

## Management Discussion and Analysis

Primarily, however, the Group looks to itself for initiatives that will enhance efficiency, competitiveness and profitability. Across the year under review, the Group identified three major areas to which it expects to pay particular attention in the coming months. All three areas represent major potential sources of increased income, according to careful analysis of the market situation and new trends. The Group will be devoting great efforts to developing and promoting them in the forthcoming year.

The first of these areas is the Group's franchise operations in the PRC, built on the back of its rapidly developed chain of self-managed retail outlets in PRC's major cities. Having established these self-operated outlets in PRC's major cities, the Group sees franchise operations as a prudent and cost-effective means of expanding its market coverage into so-called "second tier" cities, those with smaller population bases or which are more remote. Not only does the franchise system offer low risks to the Group, it will help permeate brand awareness into the heartland of PRC, building a truly nationwide exposure for  $\sim\text{H}_2\text{O}^+$  products. The addition of franchised outlets should further boost sales and profitability. The Group is looking to have from 30 to 50 franchise outlets in operation by the end of the 2003-2004 year. At the same time as it puts its franchise operations into motion, the Group will continue to expand its self-managed retail outlets in PRC, albeit at a slower pace than in the past year now that it has established a substantial network presence in most of PRC's major cities. The Group expects to increase these self-managed outlets from the current 44 to 50. It will back up both sets of operations by extensive nationwide advertising campaigns, supplemented by special events such as the provision of beauty classes in shopping malls, designed to educate Chinese consumers on skincare products while simultaneously promoting  $\sim\text{H}_2\text{O}^+$  products.

Secondly, the Group aims to increase the percentage of revenue it receives from its beauty business, which with its higher gross margins has outperformed retail sales in recent times. Moves have already been made in this direction, in fact. In 2002, the Group's retail sales accounted for 85% of its revenue, and beauty services just 15%. In 2003, by contrast, this percentage has been adjusted to a 71-29 ratio, and as further Oasis Beauty outlets are opened the beauty services percentage should continue to rise. This strategic realignment is being made in response to the steady market demand for Oasis Beauty services, and also offers another promotional mode when it comes to  $\sim\text{H}_2\text{O}^+$  products since Oasis Beauty centres use these products extensively. Given the success of the enterprise to date, the Group is also actively exploring opportunities for taking its beauty business into the PRC market.

The third measure being actively explored by the Group for enhancing profitability is one of undertaking product diversification through the design, sourcing, testing and launching of self-developed  $\sim\text{H}_2\text{O}^+$  products. In this context, "self-developed" refers to the fact that the Group is proactively taking the lead in creating and sourcing new products specifically tailored for Asian markets, rather than simply marketing existing  $\sim\text{H}_2\text{O}^+$  products. It is thus moving to act as more than simply a distributor for its  $\sim\text{H}_2\text{O}^+$  supplier in the USA, by taking on also an advisory role. As a first step in this direction, in 2003 the Group launched its self-developed paper masks. The advantages of this move into self-developed products are multiple. To begin with, such products typically attract higher product margins than more conventional products. Also, these products have the potential for worldwide distribution through  $\sim\text{H}_2\text{O}^+$  networks around the globe, and hence could become very considerable profit earners for the Group.

### Other developments

The Group's achievements in maintaining profitability over the past two years of difficult economic conditions were such that in August 2003,  $\text{H}_2\text{O}^+$  Plus, L.P. awarded the Group  $\sim\text{H}_2\text{O}^+$  distributor rights to the Singapore market. The Group believes that the confidence shown by this decision was fully justified, and will be setting up initial outlets in Singapore over the coming year. The first outlet is scheduled to open in March 2004, and the Group targets to open a total of 7 such outlets in Singapore over the next three years.

## LOOKING TO THE FUTURE

Despite the particular challenges of the year under review, the Group is approaching the 2003-2004 year with a very positive outlook. Hong Kong's economy is showing strong evidence of a turnaround, with the retail index rising and unemployment falling from previous highs. The retail sector in particular is beginning to reap the benefits of the more optimistic economic outlook, and the Group expects to fully participate in this shift as evidenced in its performance in the 4th quarter of calendar 2003. Contributing to this will be the fact that cost-cutting measures implemented over the past year will take full effect in the year to come. For example, the extensive process of rental renegotiation which the Group carried out in the past year, at the very bottom of the property market fall, has now taken effect and is contributing significant savings.

In the coming year, the Group intends to utilise its cash reserves in a more efficient way, by investing a prudent percentage of these reserves in a portfolio of investments. This may involve purchase of retail property or careful investment in blue-chip companies; in line with the Group's longstanding policy of cautious investment, this move is one that will be undertaken with considerable care and consultation.

From a year in which many businesses suffered disastrous losses on the back of world and regional events and a depressed economy, the Group has emerged fundamentally unscathed and in a good position to take advantage of improved times ahead. Although returns inevitably fell during the year, the particular challenges of the year led to careful planning for diversification and cost-cutting which have preserved the Group's overall position of profitability and enabled it to maintain its debt-free position with strong cash reserves. With burgeoning growth in the PRC and a new distributorship deal for the Singapore market, the Group has shown its ongoing ability to adapt to circumstances and its resilience in the face of difficulties, and is well-placed to capitalise on growth in the immediate future.