



Strong growth in profit

Telecommunication products



The tele-communication products business reported strong growth in profits

on the back of higher sales of AT&T and VTech branded models and a shift in the product mix from 900MHz to 2.4GHz and 5.8GHz cordless telephones. This achievement testifies to the dedication of the division's employees and the success of the customer-centric strategy that is now the corner stone of all operations.

James C. KRALIK

Chief Executive Officer,
Telecommunication Products Business

While sales of the AT&T and VTech branded products increased considerably during the financial year 2003, total revenue for the business declined by 9.0% to US\$609.8 million. This was primarily driven by the lower volume of ODM business as one of our large ODM customers exited the North America telephone market in 2002.

In North America, our new range of 2.4GHz analog and digital phones, in particular our AT&T branded phones, was well received by our customers and end consumers. This strong sales momentum was sustained by the delivery of the world's first 5.8GHz cordless phone in August 2002 which reaffirmed VTech's position in the industry as not only one of the largest suppliers of cordless phones in the United States, but also the global leader in cordless phone technology. As a result, VTech's overall market share in North America continued to increase.

The sustained shift from 900MHz cordless models to 2.4GHz and 5.8GHz cordless models also resulted in higher average selling prices and margins. During the course of the year, we were also able to lower the cost of components, following

improvements to product design and an improved procurement process that has successfully leveraged our economies of scale in purchasing. Enhanced efficiencies in manufacturing by the implementation of a cell-based manufacturing process also contributed significantly to our improved profitability.

At the same time, our customer-centric strategy continued to be at the core of all our business activities. A collaborative planning, forecasting and replenishment (CPFR) model was implemented, which feeds weekly point-of-sale data directly into our production planning process. This has enabled us to reduce inventory levels and working capital further. It has also helped us to increase the quality and level of service we offer customers, something that has been recognized by a number of important awards, including Sam's Club's "Supplier of the Year Award", Target's "Electronics Instock Award", and BJ's "Partnership Award".

Outlook

We are cautiously optimistic about achieving both revenue and profit growth

As simple as you want it. As advanced as you make it.



Exciting new product range

New AT&T and VTech products

Review of Operations



during the financial year 2004, though much will depend on overall economic conditions and consumer sentiment, particularly in the United States, our largest market. We expect that competitive pressures, especially with regard to product pricing, will remain strong and our largest competitors begin to supply 5.8GHz products to the market. According to data of the first quarter of calendar year 2003 released by NPD, Market Intelligence, however, the total cordless market in the United States will experience moderate growth in both units and revenue in the calendar years 2003 and 2004. Having both the AT&T and VTech brands, the Group is well positioned to benefit from this organic growth and to capture market share from higher end segments of this market.

In April 2003, VTech launched a new range of AT&T and VTech cordless phones that have received enthusiastic support from our retail partners. In addition to new 2.4GHz and 5.8GHz cordless phones, the "Teen Phone", a cordless phone designed specifically for the teenage market with programmable ringer tones and removable faceplates, has created particular excitement in the marketplace. Initial point of sales data for the "Teen Phone" are encouraging.

Our customer-centric strategy continues to position VTech well to win additional market share in a competitive environment. The comprehensive product range we offer under two different brand names and our track record of technology leadership enable us to gain acceptance for additional

products as retailers continue to rationalize the number of suppliers and the variety of products they carry. At the same time, continued improvements managing our supply chain will reinforce the attraction of VTech as a key supplier, and in some cases, telephone category manager.

Another growth area for the financial year 2004 will be the European market. The size of the overall European cordless phone market is approximately two-thirds of the US residential phone market. Since our European sales accounted for around 5% of the telecommunication products revenue in the financial year 2003, we see enormous potential for VTech in this market over the medium term and have set a target of raising the proportion of sales from Europe to 15% by 2006.

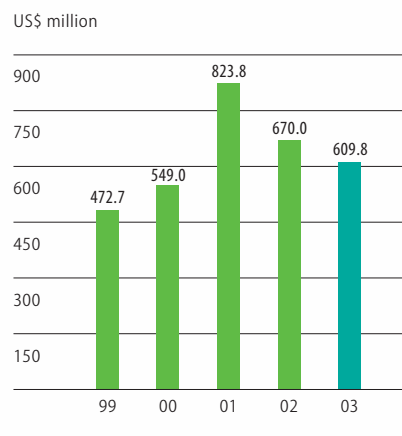
To achieve this, we will deepen the relationships we enjoy with some of the best names in European telecommunications, to which we are already a key supplier. The Group will also invest more in the research and development of products specifically for the European market and work to build our alliance with Swissvoice Group, which will market VTech's DECT phones in a number of European countries.

In addition to growth through geographical expansion, we intend over the medium term to drive revenue by entering the data networking market. This is one of the fastest growing product categories in communications and the global market is

expected to reach US\$3.0 billion by the calendar year 2005.

In January 2003, we secured an extension to our AT&T brand license that permits VTech to use the AT&T brand on data networking products. With its technical expertise and distribution presence, VTech is in a unique competitive position to take the lead in this fast growing segment, which will only expand further as voice and data converge. We have created a unique identity for these products, using the "Plug and Share™" concept to offer high quality and easy to use products. An initial range of products will be delivered in the second quarter of the financial year 2004 and we believe the combination of VTech's technology platform with the highly respected AT&T brand, will make us a powerful competitor in this exciting new market.

TELECOMMUNICATION PRODUCTS REVENUE IN LAST 5 YEARS





Rebuilding
profitability

Electronic Learning Products



Financial year 2003 has been a tough year for our ELP business, as our products

faced major challenges in the United States. Although we have been able to maintain our dominance in Europe, where VTech remains a leader in many categories, both revenue and profitability of our ELP business inevitably declined.

Edwin YING Lin Kwan
Chief Executive Officer,
Electronic Learning Products Business

Revenue for the financial year 2003 fell by 16.4% to US\$161.9 million, primarily as a result of a decline in sales in the United States.

The main factors attributable to the decline in sales in the United States are set out follows:

- The size of the ELA market has been eroded due to the popularization of personal computers. Children between age of 6 and 11 are switching to PCs, television games and hand-held games for fun and education. Accordingly the need for ELA products has reduced. Historically ELA accounted for over 50% of our revenue sources but for the financial year 2003 it only accounted for 21.0% of our revenue.
- The rise of certain strong competitors in the United States had threatened the sales of VTech products, particularly in the pre-school and infant categories. These competitors are strong and gain certain expansion momentum.
- In an effort to combat the threats of competitors, in late 2001, VTech looked into the development of certain innovative and strategic product items, namely the Voyager Adventure Systems, Smarty's Workshops and the XL Series,

which were headed by the product development team located in Connecticut, USA. Innovative ideas and play concepts were put into the design of the products and, as a result, they were well received by the trade during the preview at the New York Toy Fair in early 2002. Significant sales orders flew through from our key customers. In order to capitalize the products' early success, more than proportionate advertising dollars were committed to promote and market these products. Finally in August 2002, when these products were shipped and put on the shelf of our customers, the feedback from our consumers had not been satisfactory. Inventories had been built up at the warehouse of our customers and the less than satisfactory sell-through had caused some of our key customers to cancel their orders. Management has thoroughly studied the lessons learned in this situation and appropriate measures had been put in place to avoid similar events from recurring in the future.

The combination of the above factors had led to a significant decrease in sales in the US market, a reduction of 28.4% to US\$60.4 million.

Streamlined operations

More creative product ideas



In Europe, by contrast, VTech had been able to sustain a comparable revenue level as last year. Revenue in Europe for the financial year 2003 stood at US\$88.0 million, representing a decline of 7.5% from last year. In this market, VTech has a greater competitive advantage by virtue of its well-established distribution network and expertise in developing products in many different languages. Despite keen competition in the key European markets, VTech has been able to maintain a dominant role in many ELP categories.

Profitability of the ELP business was significantly affected by lower sales volume in the United States. A disproportionate rise in sales and marketing expenses in that market, where major marketing campaigns were launched in support of the brand image and strategic new products, was unable to generate expected results in sales due to unsatisfactory execution, further eroded the margin.

Outlook

In the financial year 2004, ELP will begin aggressively to tackle the issues at the business, especially as regards the US market.

A three-year strategic plan has been devised to restore the operation to its normal levels of revenues and profitability, under the direction of the new management of seasoned VTech executives that was put in place in late 2002.

The results of this initiative will not be immediate and we therefore do not anticipate any improvement in revenue in

the financial year 2004. However, the focus will be on the rebuilding of ELP's profitability. We intend to improve the profitability of the ELP operation through a series of important measures, some of which have already been started. These are:

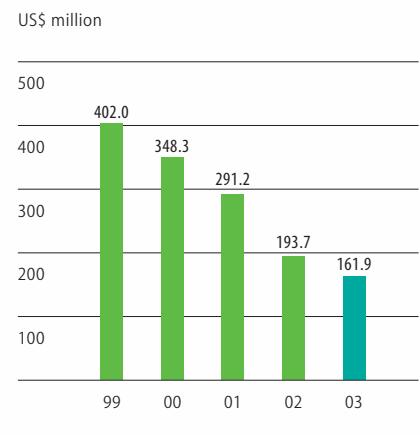
- Reorganized and streamlined Hong Kong, US and European operations in order to bring the size of the structure into proportion with the current scale of business;
- Closed the R&D centre in Connecticut, USA and consolidated the R&D activities to the R&D centres in Hong Kong and mainland China;
- Strategically allocate our advertising dollars to ensure that maximum impact will be generated with fewer resources, e.g. trade advertising; and
- In the product development perspective, we will focus on generating innovative and creative product ideas and concepts. Dedicated resources will be allocated to our product design teams in Hong Kong and mainland China. With up-to-date market intelligence collected from our distribution networks in major markets, our product design professionals will be able to generate product concepts and ideas that are most appropriate to the market and accepted by the consumers.

With profitability restored in the financial year 2004, we will shift our main focuses to driving sales, growing revenues and further profitability growth in the financial year 2005 and beyond. We have begun to revamp completely the product line and to explore entirely new product categories. The core of this longer-term growth strategy will be to integrate our technology innovation, product development and marketing

expertise in our product development processes. This will ensure new products are appropriate to the market and successful with consumers.

We also intend to leverage our competitive strength in developing products with different languages to expand our business geographically. We have begun to examine opportunities in Latin America and other emerging markets. We are also looking at mainland China, which is clearly a market of great potential in the longer term. During the financial year 2004, we will have a range of 16 different ELP products ready to test the China market. These products cover our three major categories, namely electronic infant toys, electronic pre-school toys and electronic learning aids. 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 mainland China.

ELECTRONIC LEARNING PRODUCTS REVENUE IN LAST 5 YEARS





Excellent services

Contract Manufacturing Services



The Contract Manufacturing Services (CMS) business had another solid year, with revenue increasing by 2.0% over 2002 to US\$94.7 million and stable profit. This was a significant performance against the overall EMS market.

Andy LEUNG Hon Kwong
Chief Executive Officer,
Contract Manufacturing Services Business

According to the new study from Technology Forecasters on 20th June 2003, the EMS industry recorded a 9% decline in revenues in the calendar year 2002. Our results were also well ahead of our immediate peer groups in Hong Kong where revenue was reported to have fallen by 12% over the same period.

VTech's ability to produce consistently sound results partly reflects the success of our strategy of providing quality service to medium-sized customers, and to expand through organic growth, only adding capacity when assured of sustained market demand. Currently, telecommunication and professional audio products are the largest categories we produce.

In addition, our excellent service levels enabled us not only to retain all existing

customers, but also to acquire new ones. VTech offers the solid basics of price, quality and delivery to its customers. Beyond these we provide with 24 hours-a-day access to customer service teams, overtime work to complete orders quickly and a very high degree of flexibility in accommodating changes after orders are placed.

Customers also began to benefit from our new DFX (Design For X) Programme. The success of our New Product Introduction (NPI) teams in providing superior service in the area of new product development led to the launch of this program, in which we "design for" various customer parameters, such as cost or quality, helping to improve particular aspects of existing products. We also carried through on enhancements to our processes introduced in the financial year 2002, such as implementing lead-free soldering for our more environmentally concerned customers.

Entering more market segments

New design centre



Another important factor supporting customer retention was VTech's ability to generate cost savings. We held operating costs in check, while using our economies of scale to negotiate improved materials prices, which account for over 75% of total costs. We passed the majority of these savings on to customers, further cementing the strong relationships we have.

Outlook

Market observers forecast modest growth in the EMS market in the calendar year 2003. We regard this as optimistic. The world economy is still weak and our forecast is for little growth in the overall market.

VTech nevertheless aims to increase CMS business volumes in the financial year 2004. A Vice President of business development has been recruited to spearhead various initiatives, including leveraging the extensive relationships of our material suppliers to further expand our customer base.

The scope of our product design service will be expanded. The new design centre in Shenzhen, PRC, has fully established itself and is now able to take initial concepts to a design stage, adding an important dimension to the CMS business.

We also plan to enter more segments of the market. Having gained TL9000 certificate for telecommunication products in August 2002, we intend by July 2003 to attain QS9000 and ISO13488 certifications, which will give us entry to the production of automotive parts and medical equipment respectively.

While expanding our revenue, we will also seek to contain or further reduce costs. Material prices are not expected to rise in the foreseeable future, given the weak state of the global economy, and we plan to squeeze more cost from the supply chain by shortening manufacturing cycle times.

CONTRACT MANUFACTURING SERVICES REVENUE IN LAST 5 YEARS

