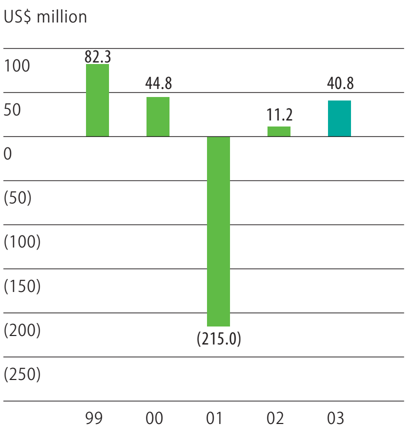
A year of solid achievements

Allan WONG
Chairman

To our Shareholders, Customers, Partners, and Employees

PROFIT/(LOSS) ATTRIBUTABLE TO SHAREHOLDERS IN LAST 5 YEARS



The financial year 2003 was one of solid achievements for VTech in its financial results. At the interim, we reported a return to a net cash position and we built on this achievement in the subsequent six months to an even stronger net cash position at the end of the financial year.

The Group revenue has declined by 9.7% from last year. Although sales of AT&T and VTech branded telecommunication products grew considerably in the financial year 2003, the increase was insufficient to offset the loss of ODM (Original Design Manufacturing) business in telecommunication products. In 2002, one of our largest ODM customers exited the North America telephone market and hence these ODM sales did not recur in financial year 2003. Lower sales at our Electronic Learning Products (ELP) business in the United States was another major factor contributing to the reduction in the Group revenue.

Despite the decrease in the Group revenue from US$959.8 million to US$866.5 million, operating profit improved from US$23.0 million to US$59.5 million. Profit attributable to shareholders stood at US$40.8 million, which compared to last year's US$11.2 million. The 264.3% rise in profit attributable to shareholders over previous year is primarily due to the gain arising from the settlement of our lawsuit against Lucent Technologies Inc. (Lucent) of US$34.0 million, improved product mix in the sales of AT&T and VTech branded telecommunication products, enhancing supply chain management and manufacturing processes. The Group also benefited from a reduction in financing costs as it strengthens its liquidity position. The results were, however, adversely affected by the less than satisfactory performance of our ELP business in the United States.

The Group is currently in discussions with the Hong Kong Inland Revenue Department (IRD) regarding a dispute over the offshore income claims made by certain subsidiaries of the Group in prior years. Whilst management considers that the subsidiaries have grounds to support these claims, the outcome of the dispute remains undetermined. The directors consider it prudent to establish a provision of US$11.0 million for the directors' best estimate of any liabilities which may arise on settlement of this dispute, which has been charged to the consolidated income statement for the year ended 31st March 2003.

The continuous improvement in VTech's financial position has led the directors to recommend a final dividend of US2.0 cents per ordinary share which, together with the interim dividend already paid, brings the full-year dividend to US3.5 cents per ordinary share.

Steady operational cash flow has given further support to the Group's improved liquidity. As at 31st March 2003, the Group had net cash of US$67.7 million, against a net debt position of US$32.5 million at 31st March 2002. Total interest bearing liabilities had decreased from US$95.8 million as at 31st March 2002 to US$2.7 million. The gross

Strong growth in branded sales

Outstanding customer service

debt to shareholders' funds ratio stood at 2.1% compared with 107.2% for the same period of last year. The Group has adequate financial resources to meet its working capital requirements.

Good Performance from Telecommunication Products

Telecommunication products were again the mainstay of VTech's revenue in the financial year 2003, at US$609.8 million accounting for 70.4% of total Group revenue. Although this figure was 9.0% lower than the financial year 2002 as a result of the decrease in ODM sales, the result is very encouraging.

The acquisition of the Lucent wired business that triggered a broad-based restructuring of our telecommunication products business had given the opportunity to the Group to enhance its operation that enabled us to stay ahead of the industry. The acquisition also brought VTech a powerful licensed brand in AT&T that allowed the Group to cover a wider spectrum of customers and positioned it as the category leader of many major retailers. This in turn opens up a major source of revenue growth.

This improvement was demonstrated during the financial year 2003 by the strong sales performance of our AT&T and VTech branded products. In a market made particularly sluggish by weak consumer sentiment, sales of our branded telecommunication products increased considerably, helping to maintain our dominant share in the US cordless phones market. For the financial year 2003, sales of the 2.4GHz and 5.8GHz models, accounted for over 50% of our telecommunication products business revenue.

The customer-centric strategy adopted by the telecommunication products business also contributed substantially to the business' operating results. During the period under review, the business received a number of important customer awards for outstanding customer services, including Sam's Club's "Supplier of the Year Award", Target's "Electronics Instock Award", and BJ's "Partnership Award".

Challenges in the US for ELP

The ELP business continued to face severe challenges in the US market, while maintaining its dominance in our principal European markets. Revenue for the financial year 2003 decreased by 16.4% to US$161.9 million.

In the United States, the rise of certain strong competitors had threatened the sales of VTech products, particularly in the pre-school and infant categories. The popularization of personal computers, television and hand-held games at the same time, has eroded the size of the electronic learning aids (ELA) segment of our ELP business. Historically, the ELA category accounted for over 50% of ELP revenue and in the financial year 2003, it only accounted for 21.0%.

A three-year plan...

...to restore revenues and profits

We also recognized the need to get closer to both the retailers which carry our products and the consumers who purchase them. To this end, two years ago we brought in new management with extensive marketing experience to develop a much more customer-centric approach. Many valuable lessons were learned and we are continuing to build our strategies using the same principles but with improved execution.

Acknowledging the need for further changes, we have devised a three-year strategic plan to restore the business to its normal level of revenue and profitability. We will first focus on rebuilding the profitability of the business, starting from reorganizing the US operations. To improve efficiency in product development, we closed the R&D centre in Connecticut, USA and consolidated the new product development function completely in Hong Kong and mainland China under the leadership of our new senior management team. Our product design teams in Hong Kong and mainland China will be supported by the up-to-date market intelligence collected from our distribution networks in major markets. Dedicated resources will also be allocated to them to generate innovative and creative product ideas and concepts. We have full confidence that the quality of the new product development process will be much improved by this new arrangement and the change in management.

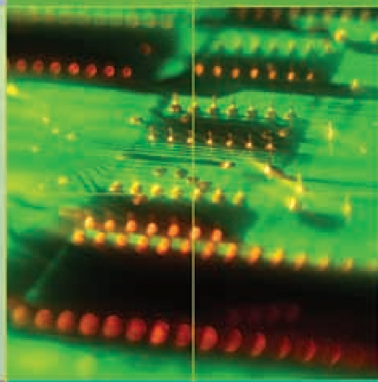
Stable Contract Manufacturing Services (CMS)

VTech's ability to provide the complete range of Electronics Manufacturing Services (EMS) to medium-sized companies again provided the Group with sustainable revenue in the financial year 2003, despite soft conditions in the worldwide EMS market. Our CMS business had a steady year, with modest revenue growth of 2.0% to US$94.7 million and a stable profit. The business also made important improvements during the year to its operations, upgrading to ISO9001:2000 version, gaining TL9000 certification for telecommunication products, introducing lead-free soldering and establishing a new R&D centre in Shenzhen, mainland China. All these enhancements position VTech well for future growth opportunities.

Outlook

The macro-economic outlook for the financial year 2004 remains highly uncertain, with consumer sentiment in the United States and Europe highly contingent on a number of factors. For VTech, however, the financial year 2004 is a year that we look forward to further growth in revenue and profitability.

One-stop shop OEM services



Stable profit

In telecommunication products, we have already delivered some of the new 2.4GHz and 5.8GHz cordless phones to sustain the sales momentum created during the financial year 2003 and capture more market share in the United States. A large number of new models were introduced at the Consumer Electronics Show (CES) in January 2003 that were very well received by the industry and are expected to drive sales and profits in the financial year 2004. These continue the VTech tradition of innovation and technology leadership, including the TeleZapper® phones and the "Teen Phone".

Our telecommunication products business will also expand aggressively in Europe. We are deepening the relationships we have already established with some of the best names in European telecommunications, to which we are already a key supplier. In March 2003, we entered into an alliance with the Swissvoice Group, a Switzerland-based leader in the marketing of residential fixed line telephones in Europe. Swissvoice will market VTech's DECT phones in various European markets. Our aim is to raise the proportion of the Group's telecommunication products revenue from Europe to 15% by 2006, around three times the current proportion.

In a more dramatic development, in January 2003, we secured an extension to the brand license agreement with AT&T that permits VTech to use the AT&T brand on data networking products. Wireless Local Area Networks are proliferating rapidly around the world, as consumers seek the mobility and convenience they offer. The global data networking market, which is still in its early stage is growing fast and the technology used in data networking devices is a common platform with the 2.4GHz cordless phone technology. We have leveraged our expertise to create a product range in this area, which will be an important new growth driver for our telecommunication products business in longer term.

The ELP business will also turn around as we implement our three-year strategic plan. The immediate focus will be to rebuild profitability. The ELP operation will be altogether leaner and more productive in the financial year 2004, following the actions we have already undertaken to rationalize the cost structure of the business. These include allocating our advertising dollars strategically in the financial year 2004 to ensure that maximum impact will be generated with fewer resources. The Hong Kong, US and European operations were also streamlined and reorganized to bring the size of the structure into proportion with the current scale of the business. As a result, we are confident of much improved bottom line results for the financial year 2004.

With profitability restored at our ELP business, we expect to achieve solid revenue growth in the financial year 2005 and beyond, as new products come on stream. A completely revamped product range for

the calendar year 2004 is being developed, based on the marketing skills we have gained over the past three years with our deep reservoir of product development expertise in Hong Kong. We are also exploring entirely new product categories.

During the financial year 2004, we have a range of 16 different electronic learning products ready to test the longer-term China market. These products cover our three major categories, namely electronic infant toys, electronic pre-school toys and ELA. They are designed to appeal to the children aged 6 months to 11 years old and will initially be sold in the Pearl River Delta area in the mainland China.

CMS, meanwhile, is expected to continue to make a solid contribution to the Group's results, and benefit from the need of more companies to outsource. The scope of our product design service will be expanded and we plan to enter more segments of the market by attaining QS9000 and ISO13488 certifications, which will give us entry to the production of parts for the automotive and equipment for the medical sectors respectively.

To strive for greater efficiency and enhanced performance, we have launched a balanced scorecard project on a global basis. With this new management system, we are able to integrate the Group's overall strategies into operations and raise the Group's performance to a higher level.

Depending on the resilience of consumer demand in all major markets, we expect steady growth in revenues and recurrent profits in the financial year 2004. Over the next three years, however, as the new initiatives come to fruition, we expect to return to a more rapid and broadly based growth path, producing much stronger financial results that will enable us to reward our shareholders more fully for their supports during the past few years.

Appreciation

Last but not the least, I would like to thank my fellow directors and senior management, as well as all VTech employees for their continued commitment to ensuring continued improvement for the Group. Likewise, my thanks go out to our bankers and business partners for their invaluable supports.

Allan WONG Chi Yun
Chairman
Hong Kong, 25th June 2003