



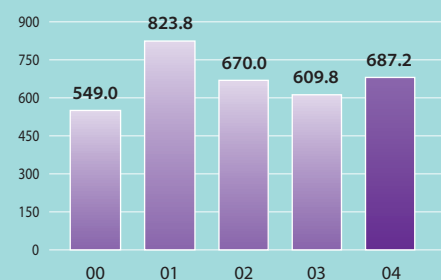
## Review of Operations

# Telecommunication Products

### The telecommunication products business reported strong growth in revenue and profit during the financial year 2004

Telecommunication Products Revenue in Last 5 Years

US\$ million



The telecommunication products business reported strong growth in revenue and profit during the financial year 2004. Revenue increased by 12.7% to US\$687.2 million, while sales of corded and cordless phones, as well as accessories grew by 17.4% over the same period. The growth in revenue was primarily driven by strong sales of both AT&T and VTech branded cordless phones as well as the expansion of the European DECT cordless phone business. At the same time, the telecommunication products business was also able to record a second consecutive record year in terms of profitability. This was particularly notable given the challenges brought by SARS in the early part of the year as well as the disruption in the supply of some key components that began in mid 2003 and continued throughout the remainder of the financial year 2004.

A notable success during the financial year 2004 was the launch and sales of nearly one million VTech VMIX 2.4GHz cordless phones in North America. Designed specifically for the teenage and young adult market, these phones include innovative features such as polyphonic musical ring tones, recordable ring tones, and interchangeable multicolour handset and base faceplates. Also noteworthy were sales of both AT&T and VTech branded 5.8GHz cordless phones, which once again demonstrated significant growth as the 5.8GHz technology pioneered by VTech continued to be well accepted by consumers. As a result of these and other products launched during the financial year, we remained the largest provider of corded and cordless phones in North America.

Europe was also a key growth driver for the business, as the telecommunication products business aggressively expanded



## Innovation Drives Growth

its presence in the European market by working closely with leading telecommunication operators in the UK and Germany as well as the Swissvoice Group. Sales of DECT cordless phones rose by 91.1% over the previous financial year. As a result of this increase, sales in Europe accounted for 8.1% of the total revenue of the telecommunication products business in the financial year 2004, compared with 4.8% during the financial year 2003.

In January 2004, the telecommunication products business launched its first data networking products sold under the AT&T brand in North America. These products included wireless routers, notebook and PCI adapters, and other data networking accessories. The launch of these products provides an opportunity for future revenue growth, and will support the development of new telephony products that benefit from the increasingly rapid convergence of voice and data transmission, through technologies such as Voice over Internet Protocol (VoIP).

Once again, the telecommunication products business' customer-centric approach was an important factor in its success. During the financial year 2004, customer relationships were further strengthened as the business rolled out its collaborative planning, forecasting and replenishment programme to more key



customers. This programme enables both customers and VTech to achieve better inventory management. It further enables VTech to match customers' requests and requirements more closely and with a higher degree of flexibility through its lean manufacturing operations. As a result of these and other enhancements throughout the entire supply chain, the business was able to deliver significant revenue growth without a corresponding increase in working capital.

The telecommunication products business' revenue growth was further supported by a substantial increase in R&D spending during the financial year 2004. This resulted in an increased number of new products launched in time for the Spring 2004 modular resets of key North American retail customers and further supported our expansion in Europe. Overall, R&D expenditure for the telecommunication products business rose by 31.0% to US\$22.0 million during



the financial year 2004. Through the introduction of innovative and feature rich products, such as colour LCD 5.8GHz cordless phones with downloadable pictures and recordable ring tones in North America and more feature rich DECT phones in Europe, the business actively countered continuing price erosion of maturing cordless features and technology platforms.

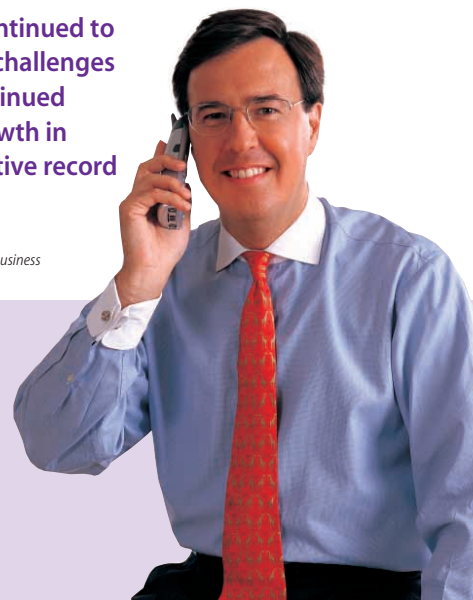
In addition to increasing its commitment to R&D, the telecommunication products business also embarked upon a comprehensive upgrade of its internal IT infrastructure. This project includes the implementation of new Oracle database and reporting modules for financial control and reporting, order management, enterprise resource planning, and customer relationship management. The benefits from this upgrade will be seen beginning in the financial year 2005.

Looking forward, management expects that the 2005 financial year ahead will be challenging. The telecommunication products business operates in an exceptionally competitive environment with strong competitors, ongoing price erosion of existing technology platforms, and the potential of disruption and unfavourable pricing of key electronic components. Nonetheless, the business is well positioned for further revenue and profit growth, particularly given its improved market position and performance over the past three years and its substantial and ongoing investments in R&D, IT infrastructure, and most importantly, its people.



**"I am very pleased to report that the telecommunication products business continued to perform well during the financial year 2004. Although we faced tremendous challenges throughout the year, the extraordinary commitment of our team and the continued support of our customers and suppliers enabled us to record a significant growth in revenue for the first time in three years and further achieve a second consecutive record year in terms of profitability."**

**James C. KRALIK**  
Chief Executive Officer  
Telecommunication Products Business



**Awards**

✔ Telecommunication products business was awarded the prestigious "2003 Hong Kong Awards for Industry: Productivity Award" for its achievement in the "Lean Manufacturing Project".



✔ The gz2456 2.4GHz cordless phone and i5801 5.8GHz cordless phone handset were awarded the Silver Award and Grand Prize respectively in the HKEIA Award for Outstanding and Innovative Product Competition.





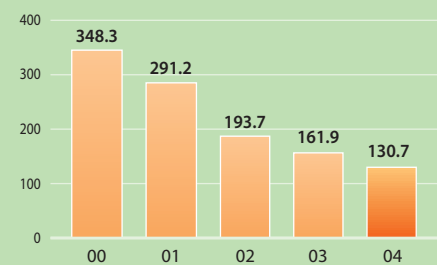


## Review of Operations

# Electronic Learning Products

### Electronic Learning Products Revenue in Last 5 Years

US\$ million



The electronic learning products business achieved marked progress during the financial year 2004 in revitalising its business. Profitability improved dramatically despite there was a 19.3% decline in revenue to US\$130.7 million.

The reduction in revenue had been expected by management at the beginning of financial year 2004 and was mainly due to our underperformance in the US market in the previous year. Shelf space allocated by our retail customers to VTech products decreased in 2003, which directly caused reduction in sales revenue, despite the fact that our 2003 product range achieved solid demand from consumers and satisfactory sell-through situation in the US market. Sales in Europe continued to be strong with especially good results in the United Kingdom,

France, Germany and Spain, enabling VTech to continue its leadership position in major electronic learning products segments in Europe. These segments are: Electronic Infant Toys, Electronic Pre-school Toys and Electronic Learning Aids.



The improvement in profitability was mainly supported by a much leaner operating structure that was implemented by the present management in late 2002. The savings in operating expenses were dramatic, as we rationalised advertising and promotional expenses as well as selling and administrative overhead to make them proportionate to the scale of our present operations.

Our new approach to R&D is more efficient and responsive to the demands in the market. This new approach brings a much tighter integration between our

overseas marketing experts and our R&D professionals, design engineering and product development teams, located in Hong Kong SAR and mainland China. In this new approach, substantial market information and data are fed to the R&D professionals to facilitate innovation and development of our new products that meet the demands in our target market

**The new and revamped product lines have successfully enabled VTech to regain shelf space in the US market**



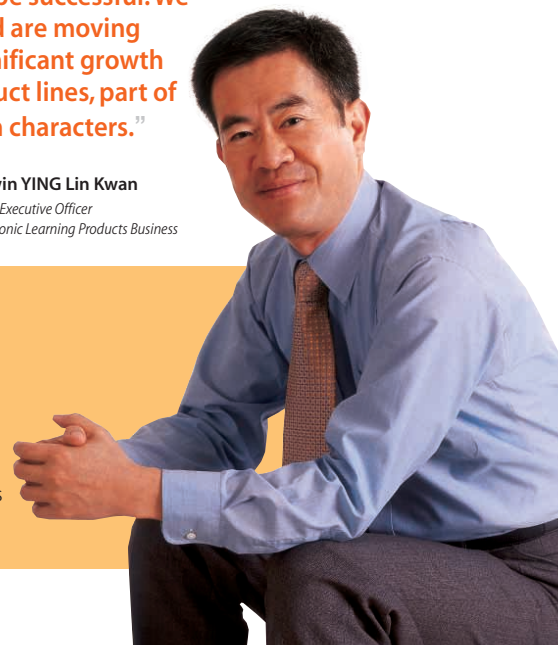
**“The three-year strategic plan which was initiated in late 2002 to revitalise our electronic learning products business has proven to be successful. We have achieved good results in the financial year 2004 and are moving confidently to accomplishing the plan, i.e. to achieve significant growth in both revenue and profitability with exciting new product lines, part of which feature the world’s most famous children’s cartoon characters.”**

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

### Awards



- ✓ V.Smile was given “Seal of Approval” by the National Parenting Center in the US.
- ✓ Fly & Discover Globe was awarded Dr.Toy’s “100 Best Toys of 2003” in the US.



# Innovation Drives Synergy



places. In addition, the resources allocated to the design engineering teams have been proportionately expanded to increase the number of new innovative products created and shorten the development cycle considerably.

The benefits of our new approach to R&D are readily evidenced in the completely revamped 2004 products line-up. In October 2003, we launched the industry's first TV Learning System, V.Smile, specifically designed for children between the age of 3–7 years old. V.Smile offers to “turn game time into brain time” by combining educational value and game contents in a form currently available only to older children. VTech produces both the console and the

interchangeable game cartridges. Our customers’ responses to V.Smile have been enthusiastic. In addition, our new product line-up also included fresh new features such as pen writing recognition technology that have increased customers’ acceptance.

As an important strategy for our electronic learning products business, V.Smile and certain other electronic learning products now feature the world’s most famous children’s cartoon characters. Various licensing agreements were concluded in the financial year 2004. The incorporation of popular children’s cartoon characters such as Winnie the Pooh, Lion King, Little Mermaid, Mickey & Friends, Scooby-Doo,

Care Bears, Brainy Baby and Spiderman greatly enhances the attraction of our products to children and recognition among parents. More licensed characters will be added in future to add value to our products.

During the financial year 2004, VTech also began laying the groundwork to expand into new markets in Latin America, Scandinavia, Central and Eastern Europe, and Asia Pacific.

The new and revamped product lines have successfully enabled VTech to regain shelf space in the US market and further expand our dominance in Europe. These would result in a significant bounce back in revenue and further improvement in profitability in the financial year 2005.





# Innovation Drives Competitiveness

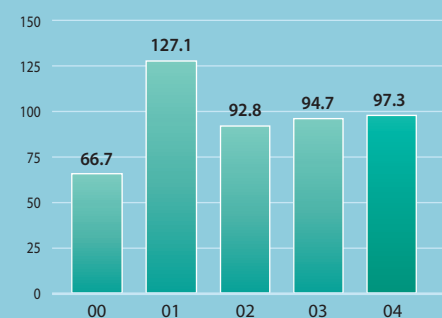


## Review of Operations

# Contract Manufacturing Services

Contract Manufacturing Services Revenue in Last 5 Years

US\$ million



The contract manufacturing services business continued to deliver steady organic growth. Revenue increased slightly by 2.7% over the financial year 2003 to US\$97.3 million. Efforts in cost control contributed to stable profit for the business.

Revenue growth was constrained by a sharp drop in orders from two customers whose products performed

badly in the market following changes in the US regulations. Although the drop was offset by a strong increase in orders from other customers, the result was that revenue grew modestly as compared with other China based electronic manufacturing services providers.

During financial year 2004, VTech was able to secure additional businesses from existing customers, some of whom even doubled their orders. This performance testifies our ability to deliver quality products, as well as flexible and price competitive services to customers.

The well-diversified nature of the contract manufacturing services business supported its stable development. Geographically, 46.0% of sales was generated from customers in Europe,





**During the financial year 2004, VTech was able to secure additional businesses from existing customers, some of whom even doubled their orders**



and promotion saw good progress and we confidently expect additional business and new customers from these two areas.

Customer service levels were enhanced as the new R&D centre in Shenzhen came into full operation. VTech is now able to offer a comprehensive “one-stop shop” service. This not only helps customers improve product design from a cost and quality perspective, but takes initial concepts from first design through to full production. The service will drive considerable revenue growth in the financial year 2005.

During the final quarter of the financial year 2004, the business also began to implement the cell-based manufacturing process that has raised productivity and increased flexibility at the other businesses. This will further enable VTech to improve its responsiveness to customers and to offer incremental improvements in costs, which are the key to achieving top and bottom line growth.

30.9% from those in the US and 13.4% from the Japanese market. By product category, professional audio equipment accounted for 30.5% of total contract manufacturing services revenue, followed by power supplies at 26.1% and wireless products at 13.4%.

medical equipment. Orders in these segments from existing customers accounted for only a small portion of contract manufacturing services revenue in the financial year 2004, but marketing

The prices of raw materials and components began to rise from the second quarter of the financial year 2004, as the global economy gradually improved. The business was able to find local alternative sources and leverage the Group’s purchasing power, which mitigated the impact of the price increases.

**“Our ability to deliver quality products, as well as flexible and price competitive services resulted in a record number of customer awards during the financial year. The diversified nature of the business, meanwhile, ensured the business to achieve steady development.”**

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



In the second quarter of the financial year 2004, the business was successful in securing ISO13488 and TS16949

certifications, enabling VTech to enter into the production of automotive parts and

**Awards**



Contract manufacturing services business was given the “2003 Valued Supplier Award” by ITC.

Contract manufacturing services business was given the “Value Added Supplier of the Year Award for 2003” by Harman Music Group.

