The Group has not been idle in its involvement in the Hong Kong market, however, as a number of new initiatives and achievements testify. It has been particularly active in working to diversify its business lines and supplement its famous ~H2O+ products. For example, the Group has broadened its spa business with the establishment of its new "Oasis Beauty" business line, offering a range of competitively-priced beauty treatments aimed at mass market consumers. Five such Oasis Beauty centres have been opened around Hong Kong in recent months, catering to a mass sector market and quickly attracting a strong clientele.

> "The Group has been **highly active** in expanding its presence into the **huge potential PRC market** while at the same time, has not been idle in its involvement in the HK market, as a number of **new initiatives** and **achievements testify.**"

The Group's status in the Hong Kong business environment was confirmed by a further business achievement over the course of the year, with the launch of the exclusive "Citibank Oasis Visa Card", which offers its users a number of beauty benefits. As a bank which is highly selective in its choice of partners for its credit card schemes, Citibank's selection of the Group as card partner is a strong testimony to the Group's standing amongst financial institutions. The launching of the Citibank Oasis Visa Card will act as a valuable marketing tool for the Group, and the range of free gifts and benefits that it offers users represents an astute strategy for consolidating customer loyalty and enlarging the Group's market segments.

~H_2O+ RETAIL BUSINESS

Hong Kong

The Group's ~H_2O+ retail outlets in Hong Kong experienced an overall year-on-year fall of ~H_2O+ product sales of 26%. There have been limited opportunities to pare costs in line with this fall, since rental leases remain high despite the economic downturn, and certain recurring marketing costs remained similar to last year, costs which included essential television and periodical advertising and public relation activities. The Group has, however, taken every opportunity to reduce costs where possible, and has devised a comprehensive programme for increasing profitability in the coming year.

Adding to the pressure on profit attributable to shareholders has been the additional necessary costs incidental upon the Group's regional expansion programme. These have included increased payroll costs as new administrative offices and retail outlets have been opened in the PRC and Taiwan. The Group's expansion is a carefully planned one which is already beginning to signal the likelihood of significant long-term returns, but inevitably its initial phases have involved start-up costs which, over a few short months, have yet to pay themselves off though increased profitability.

Despite the muted atmosphere over the past twelve months within the retail cosmetics and beauty market generally, the Group is able to report a profit for the year under review, indicating prudent financial management, responsiveness to market conditions, a fundamental financial stability and strong customer loyalty. All these factors, Management believes, lie behind the Group's ability to deal decisively with the current market challenges, and will see the Group emerge even stronger from the economic downturn.

Diversification for growth

The Group responded to market conditions with a series of diversification initiatives designed to open up new revenue streams. These included the introduction of new beauty services at ~H_2O+ retail outlets and the sale of a range of Japanese health drinks. Compared with the HK$7 million of the Group's sales in 2001 coming from these lines of revenue, in the year under review some HK$37 million in sales of such lines was achieved, a remarkable fivefold increase.

Taiwan

Steady expansion

The Group's Taiwan presence has been strengthened during the year, with the addition of three new retail outlets around Taipei. In a market showing great demand for prestigious foreign cosmetics and skin-care brands where relatively few such brands are available, the Group's ~H_2O+ line is attracting increasing numbers of loyal and enthusiastic buyers, a development reflected in the 74% rise in sales during the year under review. The nature of the Taiwan market means that profit margins tend to be lower than those obtainable in Hong Kong, for instance, yet the Group's growth in Taiwan has been on a scale that has seen profit attributable to shareholders in 2001/2002 rise by 58% over the previous year.

The PRC

Grasping burgeoning opportunities

The Directors believe that the PRC represents a major new opportunity for the Group. Hence the Group's policy of aggressive expansion, which has seen the opening of 23 retail outlets mostly between August and September 2002. Urban Chinese in the PRC are driving a huge demand for foreign and luxury products, and the Group believes that now is the time to establish a powerful presence on the Mainland. To this end, some HK$7 million was spent during the year in initial advertising costs to introduce the ~H_2O+ brand to potential customers, particularly those in northern cities such as Beijing and Shanghai. The level of potential in this market is shown by the fact that the Group spent three years carefully building up its 17 Hong Kong outlets, while it has taken just nine months to establish 23 booming outlets in the PRC.

The first six months of the Group's PRC operations commencing from April 2002 incurred losses of HK$8 million, largely in essential set-up costs which dominated the initial consolidation period. Losses at this level are normal and were expected and planned for by the Group as part of the starting-up process. However, by December 2002, just nine months after the Group first entered the PRC market, its Mainland outlets began contributing a profit, a remarkable achievement given the fact that the Group arrived as a complete newcomer to the PRC market, selling a product line largely unknown in China at the outset. Furthermore, the Group's rapid PRC expansion has been achieved with no dilution of sales, suggesting that there remains considerable room for growth within the market. The Directors believe that the Group's performance in the PRC represents a significant level of achievement, and that the Group has significantly outperformed competitors who have sought to establish a foothold there.

The Group's success in this market is still at an early stage, and the booming performance of its new PRC outlets is too recent to impact on the Group's financial results for the year. Indicators, however, are proving extremely positive for the future, and Management strongly believes that the market opportunities arising for the Group are huge. In the short term, profit margins in the PRC will remain relatively small compared with Hong Kong because of the current PRC tax regime, despite the fact that the retail prices of ~H_2O+ products are high as a direct result of demand. In the longer term, profit margins too should improve as China implements WTO standards and progressively lowers tariffs and taxes.

THE SPA BUSINESS

Oasis Spa

In the first half of the year under review, the Group's Oasis Spa business was adversely affected by a fall in consumer confidence, following on from a number of high-profile failures of spa and health businesses in Hong Kong. The Group worked hard to rebuild confidence and reassure customers of the fundamental strengths of Oasis Spa, a strategy which paid off in the second half of the year, as sales rebounded. As a result, the negative results of the first half were turned around and the business went on to contribute HK$1.6 million to the Group's bottom line in the second half, making an overall contribution across the year of HK$1.4 million.

Oasis Beauty

Oasis Beauty represents a cautious business development on the part of the Group, tailored to the current tough business climate. Oasis Beauty outlets offer affordable beauty treatment aimed at mass market consumers, making use mainly of ~H_2O+ products, and the five initial outlets opened in Hong Kong have required relatively lower initial capital investment due to the scale of these operations. The Group is watching the performance of this new business line carefully to assess its potential for expansion, and has been encouraged by the initial consumer response. Although the first of the outlets commenced operation only as recently as July 2002, the Group began to reap profits from its Oasis Beauty outlets in September, just two months later. Initial setup costs have affected the immediate returns from this new line of business, and the Group has consequently incurred a relatively small loss of HK$0.8 million for the year. The Group's general prudence in developing this business line and the signs of profitability already appearing suggest that Oasis Beauty will prove to be a useful and valuable business diversification in the longer term.

PROSPECTS

The Group's policies of aggressive expansion within growth markets and effective diversification in Hong Kong are, the Directors believe, the way forward for the Group in the current tight economic conditions. Early signs from the Group's new China operations in particular suggest a huge potential for growth in this rapidly opening market.

As a result, the Group intends to continue pursuing its rapid and aggressive expansion in the PRC. It expects to increase the number of outlets there from the current 23 to a total of approximately 30 by the coming Lunar New Year. These additional outlets will all be situated in prime locations, and will benefit from the extensive advertising and marketing of ~H_2O+ that has already taken place. At the same time, the Group is negotiating to set up franchise operations that will expand the distribution of ~H_2O+ products into various Chinese cities. Franchisees will be carefully selected by the Group, which will also benefit financially through franchising fees that the selected distributors will be required to pay. The Directors believe that its intensive investment in the China market will bring the Group rapid returns and establish the ~H_2O+ brand firmly in the consciousness of China's newly affluent consumers, setting up long-term sales potential.

Within Hong Kong, supplementing the Group's core focus on the ~H_2O+ brand, Oasis Beauty will be built up to become a firm contributor of turnover and profits from the mass sector. Represented at every level of the skin-care and beauty treatment market, the Group's status in the market place and its increasingly diverse sources of income should consolidate its position as a market leader in Hong Kong.

Fundamental underlying strengths

The Group's considerable prospects testify to its strengths, which are built upon a fundamental financial soundness. Debt-free and with some HK$89 million of cash reserves in hand, the Group is well-equipped with resources for funding development and expansion strategies. Nevertheless, the Group maintains a prudent financial regimen, adopting risk-averse policies and avoiding speculative investments. Major investment decisions are made only after detailed analysis, although the Group is quick to act to take advantage of fast-moving situations, as is the case with its PRC developments in a booming market.

The Group takes a proactive approach to dealing with economic fluctuations, and expects to implement a number of measures for increasing its cost-effectiveness and profitability over the coming year. Tighter control over payroll expenses is one such measure, supplemented by outlet rationalization, which may include renegotiating rental costs and relocating outlets for maximum cost-effectiveness. In addition, the Group will be adopting more economical advertising strategies, with greater use of in-store advertising and higher exposure in local magazines. The launch of the Citibank Oasis Visa Card will also play its part in raising the Group's profile in an effective and economically efficient manner.

The Group's ability to respond prudently and effectively to changing conditions lies behind the confidence which many investors have in its longer-term prospects. Management has successfully maintained profitability in a challenging year, while at the same time taken well-timed steps to expand and diversify, steps that seem set to strengthen the Group's performance further in the years to come.