

## Management Discussion and Analysis

### ~H<sub>2</sub>O+ RETAIL BUSINESS

#### Hong Kong and Macau

##### *Adapting for difficult times*

As outlined in some detail above, the Hong Kong retail environment has been under heavy pressure right across the year under review, and especially in the SARS-affected period from March to August 2003. Hong Kong remains the Group's core market, and as a result of these factors it experienced a drop in revenue income of approximately 30% compared with the previous year. Such a result was to some extent unavoidable given the severity of the problems that Hong Kong was labouring under across the year, and recent signs that Hong Kong has moved out of recession bode well for a steady improvement of the Group's Hong Kong results in the months to come. Nevertheless, the Group has been far from idle when it comes to responding to adversity. Seeing the falling trend for retail sales of ~H<sub>2</sub>O+ products, the Group continued to promote other revenue streams across the year, including its range of beauty services and a popular line of health drinks, as a successful means of boosting revenue.

#### Taiwan

##### *Brand strength proven*

With Taiwan too undergoing a serious SARS-related downturn, a similar retail environment to Hong Kong's affected the Taiwan market. The Group's revenue income from this market in the second half of the year came under heavy pressure, and profits fell. Nevertheless, the Group's fundamental brand strength held steady, allowing the Group to record year-end profitability despite its drop in income.

#### The PRC

##### *Solid foundations laid for further growth*

The Group continued its strategy of an ongoing and aggressive roll-out of new retail outlets in PRC. It moved from having 23 to having 44 such outlets operational over the course of the year. Last year, the Group was financing this expansion plan from its reserves; over the course of 2002-2003, however, the cash-flow situation in PRC was at a break even position, meaning that the PRC operations can now draw on their own funding for expansion.

Having gained a significant presence in some of PRC's foremost cities, the Group has now achieved wide coverage within the PRC. To extend its influence even further, but without over-committing resources, the Group is launching a franchise plan whereby independent retailers will have the option of handling ~H<sub>2</sub>O+ products in selected cities. 6 franchise outlets have been opened with the first one located in Kunming, commenced business in December 2003. The Group will monitor its franchise arrangements very carefully to ensure that its reputation is enhanced through its franchisee representation.

## SPA AND BEAUTY BUSINESSES

### Oasis Spa

The Group's medium- and high-end Oasis Spa operations, offering luxury beauty treatments, continued to be affected by the unfavourable environment. Having said this, the Oasis Spa business managed to maintain a profitable position across the year. The interim report noted a small profit at the end of March 2003, and this result was maintained even across the ensuing half year, with all its attendant SARS disruption. The Group is confident that, with an improving economy, its Oasis Spa centres will soon again be healthy contributors to its bottom line.

### Oasis Beauty

Oasis Beauty originated as a cautious business investment specially tailored to a tough business climate, and quickly attracted positive consumer attention. Its combination of low-cost and high-quality services was a pioneering one at the outset, and appealed strongly to mass market consumers, especially in a deflationary environment. Over the year under review, the Group has continued to take advantage of the evident success of its Oasis Beauty outlets, working to perfect the Oasis Beauty formula and achieve the best possible profit margins. At year end, a total of 9 Oasis Beauty outlets were operational, up from 4 at the same time last year. Together, these outlets contributed a healthy HK\$8.6 million to the Group's bottom line for the year ended 30th September 2003. The strong performance of Oasis Beauty across the difficult SARS period is cause for considerable optimism, particularly as the economy continues to improve and more and more consumers are willing to spend on health- and style-related products and services.

During the year, the Group also planned an ambitious expansion of its Oasis Beauty concept into men's health and beauty care. Having pioneered the successful Oasis Beauty concept for female consumers, the Group made an intensive study of the untapped men's market and identified a significant gap in the market for a similar service tailored for men. Again pioneering in a largely untrodden field, the Group is confident that it will come to be seen as a first mover in what it expects to be a potentially large market in the long run. The first of its men's outlets, called "Oasis Beauty Homme", was launched after year end, and now brings to 10 the total number of Oasis Beauty outlets operating. Carefully planned and sensitively marketed, the first Oasis Beauty Homme venture offers an ambience designed to appeal to male users, and the Group is confident that the male beauty concept has major growth potential in a city such as Hong Kong.

## PROSPECTS

Despite the trials of the year, the Group's longstanding policy of prudence and cautious investment has left it strongly positioned to exploit the economic comeback stirring in Hong Kong and around the region. Its cash reserves remain high as last year, with HK\$79 million on hand for investment purposes as required. It continues debt-free, and hence with few constraints on its financial decision-making. The Group intends to continue this policy of prudence in the foreseeable future; however, it also intends to put its cash reserves to more positive use while they are not required for business funding purposes.

### Strategies for enhancing profitability

Financial caution should not imply financial complacency, however. Rather, the Group is constantly searching for new ways to enhance its profitability by expanding its markets, diversifying its products and services, and reducing its exposure in areas of low profitability.

Some routes to increased profitability are the result of external political factors which will have positive effects on the Group in coming years. For example, China's WTO entry is leading progressively to a lowering of tariffs and taxes on imported goods, which impact on the Group's profitability in the PRC market. More recently, the CEPA agreement is resulting in preferential treatment on the Mainland for Hong Kong companies, and this too will result in positive effects for the Group's PRC operations.