net assets including pension liabilities under FRS 17	**736.6**	1,088.8
Group profit and loss reserve		
Group profit and loss account reserve per consolidated balance sheet	**(759.0)**	(374.9)
Reversal of SSAP 24 (prepayments)/liabilities	**(11.2)**	8.1
Pension reserve	**(273.6)**	(277.8)
Group profit and loss reserve including pension liabilities under FRS 17	**(1,043.8)**	(644.6)

25 Pensions (continued)

Movement in deficit during the two years ended 31 December 2004	The P&O UK Scheme £m	Other schemes £m	Total Group schemes £m	Share of P&O Nedlloyd schemes £m	Total £m
Deficit in schemes at 1 January 2003	(154.7)	(21.3)	(176.0)	(48.4)	(224.4)
Current service cost	(9.8)	(6.1)	(15.9)	(3.1)	(19.0)
Contributions paid	11.5	9.1	20.6	3.7	24.3
Past service cost	(2.1)	(0.8)	(2.9)	(0.7)	(3.6)
Net gain on settlements and curtailments	–	0.4	0.4	–	0.4
Other finance expense	(2.4)	(0.7)	(3.1)	(0.8)	(3.9)
Actuarial loss	(39.6)	(3.4)	(43.0)	(12.4)	(55.4)
Exchange	–	0.1	0.1	–	0.1
Deficit in schemes at 31 December 2003	(197.1)	(22.7)	(219.8)	(61.7)	(281.5)
Disposals	–	–	–	27.0	27.0
Current service cost	(10.5)	(6.1)	(16.6)	(2.1)	(18.7)
Contributions paid	29.7	8.0	37.7	7.0	44.7
Past service cost	(0.4)	(0.3)	(0.7)	(0.1)	(0.8)
Net gain on settlements and curtailments	2.6	0.3	2.9	0.4	3.3
Other finance expense	–	(0.2)	(0.2)	–	(0.2)
Actuarial loss	(45.6)	(0.2)	(45.8)	(5.1)	(50.9)
Exchange	–	0.1	0.1	–	0.1
Deficit in schemes at 31 December 2004	(221.3)	(21.1)	(242.4)	(34.6)	(277.0)

The deficit shown in the table above excludes certain defined benefit industry schemes, that the Group is treating as if they were defined contribution schemes. As set out on page 75, from 2003 the Group's share of the deficit on the P&O UK Scheme excludes those assets and liabilities attributed to its associated company P&O Nedlloyd.

The movement on disposals represents 25 per cent of the P&O UK Scheme deficit attributable to P&O Nedlloyd at the date of the P&O Nedlloyd transaction described in note 14(g).

The Group provides defined contribution (401k) plans for its US employees and some post-retirement healthcare benefit plans, principally in the US. The cost of these post-retirement healthcare benefit plans is not considered material to these accounts.

P&O UK Scheme actuarial valuation for funding purposes

Formal actuarial valuations of 100 per cent of the P&O UK Scheme are carried out triennially by qualified independent actuaries, the latest valuation report for the scheme being at 1 April 2003, using the Projected Unit valuation method.

At this date the market value of the P&O UK Scheme's assets was £996m and the value of accrued benefits to members allowing for future increases in earnings was £1,154m giving a deficit of £158m and a funding ratio of 86.3 per cent.

The principal long term assumptions in the P&O UK Scheme's 2003 valuation were:

	Nominal % per annum
Price inflation	3.00
Investment return on existing assets	7.10
Investment return on future contributions	6.60
Earnings escalation	4.50
LEL escalation	3.00
Increases in pensions in excess of Guaranteed Minimum Pensions	2.75

As a result of this valuation the Group and P&O Nedlloyd are making additional cash contributions of £12.5m per annum and £7.5m per annum respectively, which were scheduled to continue until 31 March 2015 but with a review of the level of these contributions to be undertaken at the next funding valuation. An initial nine month catch up payment of £15m was made in January 2004 by the Group and P&O Nedlloyd, with monthly payments totalling £1.7m thereafter.

The establishment of the new P&O Nedlloyd Scheme led to the funding valuation being brought forward and it will be finalised during 2005. The deficit payments will be increased from 2005 as described on page 75.

Excluding the deficit reduction payments described above, the future service contribution rate for the P&O UK Scheme was an average of 19.3 per cent from 1 January 2004.

Industry schemes

The Merchant Navy Ratings' Pension Fund (''MNRPF'') and the Merchant Navy Officers' Pension Fund (''MNOPF'') are industry wide defined benefit pension schemes.

The MNRPF is a defined benefit multi-employer scheme in which sea staff employed by companies within the Group have participated. The scheme has a funding deficit and has been closed to further benefit accrual.

25 Pensions (continued)

As at 31 March 2002, the date of the most recent full triennial actuarial valuation carried out by an independent actuary, the scheme had assets with a market value of £506m, representing 84 per cent of the benefits accrued to members allowing for future increases. The scheme had however exceeded its minimum funding requirement at that date. Approximately 66 per cent of the scheme's assets were invested in bonds, 23 per cent in equities and 11 per cent in property and cash. The valuation assumptions were as follows:

	%
Discount rate	**5.8**
Rate of salary increases	**4.0**
Rate of pension increases (where increases apply)	**2.5**
Expected return on assets	**5.8**

As a result of this valuation a revised fixed schedule of payments has been drawn up which remains in place until 31 March 2007. Companies within the Group, along with other employers, are making these payments into the scheme under a non-binding Memorandum of Understanding to reduce the deficit. The Group is making contributions in respect of subsidiaries that are current employers in the scheme and in respect of subsidiaries that have settled the relevant statutory debt obligations and are no longer current employers within the scheme. Current contributions and voluntary payments by the Group to the scheme in 2004 totalled £5.6m, which included amounts previously provided for. These payments are included within the merchant navy pension schemes charge on page 74.

P&O has appointed an independent actuary to estimate the deficit of the MNRPF as at 31 December 2004 using the same assumptions as applied for the FRS 17 valuation of the P&O UK Scheme as set out above. Based on the share of current contributions to the scheme by P&O's Group companies, the Group's share of the estimated deficit could be between £5m and £10m.

The Group cannot identify its share of the underlying assets and liabilities of the MNRPF on a consistent and reasonable basis and is therefore accounting for the MNRPF under both SSAP 24 and FRS 17 as if it were a defined contribution scheme.

The MNOPF is a defined benefit multi-employer scheme in which officers employed by companies within the Group have participated and continue to participate.

The scheme is divided into two sections, the Old Section and the New Section both of which are closed to new members and the latest valuation was carried out at 31 March 2003.

The Old Section has been closed to benefit accrual since 1978. The scheme's independent actuary advised that at 31 March 2003 the market value of the scheme's assets for the Old Section was £1,316m, representing approximately 115 per cent of the value of the benefits accrued to members on the valuation basis. The assets of the Old Section were substantially invested in bonds.

As at 31 March 2003, the date of the most recent formal actuarial valuation, the New Section had assets with a market value of £1,168m, representing approximately 86 per cent of the benefits accrued to members. The valuation assumptions were as follows:

	%
Discount rate	**7.8**
Rate of salary increases	**4.0**
Rate of pension increases (where increases apply)	**2.5**
Expected return on assets	**7.8**

At the date of the valuation, approximately 59 per cent of the New Section's assets were invested in equities, 28 per cent in bonds and 13 per cent in property and cash.

It is unclear how the deficit will be allocated between employers and there is currently a court case in progress to establish the principles for such allocation.

For FRS 17 purposes although the employers' contributions to the MNOPF would be affected by a surplus or deficit in the scheme, the Group is unable to identify its share of the underlying assets and liabilities on a consistent and reasonable basis. The Group is therefore accounting for contributions to the MNOPF as if it were a defined contribution scheme.

Based on information provided by the Trustee, P&O's share of the deficit payments could be 18 per cent or 4 per cent, depending on the outcome of the court case, with these figures potentially increasing if payments from other employers are not forthcoming. P&O has appointed an independent actuary to estimate the deficit of the MNOPF New Section at 31 December 2004 using the same assumptions as applied for the FRS 17 valuation of the P&O UK Scheme as set out above. P&O's share of the deficit under FRS 17 is estimated at either £125m for an 18 per cent share or £30m for a 4 per cent share.

Other industry schemes are mainly overseas multi-employer schemes, in which the Group is unable to identify its share of the underlying assets and liabilities on a consistent and reasonable basis. The Group is therefore accounting for contributions to these schemes as if they were defined contribution schemes for FRS 17 purposes.

25 Pensions (continued)

Company

The Company is a participating employer in the P&O UK Scheme. Applying the assumptions for FRS 17 set out in the tables above, its share of the scheme's liabilities is £294.2m (2003 £267.8m) and its share of the scheme's assets is £228.6m (2003 £209.1m), resulting in a net deficit of £65.6m (2003 £58.7m). This amount would be deducted from the Company reserves under FRS 17.

26 Directors' emoluments

The aggregate emoluments of the directors of the Company were:	2004 £000	2003 £000
Fees	**149**	116
Salaries and benefits	**2,264**	2,756
Performance related bonuses	**1,078**	564
	3,491	3,436

Further details on directors' emoluments, long term incentives, pension entitlements and deferred stock under option held by the directors are shown in the directors' remuneration report on pages 37 to 45.

27 Commitments

	Group	
Capital Contracted	2004 £m	2003 £m
Ships	**2.7**	3.6
Land and buildings	**13.6**	19.0
Other	**45.6**	33.2
	61.9	55.8

Of the above capital commitments it is expected that the Group will pay £61.3m in 2005. The Group's share of capital commitments within its joint ventures and associates is £109.3m (2003 £51.2m). There were no commitments at 31 December 2004 in the Company (2003 £nil).

Revenue

The commitment of the Group during the following year in respect of non-cancellable operating leases is as follows:

	Property		Other	
Lease expiring:	2004 £m	2003 £m	2004 £m	2003 £m
Within one year	**7.1**	4.3	**10.6**	8.6
Between one and five years	**14.1**	17.6	**52.6**	67.4
Over five years	**49.3**	39.2	**16.0**	12.9
	70.5	61.1	**79.2**	88.9

28 Contingent liabilities

	Group		Company	
	2004 £m	2003 £m	2004 £m	2003 £m
Loan and lease guarantees on behalf of joint ventures and associates				
Ports	**37.6**	40.2	**–**	–
Property	**3.6**	250.2	**3.6**	250.2
	41.2	290.4	**3.6**	250.2
Loan and lease guarantees on behalf of subsidiaries	**–**	–	**471.6**	586.0
Other contingent liabilities	**103.8**	104.0	**78.7**	97.9
	145.0	394.4	**553.9**	934.1

Other contingent liabilities in the Group and the Company include £78.7m (2003 £97.9m) relating to guarantees of the financial liabilities of previous associates of the Group. The other contingent liabilities in 2004 relate to the present value of total commitments of Associated Bulk Carriers Limited and its subsidiary for seven leased/chartered vessels. The leases/charters expire between 2008 and 2011. Associated Bulk Carriers Limited was sold to Eurotower Holdings SA in December 2003 and as part of the transaction, P&O received a counter indemnity for these liabilities from First Omega Shipping Inc, the owner of Eurotower and a significant number of other shipping interests.

28 Contingent liabilities (continued)

On 3 September 2003, the Company announced that the European Commission had commenced an investigation concerning possible infringements of European Community competition law in connection with the provision of passenger and/or freight transport services (excluding by air) between the United Kingdom, Ireland and Continental Europe. The Company is one of the companies that has been visited by the European Commission in connection with the investigation. The European Commission can fine companies and infringements can give rise to civil liability claims. However, no specific allegations have been made about the Company to date and no formal communication has been received from the European Commission on the matter since 17 March 2004. In any event, the Company would defend its position strongly were that ever to be necessary.

Included within amounts receivable relating to previous corporate disposals is an amount outstanding of £32.2m net of relevant provisions arising following the sale of Bovis Group plc in 1999. Pursuant to the sale terms P&O is obliged to provide loan funding and partial indemnification for one of Bovis' projects, the construction of which is now completed and is the subject of litigation. Bovis has been awarded damages against the client and the client's material counter claims (including speculative claims for lost profits) have been dismissed in the principal proceedings. These are now subject to appeal. Other related litigation continues including counter claims for consequential losses. The prior dismissal of similar claims has resulted in opinions by outside counsel that these claims do not represent a material risk.

29 Notes to the Group cash flow statement

(a) Reconciliation of operating profit to net cash inflow from operating activities	2004 £m	2003 £m
Group operating (loss)/profit	(114.0)	98.9
Depreciation, amortisation and impairment charge	327.9	155.8
Decrease/(increase) in properties held for development and sale	145.7	(23.1)
Decrease/(increase) in stocks	11.1	(0.9)
(Increase)/decrease in debtors	(4.3)	37.5
Increase/(decrease) in creditors and provisions	50.6	(20.4)
Net cash inflow from operating activities	417.0	247.8

(b) Reconciliation of net cash flow to movement in net debt	2004 £m	2003 £m
Decrease in cash in the period	(14.0)	(5.9)
Cash outflow/(inflow) from changes in loans and lease financing	453.4	(171.1)
Cash outflow/(inflow) from changes in short term borrowings	7.1	(7.4)
Changes in net debt resulting from cash flows	446.5	(184.4)
Borrowings of subsidiaries acquired	(17.0)	(2.7)
Borrowings of subsidiaries sold	6.1	–
Curtailment of finance leases	3.7	–
Inception of finance leases	(8.4)	(9.5)
Amortisation of bond issue costs	(0.5)	(0.1)
Exchange movements in net debt	42.7	40.8
Movement in net debt in the year	473.1	(155.9)
Net debt at the beginning of the year	(1,502.7)	(1,346.8)
Net debt at the end of the year	(1,029.6)	(1,502.7)

(c) Analysis of net debt	At 1 January 2004 £m	Cash flow £m	Purchase of subsidiaries £m	Sale of subsidiaries £m	Other non-cash movements £m	Exchange movements £m	At 31 December 2004 £m
Cash available on demand	64.0	(15.8)				2.6	50.8
Overdrafts	(21.3)	1.8				(1.3)	(20.8)
		(14.0)					
Loans due after one year	(1,332.1)	354.5	–	6.1	(2.1)	37.1	(936.5)
Loans due within one year	(89.2)	68.3	–	–	(53.3)	3.8	(70.4)
Finance leases due after one year	(104.9)	20.6	(16.5)	–	57.3	0.1	(43.4)
Finance leases due within one year	(11.6)	10.0	(0.5)	–	(7.1)	(0.1)	(9.3)
		453.4					
Short term borrowings	(7.6)	7.1	–	–	–	0.5	–
Total	(1,502.7)	446.5	(17.0)	6.1	(5.2)	42.7	(1,029.6)

In these accounts net debt equates to net borrowings, which comprise loans, finance leases, short term borrowings and overdrafts less cash.

29 Notes to the Group cash flow statement (continued)

(d) Purchase of subsidiaries and businesses	Fair value balance sheets 2004 £m	Fair value balance sheets 2003 £m
Net assets acquired:		
Fixed assets	0.2	168.5
Properties held for development and sale	43.7	12.0
Other net current assets	4.1	0.5
Loans	(17.0)	(2.7)
Cash and overdrafts	2.3	1.4
Minority interests	(0.1)	2.1
	33.2	181.8
Goodwill	–	10.8
	33.2	192.6
Satisfied by:		
Cash	0.7	181.1
Investments already owned	32.5	11.5
	33.2	192.6

The cash inflow of £1.6m (2003 outflow £185.1m) on the purchase of subsidiaries and businesses comprises the cash consideration of £0.7m (2003 £181.1m), less net cash of £2.3m (2003 £1.4m) of the subsidiaries at the dates of acquisition, plus payments totalling £nil (2003 £5.4m) made in 2004 relating to companies purchased in prior years. The investments already owned of £32.5m (2003 £11.5m) represent the reserves of and loans to joint ventures and associates now consolidated as subsidiaries. There were no fair value adjustments in respect of the above acquired subsidiaries and businesses.

The subsidiaries acquired during the year included above had no material effect on the Group's cash flows.

(e) Sale of subsidiaries and termination of businesses	Australian resorts 2004 £m	La Manga Club 2004 £m	Other subsidiaries 2004 £m	Disposal balance sheets 2004 £m	Disposal balance sheets 2003 £m
Net assets sold:					
Fixed assets	51.4	83.0	17.8	152.2	1.1
Other net current assets/(liabilities)	0.1	4.2	(7.5)	(3.2)	7.4
Loans	–	–	(6.1)	(6.1)	–
Cash and overdrafts	1.8	1.2	1.8	4.8	–
Corporate taxation	0.7	(2.9)	(0.1)	(2.3)	–
Provisions	(0.5)	–	0.1	(0.4)	–
Minority interests	–	–	2.0	2.0	(1.1)
Less: investment in joint ventures and associates retained	–	–	(4.6)	(4.6)	–
	53.5	85.5	3.4	142.4	7.4
Goodwill realised on disposal				0.3	–
Profit/(loss) on sale and termination of businesses				28.3	(22.0)
				171.0	(14.6)
Satisfied by:					
Net cash consideration				191.3	(7.0)
Deferred consideration				(20.0)	(3.8)
Accrued costs				(0.3)	(3.8)
				171.0	(14.6)

The cash inflow of £186.5m on the sale of subsidiaries and termination of businesses comprises cash received of £191.3m less net cash of £4.8m of the subsidiaries at the dates of disposal. In 2003 the cash outflow of £7.0m on the sale of subsidiaries and termination of businesses comprised the net cash paid in disposal costs of £7.0m.

The material subsidiaries disposed of during the year contributed £11.5m to the Group's net operating cash flows, paid £4.1m in respect of net returns on investments and servicing of finance, received £0.2m in respect of taxation and utilised £10.6m of capital expenditure.

30 Financial instruments

This note contains disclosures as required under Financial Reporting Standard 13 ''Derivatives and other financial instruments: disclosures''. The Group's policies and procedures in relation to the role and management of financial instruments and financial risk are set out in the Group financial review on pages 18 to 21. For the purpose of this note, other than currency disclosures, the only debtors and creditors included are deferred consideration receivable in more than one year, totalling £7.2m (2003 £33.6m), deferred consideration payable in more than one year, totalling £5.0m (2003 £2.5m), other interest bearing balances of £nil (2003 £0.1m) included within creditors falling due in more than one year, and all loans, bank overdrafts and short term borrowings, as permitted by FRS 13.

The interest rate profile of the financial liabilities of the Group after taking into account the effect of interest rate swaps is set out in the tables below:

31 December 2004	Total £m	Variable rate financial liabilities £m	Fixed rate financial liabilities £m	Financial liabilities on which no interest is paid £m	Weighted average interest rate for fixed rate financial liabilities %	Average time over which interest rate is fixed months
Currency:						
Non-equity stockholders' funds: irredeemable	**69.9**	**–**	**69.9**	**–**	**5.48**	**n/a**
Sterling	**400.9**	**204.8**	**192.8**	**3.3**	**6.30**	**52**
Sterling: irredeemable	**4.7**	**–**	**4.7**	**–**	**6.29**	**n/a**
US dollars	**283.9**	**63.9**	**218.4**	**1.6**	**5.71**	**33**
Australian dollars	**130.1**	**52.6**	**77.4**	**0.1**	**5.65**	**28**
Euro	**13.9**	**5.9**	**8.0**	**–**	**3.38**	**3**
Indian rupees	**128.3**	**2.5**	**125.8**	**–**	**7.58**	**43**
Other	**123.6**	**64.7**	**58.9**	**–**	**7.63**	**44**
Total	**1,155.3**	**394.4**	**755.9**	**5.0**	**6.27**	**40**

31 December 2003	Total £m	Variable rate financial liabilities £m	Fixed rate financial liabilities £m	Financial liabilities on which no interest is paid £m	Weighted average interest rate for fixed rate financial liabilities %	Average time over which interest rate is fixed months
Currency:						
Non-equity stockholders' funds: irredeemable	69.9	–	69.9	–	5.40	n/a
Sterling	592.0	318.8	273.2	–	6.20	53
Sterling: irredeemable	4.7	–	4.7	–	6.29	n/a
US dollars	454.1	180.2	273.9	–	5.42	49
Australian dollars	191.9	82.1	109.8	–	5.89	35
Euro	69.3	68.6	0.7	–	5.46	9
Indian rupees	122.2	0.6	121.6	–	8.00	49
Other	135.1	85.0	50.0	0.1	6.28	45
Total	1,639.2	735.3	903.8	0.1	6.11	48

The Group borrows in a range of currencies at both fixed and variable rates of interest.

The variable rate financial liabilities comprise bank borrowings and overdrafts bearing interest at rates fixed in advance for periods ranging from one to six months by reference to the applicable reference rate, primarily LIBOR for sterling, US dollar and euro borrowings, and the BBSY rate for Australian dollar borrowings.

Financial liabilities on which no interest is paid do not have fixed periods to maturity.

30 Financial instruments (continued)

The interest rate profile of the financial assets of the Group is set out in the tables below:

31 December 2004	Total £m	Variable rate financial assets £m	Fixed rate financial assets £m	Financial assets on which no interest is received £m	Weighted average interest rate for fixed rate financial assets %	Average time over which interest rate is fixed months
Currency:						
Sterling	**15.5**	**14.7**	**–**	**0.8**	**n/a**	**n/a**
US dollars	**14.9**	**11.5**	**–**	**3.4**	**n/a**	**n/a**
Australian dollars	**3.5**	**2.5**	**–**	**1.0**	**n/a**	**n/a**
Euro	**6.1**	**4.1**	**–**	**2.0**	**n/a**	**n/a**
Other	**29.2**	**29.0**	**–**	**0.2**	**n/a**	**n/a**
Total	**69.2**	**61.8**	**–**	**7.4**	**n/a**	**n/a**

31 December 2003	Total £m	Variable rate financial assets £m	Fixed rate financial assets £m	Financial assets on which no interest is received £m	Weighted average interest rate for fixed rate financial assets %	Average time over which interest rate is fixed months
Currency:						
Sterling	56.1	23.2	30.4	2.5	11.00	57
US dollars	13.9	13.9	–	–	n/a	n/a
Australian dollars	5.0	3.8	–	1.2	n/a	n/a
Euro	17.8	16.4	–	1.4	n/a	n/a
Other	17.4	17.2	–	0.2	n/a	n/a
Total	110.2	74.5	30.4	5.3	11.00	57

The majority of variable rate financial assets comprise bank accounts bearing interest at the applicable LIBOR rate for sterling deposits or the applicable local equivalent rate. Fixed rate financial assets include deferred consideration relating to the sale of fixed assets and businesses, and other interest bearing and non-interest bearing investments.

The financial assets on which no interest is received do not have fixed periods to maturity.

30 Financial instruments (continued)

The following tables show the Group's currency exposures, being exposures that give rise to the net currency gains and losses recognised in the profit and loss account. Such exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating unit concerned, excluding certain non-sterling borrowings treated as hedges of net investments in overseas operations.

The amounts shown take into account the effect of any forward contracts entered into to manage currency exposures.

31 December 2004	Net foreign currency monetary assets/(liabilities)					
Functional currency of Group operation:	Sterling £m	US dollars £m	Australian dollars £m	Euro £m	Other £m	Total £m
Sterling	–	–	–	(19.2)	–	(19.2)
Australian dollar	–	(0.3)	–	0.2	1.4	1.3
Other	–	(0.4)	–	–	–	(0.4)
	–	(0.7)	–	(19.0)	1.4	(18.3)

31 December 2003	Net foreign currency monetary assets/(liabilities)					
Functional currency of Group operation:	Sterling £m	US dollars £m	Australian dollars £m	Euro £m	Other £m	Total £m
Sterling	–	22.5	(5.0)	(5.0)	(1.4)	11.1
Australian dollar	(0.9)	0.7	–	–	0.9	0.7
Other	–	(4.5)	–	–	–	(4.5)
	(0.9)	18.7	(5.0)	(5.0)	(0.5)	7.3

A comparison by category of book value and fair value of the Group's financial assets and liabilities is as follows:

	2004		2003	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Primary financial instruments held or issued to finance the Group's operations:				
Loans	(1,059.6)	(1,060.4)	(1,537.8)	(1,540.3)
Other investments and deferred consideration receivable	18.4	18.4	46.3	46.3
Other creditors and deferred consideration payable	(5.0)	(5.0)	(2.6)	(2.6)
Cash	50.8	50.8	64.0	64.0
Bank overdrafts	(20.8)	(20.8)	(21.3)	(21.3)
Short term borrowings	–	–	(7.6)	(7.6)
Non-equity stockholders' funds	(69.9)	(75.9)	(69.9)	(104.1)
Derivative financial instruments held to manage the interest rate and currency profile:				
Interest rate swaps	–	(25.8)	–	(36.6)
Currency swaps	–	(0.7)	–	(1.1)
Derivative financial instruments held or issued to hedge the currency exposure on expected future transactions:				
Forward foreign currency contracts	–	(2.5)	–	3.4
	(1,086.1)	(1,121.9)	(1,528.9)	(1,599.9)

The fair value of non-convertible bonds and dollar notes included in loans above is based on the quoted market price of comparable debt. Other loans include term loans and finance leases. These are largely at variable interest rates and therefore the book value normally equates to the fair value.

The fair value of other investments is based on the year end quoted price for listed investments and the estimated recoverable amount for unlisted investments.

The fair value of deferred consideration and other creditors is based on the estimated recoverable and payable amounts.

The fair value of cash and bank overdrafts approximates to the book value due to the short term maturity of the instruments.

The fair value of non-equity stockholders' funds, which relate to the preferred stock and concessionary stock, is based on the quoted market price.

The fair value of derivative financial instruments is discounted to the net present value using prevailing market rates and foreign currency rates at the balance sheet date.

30 Financial instruments (continued)

Gains and losses on instruments used for hedging are not recognised until the exposure that is being hedged is itself recognised. Unrecognised gains and losses on forward foreign currency contracts, fuel price swaps, cross currency swaps and interest rate swaps are as follows:

	Gains £m	(Losses) £m	Net gains/ (losses) £m
At 31 December 2002	18.1	(69.5)	(51.4)
Gains/(losses) arising before 1 January 2003 that were recognised during the year ended 31 December 2003	(6.0)	29.1	23.1
Gains/(losses) arising before 1 January 2003 that were not recognised during the year ended 31 December 2003	12.1	(40.4)	(28.3)
Gains/(losses) arising in the year to 31 December 2003 that were not recognised during the year ended 31 December 2003	(1.3)	(4.7)	(6.0)
At 31 December 2003	10.8	(45.1)	(34.3)
Gains/(losses) arising before 1 January 2004 that were recognised during the year ended 31 December 2004	**(2.2)**	**18.0**	**15.8**
Gains/(losses) arising before 1 January 2004 that were not recognised during the year ended 31 December 2004	**8.6**	**(27.1)**	**(18.5)**
Gains/(losses) arising in the year to 31 December 2004 that were not recognised during the year ended 31 December 2004	**(1.6)**	**(8.9)**	**(10.5)**
At 31 December 2004	**7.0**	**(36.0)**	**(29.0)**
Of which:			
Gains/(losses) expected to be recognised in less than one year	**2.0**	**(12.5)**	**(10.5)**
Gains/(losses) expected to be recognised after more than one year	**5.0**	**(23.5)**	**(18.5)**
	7.0	**(36.0)**	**(29.0)**

Of the above unrecognised net gains/(losses) at 31 December 2004, a £3.0m gain (2003 £3.4m gain) is a result of forward contracts taken out to fix the contracted capital expenditure and operating lease commitments on ships into their functional currency as follows:

	Gains £m	(Losses) £m	Net gains/ (losses) £m
Net gains/(losses) at 31 December 2004	**7.0**	**(36.0)**	**(29.0)**
Less: (Gains)/losses on contracted foreign currency capital expenditure and operating lease commitments	**(2.7)**	**5.7**	**3.0**
Gains/(losses) on other hedges	**4.3**	**(30.3)**	**(26.0)**

The underlying commitments, after taking these contracts into account, are reflected within note 27.

31 Post balance sheet events

On 24 January 2005, the Group announced that the HTC Hanseatic Trade Center GmbH & Co. Grundbesitz partnership (in which the Group holds a 47.5 per cent interest) had sold the remaining four buildings of its office development in Hamburg for €200m (£140m) in cash to a consortium comprising affiliates of Lehman Brothers Real Estate Partners, L.P., Tishman Speyer Properties and Quantum Immobilien AG. Further information on the financial impact of this transaction is disclosed in note 4. Under the terms of the sale agreement, P&O will provide contingent funding, primarily in respect of the achievement of leasing targets over the next three years, in exchange for the right to participate in a share of the proceeds above certain agreed levels in the event of a subsequent sale of the buildings.

On 31 January 2005, the Group announced that it had realised £55m in cash from its 600,000 sq ft shopping centre development in Plymouth through a sale to Morgan Stanley Real Estate Fund.

On 28 February 2005, the Group announced that it had been informed by Brittany Ferries that they no longer intended to proceed with the proposed transaction on the Portsmouth – Le Havre route, which had been announced by the Group on 28 September 2004. The Group intends to continue to operate this route until the end of September 2005 when, subject to employee consultation, it will close as previously announced. The financial impact of the fundamental review of the Group's ferry operations is set out in note 4.

On 8 March 2005, the Group announced that it had sold one of the main blocks of the Regent Quarter development at King's Cross to La Salle London Office Fund for £47m.

Principal subsidiaries, joint ventures and associates

at 31 December 2004

	Country of incorporation	Percentage of equity share capital owned	Business description
Ports			
Antwerp Gateway NV	Belgium	42.5%	Container terminal operations
Asian Terminals Inc	The Philippines	84.1%	Container terminal and other port operations
Century Group Pty Ltd	Papua New Guinea	100%	Port and maritime services
Chennai Container Terminal Private Ltd	India	75%	Container terminal operations
Container Terminals Australia Ltd	Australia	90.4%	Container terminal operations
Laem Chabang International Terminal Co Ltd	Thailand	34.5%	Container terminal operations
Mundra International Container Terminal Limited	India	100%	Container terminal operations
Nhava Sheva International Container Terminal Private Ltd	India	100%	Container terminal operations
P&O Australia Ports Pty Ltd	Australia	100%	Holding company
P&O Maritime Services Pty Ltd	Australia	100%	Offshore services, ships agency and chartering
P&O Polar Australia Pty Ltd	Australia	100%	Antarctic research and resupply services
P&O Ports Antwerp NV	Belgium	100%	Container terminal and other port operations
P&O Ports Canada Inc	Canada	100%	Container terminals and stevedoring
P&O Ports Ltd	Australia	100%	Container terminals, stevedoring and international port management
P&O Ports North America Inc	USA	100%	Stevedoring and passenger terminal services
Port Newark Container Terminal LLC	USA	50%	Container terminal operations
Ports Insurance Company Inc	USA	100%	Workers Compensation Insurance
Portsynergy SAS	France	50%	Container terminal operations
PT Terminal Petikemas Surabaya	Indonesia	49%	Container terminal operations
Qasim International Container Terminal Pakistan Ltd	Pakistan	55%	Container terminal operations
Qingdao Qianwan Container Terminal	PR China	29%	Container terminal operations
Shekou Container Terminals Ltd	PR China	22%	Container terminal operations
Southampton Container Terminals Ltd	England	51%	Container terminal operations
South Asia Gateway Terminals Pte Ltd	Sri Lanka	16.2%	Container terminal operations
Terminales Rio de la Plata SA	Argentina	53.1%	Container terminal operations
Tilbury Container Services Ltd	England	34%	Container terminal operations
Cold Logistics			
P&O Cold Logistics Argentina SA	Argentina	100%	Freezing, handling and cold storage
P&O Cold Logistics LLC	USA	100%	Freezing, handling and cold storage
P&O Cold Logistics Ltd	Australia	100%	Freezing, handling and cold storage
P&O Cold Logistics (NZ) Ltd	New Zealand	100%	Freezing, handling and cold storage
Ferries			
Larne Harbour Ltd	Northern Ireland	100%*	Harbour operator
P&O European Ferries (Irish Sea) Ltd	England	100%	Ferry services
P&O European Ferries (Portsmouth) Ltd	England	100%	Ferry services
P&O Ferries (Holdings) Ltd	England	100%	Holding company
P&O Ferries Ltd	England	100%	Ferry services
P&O Ferrymasters Ltd	Northern Ireland	100%†	International unit loads
P&O North Sea Ferries BV	Netherlands	100%	Ferry services
P&O North Sea Ferries Ltd	England	100%	Ferry services
Container Shipping			
Royal P&O Nedlloyd NV	Netherlands	25%*	International container shipping
Property			
Boston Wharf Company	USA	100%	Property development
HTC Hanseatic Trade Center GmbH & Co Grundbesitz KG	Germany	47.5%	Property development
P&O Developments Ltd	England	100%	Property development
P&O Properties Boston LLC	USA	100%	Property development
P&O Properties Inc	USA	100%	Holding company
P&O Properties Ltd	England	100%	Property management
P&O Property Holdings Ltd	England	100%*	Property investment
TCD North Inc	USA	100%	Property development

* owned directly by the Company
† 35.0 per cent owned directly by the Company

Information for stockholders

Stockholder enquiries/change of address

For enquiries relating to holdings of stock of the Company such as the loss of a stock certificate, dividend payments, or to notify a change of address, please write to the Company's registrar: Computershare Investor Services PLC, PO Box 82, The Pavilions, Bridgwater Road, Bristol BS99 7NH. Telephone: 0870 702 0139.

Stockholder information on the internet

The Company's registrar, Computershare Investor Services PLC, has introduced a facility where holders of P&O stock are able to access details of their shareholding over the internet subject to passing an identity check.

You can access this service on their website at: www.computershare.com

Payment of dividends to mandated accounts

Stockholders who do not currently have their dividends paid directly to a bank or building society account and who wish to do so should complete a mandate instruction form obtainable from the Company's registrar, as above. Tax vouchers are sent to the stockholder's registered address under this arrangement unless requested otherwise. A copy of the mandate form may also be obtained from Computershare's website.

Amalgamation of your stockholding

If you have received more than one copy of this annual report, there may be more than one account in your name on the P&O register. If you would like to amalgamate your holdings, please write to the Company's registrar, as above, giving details of the accounts concerned and instructions on how they should be amalgamated.

Dividend Reinvestment Plan

A Dividend Reinvestment Plan (''DRIP'') is available that gives stockholders the opportunity to use their cash dividend to buy P&O deferred stock through a special low-cost dealing arrangement. The DRIP is run and administered by the Company's registrar, Computershare Investor Services PLC, from whom copies of the DRIP brochure and application form are obtainable, as above. You may also request details by contacting Computershare by email at web.queries@computershare.co.uk

Individual Savings Account

The Company has made arrangements with Halifax Share Dealing Limited, to provide stockholders with a stocks and shares Individual Savings Account (''ISA'') for P&O stock only. A brochure on the P&O ISA may be obtained by writing to the Company Secretary's office, 79 Pall Mall, London SW1Y 5EJ or by email at secretariat@pogroup.com. Halifax Share Dealing Limited is regulated by the Financial Services Authority, a member of the London Stock Exchange and an Inland Revenue approved ISA manager.

Low cost share dealing service

A special low cost share dealing service is available through Hoare Govett Limited for private investors who wish to buy or sell holdings of P&O stock in a simple cost effective way. Details may be obtained by contacting the Company Secretary's office, as above.

A low cost telephone dealing service has also been arranged with Stocktrade. For information on this service please call 0845 601 0995, quoting reference LOW CO133.

Travel concessions for eligible stockholders

Eligible holders of 5.5 per cent concessionary stock are entitled under the formal P&O Concessionary Fare Scheme to travel at reduced fares on the ferry services operated by P&O Ferries between Dover – Calais and Portsmouth – Le Havre and services operated by P&O Irish Sea between Cairnryan – Larne.

In addition, the directors have decided that during 2005 eligible holders of deferred stock, preferred stock or 5.5 per cent concessionary stock may travel at reduced fares (which may be varied or withdrawn at any time) on the services between Portsmouth – Bilbao and between Hull – Zeebrugge/Rotterdam operated by P&O Ferries and services operated by P&O Irish Sea between Troon – Larne.

Details of the P&O Concessionary Fare Scheme and the concessions available at the directors' discretion may be obtained by contacting the Company Secretary's office, as above.

Electronic communication

If you would like to receive notification of the availability of certain documents (for example the Annual Report and Accounts) on the P&O website you can register on-line via the Company's website, www.pogroup.com, by selecting Electronic Communication either via Quick links or the Investor section.

To register on-line you will need to have your 11 character stockholder reference number which is located on your stock certificate or dividend tax voucher.

If you have any queries please call the Computershare helpdesk on 0870 889 3109.

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P&O Group

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