

# Letter to Shareholders

**“I am pleased to report a successful year for VTech as we posted a 5.6% increase in revenue to US\$915.2 million and a 13.5% increase in net profit to US\$46.3 million for the financial year ended 31st March 2004. Earnings per share rose 13.3% to US20.5 cents per share.”**

**T**his was a particularly notable performance given the challenges faced during the year.

These included the disruption in the supply of certain key components for our telecommunication products, reduced shelf space for our electronic learning products in North America and a shortfall in orders for contract manufacturing services.

**Although the increase in revenue was small, it marked an important milestone for VTech as the Group finally returned to a path of revenue growth**

The performance testifies the Group's success in enhancing market understanding, operational efficiency and customer service over the past two years. This has made VTech a more focused, efficient and market-driven company, able to respond to market needs in a timely and cost effective manner with innovative products.

Combined with a strong balance sheet, well-recognised brands and a comprehensive distribution network in North America and Europe, these competitive advantages well position the Group for further revenue and profit growth.

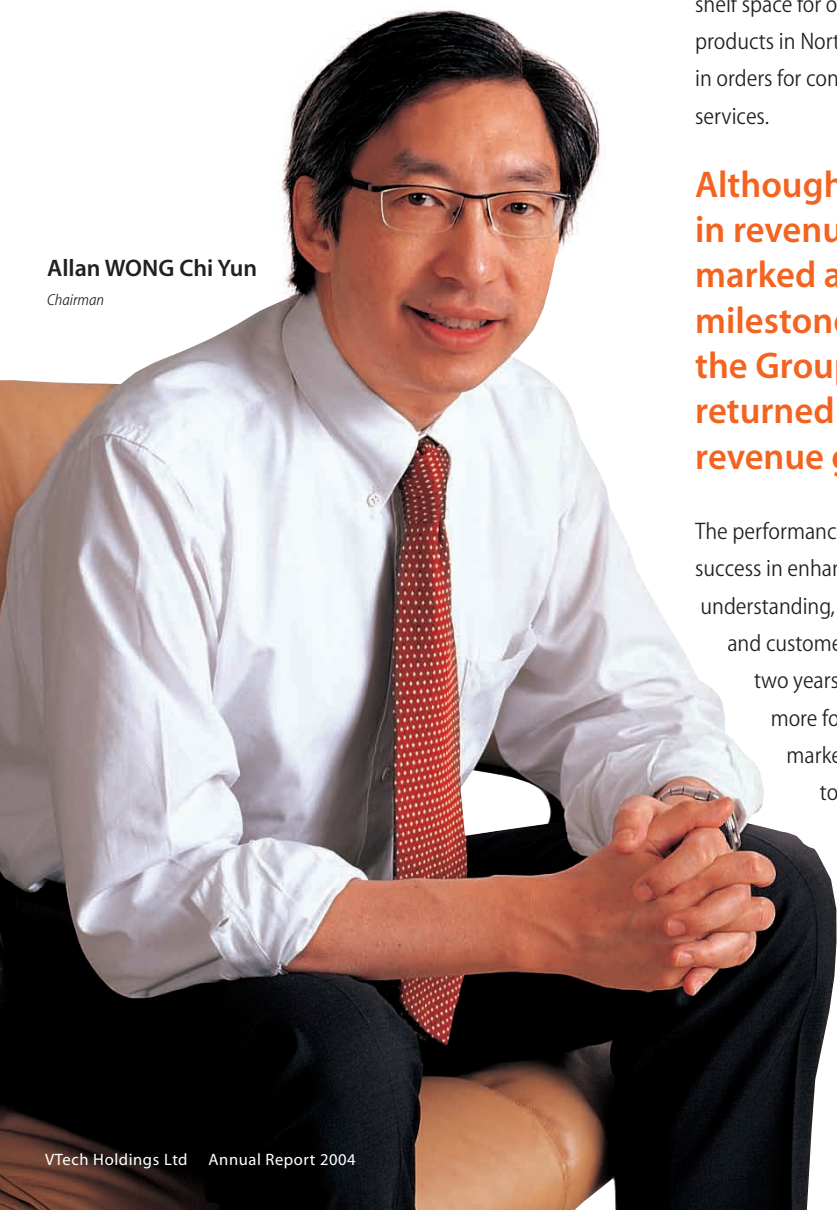
## **Outstanding Performance from Telecommunication Products**

The major contributor to higher revenue and profit at the Group was an increase in sales at the telecommunication products business, reflecting the continued success of its customer-centric strategy, and ability to launch new and innovative products.

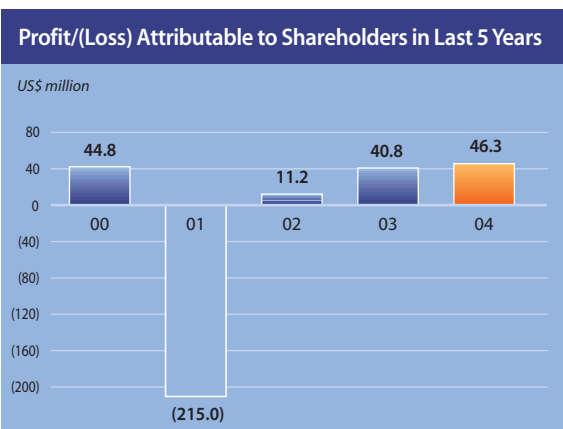
Sales growth was led by the VMIX 2.4GHz cordless phones sold under the VTech brand targeting the teenage segment and offering innovative features such as recordable ring tones. Sales of other products, especially 5.8GHz cordless phones under both AT&T and VTech brands, also recorded significant growth during the financial year.

As a result of the substantial increase in sales of both AT&T and VTech branded products, VTech continues to be the largest supplier of corded and cordless

**Allan WONG Chi Yun**  
Chairman



phones in North America. At the same time, the business recorded strong growth in Europe, where we continued to work closely with major UK and German telecommunication operators as well as the Swissvoice Group.



### Strong Profit Rebound at Electronic Learning Products

The profit of the Group was supported by a considerable improvement in profitability at the electronic learning products business, despite a decline in revenue when compared to the previous financial year.

The revenue decline occurred in the US market where reduced shelf space from retailers caused a reduction in sales revenue. Sales in Europe, however, continued to be strong and enabled us to

sustain our leadership position in major European market segments.

The improved profitability was the result of a leaner and more efficient structure established by the present management of electronic learning products business. A series of cost rationalisation campaigns was executed in the last quarter of the financial year 2003. As a result, substantial savings were achieved in advertising and promotion expenses as well as selling and general administrative expenses during the financial year 2004.

The new electronic learning product lines for 2004 achieved a breakthrough when in October 2003 we launched the TV Learning System, V.Smile, a first of its kind TV game console that combines education and entertainment for children



in the 3-7 years old category. As importantly, the new

2004 line-up, including V.Smile cartridges, features some of the world's best-known cartoon characters, significantly enhancing its attraction.

### Stable Contribution from Contract Manufacturing Services

The contract manufacturing services business again produced a stable contribution to the Group. Its ability to deliver high quality products, as well as flexible and price competitive services contributed to the organic growth of the business.

During the financial year 2004, contract manufacturing services retained its focus on medium-sized customers seeking precision products. The Group's manufacturing know-how and its outstanding customer service were key to maintaining stable margins for this business.

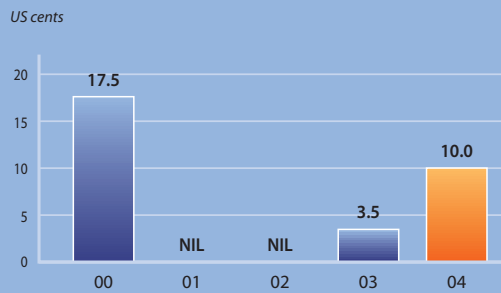


To expand the business further, contract manufacturing services succeeded in gaining additional quality certifications that will enable VTech to enter the production of automotive parts and medical equipment. Following the full operation of the new R&D centre in Shenzhen, the business has been able to offer full turnkey solutions to customers and the enhancement in customer service level resulted in a record number of customer awards in the financial year 2004.

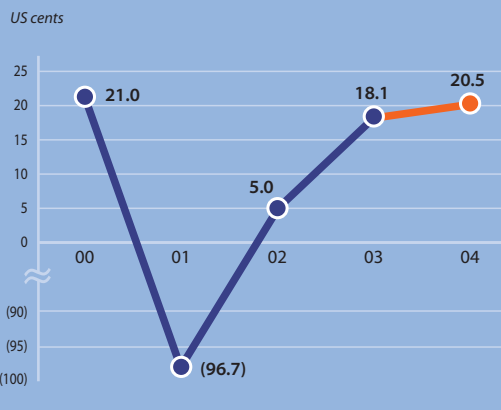
### Strong Financial Position

The continuing improvement in the Group's results and productivity leaves VTech strongly financed. Our net cash position improved from US\$67.7 million as at 31st March 2003 to US\$102.6 million as at 31st March 2004.

**Dividends Per Share in Last 5 Years**



**Earnings/(Loss) Per Share in Last 5 Years**



**The outlook for the financial year 2005 appears broadly conducive to a further increase in revenue, profit and earnings per share**

The strength of our balance sheet will ensure the Group has sufficient funds to sustain its steady growth trajectory, while also giving the Group the capital it needs to invest prudently in areas of opportunity that may arise.

**Increased Dividend**

The improved results and the sound financial position of the Group, have enabled us to recommend an increased final dividend of US7.0 cents per share. Together with the interim dividend of US3.0 cents per share which was declared and paid during the year, this gives total dividends for the year of US10.0 cents per share, against US3.5 cents per share for the financial year 2003.

**Senior Management Changes**

During the financial year 2004, Mr. Paddy Law Wai Leung resigned as Group CEO and Executive Director to pursue his personal interest. I have resumed the Group CEO role since 1st January 2004. In addition to this, we appointed Dr. King F. Pang to a new position of Chief Technology Officer in February 2004.

Dr. Pang will help ensure the Group has the strategic direction it needs in technology, speeding up the Group's product development cycle and increasing the introduction of innovative products.

**Outlook — Cautiously Optimistic**

We expect that the financial year 2005 will continue to be challenging. The key challenges faced by the Group include intensification of market competition, the possible slow down of US consumer spending, ongoing price erosion of our products, and the potential of disruption and unfavourable pricing of key electronic components.

Despite the above, the Group is well positioned for further revenue and profit growth by continuously enhancing our innovative capability as we put more investment in our R&D, aggressively expand our businesses in Europe and Asia, and upgrade our IT infrastructure to further enhance our supply chain and management processes.

VTech is now much more competitive in the fields in which it operates, with a number of competitive advantages:







technology platforms, we are well positioned for further revenue and profit growth, given our improved market position and performance over the past three years.

- ✔ **Market dominance**, as the largest supplier of corded and cordless phones in North America and a leading supplier of electronic learning products in North America and Europe;
- ✔ **Lean operating structure** that makes us highly cost competitive;
- ✔ **Well-integrated R&D** function that provides rapid product innovation and maintains technology leadership;
- ✔ **Strong distribution networks** among major retailers in North America and Europe;
- ✔ **Well recognised multiple brands**, including AT&T and VTech brands and certain popular licensed characters;
- ✔ **Efficient supply chain management** that optimises working capital and ensures on time product delivery; and
- ✔ **More in-depth market understanding** that results in the timely introduction of well-accepted products and effective marketing.

The Group will continue to leverage these advantages to drive both revenue and profit growth in our core businesses.

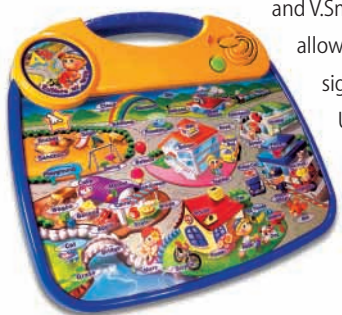
At the telecommunication products business, despite continuing strong competition and ongoing price erosion of existing

Performance will be underpinned by new product launches, such as the AT&T branded E-line of 2.4GHz and 5.8GHz cordless phones which was introduced in April 2004. New data networking products will further bring incremental revenue, and more importantly, support the development of new telephony products that benefit from the increasing convergence of voice and data through Voice over Internet Protocol (VoIP) technology.

We expect our positive momentum in Europe to continue as the European market follows the US pattern of sourcing more products from Asia. As a result, we will substantially increase the R&D in telecommunication products, particularly with regard to developing more feature rich DECT phones for the European market. In addition, we will increase the spending on IT and people development, to ensure we have the infrastructure and skills base to succeed.

The electronic learning products business is expected to achieve a significant rebound in revenue and further profit growth. Trade customers' responses to the new product ranges

and V.Smile has been enthusiastic, allowing VTech to regain significant shelf space at key US retailers. Having achieved good sell-in with retailers, we intend to execute marketing



and promotional campaigns carefully to achieve good sell-through to the end consumers. To help build further critical mass for V.Smile, we plan to launch a major promotion campaign. We will also continue to build our platform in the China market, which we see as a growth potential in the medium term.

The contract manufacturing services business will continue to benefit from the organic growth offered by the global electronic manufacturing services market, which is expected to see a double-digit sales increase in calendar year 2004. Implementation of cell-based manufacturing should further raise productivity and enhance competitiveness. We will also expand the customer base through selected media advertising, participation in trade fairs, as well as increased investment in business development and product design support for customers.



### Stakeholders' Support

Finally I would like to thank my fellow directors, the executive management and all employees of VTech for their continued hard work and dedication. My thanks go also to our customers, brand partners and suppliers for their continued commitment to our joint success, and to our shareholders for their valued support.

### Growth with Innovation

VTech has turned the corner. We are firmly back on the growth path, with an operation that is delivering exciting product innovation and excellent execution. With its core competencies, I am confident that VTech can create greater value for its shareholders in the years ahead.

**Allan WONG Chi Yun**  
 Chairman  
 Hong Kong, 29th June 2004