P&O PRINCESS CRUISES PLC
Form 20-F
March 14, 2003
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As filed with the Securities and Exchange Commission on March 14, 2003

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

[ ] REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g)

OF THE SECURITIES EXCHANGE ACT OF 1934

OR

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

for the transition period from to

Commission file number 1-15136

P&O PRINCESS CRUISES PLC

(Exact name of Registrant as specified in its charter)

Not Applicable

(Translation of Registrant s Name Into English)

England and Wales

(Jurisdiction of Incorporation or Organization)

77 New Oxford Street

London WC1A 1PP

England

(Address of Principal Executive Offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange On Which Registered
Ordinary Shares of 50 cents each represented by American Depositary Shares*	New York Stock Exchange

* Each ADS represents four (4) Ordinary Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

Indicate the number of outstanding shares of each of the issuer s classes of capital or common stock as of the close of the period covered by the annual report.

Title of each class	Number of outstanding shares
Ordinary Shares of 50 cents each	693,605,328

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes __X__ No_____

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17_____ Item 18 __X__

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In this annual report, unless the context indicates otherwise, the terms P&O Princess , the Company , we , our or us refer to P&O Princess Cruises plc, a public limited company incorporated under the laws of England and Wales under the Companies Act 1985 as amended, together with its subsidiaries.

In this annual report, unless indicated otherwise, U.S. dollar, U.S.$, cents or $ refers to the currency of the United States and pounds sterling, £, pence or p refers to the currency of the United Kingdom.

We intend to furnish our shareholders with annual reports containing audited financial statements for 2002.

Trademarks

We use many registered and unregistered trademarks, some of which are referred to in this annual report. These trademarks include Princess, Princess Cruises, Princess Tours, the Princess Logo, Personal Choice, where i belong , What You Want, When You Want and Midnight Sun Express ULTRA DOME , P&O Cruises, Ocean Village, Swan Hellenic, AIDA, Seetours, A ROSA and our ship and wilderness lodge names. We have a license to use P&O and the P&O flag in relation to cruises and related activities and we have a license to use Love Boat and related marks.

Important Note Regarding Forward Looking Statements

Certain statements in this annual report are forward-looking statements that involve risks, uncertainties and assumptions with respect to P&O Princess and its subsidiaries, including certain statements concerning the transactions described in this document, profit forecasts, working capital, future results, plans and goals and other events which have not yet occurred. These statements are intended to qualify for the safe harbors from liability provided by Section 27A of the U.S. Securities Act of 1933, as amended (the Securities Act), and Section 21E of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act), which are part of the U.S. Private Securities Litigation Reform Act of 1995. You can find many (but not all) of these statements by looking for words like will , may , believes , expects , anticipates , forecast , f intends , plans and estimates and for similar expressions.

Because forward-looking statements involve risks and uncertainties, there are many factors that could cause the matters described herein not to occur and/or P&O Princess actual results,

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performance or achievements to differ materially from those expressed or implied in this document. These factors include, but are not limited to:

- **general economic and business conditions which may impact levels of disposable income of consumers and the net revenue yields for our cruise brands;**
- **conditions in the cruise and land-based vacation industries, including competition from other cruise ship operators and providers of other vacation alternatives and increases in capacity offered by cruise ship and land-based vacation alternatives;**
- **the impact of operating internationally;**
- **the international political and economic climate, armed conflict, terrorist attacks and other world events and negative media publicity and their impact on the demand for cruises;**
- **accidents and other incidents at sea affecting the health, safety, security and vacation satisfaction of passengers;**
- **the ability to implement our shipbuilding programs and brand strategies and to continue to expand our business worldwide;**
- **the ability to attract and retain shipboard crew;**
- **the ability to obtain financing on terms that are favorable or consistent with our expectations;**
- **the impact of changes in operating and financing costs, including changes in foreign currency and interest rates and security, fuel, food and insurance costs; and**
- **changes in the tax, environmental and other regulatory regimes under which each company operates.**

In addition, some of the following statements are forward-looking in nature and contain important cautionary statements and/or a discussion of many of the factors that could materially affect the accuracy of the forward-looking statements and/or adversely affect our business, results of operations and financial positions:

- **statements in Item 3. Key Information Proposed DLC Transaction with Carnival on page 1 with regard to the impact of the DLC transaction with Carnival;**
- **statements in Item 3. Key Information Risk Factors beginning on page 10 with regard to our business objectives, sources of financing and market trends;**

statements in Item 4. Information on the Company beginning on page 15 with regard to strategy and management objectives, sources of financing, prices, industry standing and product volumes and the effects of changes or prospective changes in regulation;

statements in Item 5. Operating and Financial Review and Prospects beginning on page 43 with regard to trends in results, prices, volumes, operations, margins, overall industry trends and exchange rates; and

statements in Item 8. Financial Information Dividend Policy on page 77 with regard to dividends and the timing of dividend payments.

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As a consequence, current plans, anticipated actions and future financial conditions and results may differ from those expressed in any forward-looking statements made by or on behalf of our Company. The most significant risk factors identified by the Company relevant to an investment in our shares are described under Item 3. Key Information Risk Factors beginning on page 10. Forward-looking statements should not be relied upon as a prediction of actual results. Subject to any continuing obligations under applicable law or any relevant listing rules, P&O Princess expressly disclaims any obligation to disseminate, after the date of this document, any updates or revisions to any such forward-looking statements to reflect any change in expectations or events, conditions or circumstances on which any such statements are based.

Additionally, certain statements in this annual report contain forward looking statements with respect to the combined group of P&O Princess and Carnival Corporation (Carnival) and their respective subsidiaries (the Combined Group) resulting from the proposed business combination transaction under a dual listed company (DLC) structure (the Proposed Carnival DLC Transaction). The foregoing cautionary note regarding forward looking statements is also applicable to forward looking statements concerning the Combined Group and the Proposed Carnival DLC Transaction and such statements are intended to qualify for the safe harbors from liability provided by Section 27A of the Securities Act and Section 21E of the Exchange Act. In addition to the factors described above, additional factors could cause the transactions described in this document not to occur and/or each of P&O Princess , Carnival s and the Combined Group s actual results, performance or achievements to differ materially from those expressed or implied in this document. These factors include, but are not limited to:

- **completion of the Proposed Carnival DLC Transaction, which is dependent upon, *inter alia*, approval of both Carnival and P&O Princess shareholders;**
- **achievement of expected benefits from the Proposed Carnival DLC Transaction;**
- **risks associated with the combination of Carnival s and P&O Princess businesses by means of the DLC structure;**
- **risks associated with the relative share prices of P&O Princess and Carnival as well as liquidity and index inclusion as a result of the implementation of the DLC structure, including a possible mandatory exchange;**
- **risks associated with the uncertainty of the tax status of the DLC structure; and**
- **the ability of a small group of shareholders effectively to control the outcome of shareholder voting.**

This annual report also contains market data and assumptions related to the cruises industry that have been included in studies published by various market research firms and other third parties. If assumptions about market data included in these studies turn out to be incorrect, actual results may differ from the projections based on these assumptions.

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PART I

ITEM 3. KEY INFORMATION

Our Company

We are an international cruise vacation company, with operations in North America, the United Kingdom, Germany and Australia. We are a leading provider of cruises to Alaska, the Caribbean, Europe, the Mediterranean, the Panama Canal and other locations (principally South America, the South Pacific, the Orient and India). Among the world s cruise operators, we rank third in terms of revenue and operating income.

Our holding company, P&O Princess Cruises plc, was incorporated on July 19, 2000, in connection with the spin-off (referred to as a demerger in the United Kingdom) of the cruise business of The Peninsular and Oriental Steam Navigation Company (P&O) from P&O s other activities. The spin-off was completed on October 23, 2000 and we have been an independent publicly listed company since that date.

The Cruise Industry

We believe that cruising is a component of the overall vacation market and that cruise vacation operators compete for disposable income normally spent by consumers on vacations. The cruise vacation industry offers a broad range of products to suit customers of many ages, backgrounds and interests.

Since 1970, cruising has been one of the fastest growing parts of the vacation market. The largest cruise sector in the world is North America, where cruising has developed into a mainstream alternative to land-based resort and sightseeing vacations. According to Cruise Lines International Association (CLIA), a leading U.S. industry trade group, approximately 7.4 million North American passengers took cruises for two consecutive nights or more in 2002. This sector has grown significantly in recent years as new capacity has been introduced. We estimate that the average annual compound growth in the number of North American cruise passengers since 1970 is approximately 9%.

The number of new cruise ships currently on order from shipyards indicates that the growth in supply of capacity for the industry is set to continue for a number of years. Because of this continuing growth in supply, continued growth in demand across the industry, and particularly in North America, will be required in order to take up this increase in supply.

Outside North America, the principal sources of passengers for the industry are the United Kingdom, Germany, other continental European countries and Asia. In all of these areas, cruising represents a smaller proportion of the overall vacation market than it does in North America, but, based on industry data, is generally experiencing higher growth rates. We expect this trend to continue.

Proposed DLC Transaction with Carnival

On November 20, 2001, P&O Princess announced that it had entered into agreements to combine with Royal Caribbean Cruises Ltd. (Royal Caribbean) under a DLC structure. On December 13, 2001, Carnival submitted a proposal to the board of P&O Princess (the Board) regarding an offer to acquire the entire issued share capital of P&O Princess. Carnival also proposed the possibility of effecting a combination of Carnival and P&O Princess by other means, including a DLC structure. The Board carefully considered Carnival s proposal and determined that it was not more favorable from a financial point of view to P&O Princess shareholders than the proposed transaction with Royal Caribbean and that there was reasonable doubt as to its deliverability.

On January 30, 2002, Carnival revised its offer to acquire P&O Princess but, for reasons as before, the Board continued to recommend the Royal Caribbean proposal.

On February 7, 2002, Carnival announced the terms of a further increased offer of 0.3004 shares in Carnival for each share in P&O Princess. The Board considered the offer from Carnival but, in view of its concerns about the structure and deliverability of the proposal, the Board continued to recommend the proposal to enter into a DLC combination with Royal Caribbean. On February 14, 2002, at an extraordinary general meeting convened to consider the Royal Caribbean proposal, shareholders voted to adjourn the meeting until such time as the outcome of the antitrust reviews of both the Royal Caribbean proposal and the Carnival proposal were known.

On October 4, 2002, the Federal Trade Commission of the United States announced that it would not oppose a combination of P&O Princess with either Royal Caribbean or Carnival. The regulatory authorities of the United Kingdom and Germany had previously cleared the Royal Caribbean proposal and the European Commission had previously cleared the Carnival proposal. Following the Federal Trade Commission s announcement, P&O Princess re-examined Carnival s offer and, in particular, Carnival s proposal to enter into a DLC transaction with P&O Princess as an alternative to its share acquisition offer. The Board determined that the Carnival DLC proposal was more favorable financially to P&O Princess shareholders than the Royal Caribbean DLC combination and was reasonably likely to be consummated since all regulatory clearance had been obtained. As a result, P&O Princess was then willing and able to enter into talks with Carnival to discuss its DLC proposal.

On January 8, 2003, the Board announced that it had agreed and recommended the proposal to enter into a DLC transaction with Carnival and that P&O Princess had entered into an implementation agreement, dated as of that date, to effect the Proposed Carnival DLC Transaction. The implementation of the DLC structure will involve a strategic combination of the businesses of P&O Princess and Carnival. The economic interests of P&O Princess and Carnival will be aligned under the DLC structure and they will pursue common objectives. The two companies will have a single senior executive management team and identical boards of directors, and will be run as if they were a single economic enterprise. The current P&O Princess shareholders will hold approximately 26% of the equity in the Combined Group and the current Carnival shareholders will hold approximately 74%. It is expected that an extraordinary general meeting of shareholders to consider the proposed transaction with Carnival will be held in April 2003. Completion of the Proposed Carnival DLC Transaction is subject to, among other things, shareholder approval.

Termination of proposed DLC combination with Royal Caribbean

In connection with Carnival s DLC proposal, on October 25, 2002 we entered into an agreement (the Termination Agreement) with Royal Caribbean which terminated the implementation agreement with Royal Caribbean (the Royal IA) immediately, terminated the joint venture agreement, dated as of November 19, 2001 (the Joint Venture Agreement) with Royal Caribbean and Joex Limited on January 1, 2003 as long as no change of control of P&O Princess occurred prior to that date, and provided mutual releases from liabilities arising under the two agreements. Pursuant to the Termination Agreement, we paid Royal Caribbean $62.5 million as a break fee under the Royal IA. On January 2, 2003, P&O Princess announced that the Joint Venture Agreement had been terminated.

For more information about the Proposed Carnival DLC Transaction, see Item 10. Additional Information Our Proposed DLC Transaction with Carnival on page 79, and for more information about the termination agreement with Royal Caribbean, see Item 10. Additional Information Termination Agreement with Royal Caribbean on page 82.

SELECTED FINANCIAL DATA

The selected consolidated financial information set out below for each of the years ended December 31, 1998, 1999, 2000, 2001 and 2002 has been extracted or derived from the audited consolidated financial statements of the Company. The consolidated financial statements for each of the years in the five-year period ended December 31, 2002 have been audited by KPMG Audit Plc, chartered accountants, registered auditor.

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Our consolidated financial statements are presented on the basis that P&O s cruise business and subsidiaries were our business and subsidiaries for all years presented or, if not owned by P&O at all times during such period, from the date such businesses and subsidiaries were acquired by P&O and/or until the date on which P&O disposed of them, as applicable.

Our consolidated financial statements have been prepared in accordance with United Kingdom generally accepted accounting principles (U.K. GAAP), which differs in certain significant respects from United States of America generally accepted accounting principles (U.S. GAAP). A detailed description of the principal differences between U.K. GAAP and U.S. GAAP as they relate to us and a reconciliation to U.S. GAAP of profit attributable to shareholders for the three years ended December 31, 2002 and of shareholders equity as of December 31, 2000, 2001 and 2002 is given in Note 28 to our Financial Statements included in this annual report and Item 5. Operating and Financial Review and Prospects of this annual report.

The selected consolidated financial information should be read in conjunction with, and is qualified in its entirety by reference to, our audited consolidated financial statements and related notes, included in this annual report.

	Years ended December 31 (restated)(c),				
	1998(a)	1999(a)	2000	2001	2002
	Dollars in millions, except per share and per ADS information				
Selected Profit and Loss Information					
U.K. GAAP					
Turnover	1,852.4	2,111.6	2,423.9	2,451.0	2,526.8
Net operating costs	(1,509.2)	(1,723.3)	(2,050.8)	(2,089.7)	(2,228.1)(b)
Group operating profit	343.2	388.3	373.1	361.3	298.7
Share of operating results of joint ventures	0.3		0.5	0.1	
Total operating profit	343.5	388.3	373.6	361.4	298.7
Non-operating profit/(loss)		(4.8)	(6.5)	(1.9)	1.2
Profit on ordinary activities before interest	343.5	383.5	367.1	359.5	299.9
Net interest and similar items	(31.4)	(25.7)	(49.1)	(58.0)	(74.0)
Profit on ordinary activities before taxation	312.1	357.8	318.0	301.5	225.9
Taxation(c)	(88.8)	(73.6)	(57.2)	81.7(f)	(17.1)
Profit on ordinary activities after taxation	223.3	284.2	260.8	383.2	208.8
Equity minority interests		(0.5)	(2.6)	(0.1)	
Profit for the financial year attributable to Shareholders	223.3	283.7	258.2	383.1	208.8
Basic earnings per ordinary share (cents)	32.8	41.7	38.1	55.4(f)	30.2
Diluted earnings per share (cents)	32.8	41.7	38.1	55.2(f)	30.0
Basic earnings per ADS (cents)	131.2	166.8	152.4	221.6	120.8
Diluted earnings per ADS (cents)	131.2	166.8	152.4	220.8	120.0
Fixed charge cover(d)	6.6	8.7	4.8	3.8	2.9

Dividend per share (cents)	12.0	12.0	12.0
Dividend per ADS (cents)	48.0	48.0	48.0

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	Years ended December 31 (restated)(c),				
	1998(a)	1999(a)	2000	2001	2002
	Dollars in millions, except per share and per ADS information				
Selected Profit and Loss Information					
US GAAP					
Net income	222.4	267.7	253.7	425.2(e)(f)	212.9
Basic earnings per share (cents)(g)	32.6	39.3	37.1	61.5	30.7
Diluted earnings per share (cents)(g)	32.6	39.3	37.1	61.2	30.6
Basic earnings per ADS (cents)	130.5	157.1	148.4	246.0	122.8
Diluted earnings per ADS (cents)	130.5	157.1	148.4	244.8	122.4

(a) Prior to the demerger of P&O Princess from P&O in 2000, no combined financial statements had been prepared for the companies and businesses comprising P&O Princess. The financial information for financial years 1998 and 1999 has been extracted from KPMG Audit Plc s accountants report on P&O Princess contained in the listing particulars dated September 26, 2000 which were prepared for the demerger.

(b) In fiscal 2002, net operating costs under U.K. GAAP included $117.0 million of transaction costs.

(c) At January 1, 2002, P&O Princess adopted FRS19. The 2001 balance sheet was restated to reflect full provision for deferred tax, an increase in deferred tax liabilities of $108.1 million. The tax credit for the year ended December 31, 2001 has been increased to reflect the elimination of the majority of future potential tax liabilities upon P&O Princess election to enter the U.K. tonnage tax regime by $96.8 million. The profit and loss account and balance sheet information for years 1998 to 2001 presented above under U.K. GAAP have been restated for the adoption of Financial Reporting Standard 19: Deferred Tax.

(d) Defined as profit before fixed charges (excluding capitalized interest) and taxation divided by fixed charges. Fixed charges consist of the net interest expense in the profit and loss account, interest capitalized in respect of ships and other fixed assets and an estimate of the interest implicit in operating lease rentals.

(e) At January 1, 2001, P&O Princess adopted SFAS No. 133. The cumulative effect of the change in this accounting policy at that date was a charge of $9.0 million, which is included in net income for the fiscal year ended December 31, 2001. The basic and diluted earnings per share for fiscal 2001 is computed after the cumulative effect of the change in this accounting principle.

(f) Under U.K. GAAP, the year ended December 31, 2001 includes a tax credit of $97.5 million, comprising a credit from the release of deferred tax on entry into the tonnage tax regime of $192.5 million and tax charges arising from internal corporate restructuring of $95.0 million. The U.S. GAAP tax credit for the year ended December 31, 2001 is for the release of deferred taxes.

(g) Effective January 1, 2002, P&O Princess adopted SFAS No. 142, which requires that companies stop amortizing goodwill and requires an annual, or when events or circumstances dictate a more frequent, impairment review of goodwill. Accordingly, as of January 1, 2002, P&O Princess no longer amortizes its goodwill under U.S. GAAP, if goodwill had not been recorded for periods prior to January 1, 2002, P&O Princess adjusted net income and adjusted basic and diluted earnings per share would have been as follows:

	Years Ended December 31,			
	1998	1999	2000	2001
	(U.S. dollars in thousands, except per share data)			
U.S. GAAP				
Net income	222.4	267.7	253.7	425.2
Goodwill amortization	0.8	1.0	2.0	2.9
Adjusted net income	223.2	268.7	255.7	428.1

Adjusted earnings per share				
Basic	32.7	39.4	37.4	61.9
Diluted	32.7	39.4	37.4	61.6

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	At December 31 (restated)(c),				
	1998	1999	2000	2001	2002
	Dollars in millions				
Selected Balance Sheet Information					
U.K. GAAP					
Fixed assets	2,949.7	3,258.3	3,959.5	4,418.3	5,772.8
Current assets	382.4	406.7	649.3	451.4	558.9
Total assets	3,332.1	3,665.0	4,608.8	4,869.7	6,331.7
Other creditors and provisions	(1,494.4)	(1,343.8)	(1,190.4)	(847.0)	(1,000.9)
Creditors: amounts falling due after one year	(139.7)	(216.7)	(1,062.7)	(1,393.1)	(2,516.8)
Total liabilities	(1,634.1)	(1,560.5)	(2,253.1)	(2,240.1)	(3,517.7)
Equity minority interests		(7.7)	(0.2)	(0.2)	(0.2)
Consolidated shareholders funds	1,698.0	2,096.8	2,355.5	2,629.4	2,813.8
U.S. GAAP					
Total Assets	3,252.1	3,571.3	4,460.7	4,996.3	6,368.9
Long-term obligations	(296.8)	(416.1)	(1,275.5)	(1,641.8)	(2,623.6)
Consolidated shareholders equity	1,622.0	2,006.8	2,296.3	2,551.8	2,724.9

	Years ended December 31,				
	1998	1999	2000	2001	2002
Capacity offered					
(in passenger cruise days, thousands)					
North America	4,450	5,262	5,903	6,205	6,769
Europe and Australia	1,857	1,871	2,828	3,260	3,901
Total	6,307	7,133	8,731	9,465	10,670
Occupancy (in %)					
North America	99.5%	100.4%	99.9%	100.5%	102.0%
Europe and Australia	95.3%	98.8%	97.9%	99.0%	96.6%
Total	98.3%	100.0%	99.3%	100.0%	100.0%

	At December 31,	
	2001	2002
Called up share capital:		
Number of shares	692,643,428	693,472,619

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Quarterly Results of Operations

The following unaudited quarterly financial information has been prepared in conformity with U.K. GAAP on the same basis as applied to the full year financial statements and includes all adjustments, in the opinion of management, necessary for a fair presentation of the results of operations for the quarterly periods presented. These adjustments are, in the opinion of management, of a normal, recurring nature.

Results of operations for any quarter are not necessarily indicative of the results to be expected for the entire fiscal year or for any future period. We have experienced and may in the future experience significant quarterly fluctuations in the results of operations. Quarterly results may fluctuate for a variety of reasons, including seasonal demands for our services or products, the mix of revenues, acquisitions, the geographic origin of revenues and other factors described under Item 5. Operating and Financial Review and Prospects on page 43.

	Year ended December 31, 2001				
	Quarters ended,				Full year
	March 31	June 30	September 30	December 31	
	Unaudited	Unaudited	Unaudited Dollars in millions	Unaudited	Audited
Selected Quarterly Financial Data					
U.K. GAAP					
Turnover	542.1	647.6	776.0	485.3	2,451.0
Direct operating costs	(388.0)	(407.4)	(456.9)	(331.8)	(1,584.1)
Selling and administrative expenses	(84.6)	(92.5)	(94.7)	(85.7)	(357.5)
Depreciation and amortization	(36.8)	(36.5)	(38.2)	(36.6)	(148.1)
	(509.4)	(536.4)	(589.8)	(454.1)	(2,089.7)
Group operating profit	32.7	111.2	186.2	31.2	361.3
Share of operating results of joint ventures			0.3	(0.2)	0.1
Total operating profit	32.7	111.2	186.5	31.0	361.4
Non-operating loss		(1.9)			(1.9)
Net interest and similar items	(13.8)	(15.5)	(15.0)	(13.7)	(58.0)
Profit on ordinary activities before taxation	18.9	93.8	171.5	17.3	301.5
Taxation	95.9	(4.7)	(8.6)	(0.9)	81.7
Profit on ordinary activities after taxation	114.8	89.1	162.9	16.4	383.2
Equity minority interests		(0.1)	0.1	(0.1)	(0.1)
Profit for the financial year attributable to shareholders	114.8	89.0	163.0	16.3	383.1
Basic earnings per share (cents)	16.6	12.9	23.6	2.4	55.4
Diluted earnings per share (cents)	16.6	12.9	23.6	2.3	55.1

The above U.K. GAAP data has been restated in accordance with FRS19   Deferred Tax.

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	Years ended December 31, 2001				
	Quarters ended,				Full year
	March 31	June 30	September 30	December 31	
	Unaudited	Unaudited	Unaudited Dollars in millions	Unaudited	
Capacity offered					
(in passenger cruise days, thousands)					
North America	1,396	1,539	1,687	1,583	6,205
Europe and America	816	819	839	786	3,260
Total	2,212	2,358	2,526	2,369	9,465
Occupancy (in %)					
North America	103.0%	101.3%	99.9%	98.2%	100.5%
Europe and Australia	95.5%	99.3%	102.1%	98.9%	99.0%
Total	100.3%	100.6%	100.7%	98.4%	100.0%

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	Year ended December 31, 2002				
	Quarters ended,				Full year
	March 31	June 30	September 30	December 31	
	Unaudited	Unaudited	Unaudited Dollars in millions	Unaudited	Audited
Selected Quarterly Financial Data					
U.K. GAAP					
Turnover	512.1	638.1	806.0	570.6	2,526.8
Direct operating costs	(343.7)	(389.5)	(462.5)	(380.9)	(1,576.6)
Selling and administrative expenses*	(86.5)	(87.5)	(93.9)	(209.7)	(477.6)
Depreciation and amortization	(39.8)	(43.4)	(45.1)	(45.6)	(173.9)
	(470.0)	(520.4)	(601.5)	(636.2)	(2,228.1)
Group operating profit/(loss)	42.1	117.7	204.5	(65.6)	298.7
Share of operating results of joint ventures	0.1	(0.1)	0.2	(0.2)	
Total operating profit	42.2	117.6	204.7	(65.8)	298.7
Non-operating profit	1.0	0.2			1.2
Net interest and similar items	(16.1)	(18.9)	(20.5)	(18.5)	(74.0)
Profit on ordinary activities before taxation	27.1	98.9	184.2	(84.3)	225.9
Taxation	(1.4)	(4.9)	(9.2)	(1.6)	(17.1)
Profit on ordinary activities after taxation	25.7	94.0	175.0	(85.9)	208.8
Equity minority interests			(0.1)	0.1	
Profit for the financial year attributable to shareholders	25.7	94.0	174.9	(85.8)	208.8
Basic earnings per share (cents)	3.7	13.6	25.3	(12.4)	30.2
Diluted earnings per share (cents)	3.7	13.5	25.1	(12.4)	30.0

* Administrative expenses included transaction costs of $117.0m charged in the quarter to December 31, 2002.

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	Years ended December 31, 2002				
	Quarters ended,				Full year
	March 31	June 30	September 30	December 31	
	Dollars in millions				
Capacity offered (in passenger cruise days, thousands)					
North America	1,709	1,742	1,734	1,584	6,769
Europe and Australia	790	876	1,088	1,147	3,901
Total	2,499	2,618	2,822	2,731	10,670
Occupancy (in %)					
North America	100.5%	102.4%	103.8%	101.1%	102.0%
Europe and Australia	95.1%	98.9%	99.1%	93.5%	96.6%
Total	98.8%	101.2%	102.0%	97.9%	100.0%

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RISK FACTORS

In addition to the other information in this annual report, you should carefully consider the risks described below before deciding to invest in our ordinary shares or ADSs. Any of the risk factors could materially and adversely affect our business, financial condition or operating results. In that case, the trading price of our ordinary shares and ADSs could decline, and you could lose all or part of your investment. It is not possible to predict or identify all relevant risk factors and, therefore, the following list should not be considered to be a complete statement of all potential risks or uncertainties.

We may lose business to competitors throughout the vacation market

We operate in the vacation market and cruising is one of many alternatives for people choosing a vacation. We therefore risk losing business not only to other cruise lines, but also to other vacation operators which provide other leisure options including hotels, resorts and package holidays and tours.

We face significant competition from other cruise lines, both on the basis of cruise pricing and also in terms of the nature of ships and services they offer to cruise passengers. Our principal competitors within the cruise vacation industry include:

Carnival (with whom we have agreed to combine in the Proposed Carnival DLC Transaction), which owns, among others, Carnival Cruise Lines, Holland America Line, Cunard Line and Costa Cruises;

Royal Caribbean, which owns, among others, Royal Caribbean International and Celebrity Cruises;

Norwegian Cruise Line and Orient Lines;

Disney Cruise Line;

MyTravel s Sun Cruises, Thomson, Saga and Fred Olsen in the United Kingdom;

Festival Cruises, Hapag-Lloyd, Peter Deilmann and Phoenix Reisen in Germany;

Festival Cruises, Mediterranean Shipping Cruises, Royal Olympia Cruises and Louis Cruise Line in southern Europe;

Crystal Cruises;

Radisson Seven Seas Cruise Line; and

Silver Sea Cruises.

We also compete with land-based vacation alternatives throughout the world, including, among others, resorts and hotels located in Las Vegas, Nevada, Orlando, Florida, various Caribbean, Mexican, Bahamian and Hawaiian Island destination resorts and numerous vacation destinations throughout Europe and the rest of the world.

In the event that we do not compete effectively with other vacation alternatives and cruise companies, our market share could decrease and our results of operations and financial condition could be adversely affected.

Overcapacity within the cruise and competing land-based vacation industry could have a negative impact on net revenue yields, increase operating costs, result in ship asset impairments and could adversely affect profitability

Cruising capacity has grown in recent years and we expect it to continue to increase over the next three and a half years as all of the major cruise vacation companies are expected to introduce new ships. In order to utilize new capacity, the cruise vacation industry will need to increase its share of the overall vacation market. The overall vacation market is also facing increases in land-based vacation capacity. Failure of the cruise vacation industry to increase its share of the overall vacation market could have a negative impact on our net revenue yields. Should net revenue yields be negatively impacted, our results of operations and financial condition could be adversely affected, including the impairment of the value of

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our ship assets. In addition, increased cruise capacity could impact our ability to retain and attract qualified crew at competitive costs and, therefore, increase our shipboard employee costs.

The international political and economic climate and other world events affecting safety and security could adversely affect the demand for cruises and could harm our future sales and profitability

Demand for cruises and other vacation products has been and is expected to continue to be affected by the public s attitude towards the safety of travel, the international political climate and the political climate of destination countries. Events such as the terrorist attacks in the United States on September 11, 2001 and the threat of additional attacks, the outbreak of hostilities or war, including the possibility of military action against Iraq, and national government travel advisories, or concerns that such hostilities or war might break out, together with the resulting political instability and concerns over safety and security aspects of travelling, have had a significant adverse impact on demand and pricing in the travel and vacation industry and may continue to do so in the future. Demand for cruises is also likely to be increasingly dependent on the underlying economic strength of the countries from which cruise companies source their passengers. Economic or political changes that reduce disposable income or consumer confidence in the countries from which we source our passengers may affect demand for vacations, including cruise vacations, which are a discretionary purchase. Decreases in demand could lead to price discounting which, in turn, could reduce the profitability of our business.

Changes under the Internal Revenue Code and applicable U.S. income tax treaties may adversely affect the U.S. federal income taxation of our U.S.-source shipping income

We believe that substantially all of the U.S.-source shipping income of P&O Princess and its subsidiaries qualifies for exemption from U.S. federal income tax, either under:

- Section 883 of the Internal Revenue Code;
- the U.S.-U.K. Income Tax Treaty; or
- other applicable U.S. income tax treaties.

To date no final U.S. Treasury regulations or other definitive interpretations of the relevant portions of Section 883 have been promulgated, although regulations have been proposed. Any such final regulations or official interpretations could differ materially from our interpretation of this Internal Revenue Code provision and, even in the absence of differing regulations or official interpretations, the Internal Revenue Service might successfully challenge our interpretation. In addition, the provisions of Section 883 are subject to change at any time by legislation. Moreover, changes could occur in the future with respect to the trading volume or trading frequency of P&O Princess shares on the exchanges where they are listed, or with respect to the identity, residence, or holdings of P&O Princess direct or indirect shareholders that could affect the eligibility of certain members of the P&O Princess group otherwise eligible for the benefits of Section 883 to qualify for the benefits of the Section 883 exemption. Accordingly, it is possible that the members of the P&O Princess group whose tax exemption is based on Section 883 may lose this exemption. If any such corporation were not entitled to the benefit of Section 883, it would be subject to U.S. federal income taxation on a portion of its income, which would reduce the net income of such corporation.

As noted above, we believe that substantially all of the U.S.-source shipping income of P&O Princess and its UK resident subsidiaries qualifies for exemption from U.S. federal income tax under the U.S.-U.K. Income Tax Treaty. The U.S.-U.K. Income Tax Treaty has been renegotiated and signed but is pending ratification by the U.S.. We believe that substantially all of the U.S.-source shipping income of the companies referred to above should qualify for exemption from U.S. federal income tax under such treaty if, and as of when, the pending treaty comes into force.

These treaties may be abrogated by either applicable country, replaced or modified with new agreements that treat shipping income differently than under the agreements currently in force. If any of the

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corporations discussed in the paragraph above that currently qualify for exemption from U.S.-source shipping income under any applicable U.S. income tax treaty do not qualify for benefits under the existing treaties or the existing treaties are abrogated, replaced or materially modified in a manner adverse to the interests of any such corporation and, with respect to U.S. federal income tax only, such corporation does not qualify for Section 883 exemption, such corporation may be subject to U.S. federal income taxation on a portion of its income, which would reduce the net income of any such corporation.

We may not be able to obtain financing on terms that are favorable or consistent with our expectations

Our access to financing will depend on, among other things, the maintenance of strong long-term credit ratings. Our debt is currently rated BBB by Standard & Poor s, Baa3 by Moody s and BBB+ by FitchRatings.

We believe our current external sources of liquidity, including committed financings, and cash on hand, together with forecasted cash flows from future operations, will be sufficient to fund most or all of our capital projects, debt service requirements, dividend payments and working capital needs.

The forecasted cash flow from our future operations as well as our credit ratings may be adversely affected by various factors, including, but not limited to, declines in customer demand, increased competition, overcapacity, the deterioration in general economic and business conditions, terrorist attacks, ship incidents, adverse publicity and increases in fuel prices, as well as other factors noted under the Risk Factors and the Important Note Regarding Forward Looking Statements sections of this document. To the extent that we are required, or choose, to fund future cash requirements, including future shipbuilding commitments, from sources other than cash flow from operations, cash on hand and current external sources of liquidity, we will have to secure such financing from banks or through the offering of debt and/or equity securities in the public or private markets. If we lose eligibility for inclusion in the FTSE 100, it may be more difficult for us to access the equity capital markets.

Our future operating cash flow may not be sufficient to fund future obligations, and we may not be able to obtain additional financing, if necessary, at a cost that meets our expectations. Accordingly, our financial results could be adversely affected.

Conducting business internationally may result in increased costs

We operate our business internationally and plan to continue to develop our international presence. Operating internationally exposes us to a number of risks including:

- currency fluctuations;
- interest rate movements;
- the imposition of trade barriers and restrictions on repatriation of earnings;

political risks;

risk of increases in duties, taxes and governmental royalties; and

changes in laws and policies affecting cruising, vacation or maritime businesses or the governing operations of foreign-based companies.

If we are unable to address these risks adequately, our results of operations and financial condition could be adversely affected.

Accidents and other incidents at sea or adverse publicity concerning the cruise industry could affect our reputation and harm our future sales and profitability

The operation of cruise ships involves the risk of accidents, illness, mechanical failures and incidents at sea, which may bring into question passenger safety, health, security and vacation satisfaction and

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thereby adversely affect future industry performance. Incidents involving passenger cruise ships could occur and could adversely affect our future sales and profitability. In addition, adverse publicity concerning the vacation industry in general or the cruise industry or P&O Princess in particular could impact demand and, consequently, have an adverse impact on our profitability.

Operating, financing and tax costs are subject to many economic and political factors that are beyond our control, which may result in increases in our operating and financing costs

Some of our operating costs, including fuel, food, insurance and security costs, are subject to increases because of market forces and economic or political instability beyond our control. In addition, interest rates and our ability to secure debt or equity financing, including in order to finance the purchase of new ships, are dependent on many economic and political factors. Actions by U.S. and non-U.S. taxing jurisdictions could also cause an increase in our costs. Increases in operating, financing and tax costs could adversely affect our results because we may not be able to recover these increased costs through price increases of our cruise vacations.

Environmental legislation and regulations could affect operations and increase operating costs

Some environmental groups have lobbied for more stringent regulation of cruise ships. Some groups have also generated negative publicity about the cruise industry and its environmental impact. The U.S. Environmental Protection Agency (the EPA) is considering new laws and rules to manage cruise ship waste.

Our costs of complying with current and future environmental laws and regulations or liabilities arising from past or future releases of, or exposure to, hazardous substances or to vessel discharges, could increase the cost of compliance or otherwise materially adversely affect our business, results of operations or financial condition.

New regulation of health, safety and security issues could increase operating costs and adversely affect net income

We are subject to various international, national, state and local health, safety and security laws, regulations and treaties. IMO, which operates under the United Nations, has adopted safety standards as part of the SOLAS Convention, which is applicable to all of our ships. Generally SOLAS establishes vessel design, structural features, materials, construction and life saving equipment requirements to improve passenger safety and security.

In addition, ships that call on U.S. ports are subject to inspection by the U.S. Coast Guard for compliance with the SOLAS Convention and by the U.S. Public Health Service for sanitary standards. Our ships are also subject to similar inspections pursuant to the laws and regulations of various other countries our ships visit. Finally, the U.S. Congress recently enacted the Maritime Transportation Security Act of 2002 which implements a number of security measures at U.S. ports, including measures that relate to foreign flagged vessels calling at U.S. ports.

We believe that health, safety and security issues will continue to be areas of focus by relevant government authorities both in the U.S. and abroad. Resulting legislation or regulations, or changes in existing legislation or regulations, could impact our operations and would likely subject us to increasing compliance costs in the future.

Delays in ship construction and problems encountered at shipyards could reduce our profitability

The construction of cruise ships is a complex process and involves risks similar to those encountered in other sophisticated construction projects, including delays in completion and delivery. In addition, industrial actions and insolvency or financial problems of the shipyards building our ships could also delay or prevent the delivery of our ships under construction. These events could adversely affect our

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profitability. However, the impact from a delay in delivery could be mitigated by contractual provisions and refund guarantees we have obtained.

In addition, we have entered into forward foreign currency contracts to fix the cost in U.S. dollars of certain of our foreign currency denominated shipbuilding contracts. If any of the shipyards are unable to perform under the related contract, the foreign currency forward contracts related to that shipyard s shipbuilding contracts would still have to be honored. This might require us to realize a loss on an existing contract without having the ability to have an offsetting gain on our foreign currency denominated shipbuilding contract, thus adversely affecting our financial results.

Risks related to the Proposed Carnival Transaction

We also face risks associated with the Proposed Carnival DLC Transaction. These risks will be described in detail in the documents posted to our shareholders in connection with the Proposed Carnival DLC Transaction, including a shareholder circular with respect to the extraordinary general meeting of P&O Princess and a joint Form S-4/F-4 with respect to the deemed exchange of P&O Princess shares in connection with the Proposed Carnival DLC Transaction and the Partial Share Offer (collectively, the Shareholder Documents). The Shareholder Documents will contain important information, including risk factors, with respect to the Proposed Carnival DLC Transaction, the Partial Share Offer and an investment in P&O Princess and investors and P&O Princess shareholders are strongly encouraged to read the Shareholder Documents when they are posted to shareholders.

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ITEM 4. INFORMATION ON THE COMPANY

OUR COMPANY

We are an international cruise vacation company, with operations in North America, the United Kingdom, Germany and Australia. We are a leading provider of cruises to Alaska, the Caribbean, Europe, the Mediterranean, the Panama Canal and other locations (principally South America, the South Pacific, the Orient and India).

Historical background

P&O Princess was formed by the demerger of the cruise business of The Peninsular and Oriental Steam Navigation Company in October 2000. P&O Princess cruise business has had over 150 years of maritime history. From established positions in the United Kingdom and Australian cruise industries, P&O Princess improved its position in the North American cruise industry in the 1970s and 1980s through the acquisitions of Princess Cruises and Sitmar Cruises. Over the last decade, P&O Princess has grown mainly through new shipbuildings.

In the United Kingdom, we have a long history of passenger cruising which began in the 1840s and has included such well-known vessels as the Canberra. We have capitalized on the strength of the P&O Cruises brand with the successful introduction of four ships over the last seven years, two of which have been built specifically for the British market. In 2002 we announced the launch of a new United Kingdom cruise brand, Ocean Village, which is scheduled to commence operations in May 2003.

In 1999, we entered the German cruise industry with the acquisition of a majority stake in AIDA Cruises, which in its first seven years of operation has, according to commissioned third-party research, become one of the best known cruise products in Germany. In 2000, we acquired the remainder of AIDA Cruises and in 2002 commenced the operation of a new brand, A ROSA, in Germany.

In October 2002, we acquired two of the former Renaissance Cruises vessels under a lease purchase structure.

Proposed DLC Transaction with Carnival

On November 20, 2001, P&O Princess announced that it had entered into agreements to combine with Royal Caribbean under a DLC structure. On December 13, 2001, Carnival submitted a proposal to the P&O Princess Board regarding an offer to acquire the entire issued share capital of P&O Princess, which was subsequently increased in January and February 2002. The Board carefully considered Carnival s proposal and determined that it was not more favorable from a financial point of view to P&O Princess shareholders than the proposed transaction with Royal Caribbean and that there was reasonable doubt as to its deliverability. As a result, the Board determined P&O Princess could not negotiate with Carnival without breaching the agreements with Royal Caribbean.

In October 2002, after Carnival received all necessary regulatory clearances for its offer from the U.S. Federal Trade Commission and the European Commission, P&O Princess re-examined Carnival s offer and, in particular, Carnival s proposal to enter into a DLC transaction with P&O Princess as an alternative to its share acquisition offer. The Board determined that the Carnival DLC proposal was more favorable from a financial point of view to P&O Princess shareholders than the Royal Caribbean DLC combination and was reasonably likely to be consummated since all regulatory clearance had been obtained. As a result, P&O Princess was then willing and able to enter into talks with Carnival to discuss its DLC proposal.

On October 24, 2002, following negotiations with P&O Princess, Carnival announced the terms of a pre-conditional proposal to enter into a DLC transaction with P&O Princess. On October 25, 2002, the Board announced that it was withdrawing its recommendation of the Royal Caribbean DLC transaction. The

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Board also announced on October 25, 2002 that P&O Princess had entered into a Termination Agreement with Royal Caribbean which, upon payment of the agreed fee of $62.5 million, terminated the Royal IA immediately, terminated the Joint Venture Agreement on January 1, 2003, subject to there being no change of control of P&O Princess prior to that date, and provided mutual releases from liabilities arising under the two agreements. On January 2, 2003, P&O Princess announced that the joint-venture agreement had been terminated.

On January 8, 2003, P&O Princess and Carnival signed an Implementation Agreement to implement the Proposed Carnival DLC Transaction. The Board announced that it had agreed and recommended the proposal to enter into a DLC transaction with Carnival. The Board s recommendation of the Proposed Carnival DLC Transaction and our entry into the implementation agreement with Carnival satisfied the remaining pre-conditions to Carnival s DLC proposal.

We expect to convene an extraordinary general meeting in April for our shareholders to consider and vote on the Proposed Carnival DLC Transaction (the P&O Princess EGM). Detailed information on the Proposed Carnival DLC Transaction and the Partial Share Offer, including details of the P&O Princess EGM, will be included in the Shareholder Documents posted to P&O Princess shareholders. P&O Princess shareholders are strongly encouraged to read the Shareholder Documents.

For more information about the Proposed Carnival DLC Transaction, see Item 10. Additional Information Our Proposed DLC Transaction with Carnival on page 79, and for more information about the termination agreement with Royal Caribbean, see Item 10. Additional Information Termination Agreement with Royal Caribbean on page 82.

OUR BUSINESS

As of January 31, 2003, we had a fleet of 20 ocean cruise ships and two river vessels with an aggregate capacity of 33,100 lower berths. As of that date we also had an additional five ocean cruise ships and two river vessels on order with an aggregate capacity of 12,080 lower berths scheduled for delivery during the next two years. We have also announced the withdrawal of the chartered Minerva from our fleet in April 2003 and its replacement at that date by the former Renaissance Cruises vessel, R8, which has been renamed Minerva II, also under a charter arrangement.

We have some of the most widely recognized brands in the cruise industry, including:

North America

Princess Cruises Princess Cruises is the third largest cruise line in North America, in terms of berths, and is one of the best-known cruise brands. The brand targets experienced cruisers and travellers and draws its passengers primarily from North America. Princess has a destination focus and is a leading provider of cruises to Alaska, Europe, the Panama Canal and other exotic locations. The Princess fleet has a wide variety of dining and entertainment options onboard and has an industry leading proportion of balconied cabins. The scheduled program of fleet modernization and the introduction of new ships will increase the proportion of balconied cabins from 39% to 52% between December 31, 2001 and December 31, 2003 and will reduce the weighted average berth age of the fleet from 6.4 to 5.4 years over the same period. Princess also provides tour and shore excursion programs and is the leading Alaska cruise tour operator with five wilderness lodges located throughout Alaska.

Europe and Australia

P&O Cruises P&O Cruises is the largest cruise operator in the UK by number of berths and the best-known cruise brand in the United Kingdom. The fleet consists of Aurora, Oriana, Arcadia and Oceana. P&O Cruises offers cruises to the Mediterranean, the Baltic and Norwegian Fjords, the Caribbean as well as around the world voyages. The P&O Cruises fleet is undergoing a period of

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significant change. Oceana was introduced in November 2002, replacing Victoria. Adonia will be introduced to the fleet in May 2003, following the transfer of Arcadia to our new brand, Ocean Village. Between December 31, 2001 and December 31, 2003 the weighted average berth age of the fleet should decrease from 10.1 years to 5.3 years and the proportion of cabins with balconies in the fleet should increase from 19% to 35%.

Swan Hellenic Swan Hellenic operates a program of discovery cruises and tours. Itineraries include the Mediterranean, Arabia, India and the Far East. The introduction of the 2001 built Minerva II from April 2003 to replace the existing ship, Minerva, will provide more choice for customers. Over two thirds of Minerva II s cabins have balconies a much higher proportion than the current ship and with its faster service speed, the new ship will be able to offer a wider range of destinations in its discovery itineraries.

Ocean Village Ocean Village is a new cruise brand which has been established to provide informal, contemporary and affordable holidays at sea. Its cruise product will emphasise informality, health and well-being. The brand is specifically targeted at the wider holiday market and is designed to appeal primarily to 35-55 year olds. Ocean Village will provide a dedicated fly cruise product for the UK market from May 2003. The 2003 summer season itineraries will offer one and two-week Mediterranean cruises, together with cruise and stay holidays, and the 2003/2004 winter season itineraries will offer one and two week Caribbean cruises, together with cruise and stay holidays.

AIDA AIDA is one of the best-known brands in the German cruise industry. With its two club ships, AIDAcara and AIDAvita, AIDA offers cruises to the Mediterranean, Canary Islands and Caribbean. AIDA s style of cruising is referred to as club cruising and has an emphasis on informality and activity. AIDA caters exclusively to German speaking passengers and the brand targets younger package holiday customers around 65% of whom are first time cruisers.

A ROSA A ROSA is a new destination oriented brand catering exclusively to German-speaking customers. The A ROSA fleet comprises, one ocean cruise ship, A ROSA BLU, and two river cruise vessels. The 1,590 berth A ROSA BLU provides cruises to the Baltic, Canary Islands, the Mediterranean and the Caribbean. The two 200 berth river cruise vessels offer 7 day and 14 day cruises on the Danube.

P&O Cruises (Australia) P&O Cruises (Australia) is a cruise brand that caters to Australians. Its contemporary product, Pacific Sky, offers 7 night and 14 night cruises from Sydney to Vanuatu, New Caledonia, Fiji and New Zealand. Pacific Sky is the most modern ship deployed full time in Australia. Pacific Princess operates for half of the year as part of P&O Cruises Australia and offers a premium cruise product from Sydney to French New Caledonia and elsewhere in the South Pacific. One of the best known operators in the Australian cruise industry, P&O Cruises is a leading provider of round trip cruises from Sydney.

In addition, we own P&O Travel, a business-to-business travel agency, which is also responsible for the purchasing of part of our air travel requirements.

The vacation markets within which we operate

We provide cruise vacations in some of the largest vacation markets in the world: North America, the United Kingdom and Germany. A brief description of the principal vacation regions in which we operate is provided below.

North America

The largest vacation market in the world is North America. According to CLIA, approximately 7.4 million North American passengers took cruises for two consecutive nights or more in 2002.

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Estimates of North American-sourced cruise passengers and the number of lower berths marketed in North America compiled by CLIA from 1997 to 2002 are set out below:

Calendar Year	North American Cruise Passengers(1)	Lower Berths Marketed to North Americans(2)
1997	5,051,000	118,000
1998	5,428,000	138,000
1999	5,894,000	149,000
2000	6,882,000	166,000
2001	6,906,000	176,000
2002	7,400,000	193,000

(1) Based on passengers carried for at least two consecutive nights for the calendar year (2002 estimates are preliminary).
(2) As of the end of the calendar year. These figures include some ships which are marketed in North America and elsewhere.

The principal itineraries visited by North American cruise passengers in 2002 were the Caribbean, the Bahamas and Mexico. In addition, North American cruise passengers visited Alaska, Europe, the Mediterranean, Bermuda, the Panama Canal and other exotic locations, including South America, Africa, the South Pacific, the Orient and India.

Based on the number of ships that are currently on order worldwide and scheduled for delivery between 2003 and 2006, we expect that the net capacity serving North American consumers will increase significantly over the next several years. Projections compiled by CLIA indicate that by the end of 2003, 2004 and 2005, North America will be served by 187, 197 and 199 ships, respectively, having an aggregate passenger capacity of approximately 213,000, 236,000, and 240,000 lower berths, respectively. These figures include some ships that are expected to be marketed in North America and elsewhere. CLIA s estimates of capacity do not include assumptions related to unannounced ship withdrawals due to factors such as the age of ships or changes in the location from where ships passengers are predominantly sourced and, accordingly, could indicate a higher percentage growth in North American capacity than will actually occur. Nonetheless, we expect that net capacity serving North American-sourced cruise passengers will increase over the next several years.

Europe

We estimate that Europe is one of the largest vacation markets, but cruising in Europe has achieved a much lower penetration rate than in North America. We estimate that approximately 2.3 million European-sourced passengers took cruise vacations in 2002 compared to approximately 7.4 million North American-sourced passengers. However, from 1990 to 2002, the number of cruise passengers sourced from Europe has been growing faster than the number of cruise passengers sourced from North America. From 1997 through 2001, the rate at which Europeans took a cruise grew at a compound annual growth rate of 12 percent compared to an 8 percent growth rate with respect to North Americans. With respect to the European countries from which the most cruise passengers are sourced from 1997 through 2001 the compound annual growth rate in cruise passengers was 10 percent in the UK, 14 percent in France, 8 percent in Germany and 11 percent in Italy. Cruise vacation companies are continuing to expand their offerings in Europe. For example, more cruise vacations were marketed to European passengers in 2002 than in 2001. We expect that a number of new or existing ships will be introduced into Europe over the next several years.

United Kingdom

The U.K. is one of the largest sources for cruise passengers in the world. According to G.P Wild (International) Limited, approximately 0.8 million U.K. passengers took cruises in 2001. Cruising was

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relatively under developed as a vacation option for U.K. consumers until the mid-1990s, but since then there has been strong growth in the number of cruise passengers sourced from the U.K The number of U.K. cruise passengers increased by a compound annual growth rate of approximately 10 percent between 1997 and 2001. The main destination for U.K. cruise passengers is the Mediterranean. Other popular destinations for U.K. cruise passengers include the Caribbean, the Atlantic Islands, including the Canary Islands and the Azores, and Scandinavia.

Germany

Germany is one of the largest sources for cruise passengers in continental Europe with approximately 0.4 million cruise passengers in 2001. Germany exhibited a compound annual growth rate in the number of cruise passengers carried of approximately 8 percent. between 1997 and 2001. We believe that German cruising is an underdeveloped region for the cruise industry. The main destinations visited by German cruise passengers are the Mediterranean and the Caribbean. Other popular destinations for German cruise passengers include Scandinavia and the Atlantic Islands.

Australia

Cruising in Australia is relatively small but well established. We estimate that approximately 0.1 million Australians took cruise vacations in 2001. Cruising in Australia is mainly comprised of Sydney round-trip cruises, and a smaller fly-cruise option.

Characteristics of the Cruise Industry

Strong growth

The world s principal cruise markets have experienced significant growth in recent years. The number of new cruise ships currently on order from shipyards indicate that the growth in supply of cruise capacity is set to continue for a number of years. As a result of this continuing growth in supply, continued growth in demand across the industry, particularly in North America, will be required in order to take up this increase in supply. Given the historical growth rate of cruising and the relative low penetration levels in major vacation markets, we believe that there are significant areas for growth. However, in order for demand to meet available capacity, for the past few years there has been pressure on cruise pricing. See Risk Factors beginning on page 10.

Wide appeal of cruising

Cruising appeals to a wide demographic range of passengers. Industry surveys estimate that the principal passengers for cruising in North America (defined as households with income of $40,000 or more headed by a person who is at least 25 years old) now comprise approximately 128 million people. About half of these individuals have expressed an interest in a cruise as a vacation alternative.

Relatively Low Penetration levels

North America has the highest cruising penetration rates per capita. Nevertheless, CLIA estimates that only 15 percent of the U.S. population has ever taken a cruise. In the United Kingdom, where there has been significant expansion in the number of cruise passengers carried over the last five years, cruising penetration levels per capita are only approximately three-fifths of those of North America. In the principal vacation markets in continental Europe, cruising penetration levels per capita are approximately one-fifth of those in North America. Elsewhere in the world cruising is at an early stage of development and has far lower penetration rates.

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Satisfaction rates

Cruise passengers tend to rate their overall satisfaction with a cruise-based vacation higher than comparable land-based hotel and resort vacations. In North America, industry studies indicate that cruise passengers experience a high level of satisfaction with their cruise product, with 69 percent of cruisers finding the value of the cruise vacation experience to be as good as, or better than, the value of other vacations.

Our Strategy

As described above, on January 8, 2003, our Board recommended the Proposed Carnival DLC Transaction. The strategy of the Combined Group after the expected completion of the Proposed Carnival DLC Transaction will be described in detail in the Shareholder Documents to be posted to P&O Princess shareholders. P&O Princess shareholders are strongly encouraged to read the Shareholder Documents.

Our Brands and Products

We have some of the most widely recognized brands in the cruise industry. An overview of each brand is provided below.

Princess Cruises

Fleet deployment and market position

We currently have a fleet of 11 cruise ships under the Princess Cruises brand in North America. In 2002, Princess Cruises carried approximately 850,000 passengers. Princess Cruises passengers come mainly from North America, but are also sourced from elsewhere, including the United Kingdom. In January 2002, Princess took delivery of Star Princess which commenced passenger carryings in February 2002. In October 2002, P&O Princess took delivery of the former Renaissance Cruises vessels, R3 and R4, which were acquired in August 2002 under a lease purchase structure and renamed Pacific Princess and Tahitian Princess respectively. Pacific Princess entered passenger service in November 2002 and is the first P&O Princess ship to operate a split deployment between brands. In the period to April 2003 she will offer cruises to Australians under the P&O Cruises brand and from May to November 2003, will be marketed mainly to North Americans under the Princess Cruises brand. Tahitian Princess commenced passenger carryings under the Princess brand in December 2002. Coral Princess entered passenger service in January 2003 and Island Princess, after a slight delay in construction, is expected to enter passenger service in July 2003.

Ocean Princess left the Princess fleet in October 2002 and was transferred to P&O Cruises in the United Kingdom (and renamed Oceana) and the 1971-built Pacific Princess left the P&O Princess fleet in November 2002. Sea Princess is scheduled to be transferred to the P&O Cruises fleet in the United Kingdom in the second quarter of 2003, where she will be renamed Adonia.

The planned Winter 2002/2003 and Summer 2003 deployment for vessels in the Princess fleet is shown in the table below.

Vessel	Year of delivery	Capacity (lower berths)	Winter 2002/2003	Summer 2003
Royal Princess	1984	1,200	Exotics(1)	Europe
Regal Princess	1991	1,590	Exotics(1)	Europe
Sun Princess	1995	2,020	Panama Canal, Mexico/Hawaii	Alaska
Dawn Princess	1997	2,000	Caribbean	Alaska

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Vessel	Year of delivery	Capacity (lower berths)	Winter 2002/2003	Summer 2003
Grand Princess	1998	2,590	Caribbean	Caribbean(6)
Sea Princess(2)	1998	2,010	Caribbean	n/a
Pacific Princess(3)	1999	670	n/a	Alaska
Tahitian Princess(4)	1999	670	Exotics(1)	Exotics(1)
Golden Princess	2001	2,600	Caribbean	Europe
Star Princess	2002	2,600	Mexico	Alaska
Coral Princess	2002	1,970	Panama Canal	Alaska
Island Princess(5)	2003	1,970	n/a	Alaska

(1) Principally Tahiti, South America, the South Pacific, the Orient and India.
(2) Due to be transferred to P&O Cruises in the United Kingdom in the second quarter of 2003 and renamed Adonia.
(3) Former Renaissance Cruises vessel R3, delivered pursuant to a lease purchase structure in October 2002. The ship commenced passenger operations in Australia in November 2002, and will be deployed under the Princess Cruises brand from May 2003 to November 2003.
(4) Former Renaissance Cruises vessel R4, delivered pursuant to a lease purchase structure in October 2002. The ship commenced passenger operations in December 2002.
(5) Due to enter passenger service in July 2003.
(6) Vessel redeployment from Europe to the Caribbean announced in February 2003.

Princess Cruises is the third largest cruise vacation brand in North America measured in terms of berths and is a leading provider of cruises to Alaska, Europe, the Panama Canal and other exotic locations (principally South America, the South Pacific, the Orient and India). Princess Cruises refers to these as the destination trades. Operating cruises to these destinations and providing suitable tour and shore excursion programs requires a complex supply and logistics organization, and Princess Cruises has extensive experience in providing this type of cruising. Princess Cruises is also a leading provider of cruises to the Caribbean.

Princess Cruises also operates a private destination port of call known as Princess Cays on the Bahamian Island of Eleuthera which features retail outlets, watersports, beach and sports facilities, restaurants, bars and other amenities.

Brand and product positioning

The quality of the Princess Cruises fleet has allowed Princess Cruises to retain a leading position in the destination trades of Alaska, Europe, the Panama Canal, and other exotic locations, (principally South America, the South Pacific, the Orient and India) as well as to expand in the Caribbean trade.

In 1995 Princess Cruises introduced Sun Princess, the first of a class of vessel characterized by a high proportion of balcony cabins and a wide choice of dining, entertainment and other activities.

Between 1997 and 2000, Princess Cruises introduced three sister ships to Sun Princess, namely, Dawn Princess, Sea Princess and Ocean Princess. The Sun Princess class was followed in 1998 by the Grand Princess design that further developed and pioneered the concept of providing choice and a personalized experience for cruise passengers. Golden Princess, the first of the sister ships to Grand Princess, commenced operation in May 2001, and Star Princess, the second sister ship to Grand Princess commenced passenger operation in February 2002, as the first mega ship to be dedicated to the West Coast of North America.

Coral Princess, a new class of maxi-ship able to transit the Panama Canal entered passenger service in January 2003 and her sister ship, Island Princess, is scheduled to enter passenger service in July 2003. Approximately 75 percent of cabins on these ships have balconies.

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P&O Princess has two new mega-ships under construction at Mitsubishi Heavy Industries   Nagasaki shipyard, which are scheduled to join the Princess Cruises brand as Diamond Princess and Sapphire Princess. On each of these ships, over 70 percent of the cabins will be outside cabins and more than 75 percent of these will have private balconies. In October 2002, a major fire broke out on board one of the ships while under construction in the shipyard. The two ships from the yard will now be delivered in February and May 2004, respectively. The first will have its inaugural season in Mexico and the second ship will be based in Seattle for roundtrip Alaska cruises. The 3,100 lower berth Caribbean Princess is also expected to join the fleet in the second quarter of 2004.

In addition, two of the former Renaissance Cruises vessels, R3 and R4, joined the fleet as Pacific Princess and Tahitian Princess, respectively, in October 2002. These ships have similar features to the other vessels in the Princess fleet with over two thirds of the cabins on each ship having balconies, and with the ships incorporating a wide variety of dining alternatives. The Princess fleet includes a choice of small, medium-sized and large vessels appealing to a wide range of passenger tastes.

The changes described above will improve the overall quality of the Princess fleet and will give its customers a broader choice of amenity filled ships. The proportion of balconied cabins across the Princess fleet should increase from 39 percent on December 31, 2001 to 52 percent on December 31, 2003. The weighted average berth age of the fleet should fall from 6.4 years to 5.4 years over the same period. P&O Princess believes that these changes will also improve the cost structure of its fleet.

Princess Cruises has continued to innovate and improve its product. Princess has introduced a number of ways to give its passengers more opportunities to customise their holiday experience. The introduction of   Personal Choice   cruising has been very well received by passengers and continues to differentiate its product. A key part of this has been Personal Choice Dining, which Princess has rolled out across much of its fleet. This is a flexible dining program, which gives passengers freedom to choose between a restaurant style dining option and the more traditional cruise experience of dining at an assigned time, in an assigned restaurant with the same dining partners and waiting staff throughout the cruise. The Princess Cruises website (www.princess.com) includes a cruise personalizer enabling passengers to pre-book their shore excursions and customise other aspects of their cruise.

Princess Cruises has a customer awareness program called CRUISE (Courtesy, Respect, Unfailing in Service Excellence) which is designed to educate and motivate staff to provide the highest levels of customer service.

The cruise-tour experience

Princess Cruises provides combined cruise and land-based tours in Alaska. Princess Cruises also offers cruise tours in a variety of other locations worldwide, including the Orient, Africa, South America, Australia and Europe.

Princess Cruises is a leading Alaska cruise and cruise-tour operator offering cruise itineraries that extend far north into the Gulf of Alaska beyond Glacier Bay to locations such as College Fjord and Seward. From Seward, customers can choose from a large selection of land-based tours, including excursions into the Denali National Park and tours of the interior of Alaska. Princess Cruises also offers tours of the Canadian Rockies.

Princess Cruises operates five lodges located throughout Alaska with a total of approximately 1,100 rooms. All of these properties are situated beside rivers and are properties that have been built to provide Princess Cruises   cruise tour passengers with a comfortable   wilderness lodge   experience. The most recently built lodge, the Copper River Wilderness Lodge in the Wrangell-St. Elias region of Alaska, opened in May 2002.

Customers generally travel to these lodges by Princess Cruises   Midnight Sun Express ULTRA DOME rail cars which offer excellent all-around views of the terrain and mountains and a fine dining experience.

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Princess Cruises currently operates ten ULTRA DOME rail cars. Princess Cruises also employs a fleet of over 220 tour buses, which it uses to provide tours and transportation. Princess Cruises offers a variety of further recreation options to its customers that include hiking, horseback riding, river rafting, sightseeing and visits to local places of interest.

P&O Cruises

Fleet deployment and market position

We currently operate a fleet of four cruise ships serving U.K. cruise passengers under the P&O Cruises brand. In 2002, P&O Cruises carried approximately 154,000 passengers, sourced almost exclusively from the United Kingdom. In the United Kingdom, P&O Cruises is the largest cruise operator by number of berths. In November 2002, Oceana (formerly Ocean Princess) joined the fleet from Princess Cruises, replacing Victoria which left the fleet in the same month. Adonia (currently Sea Princess) is scheduled to join the P&O Cruises fleet in May 2003. She will replace Arcadia which is scheduled to leave the P&O Cruises fleet in March 2003 to join the new U.K. brand Ocean Village. The planned Winter 2002/2003 and Summer 2003 deployment for the vessels in the P&O Cruises fleet is shown in the table below.

Vessel	Year of Delivery	Capacity (lower berths)	Winter 2002/2003	Summer 2003
Arcadia(1)	1989	1,450	Caribbean/Exotics	n/a
Oriana	1995	1,830	Around the World	Europe
Aurora	2000	1,870	Around the World	Europe
Oceana	2000	2,020	Caribbean	Europe
Adonia(2)	1998	2,010	n/a	Europe

(1) In March 2003 Arcadia is scheduled to leave the fleet in preparation for its transfer to the new Ocean Village brand.
(2) Adonia is scheduled to enter the U.K. fleet from the Princess Cruises fleet in May 2003.

P&O Cruises also acts as a general sales agent for Princess Cruises in the U.K.

Brand and product positioning

P&O Cruises introduced Oriana in 1995 and Aurora in 2000, making it one of the only cruise operators to have recently designed and built new vessels exclusively for U.K. cruise passengers. In November 2002, Oceana (formerly Ocean Princess) entered the P&O Cruises fleet, having been refitted and tailored to meet the tastes and preferences of U.K. passengers. She will be followed in May 2003 by Adonia, which is currently sailing in the Princess fleet as Sea Princess. These new and transferred vessels have a wider choice of dining and entertainment options and a higher proportion of cabins with balconies than other ships specifically directed at U.K. cruise passengers. They have enabled P&O Cruises to continue to develop a modern style of cruising for U.K. cruise passengers, with a welcoming atmosphere and an emphasis on the attributes of Britishness , professionalism and style . Market studies indicate that these elements have appealed strongly to the British market and have further developed P&O Cruises reputation for quality and reliability. P&O Princess believes that the more modern positioning has enabled P&O Cruises to increase its appeal to younger and family passengers as well as to older and more traditional British customers. Each of the ships in the fleet has its own distinctive product positioning including one ship (currently Arcadia and from second quarter 2003, Adonia) entirely dedicated to adults. The fleet changes described above will further improve the quality of the P&O Cruises fleet. For instance, between December 31, 2001 and December 31, 2003, the weighted average berth age of its fleet should decrease from 10.1 years to 5.3 years and the proportion of cabins with balconies in the fleet should increase from 19 percent to 35 percent.

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During 2001, P&O Cruises introduced bistro-style dining options onto all its U.K. ships, giving its passengers increased flexibility and choice. P&O Princess in the U.K. also successfully introduced the CRUISE customer service program on its ships and ashore. The Mayflower Cruise Terminal in Southampton, P&O Cruises home port, is currently being redeveloped to cater for the planned expansion in the business.

Swan Hellenic

Swan Hellenic is a specialist provider of discovery cruises operating the cruise vessel Minerva with itineraries throughout Europe, India and the Orient. In 2002, Minerva carried approximately 7,500 passengers. This product is intended to appeal to passengers seeking to discover more about the destinations they are visiting. During these cruises, experts give talks and demonstrations to enhance the discovery experience.

In March 2002, we announced that Swan Hellenic had chartered the former Renaissance Cruises vessel R8, which has been re-named Minerva II, to replace the existing ship, Minerva. Minerva II, which was built in 2001, has 676 lower berths and is expected to start operations under the Swan Hellenic brand in April 2003, when the current charter for Minerva ends. Over two thirds of Minerva II s cabins have balconies, compared with only 7 percent on the current ship. With its faster service speed, the new ship will also be able to offer a wider range of destinations and itineraries.

Ocean Village

We believe there is strong potential for growth in cruising within the United Kingdom, and announced in April 2002 the creation of a new brand, Ocean Village, which will target a young and active customer base, with the aim of further expanding the appeal of cruising within the United Kingdom.

Initially, Ocean Village will have one ship, providing a dedicated fly-cruise product for the United Kingdom from May 2003. The ship, currently called Arcadia and part of the P&O Cruises UK fleet, will undergo a refit to provide 1,610 lower berths (increased from the existing 1,450 lower berths), eight bars, an internet cafe and a bistro endorsed by the TV chef, James Martin. She will provide a cruise experience designed for British passengers, with a relaxed contemporary atmosphere and an emphasis on informality, health and well-being. The 2003 summer season itineraries will offer one and two-week Mediterranean cruises, together with cruise and stay holidays, based on two alternating seven night itineraries sailing from Palma, Majorca. In Winter 2003/2004 the ship will offer one and two-week Caribbean cruises, together with cruise and stay holidays, based on two alternating seven night itineraries sailing from Barbados.

AIDA

Fleet deployment and market position

We currently operate two ships under the AIDA brand. In 2002, AIDA carried approximately 76,000 passengers sourced from German-speaking countries, the majority of whom came from Germany. AIDA provides European summer and Caribbean and Canary Island winter cruises. In May 2002 the 1,270 lower berth newbuild AIDAvita was added to the fleet and her sister ship, AIDAaura, is scheduled for delivery in April 2003.

Brand and product positioning

AIDA is designed for, and caters exclusively to, German-speaking passengers. AIDA s marketing is targeted at 20-50 year old package vacation customers who would otherwise typically take a land-based vacation. We refer to AIDA s style and concept of cruising as club cruising . Club cruising is a more casual but sophisticated cruise experience with an emphasis on lifestyle, informality, friendliness and activity. Spa areas and high quality, but informal, dining options characterize the experience on board the vessels.

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A ROSA

In July 2001, we launched A ROSA, a new consumer cruise brand in Germany with a destination-focused product in a German-speaking environment. A ROSA BLU, previously the Crown Princess, was refitted to meet German tastes and the requirements of the A ROSA brand and commenced operational service in June 2002. A ROSA BLU was deployed in the Baltic and the Mediterranean in Summer 2002 and is scheduled to be deployed to the Caribbean and Canary Islands in Winter 2002/2003. In 2002, A ROSA BLU carried approximately 28,000 passengers. Regal Princess is currently expected to be transferred from the Princess fleet in North America to the A ROSA fleet in the second quarter of 2004.

In addition, we operate A ROSA Bella and A ROSA Donna, two river cruise vessels of 200 berths each, built in 2002. As of January 31, 2003, we had two further river vessels on order, A ROSA Mia, which was delivered in February 2003 and is expected to enter operational service in April 2003, and an as yet unnamed vessel due in Spring 2004.

P&O Cruises (Australia)

Fleet deployment and market position

We operate the cruise ship Pacific Sky serving Australian cruise passengers under the P&O Cruises (Australia) brand and provides Sydney round-trip itineraries to Vanuatu, New Caledonia and Fiji lasting nine days or more. In 2002, Pacific Sky carried approximately 58,000 passengers. P&O Cruises (Australia) is one of the leading Australian cruise operators and has the largest share of the Sydney round-trip trade, which is the most popular type of cruise among Australians. The Pacific Sky is the most modern ship deployed full time in Australia. In 2002 Pacific Sky also offered a number of round-trip cruises from Auckland for New Zealand passengers for the first time and the success of this has ensured a planned repeat deployment in 2003.

In October 2002, we took delivery of the former Renaissance Cruises vessel R3 and renamed her Pacific Princess. Pacific Princess entered passenger service in November 2002 and is the first P&O Princess ship to operate a split deployment. In 2002, Pacific Princess carried approximately 3,000 passengers. In the period to April 2003 she will be homeported in Sydney and will offer cruises to Australians sailing to French New Caledonia and elsewhere in the South Pacific. From May to November 2003, the vessel will be marketed mainly to North Americans under the Princess Cruises brand.

With the addition of the Pacific Princess to Pacific Sky, P&O Cruises in Australia will increase its capacity by approximately 30 percent and will provide products designed to appeal to a wide range of Australian consumer tastes.

Brand and product positioning

P&O Cruises (Australia) provides a contemporary experience on Pacific Sky. The product on this ship is designed to appeal to Australians and to have a fun and youthful image and passengers   experience on board the vessel is intended to be casual and relaxed. P&O Cruises prices the product at a level which is intended to be affordable, accessible and good value for money. P&O Cruises (Australia) offers a premium product on Pacific Princess, designed to appeal to a more experienced cruise passenger.

P&O Travel

In addition, we own P&O Travel, a business-to-business travel agency, which is also responsible for the purchasing of part of P&O Princess   air travel requirements.

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P&O Princess fleet

As of January 31, 2003, our fleet consisted of 20 ocean cruise ships and two river vessels with an aggregate capacity of 33,100 lower berths. As of that date our ocean cruise fleet had an average vessel age (weighted by berths) of 6.1 years, an average vessel size of approximately 1,635 lower berths and 38 percent of its cabins had private balconies.

The majority of our fleet flies the British flag, known as the Red Ensign, and is registered in the United Kingdom or Bermuda. We believe that ships flying the Red Ensign are expected to meet high standards for ship operation and crew training.

The following table includes summary information concerning the ships in our fleet as of January 31, 2003 and their registry, year of delivery, gross tonnage and capacity:

Vessels	Registry	Year of delivery	Gross Tonnage	Capacity (lower berths)
North America				
Royal Princess	U.K.	1984	45,000	1,200
Regal Princess(1)	U.K.	1991	70,000	1,590
Sun Princess	U.K.	1995	77,000	2,020
Dawn Princess	U.K.	1997	77,000	2,000
Grand Princess	Bermuda	1998	109,000	2,590
Sea Princess(2)	U.K.	1998	77,000	2,010
Pacific Princess(3)	Gibraltar	1999	30,000	670
Tahitian Princess(4)	Gibraltar	1999	30,000	670
Golden Princess	Bermuda	2001	109,000	2,600
Star Princess	Bermuda	2002	109,000	2,600
Coral Princess	Bermuda	2002	92,000	1,970
United Kingdom				
Arcadia(5)	U.K.	1989	64,000	1,450
Oriana	U.K.	1995	69,000	1,830
Minerva(6)	Bahamas	1996	13,000	360
Aurora	U.K.	2000	76,000	1,870
Oceana	U.K.	2000	77,000	2,020
Germany				
AIDAcara	U.K.	1996	39,000	1,190
AIDAvita	U.K.	2002	42,000	1,270
A ROSA BLU	U.K.	1990	70,000	1,590
Germany (river boats)				
A ROSA DONNA	Germany	2002	3,500	200
A ROSA BELLA	Germany	2002	3,500	200
Australia				
Pacific Sky	U.K.	1984	46,000	1,200

Total	33,100

(1) Currently expected to be transferred to A ROSA in the second quarter of 2004.
(2) To be transferred to P&O Cruises in the U.K. in the second quarter of 2003 and renamed Adonia.

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(3) Former Renaissance Cruises vessel R3, delivered pursuant to a lease purchase structure in October 2002. The ship commenced passenger operations in November 2002 and operates on a split deployment between Princess Cruises and P&O Cruises (Australia).

(4) Former Renaissance Cruises vessel R4, delivered pursuant to a lease purchase structure in October 2002. The ship commenced passenger operations in December 2002.

(5) In March 2003, Arcadia is scheduled to leave the P&O Cruises UK fleet. Following a refit which will result in the creation of an additional 160 lower berths, she will commence sailings under the Ocean Village brand in May 2003.

(6) Chartered. To be withdrawn from the fleet in April 2003 and replaced by the charter of Minerva II.

Vessel safety and reliability

We have introduced a number of features and measures on our ships operating out of North America and the United Kingdom to enhance the safety and protect the value of these vessels which surpass the operating and safety systems required by international laws and regulations. See Regulation of the Cruise Industry below. Such features include equipping ships with voyage event recorders and comprehensive back-up systems, the presence of which helps to reduce the likelihood of breakdowns or other interruptions. We believe these features and measures have resulted in low unscheduled out-of-service periods for our fleet and we have also received a number of awards for our environmental and safety policies.

Waste management and energy efficiency

P&O Princess is committed to helping to conserve the natural environment. To minimize harmful impacts that may be associated with our wastes and discharges, we have sought to adopt more efficient operational and management practices and to equip our ships with improved treatment technologies.

Managing our fossil fuel consumption and associated air emissions is of prime importance. We strive to reduce emissions levels through investing in the development of new technologies and through effective fuel management programs.

The majority of our ships under construction are being fitted with environmentally cleaner engines designed to reduce nitrogen oxide and particulate emissions. Coral Princess is the first in the series of newbuilds to be in operation with these environmental technologies. Island Princess, Diamond Princess and Sapphire Princess will also be fitted with similar environmentally friendly technologies. We are working with leading engine manufacturers to develop systems in order to enable control technologies to be retrofitted to other newbuilds and older vessels in the fleet.

Our shore power system in Juneau, Alaska has been operating successfully and we have now equipped six ships in our fleet with the appropriate connections. While in port, the connected ship is able to turn off its diesel generators and boilers and run all onboard services from surplus hydroelectric power and from a shore based boiler, thereby cutting smoke emissions and fuel consumption.

Control of our sea emissions is also of primary importance and we continue to promote the development of innovative systems and processes to treat our ballast, bilge and wastewaters. P&O Princess was one of the first cruise companies to trial and install technologies for effectively treating ballast water, with three of our ships now operating and testing various system designs. It is now also company policy that all ships are fitted with internationally approved coalescing and centrifugal oily water separators. In addition, we are implementing a program of fitting bio-membrane wastewater treatment technology systems to our new and existing ships.

P&O Princess also places a high priority on minimizing and responsibly managing waste production and on ensuring that we have in place effective waste management standards as well as waste sorting and segregation policies. Our waste minimization initiatives include the use of digital x-ray equipment and water-based chemical dry-cleaning systems together with a program to reduce the number of chemicals used on board.

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Cruise ship construction

As of January 31, 2003, we had five cruise ships on order, information on which is provided below:

Vessel	**Capacity (lower berths)**	**Yard**	**Estimated delivery date**
AIDAaura	1,270	Aker Werft	Second quarter 2003
Island Princess	1,970	Chantiers de l Atlantique	Second quarter 2003
Diamond Princess(1)	2,670	Mitsubishi	First quarter 2004
Sapphire Princess(2)	2,670	Mitsubishi	Second quarter 2004
Caribbean Princess	3,100	Fincantieri	Second quarter 2004

(1) Formerly due to be named Sapphire Princess
(2) Formerly due to be named Diamond Princess

No assurance can be made that the vessels under construction will be introduced into service by the estimated delivery date.

With respect to our German operations, as of January 31, 2003, we had two further river cruise vessels of 200 berths each on order, the first of which was delivered in February 2003 and the second to be delivered in Spring 2004.

The ship that was previously due to be named Diamond Princess (and which will now be named Sapphire Princess), currently under construction in Mitsubishi Heavy Industries Nagasaki shipyard, suffered a major fire in early October 2002, following which a revised delivery schedule for both ships under construction at the yard was announced. The estimated delivery date of the second ship (which was previously due to be named Sapphire Princess) was brought forward from May 2004 to February 2004 and it was announced that this ship would be named Diamond Princess. It was announced that the ship that suffered the fire would be delivered in May 2004 and would now be named Sapphire Princess.

We believe that our new vessels on order will further enhance our reputation for innovation and choice. These ships will incorporate systems to improve further the safety and reliability of vessels in the fleet and their design will incorporate leading environmental protection technology. As was the case with the Coral Princess, the three vessels currently on order from Mitsubishi and Chantiers de l Atlantique will incorporate major parts of their propulsion systems, normally located in the vessel s engine rooms, in their funnels. This will reduce the size of the engine rooms and associated exhaust and other systems and release additional space for cabins and public area amenities.

We have diversified our sourcing for new vessels, having ships constructed by five major shipyards throughout the world in the last few years, and we are the first major cruise line to place an order in Asia with Mitsubishi Heavy Industries. We believe that this will give us flexibility of supply in the future.

Cruise pricing and revenues

We derive our revenues from a number of sources. The principal sources of revenue are sales of our cruises often including air transportation to and from the cruise departure ports, tours and other related activities. Included within the price of a cruise is a wide variety of activities and amenities, including meals and entertainment, together with access to a variety of facilities such as swimming pools, theatres and nightclubs, cinemas, casinos, discos and health clubs. Cruise prices vary depending on the destination, cruise length, cabin category and the time of year the vacation takes place. We also generally offer discounts as part of early booking programs and other promotional activities. The prices of our cruise tours include the cruise, scheduled land tours, lodge accommodation and access to the lodge facilities and attractions. Prices of the lodge accommodation and land tours vary depending on the type and length of land tour and the time of year the vacation takes place. For Swan Hellenic, the cruise price also includes gratuities and a full program of excursions.

We arrange air transportation as a service for customers who elect to use our air reservation services generally as part of a fly-cruise package. Air transportation prices can vary by gateway and destination.

We engage in yield management techniques across our cruise business to assist in pricing, inventory control and air routing. These techniques help us to maximize revenues and vessel and lodge occupancy by projecting demand and allowing us to focus our direct marketing and promotional efforts. We have developed and invested in sophisticated pricing and revenue management systems which we believe enable us to react quickly to changes in market conditions.

In addition to the prices of cruises, tours and air transportation, we earn revenues from gaming in shipboard casinos, the sale of alcoholic and other beverages, the sale of gift shop items, photography products and services, spa products and services and shore excursions. While we operate and manage most on-board activities ourselves, some are managed by independent concessionaires from whom we collect a portion of their income or a fee.

Shore excursions are provided at vessels ports of call and include activities such as general sightseeing, walking and trekking, water activities and sports, visits to local attractions, and local boat and beach parties. Shore excursions and tour components of cruise tours are operated either by us or by independent tour operators.

Seasonality

See Item 5. Operating and Financial Review and Prospects Seasonality and Quarterly Results on page 46.

Sales relationships and marketing activities

We are a customer service driven company and continue to invest in our service organization to assist travel agents and customers. We believe that our support systems and infrastructure are among the strongest in the cruise industry.

We sell our cruises and tours mainly through travel agents. These relationships are not exclusive and most travel agents also sell cruises and other vacations provided by our competitors. Our policy towards travel agents is to train and motivate them to support our products with competitive sales and pricing policies and joint marketing programs. We also use a wide variety of marketing techniques, including websites, seminars and videos, to familiarize the agents with our cruise brands and products. In each of our principal markets, we have familiarized the travel agency community with our cruise brands and products.

Travel agents generally receive standard commissions of 10 percent, plus the potential of additional commissions based on sales volume. Due to the complex nature of a cruise booking, commission rates earned by travel agents on cruise vacations are usually higher than commission rates on sales of airline tickets and hotel rooms.

Our investment in customer service has been focused on the development of systems and employees. We have improved our systems within the reservations, quality assurance, and customer relationship management functions, emphasising the continued support of the travel agency community while simultaneously developing greater contact and interactivity with our customer base. We have individual websites for each of our brands which provide access to information about our products to internet users throughout the world. The Princess Cruises site provides a booking engine for travel agents and access to booking information for passengers with existing bookings, ship and wedding web cams, and a shore

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excursion reservations system that enables passengers to pre-reserve in advance of travel. We also support booking capabilities through all major airline computer reservation systems (CRS) including SABRE, Galileo, Amadeus and Worldspan.

We have also invested in our customer databases. The Princess Cruises passenger database contains information on over 7 million households. Over 2 million of these households contain people who have cruised with Princess Cruises. In the United Kingdom, the P&O Cruises passenger database contains information on over 0.6 million households.

We have focused on staff training and development. The CRUISE program in North America is a customer awareness program designed to educate and motivate shipboard and shoreside staff to provide the highest levels of customer service. The program has been popular with employees, and we believe this has contributed to the increased satisfaction levels of Princess Cruises customers over the last two years. In 2000, the CRUISE program was extended to cover shore excursion staff in the Caribbean, Mexico and Alaska. In 2001, an equivalent program, CRUISE, was successfully introduced in the United Kingdom both on board ships and shoreside.

We have pursued comprehensive marketing campaigns to market our brands to customers. The principal media used are magazine and newspaper advertisements and promotional campaigns. We use television advertising to a significant extent.

Competition

We compete both with a wide array of land-based vacation alternatives and with other cruise lines for consumers disposable leisure time dollars.

We compete with land-based vacation alternatives throughout the world, including, among others, resorts and hotels located in Las Vegas, Nevada, Orlando, Florida, various Caribbean, Mexican, Bahamian and Hawaiian Island destination resorts and numerous vacation destinations throughout Europe and the rest of the world. Specifically, our land-based competitors include, among many others, MyTravel, Club Mediterranee, GoGo Tours, Fairfield Communities Vacation Ownership Club, First Choice, Harrah s Entertainment, Hilton Hotels, Hyatt Hotels, Kuoni Travel, Mandalay Resort Group, Disney, Universal Studios, Marriott International Resorts and the Marriott Vacation Ownership Club, MGM Grand, Nouvelle Frontieres, Perillo Tours, Ritz-Carlton Hotels, Saga Tours, Six Flags, Starwood Hotels and Resorts, Sandals Resorts, Sun City Resorts, Thomas Cook, Trafalgar and companies in the TUI group, as well as various other theme parks.

Our primary cruise competitors for North American-sourced passengers are Carnival Corporation (with whom we have entered into an agreement to combine in the Proposed Carnival DLC Transaction), which owns, among others Carnival Cruise Lines, Holland America Line, Cunard Line and Costa Cruises, Royal Caribbean, which owns Royal Caribbean International and Celebrity Cruises, Star Cruises, which owns Norwegian Cruise Line and Orient Lines and Disney Cruise Line.

Our cruise competitors for UK-sourced passengers include MyTravel s Sun Cruises, Fred Olsen, Saga, Thomson and Cunard (owned by Carnival Corporation). Our cruise competitors for German-sourced passengers include Hapag-Lloyd, Peter Deilmann and Phoenix Reisen. We also compete for passengers in the UK, Germany and throughout Europe with Costa Cruises (owned by Carnival Corp), Norwegian Cruise Line, Royal Caribbean International, Orient Lines, Celebrity Cruises, Festival, Louis Cruise Line, Mediterranean Shipping Cruises and Royal Olympia Cruises.

Our primary cruise competitors for Australian and New Zealand-sourced cruise passengers are Star Cruises and other international operators.

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Suppliers

Excluding the purchase of cruise ships, our largest expenditures are for airfare, travel agency commissions, advertising, food, beverage and hotel supplies, port charges, repairs and maintenance and fuel. We also bear the costs of purchasing and developing hotel sites and related infrastructure investment in Alaska. The supplies that are required for the operation of our business are generally available at competitive prices from a number of sources. Excluding contracts for the purchase of cruise ships, we are not aware of any contract with suppliers upon which we are dependent or which is material to our business and profitability.

Employees

In 2002 we employed an average of 3,654 staff in our corporate offices, hotels, travel offices and other shoreside facilities and an average of 16,298 officers, crew and staff on our vessels. A significant proportion of employees that work on our ships are unionised or are party to similar collective agreements. We believe that our employee and union relations are good.

We source the staff employed on our vessels from around the world with the principal sources being the Philippines, India, the United Kingdom, Mexico, Italy and Eastern Europe. We utilize a number of manning agents in these countries to secure the required staff.

Pensions

We are a contributing employer to various pension schemes, including some multi-employer merchant navy industry schemes.

In the United Kingdom, we operate our own defined benefit pension scheme, the assets of which are managed on behalf of the trustee by independent fund managers. This scheme is closed to new membership. As of March 31, 2001, the date of the most recent formal actuarial valuation, the scheme had assets with a market value of $60.9 million, representing 102 percent of the benefits accrued to members allowing for future increases in earnings. Approximately 70 percent of the scheme s assets are invested in bonds and 30 percent in equities.

The Merchant Navy Ratings Pension Fund (MNRPF) is a defined benefit multi-employer scheme in which sea staff employed by companies within the P&O Princess group have participated. The scheme has a significant funding deficit and has been closed to further benefit accrual. Companies within the P&O Princess group, along with other employers, are making payments into the scheme under a non-binding Memorandum of Understanding to reduce the deficit. Payments by P&O Princess group companies to the scheme in 2002 totaled $2.0 million, which represented 7 percent of the total payments made by all employers. As of March 31, 2002, the date of the most recent formal actuarial valuation, the scheme had assets with a market value of $814 million, representing 84 percent of the benefits accrued to members. Approximately 68 percent of the scheme s assets were invested in bonds, 25 percent in equities and 7 percent in property.

The Merchant Navy Officers Pension Fund (MNOPF) is a defined benefit multi-employer scheme in which officers employed by companies within the P&O Princess group have participated and continue to participate. This scheme is closed to new membership. The share of contributions being made to the scheme by P&O Princess group companies (based on the year to December 31, 2002) was approximately 7 percent. However, the extent of each participating employer s liability for any deficit in the scheme is uncertain. Accordingly, P&O Princess accounts for the scheme on a contributions paid basis, as if it were a defined contribution scheme. The scheme is divided into two sections the New Section and the Old Section. As of March 31, 2000, the date of the most recent formal actuarial valuation, the New Section had assets with a market value of $2,680 million, representing approximately 100 percent of the benefits accrued to members. At the date of valuation, approximately 77 percent of the New Section s assets were invested in equities, 14 percent in bonds and 9 percent in property and cash. As a result of this asset distribution, it is expected that the fall in equity markets since March 2000 will have resulted in the New Section now showing a significant funding deficit. The Old Section has been closed to benefit accrual since 1978. As of March 31, 2000, the date of the most recent formal actuarial valuation, it had assets with a market value of $2,233 million representing approximately 111 percent of the benefits accrued to members. The assets of the Old Section are substantially invested in bonds. Contributions from P&O Princess group companies to the MNOPF during the year to December 31, 2002 were $1.2 million.

We also operate a number of smaller defined benefit schemes in the U.S. which are unfunded, other than assets in a Rabbi Trust held on the P&O Princess group s balance sheet, and make contributions to various defined contribution schemes in various jurisdictions.

The actuarial valuations of the P&O Princess schemes and P&O Princess group s share of the MNRPF have been updated to December 31, 2002. Based on the assumptions used, which are best estimates chosen from a range of possible actuarial assumptions which may not necessarily be borne out in practice, the estimated net pension liability as of December 31, 2002 arising from these schemes was $41.3 million.

It is estimated that the funding position of the MNOPF has changed significantly since the valuation as of March 31, 2000 referred to above and that the New Section is now in deficit. The Annual Report of the MNOPF for the year ended March 31, 2002 showed that the market value of the assets of the New Section at that date was $2,404 million, of which 66 percent was invested in equities, 22 percent in bonds and 12 percent in property and cash. The deficit in the New Section at December 31, 2002 has been estimated, based on the estimated movement in assets since March 31, 2002 and in liabilities since March 31, 2000. As noted above, the extent of each employer s liability with respect to a deficit in the fund is uncertain. Based on the share of current contributions made to the scheme by P&O Princess, its share of the estimated deficit would be approximately $85 million, although the appropriate share of the deficit actually attributable to the P&O Princess group is believed to be lower than this.

For more information on our pension schemes, see Note 22 to the Financial Statements on Page F-31.

Trademarks and other intellectual property

We and our subsidiaries own and have registered several trademarks, including the names Princess , Swan Hellenic , Ocean Village and many of the names of our cruise ships, and we own and are in the process of securing registrations for a number of other trademarks including AIDA , Seetours and A ROSA . We have also registered the domain name princess.com , princesscruises.co and own and have applied to register several other domain names. P&O Princess Cruises International Limited and its affiliates have also been granted a license by P&O to use the P&O name, the P&O flag and associated logos and other relevant trademarks and domain names in conjunction with cruising.

We believe that our principal trademarks are widely recognized in their respective marketplaces.

Properties

We own or lease or have rights to use approximately 80 properties globally. Of these, the principal properties are our lodges and support facilities in Alaska and office facilities in Southampton and London, England and in several locations in the United States.

Princess Cruises operates five Alaskan lodges, two situated adjacent to the Denali National Park, one on the Kenai Peninsula, one in Fairbanks and one at Copper River in the Wrangell-St. Elias region of Alaska. We own each of these properties except for the land on which the Denali Princess Wilderness Lodge is located, for which we have a long-term ground lease that includes a right of first refusal on the freehold interest. Princess Cruises Alaska hotels have a combined capacity of approximately 1,100 guest rooms and the lodges and surrounding land total approximately 220 acres.

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Princess Cruises principal U.S. offices are located in newly-constructed office premises in Southern California. The leases expire in 2013, with two five-year options to extend the term. Princess Cruises also leases office facilities in Seattle, Washington and Fort Lauderdale, Florida and additional offices and support facilities at several locations in Alaska. We lease office facilities in Southampton and London the majority of which have remaining terms expiring between 2005 and 2016.

Insurance

General

There are a number of risks associated with owning and operating vessels in international trade. We maintain appropriate types and levels of insurance coverage for our vessels. All insurance policies are subject to limitations, exclusions and deductible levels. Premiums charged by both marine and non-marine insurers will likely be impacted by the losses to the direct and reinsurance markets regardless of the loss experience of individual insureds. We therefore expect higher premiums for upcoming insurance renewals, but anticipate continuing appropriate types of insurance.

Hull and machinery insurance

We maintain marine hull and machinery insurance policies and associated marine insurance, including, in the case of total loss, coverage for increased value. Coverage is maintained with underwriters in various first class international insurance markets in the United Kingdom (Lloyd s and London Companies), Scandinavia, United States, Japan, Germany and others.

Most insurance underwriters make it a condition for insurance coverage that a vessel be certified as in class by a classification society that is a member of IACS. All of our vessels are currently certified as in class with an IACS member. These certifications have either been issued or endorsed within the last twelve months.

Protection and indemnity cover

Third-party liabilities in connection with our cruise activities are covered by entry in a P&I Club. P&I cover is available through mutual indemnity associations (clubs), the majority of which participate in the International Group of Protection and Indemnity Associations.

Each of our vessels is entered in the U.K. P&I Club, whose members have entered more than 15 percent of the world s commercially operated vessels (as measured by gross tonnage) or the Steamship Mutual P&I Club, both members of the International Group of Protection and Indemnity Associations. Our vessel entries cover legal, statutory and pre-approved contract liabilities, including liability and other related expenses of injury or death of crew, passengers or other third parties, repatriation, wreck removal and pollution. Our P&I cover for ocean vessels includes an extension of cover for liabilities to passengers who have not yet sailed, but are intended to sail on a cancelled or delayed voyage. The extension also broadens the scope of vessel incidents covered by the entries.

Other marine insurance

We also maintain war risk insurance through the United Kingdom Mutual War Risks Association Ltd. War risk insurance includes coverage for the risk of confiscation, seizure, capture, vandalism, sabotage and other war related risks that are not covered under hull policies or rules of the protection and indemnity insurance organizations.

We maintain loss-of-earnings insurance. In the event that one or more cruise vessels are unable to operate due to certain covered events, this insurance policy pays for actual loss up to $50 million for any one occurrence (reduced limits apply to the German cruise vessels). This cover is in place for all the vessels with the exception of the river boats.

We maintain coverage for freight, defence and demurrage with the United Kingdom Freight Demurrage and Defense Association Limited or the Steamship Mutual Underwriting Association (Bermuda) Limited. In addition, we have obtained delay in delivery cover and total loss and abandonment insurance for our next two new buildings.

The foregoing is a summary of the primary forms of insurance maintained by P&O Princess. We expect to maintain appropriate forms and levels of insurance after completion of the Proposed Carnival DLC Transaction and certain of our insurance coverage may be harmonized with Carnival s policies and practices. Accordingly, certain insurance coverage currently maintained by P&O Princess, in particular coverage for passengers not yet sailed, loss of earnings, delay in delivery and total loss and abandonment may be reduced or eliminated following completion of the Proposed Carnival DLC Transaction.

Shoreside property

We have conventional insurance coverage for shoreside property, hotels, shipboard consumables and inventory and general liability risks, maintained with insurance underwriters in the United Kingdom, Germany and the United States. We also maintain business interruption insurance for our shoreside businesses, as well as coverage for the extra expense of offices and hotels in the event of an interruption in business from a variety of perils.

The Athens Convention

Current conventions in force in the United Kingdom applying to passenger ships are the Athens Convention relating to the Carriage of Passengers and their Luggage by Sea (1974), the 1976 Protocol to the Athens Convention and the Convention on Limitation of Liability for Maritime Claims (1976). In 1999, the U.K. increased the limit of liability under the Athens Convention for any carrier whose principal place of business is in the U.K.. The U.S. has not ratified any Athens Convention Protocol. However, vessels flying the flag of a country that has ratified it may contractually enforce the 1976 Athens Convention Protocol for cruises that do not call at a U.S. port.

The International Maritime Organization Diplomatic Conference agreed on a new protocol to the Athens Convention on November 1, 2002. The new protocol, which has not yet been ratified, substantially increases the level of liability limits and establishes compulsory insurance which must be maintained by passenger ship operators and provides a direct action provision, which will allow claimants access to insurers. Most of the countries in the European Union, where many of our vessels operate, supported the new protocol and are likely to ratify it in the future, however, the timing of such ratification, if obtained, is unknown. No assurance can be given that affordable and viable insurance and reinsurance arrangements will be available to provide the level of coverage required under the new protocol. We also expect insurance costs to increase once the new protocol is ratified.

Taxation

This section sets out a brief description of the current taxation of P&O Princess and its subsidiaries. Detailed information on the taxation of P&O Princess and its subsidiaries and Carnival and its subsidiaries after the expected completion of the Proposed

Carnival DLC Transaction will be described in detail in the Shareholder Documents. P&O Princess shareholders are strongly encouraged to read the Shareholder Documents.

U.K. Taxation

We are tax resident in the United Kingdom.

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Our ship owning and operating subsidiaries relating to the Princess Cruises brand are incorporated mainly in Bermuda and the United Kingdom. The U.K. ship owning/operating companies are subject to U.K. tax and entered into the U.K. tonnage tax regime (see below) effective January 1, 2002.

The non-U.K. Princess brand vessel owning and operating subsidiaries are in principle subject to the U.K. s controlled foreign company, or CFC, legislation which would ordinarily tax their profits in the United Kingdom. However, these companies currently benefit from an exemption, referred to as the Motive Test exemption, to the CFC rules. If dividends were paid from these companies to the United Kingdom, they would be subject to U.K. corporation tax in full.

U.K. Tonnage Taxation

The qualifying companies within the P&O Princess group entered the tonnage tax regime on January 1, 2002.

Companies to which the regime applies pay corporation tax on profit calculated by reference to the net tonnage of qualifying vessels. Corporation tax is not chargeable under normal U.K. tax rules on such companies relevant shipping profits. An election for the tonnage tax regime to apply takes effect for ten years and can be renewed on a rolling basis. For a company to be eligible for the regime, it must be within the charge to U.K. corporation tax and, among other matters, operate qualifying ships that are strategically and commercially managed in the United Kingdom. There is also a seafarer training requirement to which the tonnage tax companies are subject.

On entry into the tonnage tax regime, all expenditures qualifying for tax depreciation not yet utilized for tax purposes relating to assets used for tonnage tax activities are transferred to a new tonnage tax pool and no further tax depreciation is allowable in respect of the tonnage tax pool for as long as the tonnage tax regime applies. Within the regime, proceeds of future disposals of ships owned at the time of entry into the regime, and which have previously been subject to U.K. corporation tax, are deducted from this new pool and any excess proceeds are taxable under normal U.K. corporation tax subject to taper relief over seven years or rollover relief against new expenditure on qualifying ships.

Entry into the regime eliminates the need to provide for deferred tax on accelerated capital allowances used under normal U.K. corporation tax rules to offset profits that would otherwise be taxable.

Relevant shipping profits which are excluded from normal corporation tax include income which is defined as relevant shipping income. Relevant shipping income includes income from the operation of qualifying ships and broadly from shipping related activities. It also includes dividends from foreign companies which are subject to a tax on profits in their country of residence or elsewhere and the activities of which broadly would qualify in full for the U.K. tonnage tax regime if they were U.K. resident. In addition, more than 50 percent of the voting power in the foreign company must be held by one or more companies resident in an EU member state.

Our U.K. non-shipping activities that do not qualify under the U.K. tonnage tax regime, which are not forecast to be significant, remain subject to normal corporation tax.

German and Australian Taxation

The German brands and the Australian brands are operated by our U.K. operating subsidiary. The profits from these activities are subject to U.K. tonnage tax as set out above. The majority of the profits are exempt from German and Australian corporation tax by virtue of the U.K./Germany and U.K./Australian double tax treaties. Part of the German profits arise from river cruises and other activities which do not constitute international shipping. To this extent, profits will be subject to German taxation. However, our management does not believe that any such tax cost is or will be significant to the P&O Princess group as a whole.

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U.S. Taxation

The following summary of the application of the principal U.S. federal income tax laws to us, our subsidiaries and to U.S. holders of P&O Princess shares is based upon existing U.S. federal income tax law, including the Internal Revenue Code, proposed temporary and final Treasury Regulations, certain current income tax treaties, administrative pronouncements, and judicial decisions, as in effect as of the date hereof, all of which are subject to change, possibly with retroactive effect.

We and some of our ship-owning and operating subsidiaries are non-U.S. corporations engaged in a trade or business in the U.S. that, in many cases, depending upon the itineraries of our ships, receive income from sources within the U.S. for U.S. federal income tax purposes. We believe that substantially all of the U.S.-source shipping income earned by us and our subsidiaries is currently exempt from U.S. federal income tax, either under applicable income tax treaties or Section 883, as applicable. We believe that any U.S. federal income tax imposed on the non-exempt portion would not be material to the P&O Princess group as a whole.

Application of Section 883 of the Internal Revenue Code

In general, under Section 883, certain non-U.S. corporations are not subject to U.S. federal income tax or branch profits tax on certain U.S.-source income derived from the international operation of a ship or ships. A foreign corporation will qualify for the benefits of Section 883 if, in relevant part, (i) the foreign country in which the foreign corporation, is organized grants an equivalent exemption to corporations organized in the U.S. and (ii) either (a) more than 50 percent of the value of the corporation s stock is owned, directly or indirectly, by individuals who are residents of that country or of another foreign country that grants an equivalent exemption to corporations organized in the U.S., referred to as the stock ownership test (such individuals are referred to as Qualified Shareholders) or (b) the foreign corporation meets the publicly-traded test described below. In addition, to the extent a foreign corporation s shares are owned by a direct or indirect parent corporation which itself meets the publicly-traded test, then in analysing the stock ownership test with respect to such subsidiary, stock owned directly or indirectly by such parent corporation will be deemed owned by individuals resident in the country of incorporation of such parent corporation.

A company whose shares are considered to be primarily and regularly traded on an established securities market in the U.S., the U.K. or another qualifying jurisdiction will meet the publicly-traded test (the publicly-traded test). On August 2, 2002, the U.S. Treasury Department issued proposed Treasury Regulations to Section 883 which would apply to us. The proposed Regulations provide that stock will be considered primarily traded on one or more established securities markets if, with respect to each class of stock of the particular corporation, the number of shares in each such class that are traded during a taxable year on any such market exceeds the number of shares in each such class traded during that year on any other established securities market. Stock of a corporation will generally be considered regularly traded on one or more established securities markets under the proposed regulations if (i) one or more classes of stock of the corporation that, in the aggregate, represent more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote and of the total value of the stock of such corporation are listed on such market; and (ii) with respect to each class relied on to meet the more than 50 percent requirement in (i) above, (x) trades in each such class are effected, other than in de minimus quantities, on such market on at least 60 days during the taxable year, and (y) the aggregate number of shares in each such class of the stock that are traded on such market during the taxable year is at least 10 percent of the average number of shares of the stock outstanding in that class during the taxable year. A class of stock that otherwise meets the requirements outlined in the preceding sentence is not treated as meeting such requirements for a taxable year if, at any time during the taxable year, one or more persons who own, actually or constructively, at least 5 percent of the vote and value of the outstanding shares of the class of stock, own, in the aggregate, 50 percent or more of the vote and value of the outstanding shares of the class of stock (the 5 percent Override Rule). However, the 5 percent Override Rule does not apply (a) where the foreign corporation establishes that Qualified Shareholders own sufficient shares of the closely-held block of stock to preclude non-Qualified Shareholders of the closely-held block of stock from owning 50 percent or more of the total value of the

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class of stock for more than half of the taxable year; or (b) to certain investment companies provided that no person owns, directly or through attribution, both 5 percent or more of the value of the outstanding interests in such investment company and 5 percent or more of the value of the shares of the class of stock of the foreign corporation.

Additionally, the recently revised proposed Treasury Regulations issued under Section 883 require that corporations organized in a country that grants an equivalent exemption through an Income Tax Treaty must claim an exemption from U.S. federal income tax under such Treaty rather than pursuant to Section 883 (a recent IRS ruling can also be read to take this position, although the Technical Explanation of the current U.K.-U.S. Income Tax Treaty supports the position that it provides for an exemption under Section 883). We and certain of our subsidiaries are organized in such a country (i.e. the U.K.). As discussed below, their U.S.-source shipping income should be exempt from U.S. federal income tax under Article 8 of the current U.K.-U.S. Income Tax Treaty.

Application of the United Kingdom-United States Income Tax Treaty

Article 8 of the current U.K.-U.S. Income Tax Treaty provides substantially the same exemption from U.S. federal income tax on U.S-source shipping income as provided by Section 883. We believe that substantially all of the U.S.-source shipping income earned by us and our U.K. resident subsidiaries should qualify for exemption from U.S. federal income tax under Article 8 of the current U.K.-U.S. Income Tax Treaty.

The U.K.-U.S. Income Tax Treaty has been renegotiated and signed (though it still has not entered into force as it is still pending ratification by the U.S.). The provisions of Article 8, as renegotiated, are essentially the same as the provisions in the existing treaty. However, the pending treaty, unlike the current treaty, contains a Limitation on Benefits Article that requires one of certain alternative tests to be satisfied in order for a party to be eligible for benefits under the pending Treaty. We believe that we and our U.K. resident subsidiaries would satisfy the Limitation on Benefits article of the pending U.K.-U.S. Income Tax Treaty. The pending treaty also contains other limitations that would deny the availability of treaty benefits for income earned through certain entities. While these other limitations would apply to income earned through certain P&O Princess entities, we believe, based on our current circumstances, that we will be able to reorganize as necessary by, for example, moving the affected operations into a U.K. entity or one formed in another equivalent exemption jurisdiction such that the relevant U.S.-source shipping income should qualify for an exemption from U.S. federal income tax, either under the pending treaty or pursuant to Section 883.

Exemption of U.S.-Source Shipping Income

Based upon the foregoing, we believe that substantially all of the U.S.-source shipping income earned by us and our subsidiaries should qualify for exemption from U.S. federal income tax, either under Section 883 or under Article 8 of the U.K.-U.S. Income Tax Treaty, as currently applicable. We believe that any U.S. federal income tax imposed on the non-exempt portion would not be material to the P&O Princess group as a whole.

To date no final U.S. Treasury regulations of the relevant portions of Section 883 have been promulgated, although, as discussed above, regulations have been proposed. Those regulations, when finalised, or official interpretations could differ materially from our interpretation of this Internal Revenue Code provision and, even in the absence of differing regulations or official interpretations, the Internal Revenue Service might successfully challenge such interpretation.

Section 883 has been the subject of legislative modifications in past years that have had the effect of limiting its availability to certain taxpayers and there can be no assurance that future legislation or changes in the ownership of our shares will not preclude us and our subsidiaries from obtaining the benefits of Section 883. In addition, tax treaties may be abrogated by either applicable country, replaced or modified with new agreements that treat shipping income differently than under the agreements currently in force. At this time, however, there is no known limiting legislation pending before the U.S.

Congress nor are we aware of any pending modifications relating to the taxation of shipping under the U.K.-U.S. Income Tax Treaty, other than as discussed above.

Taxation in the absence of an exemption under Section 883 or any applicable U.S. Income Tax Treaty

Shipping income that is attributable to transportation of passengers which begins or ends in the U.S. is considered to be 50 percent derived from U.S.-sources. Shipping income that is attributable to transportation of passengers which begins and ends in foreign countries is considered 100 percent derived from foreign sources and not subject to U.S. federal income tax. Shipping income that is attributable to the transportation of passengers which begins and ends in the U.S. without stopping at an intermediate foreign port is considered to be 100 percent derived from U.S.-sources.

The legislative history of the transportation income source rules suggests that a cruise that begins and ends in a U.S. port, but that calls on more than one foreign port, will derive U.S.-source income only from the first and last legs of the cruise. Because there are no regulations or other IRS interpretations of these rules, the applicability of the transportation income source rules in the aforesaid manner is not free from doubt.

In the event that we or any of our subsidiaries were to fail, in part or in whole, to meet the requirements of Section 883 of the Internal Revenue Code or Article 8 of the U.K.-U.S. Income Tax Treaty, as appropriate, then the non-exempt U.S.-source shipping income of any such corporation would be subject to either the 4 percent of gross income tax regime of Section 887 of the Internal Revenue Code (the 4 percent tax regime) or the net income and branch profits tax regimes of Section 882 and Section 884 of the Internal Revenue Code (collectively, the net tax regime).

The net tax regime is only applicable where the relevant foreign corporation has (or is considered to have) a fixed place of business in the U.S. that is involved in the earning of U.S.-source shipping income and substantially all of this shipping income is attributable to regularly scheduled transportation. Under the net tax regime, U.S.-source shipping income, net of applicable deductions, would be subject to a corporate tax of up to 35 percent and the net after-tax income would be potentially subject to a further branch tax of 30 percent. In addition, interest paid by the corporations (if any) would generally be subject to a 30 percent branch interest tax.

Under the 4 percent tax regime, which should be the tax regime applicable to vessel owning subsidiaries, the U.S.-source shipping income of each of the vessel owning subsidiaries would be subject to a 4 percent tax imposed on a gross basis (without benefit of deductions). Under the 4 percent tax regime, the maximum effective rate of tax on the gross shipping income of these subsidiaries attributable to transportation that either begins or ends in the U.S. would not exceed 2 percent.

Legal proceedings

An Italian subsidiary of P&O Princess made a claim for a tax allowance for the 1995 financial year under the Italian Tremonti law, reducing taxable profits by just over 250 billion Lire. Qualification for the allowance is dependent on ownership of relevant assets. The subsidiary in question bare-boat chartered a vessel it owned to a fellow subsidiary. In December 2001, the Italian tax authorities submitted an assessment for tax of 70.7 million ($74 million) with penalties of 70.7 million ($74 million) on the grounds that the subsidiary had finance leased, rather than chartered, the vessel and therefore did not qualify for such an allowance. The

Italian subsidiary has appealed against the assessment and the outcome of court proceedings in the Low Tax Court of Palermo is awaited. The P&O Princess board, which has been so advised by its Italian advisers, believes that the relevant assets were owned and not the subject of a finance lease and that the allowance is due.

Princess Cruises is a party to a purported class action litigation relating to alleged inappropriate assessing of passengers with certain port charges in addition to their cruise fare. The plaintiffs have not claimed a specific damage amount but settlement of this litigation had been agreed in principle with the

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plaintiffs for coupons for future travel in amounts between $5 and $24 with a total face value of approximately $13.4 million. However, on January 17, 2002, a Los Angeles Superior Court Judge ruled that he would not consider the class-wide settlement agreed by the parties on the grounds that he had previously ruled that there was no appropriate class. The plaintiffs appealed the ruling and the court of appeals upheld the ruling in Princess favor. The plaintiffs then petitioned for rehearing, which was denied. As a result of this ruling, the case remains pending. Notwithstanding this development, the P&O Princess board does not believe that a material liability will arise with respect to this case and no provision has been made in the accounts for this contingency. However, if there is a settlement, there can be no guarantee that it would be of an amount previously indicated.

In the normal course of business, various other claims and lawsuits have been filed or are pending against P&O Princess. The majority of these claims and lawsuits are covered by insurance. P&O Princess management believes the outcome of any such suits, which are not covered by insurance, would not have a material adverse effect on P&O Princess financial statements.

Regulation of the cruise industry

Maritime Regulations

Government regulation materially affects the ownership and operation of our vessels. This governmental regulation includes international conventions, national, state and local laws and regulations in force in the jurisdictions in which the vessels may operate, as well as in their country of registration. We cannot predict the ultimate cost of complying with these requirements or the impact of these requirements on the resale value or useful lives of our vessels.

The most relevant maritime regulations for our business are those adopted by the International Maritime Organization. In particular, the International Maritime Organization adopted the SOLAS Convention which imposes a variety of standards to regulate design and operational functions.

The SOLAS Convention also incorporates the International Safety Management Code. The International Safety Management Code requires operators of passenger vessels to develop an extensive Safety Management System that includes, among other things, the adoption of a safety and environmental protection policy. That code came into force on July 1, 1998 and the required Document of Compliance has been issued to P&O Princess companies and Safety Management Certificates have been issued for all relevant P&O Princess vessels.

Each ship is also subject to the regulations issued by its country of registry which conducts periodic inspections to verify compliance. Ships operating out of U.S. ports are also subject to inspection by the U.S. Coast Guard and by the U.S. Public Health Service.

All of our vessels are subject to a program of periodic inspection by classification societies which conduct annual, intermediate, dry-docking and class renewal surveys. A classification society conducts these surveys not only to ensure that vessels are in compliance with international conventions adopted by the flag state as well as domestic rules and regulations, but also to verify that a vessel has been maintained in accordance with the rules of the society and recommended repairs have been conducted satisfactorily.

The U.S. Congress recently enacted the Maritime Transportation Antiterrorism Act of 2002 which implements a number of security measures of U.S. ports, including measures that relate to foreign flagged vessels calling at U.S. ports. We believe that the issue of safety and security will continue to be an area of focus by relevant government authorities both in the U.S. and elsewhere and, accordingly this will likely subject us to increasing compliance cost in the future.

Additional or new conventions, laws and regulations may be adopted which could limit our ability to do business and which could have a material adverse effect on our business and results of operations.

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Permits for Glacier Bay, Alaska

In connection with certain of its Alaska cruise operations, Princess Cruises relies on concession permits from the U.S. National Park Service (NPS) to operate its cruise ships in Glacier Bay National Park. Such permits must be periodically renewed and there can be no assurance that they will continue to be renewed or that regulations relating to the renewal of such permits, including preference or historical rights, will remain unchanged in the future. In addition, there can be no assurance that the NPS will not consider, under relevant regulations, the Proposed Carnival DLC Transaction to be a change of control, which could result in a loss of preferential and historical rights of Princess Cruises.

A court decision of February 23, 2001 concerning the failure on the part of the NPS in 1996 to prepare an environmental impact statement before the NPS increased the number of cruise ship entry permits for Glacier Bay National Park for the 2001 through 2004 period, resulted in the NPS being directed by law to complete and issue an environmental impact statement by no later than January 1, 2004. The environmental impact statement is to be used to set the maximum level of vessel entries in Glacier Bay National Park. Until the new level of entries is set, the number of vessel entries into the park remains the same as the number in effect during 2000, which includes the additional entry permits issued by the NPS. The outcome of the environmental impact statement may result in the additional entry permits being withdrawn and it is possible, but not expected, that the environmental impact statement may result in certain existing permits being withdrawn.

Any loss of rights or reduction of permits is not expected to impact us materially because we could still apply for permits to replace our preferential or historical permits and additional attractive alternative destinations in Alaska can be substituted for Glacier Bay.

Alaska Environmental Regulations

The State of Alaska enacted legislation in 2001 that establishes standards for wastewater discharge from cruise ships operating within Alaskan waters. The legislation requires that certain information be gathered with respect to solid waste and other marine discharges. The legislation also provides that repeat violators of the regulations could be prohibited from operating in Alaskan waters. The specific regulations are subject to a negotiated rule making process, which took place in 2002. The standards require treatment of wastewater and provide for restrictions on discharges. The legislation takes full effect in 2003. The Company is in the process of retro-fitting certain of its ships with advanced wastewater treatment systems. Management believes that the Company will be able to comply with the legislation and related regulations and believes its operating standards with respect to air emissions, solid waste and marine discharges are among the highest of the major cruise lines operating in Alaskan waters.

Other Environmental, Health and Safety Matters

We are subject to various international, national, state and local environmental protection and health and safety laws, regulations and treaties that govern, among other things, employee health and safety, air emissions, water discharge, waste management and disposal and storage, handling, use and disposal of hazardous substances such as solvents, paints and asbestos.

In particular, in the United States, the Oil Pollution Act of 1990 provides for strict liability for oil pollution or threatened oil pollution incidents in the 200-mile exclusive economic zone of the United States, subject to monetary limits. These monetary limits do not apply, however, where the discharge is caused by gross negligence or wilful misconduct of, or the violation of, an applicable regulation by a responsible party.

In order to operate in U.S. waters, we are also required to obtain Certificates of Financial Responsibility from the U.S. Coast Guard for each of our vessels. These certificates demonstrate our ability to meet removal costs and damages for an oil spill or a release of a hazardous substance up to the vessel s statutory strict liability limit.

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In the United States, the Comprehensive Environmental Response, Compensation and Liability Act of 1980, more commonly known as Superfund, and its state counterparts provide that the owner or operator (including for the purpose of the statute, a bareboat charterer of a vessel) is strictly, jointly and severally liable for damages, removal costs and investigative expenses incurred in connection with the release of a hazardous substance. We are named as a potentially responsible party under the Superfund laws at a site in California, although we believe that we have viable defences in relation to this site and we do not expect our liabilities under the Superfund laws in connection with this site to be material.

In addition, most U.S. states that border a navigable waterway have enacted environmental pollution laws that impose strict liability on a person for removal costs and damages resulting from a discharge of oil or a release of a hazardous substance. These laws may be more stringent than U.S. federal law.

Many countries have ratified and agreed to follow a stringent liability scheme concerning oil pollution adopted by the International Maritime Organization which, among other things, imposes strict liability for pollution damage subject to defences and to monetary limits, which monetary limits do not apply where the spill is caused by the owner s actual fault or privity with the offending party, or the owner s intentional or reckless conduct. In jurisdictions that have not adopted the International Maritime Organization oil pollution liability scheme, various national, regional or local laws and regulations have been established to address oil pollution.

If we violate or fail to comply with environmental laws, regulations or treaties, we could be fined or otherwise sanctioned by regulators. Although we have made, and will continue to make, capital and other expenditures to comply with environmental laws and regulations, we do not expect these expenditures to have a material impact on our financial status in 2003.

From time to time, environmental regulators consider more stringent regulations which may affect our operations and our compliance costs. For example in April, 2000, the U.S. Environmental Protection Agency or EPA launched a national review of the cruise ship industry s waste disposal practices and the quantity and content of waste discharges.

Consumer Regulations

Under regulations promulgated by the FMC each of our operating companies that embark passengers in U.S. ports are required to obtain certificates from the FMC evidencing their ability to meet liability in cases of non-performance of obligations to passengers. Currently, this obligation has a maximum of $15 million. A bond of $15 million has been provided to FMC and counter indemnified by us through a letter of credit for $16.5 million. A present proposed revision to the regulations would require us to significantly increase the amount of this bond based on the level of customer deposits which will increase the cost of bonding or insurance. We have also obtained certificates of financial responsibility required by the FMC to cover casualty and personal injury. We also have obtained a bond of $1 million in favour of the United States Tour Operators Association Tour Depositor s Trust.

In the United Kingdom, we are required to bond and obtain licenses from various organizations in connection with the conduct of our business and our ability to meet liability in the event of non-performance of obligations to consumers. These organizations include the Passenger Shipping Association and the Civil Aviation Authority. Under current regulations, we are required to provide bonds in the amount of approximately £100 million as a condition to obtaining the required licenses.

We are required by German law to obtain a guarantee from a reputable insurance company to ensure that in case of insolvency, our customers will be refunded any monies they have paid on account of a booking and, in addition, that they will be repatriated without additional cost if insolvency occurs after a journey starts.

In Australia, we are a member of the Travel Compensation Fund which provides compensation, as a last resort, to consumers who suffer losses in their dealings with travel agents.

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Registered Office

P&O Princess registered office is at 77 New Oxford Street, London WC1A 1PP.

Telephone: +44 20-7805-1200.

Subsidiaries

For a list of our significant subsidiaries, see Note 27 to the Financial Statements on page F-43.

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ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read in conjunction with the audited consolidated financial statements and the related notes included in this annual report. The following discussion contains forward-looking statements that reflect our plans, estimates and beliefs. Our actual results could differ materially from those discussed in the forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this annual report, particularly in Item 3. Key Information Risk Factors beginning on page 10.

Basis of Consolidation

P&O Princess Cruises plc acquired the cruise business of P&O on October 23, 2000. The acquisition was effected by way of a share exchange between P&O and its shareholders.

The consolidated financial statements have been prepared using merger accounting principles as if the businesses comprising P&O Princess had been part of P&O Princess for all periods presented, since they have been under common control throughout this period. Businesses acquired from or disposed of to third parties during the periods presented have been accounted for using acquisition accounting, from or to the date control passed.

While we believe that the financial information set forth in our consolidated financial statements is an appropriate presentation, this financial information is not necessarily indicative of the financial results that might have occurred had we been an independently financed and managed public entity prior to October 23, 2000 or of our financial results that may occur in the future.

Turnover (Gross Revenue)

We earn our revenues primarily from:

- the sale of cruises, including where relevant the sale of air transportation to and from cruise ships, and pre and post cruise land packages, including those in Alaska; and

- the sale of goods and services on board our cruise ships (including bar, gift shop, art and photo sales, casino gaming and shore excursions).

Pre and post cruise land packages and activities relating to the sale of goods and services on board our cruise ships are either performed by us or by independent concessionaires or third parties.

Our revenues are affected by our overall passenger capacity and occupancy, cruise pricing, yields and seasonality. Each of these factors is described in more detail below.

Capacity and Occupancy

In the years 1998 through 2002, our overall capacity offered has increased by approximately 69% due to the introduction of new ships, including Grand Princess, Sea Princess, Ocean Princess, Golden Princess, Star Princess, Pacific Princess and Tahitian Princess into North America, Aurora into the U.K. and the addition of AIDA (now named AIDAcara), AIDAvita, Arkona and two river vessels to our fleet in Germany, offset by the withdrawal of the Island Princess (1999), Fair Princess (2000), Pacific Princess, Arkona and Victoria (2002). For the year ending December 31, 2003, we expect capacity to increase by 19% largely due to the introduction of Coral Princess and Island Princess in North America, AIDAaura in Germany, Minerva II in the U.K. together with the full year effect of ships introduced in 2002, offset by the withdrawal of Minerva in the U.K., together with the full year effect of ships withdrawn from service in 2002.

In accordance with industry practice, our capacity is measured in passenger cruise days (pcds) calculated as the number of passengers who could be carried on board in the two lower berths in each cabin multiplied by the available cruise days, even though some cabins can accommodate three or four

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passengers. Accordingly, percentages in excess of 100% indicate that more than two passengers occupied some cabins. Cruises that begin in one accounting period and end in another have their passenger cruise days apportioned accordingly. The following tables provide our capacity offered in passenger cruise days and achieved occupancy for each of the quarters in the years ended December 31, 2001 and 2002 and for the years ended December 31, 1998 through 2002.