NOTES TO THE ACCOUNTS

1. ORGANISATION AND PRINCIPAL ACTIVITIES

Water Oasis Group Limited (the "Company") was incorporated in the Cayman Islands as an exempted company with limited liability on 27th September 2001 under the Companies Law, Cap. 22 (Law 3 of 1961, as consolidated and revised) of the Cayman Islands. Its shares have been listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") since 11th March 2002.

The Company is an investment holding company. Its subsidiaries are principally engaged in the distribution of skin-care products in Hong Kong, Macau, Taiwan, Singapore and China and the operation of spa and beauty centers in Hong Kong.

2. PRINCIPAL ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these accounts are set out below:

(a) BASIS OF PREPARATION

The accounts have been prepared in accordance with accounting principles generally accepted in Hong Kong and comply with accounting standards issued by the Hong Kong Institute of Certified Public Accountants (the "HKICPA"). They have been prepared under the historical cost convention except that, as disclosed in the accounting policies below, investment properties and trading investments are stated at fair value.

In current year, the Group adopted the Statements of Standard Accounting Practice ("SSAP") 12 (revised) "Income Taxes" issued by the HKICPA which is effective for accounting periods commencing on or after 1st January 2003. The change to the Group's accounting policy and the effect of adopting this revised SSAP is set out below.

The 2003 comparative figures presented herein have incorporated the effect on the adoption of SSAP 12 (revised).

(b) BASIS OF CONSOLIDATION

The consolidated accounts include the accounts of the Company and its subsidiaries made up to 30th September. Subsidiaries are those entities in which the Company, directly or indirectly, controls more than one half of the voting power; has the power to govern the financial and operating policies; to appoint or remove the majority of the members of the board of directors; or to cast majority of votes at the meetings of the board of directors.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated profit and loss account from the effective date of acquisition or up to the effective date of disposal, as appropriate.

All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Minority interests represent the interests of outside shareholders in the operating results and net assets of subsidiaries.

In the Company's balance sheet, the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividends received and receivable.

NOTES TO THE ACCOUNTS

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(c) INTANGIBLE ASSETS

Expenditure on acquiring licenses for sale of products in PRC is capitalised and amortised using the straight-line method over the licenses period. Licenses are not revalued as there is no active market for these assets.

Where an indication of impairment exists, the carrying amount of any intangible asset is assessed and written down immediately to its recoverable amount.

(d) INVESTMENT PROPERTIES

Investment properties are interests in land and buildings in respect of which construction work and development have been completed and which are held for their investment potential, any rental income being negotiated at arm's length.

Investment properties held on leases with unexpired periods of greater than 20 years are valued by independent valuers annually. The valuations are on an open market value basis related to individual properties and separate values are not attributed to land and buildings. The valuations are incorporated in the annual accounts. Increases in valuation are credited to the investment properties revaluation reserve. Decreases in valuation are first set off against increases on earlier valuations on a portfolio basis and thereafter are debited to operating profit. Any subsequent increases are credited to operating profit up to the amount previously debited.

Upon the disposal of an investment property, the relevant portion of the revaluation reserve realised in respect of previous valuations is released from the investment properties revaluation reserve to the profit and loss account.

(e) FIXED ASSETS

Fixed assets are stated at cost less accumulated depreciation and accumulated impairment losses.

Depreciation of leasehold improvements is calculated to write off their costs less accumulated impairment losses on a straight-line basis over the unexpired periods of the leases.

Depreciation of other fixed assets is calculated to write off their costs less accumulated impairment losses on a straight-line basis over their estimated useful lives to the Group. The principal annual rates used for this purpose are as follows:

Motor vehicles	20% to $33^1/_3$%
Computer equipment	$33^1/_3$%
Machinery and equipment	20%
Office equipment, furniture and fixtures	20% to $33^1/_3$%

Major costs incurred in restoring fixed assets to their normal working conditions are charged to the profit and loss account. Improvements are capitalised and depreciated over their expected useful lives to the Group.

At each balance sheet date, both internal and external sources of information are considered to assess whether there is any indication that assets included in fixed assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated and where relevant, an impairment loss is recognised to reduce the asset to its recoverable amount. Such impairment losses are recognised in the profit and loss.

The gain or loss on disposal of a fixed asset other than investment properties is the difference between the net sales proceeds and the carrying amount of the relevant asset, and is recognised in the profit and loss account.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(f) OPERATING LEASES

Leases where substantially all the risks and rewards of ownership of assets remain with the leasing company are accounted for as operating leases. Payments made under operating leases, net of any incentives received from the leasing company are charged to the profit and loss account on a straight-line basis over the lease periods.

(g) INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost represents invoiced value on purchases and is calculated on a weighted-average basis. Net realisable value is determined on the basis of anticipated sales proceeds less estimated selling expenses.

(h) INVESTMENTS

(i) Trading investments

Trading investments are carried at fair value. At each balance sheet date, the net unrealised gains or losses arising from the changes in fair value of trading investments are recognised in the profit and loss account. Profits or losses on disposal of trading investments, representing the difference between the net sales proceeds and the carrying amounts, are recognised in the profit and loss account as they arise.

(ii) Other investments

Other investments held for long-term purposes are stated at cost less any provision for impairment in value which is other than temporary in nature.

The carrying amounts of other investments are reviewed at each balance sheet date to assess whether the fair values have declined below the carrying amounts. When a decline other than temporary has occurred, the carrying amount of such investments will be reduced to its fair value. The amount of the reduction is recognised as an expense in the profit and loss account.

(i) ACCOUNTS RECEIVABLE

Provision is made against accounts receivable to the extent they are considered to be doubtful. Accounts receivable in the balance sheet are stated net of such provision.

(j) CASH AND CASH EQUIVALENTS

Cash and cash equivalents are carried in the balance sheet at cost. For the purposes of the cash flow statement, cash and cash equivalents comprise cash on hand and deposits with banks.

(k) PROVISIONS

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be made.

NOTES TO THE ACCOUNTS

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(l) EMPLOYEE BENEFITS

(i) Employee leave entitlements

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(ii) Pension obligations

The Group's subsidiaries in Hong Kong and China participate in relevant defined contribution schemes, the assets of which are held separately from those of the Group in independently administered funds. Contributions are made to these schemes based on a certain percentage of the applicable payroll costs. The contributions are expensed as incurred.

The Group's subsidiary in Taiwan participates in a defined benefit pension plan in accordance with the local statutory regulations. Pension costs are assessed using the projected unit credit method. The pension obligation is measured as the present value of the estimated future cash outflows using discount rate based on the rate of return on high-quality fixed-income investments in Taiwan which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognised over the average remaining service lives of employees. Past service costs are recognised as expenses on a straight-line basis over the average period until the benefits become vested. The contributions are charged to the profit and loss account in the period to which the contributions relate.

(iii) Profit sharing and bonus plans

The expected cost of profit sharing and bonus payments are recognised as a liability when the Group has a present legal or constructive obligation as a result of services rendered by employees and a reliable estimate of the obligation can be made.

Liabilities for profit sharing and bonus plans are expected to be settled within 12 months and are measured at the amounts expected to be paid when they are settled.

(m) CONTINGENT LIABILITIES

A contingent liability is a possible obligation that arises from past events and whose existence will only be confirmed by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group. It can also be a present obligation arising from past events that is not recognised because it is not probable that outflow of economic resources will be required or the amount of obligation cannot be measured reliably.

A contingent liability is not recognised but is disclosed in the notes to the accounts. When a change in the probability of an outflow occurs so that outflow is probable, they will then be recognised as a provision.

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(n) DEFERRED TAXATION

Deferred taxation is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the accounts. Taxation rates enacted or substantively enacted by the balance sheet date are used to determine deferred taxation.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred taxation is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

In prior year, deferred taxation was accounted for at the current taxation rate in respect of timing differences between profit as computed for taxation purposes and profit as stated in the accounts to the extent that a liability or an asset was expected to be payable or recoverable in the foreseeable future. The adoption of the SSAP 12 (revised) represents a change in accounting policy, which has been applied retrospectively so that the comparatives presented have been restated to conform to the changed policy.

As detailed in note 22 to the accounts, opening retained earnings at 1st October 2002 and 2003 have been increased by HK\$629,000 and HK\$3,316,000 respectively which represent the unprovided net deferred tax assets. This change has resulted in an increase in deferred tax assets at 30th September 2003 by HK\$3,436,000. The loss attributable to shareholders and the share of net losses by minority interest for the year ended 30th September 2003 have been reduced by HK\$2,687,000 and HK\$120,000 respectively.

(o) TRANSLATION OF FOREIGN CURRENCIES

Transactions in foreign currencies are translated at exchange rates ruling at the transaction dates. Monetary assets and liabilities expressed in foreign currencies at the balance sheet date are translated at rates of exchange ruling at the balance sheet date. Exchange differences arising in these cases are dealt with in the profit and loss account.

The balance sheets of subsidiaries expressed in foreign currencies are translated at the rates of exchange ruling at the balance sheet date whilst the profit and loss account is translated at average rates. Exchange differences are dealt with as a movement in reserves.

NOTES TO THE ACCOUNTS

2. PRINCIPAL ACCOUNTING POLICIES (continued)

(p) REVENUE RECOGNITION

Revenue from the sale of goods is recognised on the transfer of risks and rewards of ownership, which generally coincides with the time when the goods are delivered to customers and the title has passed.

Receipts from the sale of gift coupons are recorded as liabilities. Such receipts are recognised as sales when the coupons are redeemed for products or as other income upon the coupon expiry date.

Revenue from rendering of services is recognised when the services are rendered.

Operating lease rental income is recognised on a straight-line basis.

Interest income is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rates applicable.

(q) SEGMENT REPORTING

In note 3 to the accounts, the Group had disclosed segment revenue and results as defined under SSAP 26.

In accordance with the Group's internal financial reporting, the Group has determined that business segments be presented as the primary reporting format and geographical as the secondary reporting format.

Unallocated costs represent corporate expenses. Segment assets consist primarily of fixed assets, inventories, receivables and operating cash. Segment liabilities comprise operating liabilities. Capital expenditure comprises additions to fixed assets.

In respect of geographical segment reporting, sales are reported based on the country/place in which the customers are located. Total assets and capital expenditure are reported where the assets are located.

3. TURNOVER, REVENUE AND SEGMENT INFORMATION

The Group is principally engaged in the retail sales of skin-care products, provision of beauty salon, spa and related services. Revenues recognised during the year are as follows:

	2004 HK$'000	2003 HK$'000
Turnover		
Sales of goods	256,396	220,531
Rendering of services	101,157	89,705
	357,553	310,236
Other revenues		
Interest income	340	651
Gross rental income from investment properties	903	273
Income from expired gift coupons	493	135
Dividend income	58	–
Others	200	190
	1,994	1,249
Total revenues	359,547	311,485

NOTES TO THE ACCOUNTS

3. TURNOVER, REVENUE AND SEGMENT INFORMATION (continued)

PRIMARY REPORTING FORMAT – BUSINESS SEGMENTS

	Retailing		Services		Elimination		Group	
	2004 HK$'000	As restated 2003 HK$'000	2004 HK$'000	As restated 2003 HK$'000	2004 HK$'000	As restated 2003 HK$'000	2004 HK$'000	As restated 2003 HK$'000
Sales to external customers	254,664	220,531	102,889	89,705	–	–	357,553	310,236
Inter-segment sales	7,110	4,032	–	–	(7,110)	(4,032)	–	–
Total	261,774	224,563	102,889	89,705	(7,110)	(4,032)	357,553	310,236
Segment results	19,205	1,727	12,307	23,960	–	–	31,512	25,687
Other revenues							1,994	1,249
Unallocated corporate expenses							(29,929)	(34,646)
Operating profit/(loss)							3,577	(7,710)
Taxation							(1,678)	(41)
Profit/(loss) after taxation							1,899	(7,751)
Minority interests							(205)	654
Profit/(loss) attributable to shareholders							1,694	(7,097)

	Retailing		Services		Group	
	2004 HK$'000	As restated 2003 HK$'000	2004 HK$'000	As restated 2003 HK$'000	2004 HK$'000	As restated 2003 HK$'000
Segment assets	172,305	98,928	44,872	27,461	217,177	126,389
Unallocated assets					42,803	73,295
Total assets					259,980	199,684
Segment liabilities	50,120	27,684	50,975	25,455	101,095	53,139
Unallocated liabilities (including minority interests)					2,001	2,894
Total liabilities					103,096	56,033
Depreciation	8,678	8,735	6,747	5,051	15,425	13,786
Amortisation	1,169	1,009	–	–	1,169	1,009
Capital expenditures	47,222	8,041	6,968	8,117	54,190	16,158

3. TURNOVER, REVENUE AND SEGMENT INFORMATION (continued)

SECONDARY REPORTING FORMAT – GEOGRAPHICAL SEGMENTS

	Turnover		Capital expenditures		Total assets	
						As restated
	2004 HK$'000	2003 HK$'000	**2004 HK$'000**	2003 HK$'000	**2004 HK$'000**	2003 HK$'000
Hong Kong and Macau	**210,433**	190,772	**49,032**	10,113	**145,160**	57,529
China	**75,869**	50,323	**1,632**	5,326	**39,424**	40,138
Taiwan	**68,915**	69,141	**2,029**	719	**29,515**	28,722
Singapore	**2,336**	–	**1,497**	–	**3,078**	–
	357,553	310,236	**54,190**	16,158	**217,177**	126,389
Unallocated assets					**42,803**	73,295
					259,980	199,684

4. OPERATING PROFIT/(LOSS)

Operating profit/(loss) is stated after crediting and charging the following:

	2004 HK$'000	2003 HK$'000
Crediting		
Gain on disposal of fixed assets	**566**	102
Gain on disposal of other investment	**–**	69
Revaluation gain/(deficit) on investment properties	**1,300**	(350)
Charging		
Loss on disposal of trading investments	**47**	–
Amortisation of intangible assets	**1,169**	1,009
Auditors' remuneration	**933**	823
Operating leases rental on land and buildings	**40,033**	45,918
Unrealised loss on trading investments	**70**	17
Net exchange loss/(gain)	**466**	(89)
Interest expense on long-term bank loan	**140**	–

NOTES TO THE ACCOUNTS

5. TAXATION

	2004 HK$'000	As restated 2003 HK$'000
Current taxation		
Hong Kong profits tax	1,550	1,074
Overseas taxation	1,131	872
(Over)/under provision in prior years	(63)	223
Deferred taxation relating to the origination and reversal of temporary differences (Note 24)	(940)	(2,128)
	1,678	41

Hong Kong profits tax has been provided at the rate of 17.5% (2003:17.5%) on the estimated assessable profit for the year after setting off available tax losses brought forward from prior years. Taxation on overseas profits has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the countries/places in which the Group operates.

The taxation on the Group's profit/(loss) before taxation differs from the theoretical amount that would arise using the taxation rate of the major business territory of the Group as follows:

	2004 HK$'000	As restated 2003 HK$'000
Profit/(loss) before taxation	3,577	(7,710)
Calculated at a taxation rate of 17.5% (2003: 17.5%)	626	(1,349)
Effect of different taxation rates in other countries	160	241
Income not subject to taxation	(398)	(125)
Expenses not deductible for taxation purposes	1,636	1,637
Utilisation of tax losses	(283)	(586)
(Over)/under provision in prior years	(63)	223
Taxation charge	1,678	41

6. PROFIT/(LOSS) ATTRIBUTABLE TO SHAREHOLDERS

The profit attributable to shareholders is dealt with in the accounts of the Company to the extent of approximately HK$8,413,000 (2003: HK$5,184,000).

7. DIVIDENDS

	2004 HK$'000	2003 HK$'000
Interim, paid, of 0.5 HK cents per ordinary share (2003: 0.5 HK cents)	1,711	1,610
Final, proposed on 19th January 2005, of 0.5 HK cents per ordinary share (2003: 1.0 HK cents)	1,711	3,391
	3,422	5,001

8. EARNINGS/(LOSS) PER SHARE

The calculation of basic earnings/(loss) per share is based on the Group's profit attributable to shareholders of approximately HK$1,694,000 (2003: loss attributable to shareholders of approximately HK$7,097,000 as restated) and the weighted average number of 333,845,271 (2003: 322,330,137) ordinary shares in issue during the year.

No diluted earnings/(loss) per share is calculated for the years ended 30th September 2004 and 2003 since the exercise prices of the Company's outstanding options were higher than the average fair value per share of the Company during the year and the potential ordinary shares would have no dilutive effect.

9. STAFF COSTS (including directors' emoluments)

	2004 HK$'000	2003 HK$'000
Wages and salaries	97,663	80,969
Pension costs-defined benefit plan (Note 23)	395	154
Pension costs-defined contribution plans	3,668	3,387
Unutilised annual leave	492	258
	102,218	84,768

NOTES TO THE ACCOUNTS

10. DIRECTORS' EMOLUMENTS AND FIVE HIGHEST PAID INDIVIDUALS

(a) DIRECTORS' EMOLUMENTS

The aggregate amounts of emoluments payable to directors of the Company during the year are as follows:

	2004 HK$'000	2003 HK$'000
Fees	225	200
Other emoluments:		
Basic salaries, housing allowances, other allowances and benefits-in-kinds	8,580	8,617
Retirement benefit costs	60	60
	8,865	8,877

Directors' fees disclosed above are all payable to independent non-executive directors.

Certain directors of the Company have been granted options to acquire shares of the Company. Details of share options granted, exercised and lapsed during the year are disclosed in the Directors' Report.

The emoluments of the directors fell within the following bands:

	Number of Directors	
	2004	2003
Emolument bands		
HK$ nil – HK$1,000,000	6	5
HK$1,000,001 – HK$1,500,000	1	1
HK$1,500,001 – HK$4,500,000	–	–
HK$4,500,001 – HK$5,000,000	1	1
	8	7

10. DIRECTORS' EMOLUMENTS AND FIVE HIGHEST PAID INDIVIDUALS (continued)

(b) FIVE HIGHEST PAID INDIVIDUALS

The five individuals whose emoluments were the highest in the Group for the year include four (2003: four) directors whose emoluments are reflected in the analysis presented above. Emoluments payable to the remaining one (2003: one) individual during the year are as follows:

	2004 HK$'000	2003 HK$'000
Basic salaries, housing allowances, other allowances and benefits-in-kinds	1,520	1,381
Bonuses	300	–
Retirement benefit costs	12	12
	1,832	1,393

The emoluments of the employee fell within the following band:

	Number of Employees	
	2004	2003
Emolument bands		
HK$ nil – HK$1,000,000	–	–
HK$1,000,001 – HK$1,500,000	–	1
HK$1,500,001 – HK$2,000,000	1	–
	1	1

For the years ended 30th September 2004 and 2003, no directors waived any emoluments and no emoluments have been paid by the Group to the directors or any of the five highest paid individuals as an inducement to join or upon joining the Group as compensation for loss of office.

NOTES TO THE ACCOUNTS

11. INTANGIBLE ASSETS

GROUP

	License fees	
	2004	2003
	HK$'000	HK$'000
Beginning of year	**2,725**	3,256
Additions	**366**	478
Amortisation charge	**(1,169)**	(1,009)
End of year	**1,922**	2,725
End of year		
Cost	**4,511**	4,145
Accumulated amortisation	**(2,589)**	(1,420)
Net book amount	**1,922**	2,725

12. FIXED ASSETS

GROUP

	Investment properties HK$'000	Leasehold improvements HK$'000	Motor vehicles HK$'000	Computer equipment HK$'000	Machinery and equipment HK$'000	Office equipment, furniture and fixtures HK$'000	Total HK$'000
Cost or valuation							
As at 1st October 2003	5,600	38,716	3,249	4,414	9,568	5,345	66,892
Additions	39,266	8,572	916	923	3,493	1,020	54,190
Disposals	–	(741)	(1,513)	(4)	(510)	(362)	(3,130)
Revaluation	7,734	–	–	–	–	–	7,734
Exchange adjustment	–	51	3	–	1	39	94
As at 30th September 2004	52,600	46,598	2,655	5,333	12,552	6,042	125,780
Accumulated depreciation							
As at 1st October 2003	–	22,971	2,738	2,926	2,864	2,912	34,411
Charge for the year	–	10,655	456	947	2,257	1,110	15,425
Disposals	–	(725)	(1,513)	(2)	(273)	(281)	(2,794)
Exchange adjustment	–	43	2	–	–	24	69
As at 30th September 2004	–	32,944	1,683	3,871	4,848	3,765	47,111
Net book value							
As at 30th September 2004	52,600	13,654	972	1,462	7,704	2,277	78,669
As at 30th September 2003	5,600	15,745	511	1,488	6,704	2,433	32,481

12. FIXED ASSETS (continued)

The analyse of the cost or valuation as at 30th September 2004 and 2003 of the above assets are as follows:

	Investment properties HK$'000	Leasehold improvements HK$'000	Motor vehicles HK$'000	Computer equipment HK$'000	Machinery and equipment HK$'000	Office equipment, furniture and fixtures HK$'000	Total HK$'000
2004							
At cost	–	46,598	2,655	5,333	12,552	6,042	73,180
At valuation	52,600	–	–	–	–	–	52,600
	52,600	46,598	2,655	5,333	12,552	6,042	125,780
2003							
At cost	–	38,716	3,249	4,414	9,568	5,345	61,292
At valuation	5,600	–	–	–	–	–	5,600
	5,600	38,716	3,249	4,414	9,568	5,345	66,892

The Group's interests in investment properties at their net book values are analysed as follows:

	2004 HK$'000	2003 HK$'000
In Hong Kong, held on:		
Leases of over 50 years	45,300	–
Leases of between 10 to 50 years	7,300	5,600
	52,600	5,600

The investment properties were revalued at 30th September 2004 on the basis of their open market values by American Appraisal China Limited, an independent firm of chartered surveyors.

At 30th September 2004, the net book value of an investment property of HK$41,000,000 was pledged as security for the Group's long-term bank loan (2003: Nil).