

MANAGEMENT DISCUSSION AND ANALYSIS

Achieving effective market penetration

In addition, the Group's new operation in Singapore is also progressing well, with 3 outlets up and running there and another 2 planned for opening in the coming six months. The Group's first Singapore ~H₂O+ outlet located in Suntec City was elected the "Most Outstanding Retail Outlet" among a total of 270 participating retail stores in the Suntec Awards 2004. The award goes to the retail store that provides excellent service, has staff with the best attitude and attentiveness and the best product knowledge, delivers innovative marketing and promotional activities, creative window and in-store displays, store concept, good value for money and provides a memorable shopping experience.

The major growth in sales outlets came, naturally enough, in China, which now has 51 self-managed ~H₂O+ outlets in major cities and a further 24 franchised operations in other strategic areas. The Group's franchising strategy has proved particularly successful over the year, prompting the Group to consider further expansion through this method.

CHINA: STRATEGIES FOR LARGE-SCALE EXPANSION

The Group has seen ongoing growth in its China operations across the year, and has continued to increase the number of outlets in major cities around the country. Sales continue to grow as the ~H₂O+ brand becomes more and more familiar to China-based consumers. The recent "Trends Cosmo Beauty Awards 2004" organised by *Cosmopolitan* magazine selected the "Sea Salt Skin Smoother" as the "Best Body Scrub", hence showed the popularity of ~H₂O+ products in China.

As it establishes itself in China, the Group is looking for new ways to effectively penetrate the market, taking into account the latest retailing trends. Of particular importance for the Group's expansion strategies has been the success of its franchise arrangements within China. The Group has worked hard to ensure that its franchise partners operate high quality retail operations which effectively represent the ~H₂O+ brand. As a result, motivated franchise partners are bringing ~H₂O+ products to new areas of China, accumulating profits for the Group while minimizing risks. The Group's mix of self-managed and franchised outlets across major China cities has proved to be an excellent formula for growth.

The Group is also strategically planning to introduce its Oasis Spa operation model into the China market through on-going proactive negotiations and concrete plans will be established once dominant issues straightened out.



HONG KONG: FOCUS ON STORE LOCATIONS AND DESIGN

The year saw an ongoing rationalization of outlets around Hong Kong to ensure the Group continues to get the best value from each one of its retail stores. One of its strategies was to reduce the number of department store outlets in Hong Kong from 4 to 2, since experience has shown that the ratio of rental costs to sales in these environments is not as favourable as that achieved in the Group's standalone stores in Hong Kong. One retail store in Mongkok was relocated, so that the Group is now represented in the vicinity of Mongkok's prestigious and popular new Langham Place shopping area. In Causeway Bay, meanwhile, the Group added a new shop in Percival Street to supplement its existing branch nearby in Russell Street. This was done with an eye on reducing rental exposure in the popular Times Square vicinity. The second outlet also gives the Group the option of giving up its old store if upcoming lease renewal rates prove unfavourable.

The Group's high-profile Percival Street retail store has been the first to experience a design makeover which, depending on feedback, may eventually be extended across the Group's other outlets. In a departure from the cool blue and white colour scheme that has characterised its retail store decor up till now, the Group has adopted a new theme for the store that emphasizes harmonious natural materials and which carries elegant resonances of both traditional Japanese and Thai design. Sales staff also offer customers value-added hospitality services when they enter the store, helping create a natural and highly relaxing atmosphere.



A sophisticated new style
in ~H₂O+ retail shopping

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diversify⁺



+ Successful beauty operations

THE SPA AND BEAUTY BUSINESSES

STEADY RETURNS FROM BEAUTY OPERATIONS

The Group's Oasis Beauty centres achieved a profitable bottom line for the year, and were steady contributors to growth. Over the year, the number of Oasis Beauty centres in Hong Kong went from 9 to 12. 3 new centres were opened in Causeway Bay, Tseung Kwan O and Kowloon West. The expansion in centres did cause a slight drop in profits due to the ensuing dilution of the customer base, but margins remain high and the venture is performing well overall.

The Oasis Spa operation posted a loss this year, part of the reason for which was the newly introduced accounting system that was described in the interim report. The Group expects that once the implications of the new accounting system have worked their way through, Oasis Spa will once again move into profitability. The Oasis Spa operation is meanwhile keeping a high profile and maintaining a reputation for quality, as was seen when it was recently named "Best Spa of the Year 2004" by *Cosmopolitan* magazine.

AN ASTUTE INVESTMENT DECISION

Taking advantage of low property prices in the Hong Kong market earlier in 2004, the Group purchased a retail shop in Causeway Bay for approximately HK\$35 million. The purchase was primarily for investment purposes, although it represents also a fallback position if rental negotiations for the Group's two current Causeway Bay premises should pose problems in the future. The shop is currently being rented out to tenants. Recent market conditions suggest the value of the property has already risen significantly, which gives the Group considerable planning flexibility, including the option of selling the property and profiting from the gains.

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multiply⁺



FUTURE DEVELOPMENT

CHINA: GROWTH THROUGH EXPANSION AND ADVERTISING

The Group expects further growth in its China operations over the coming year. It intends to add another 10 self-managed outlets to its portfolio, while at the same time extending the number of franchised outlets to between 50 and 70. Beauty services have now also begun being offered in the Group's Beijing store, the first step of transplanting the Group's beauty operations into the China market.

The rise in the number of China outlets also allows the Group to revisit its advertising spend and look into the feasibility of conducting larger-scale advertising campaigns on the Mainland in 2005, which should boost its profitability further.



+ Rapid retail
expansion in China

MANAGEMENT DISCUSSION AND ANALYSIS

Creating a new breed of beauty professionals

HONG KONG AND TAIWAN: MAINTAINING A STABLE, PROFITABLE RETAIL NETWORK

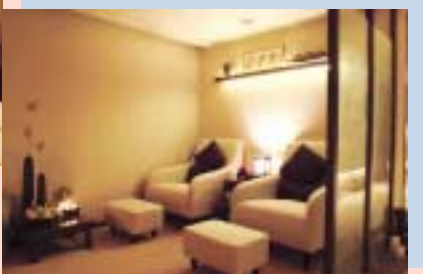
The Group considers itself currently to be operating the optimum number of retail stores in both the Hong Kong and Taiwan markets given market conditions, and is thus not planning any major expansion in its retail outlets for the immediate future except for plans to open 1 new Hong Kong store in a concept mall located in Kwun Tong.

To avoid dilution of the market, the Group also plans to keep its Oasis Beauty and Oasis Spa centres at their existing numbers. It is, however, considering opening a further Oasis Beauty centre in Kowloon to take advantage of the rejuvenation of the shopping environment there. It also is considering plans to expand the size of its Causeway Bay Oasis Spa centre to meet demand for treatment rooms particularly in peak periods.

OASIS BEAUTY SCHOOL

This year, the Group has planned and begun to implement a new venture, provisionally called the "Oasis Beauty School" (the "School"). Designed to operate as a profitable and self-financing training school for beauty professionals, it is also expected to provide the Group with a ready supply of skilled talent for its own beauty centres. The Group is linking up with international beauty bodies to provide certifications for its courses.

The Group has approached this venture cautiously from the outset, determined that costs should be minimised as far as possible. To this end, the School will initially be housed within the Group's existing Causeway Bay headquarters, using some 3,000 square feet of office space that is currently under-utilized. This means there will be no additional rental costs associated with the operation, and the only set-up costs will be those of renovating the section of the premises to be used as the School.



The Group has employed an experienced consultant to advise on the project and oversee initial setup. Progress has been smooth, and the School is now well on track for opening in around March or April 2005.

SOUND MANAGEMENT POLICIES EXTENDING INTO THE FUTURE

Overall, the Group is expecting sales in the established markets of Hong Kong and Taiwan to remain steady in the coming year, while in China it is predicting a substantial sales growth rate, spurred partly by growth in the Group's retail presence, partly by increased advertising, and partly by the continued prosperity and rising affluence of consumers there.

The Group will continue working hard to maintain its momentum, introducing new ventures in its traditional market and planning carefully for expansion in China. Its strategy has always been one of adopting caution while maintaining the full confidence of its shareholders. It continues to hold a healthy balance of around HK\$79 million in cash. New investments are adopted prudently, and must not be cost-intensive or involve much cash outflow. By these measures, the Group is maintaining the reputation for sound management that has seen it handle fluctuations in the market confidently and effectively over recent years.



Building on
rising prosperity
across the region