

Telecommunication Products



» A Year of *Rationalisation*

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The financial year 2005 was a challenging year for the telecommunication products business. Revenue fell by 10.9% to US\$612.5 million due to the unsatisfactory performance in the US market, which outstanding results in the European market were unable to offset. Profitability of the business was substantially affected by the underperformance in the United States. In the financial year 2005, the business accounted for 59.9% of Group revenue, compared to 75.1% in the financial year 2004.

Unsatisfactory Results in the United States

In North America, revenue declined by 23.6% to US\$475.3 million, accounting for 77.6% of the total telecommunication products revenue, compared to 90.5% in the financial year 2004. The decrease in revenue was mainly the result of lower sales in the United States, as our phones failed to compete on both product design and price. Over-optimistic sales projections also led to higher overheads and operating costs, resulting in operational inefficiency which further impacted profitability.

Comprehensive Measures to Rectify the Problems

Management moved swiftly to identify and address the problems, so that the situation was successfully brought under control in the second half of the financial year 2005. In November 2004, Mr. Allan Wong, Chairman and Group CEO assumed the role of CEO of the telecommunication products business, following the departure of the former CEO, Mr. James C. Kralik. A comprehensive and broad-based improvement programme was put in place to re-engineer all processes worldwide, with the aim of managing the brands better, strengthening channel marketing, forecasting demand more accurately, rationalising product design and development and raising productivity. The business also moved to streamline

operations and tighten cost control globally.

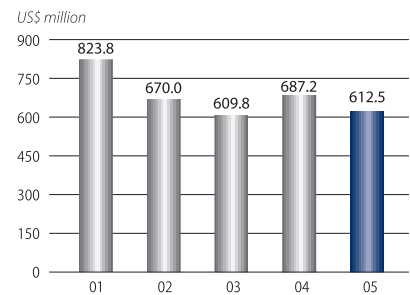
More specifically, overheads were reduced to bring them in line with the level of sales. Product management, marketing communications and channel marketing functions in the US sales offices began a process of integration to strengthen communication, thereby improving product offerings and marketing. Product design and development began to be consolidated to Hong Kong to shorten the product development cycle. Greater emphasis has been put on understanding retailer expectations to ensure product design and features correspond to consumer preferences. A revamped product line is being developed and will be introduced in early 2006.

Strong Performance in Europe

Despite the challenges in the United States, VTech continued to make progress in developing the European markets, where revenue rose strongly by 102.2% over the financial year 2004 to US\$112.8 million. Europe, in the financial year 2005, accounted for 18.4% of the total telecommunication products revenue, compared to 8.1% in the financial year 2004.

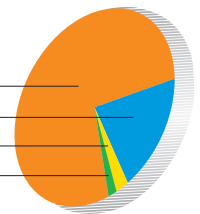
VTech is supplying products to the leading fixed-line telephone operators on an Original Design Manufacturing (ODM)

Telecommunication Products Revenue in Last 5 Years



Telecommunication Products Revenue by Region

	%	2005 US\$ million
North America	77.6	475.3
Europe	18.4	112.8
Others	2.4	14.6
Asia Pacific	1.6	9.8
Total	100.0	612.5



basis. The European business is benefiting from the increasing opening of the markets. VTech will adopt the same strategy to pursue opportunities in markets outside Europe and North America.

VoIP Products - Tapping Longer Term Potential

In addition to geographical diversification, the business has been developing a range of products for the VoIP market, which is beginning to grow rapidly. In January 2005, VTech announced the launch of the first VoIP 5.8GHz cordless phone with Vonage, North America's leading broadband phone service provider and the first VoIP 2.4GHz cordless phone with Skype, the leading free Internet telephony service provider worldwide. We expect these products to start delivering a meaningful contribution to the business in the financial year 2007.



Electronic Learning Products

» A Year of

Excellence

The V.Smile TV Learning System is a dynamic video game platform for children aged 3-7. The response to V.Smile from both the trade and consumers has been overwhelmingly positive, making it a "star" in the ELP market worldwide.



The ELP business recorded a strong performance in the financial year 2005. Revenue rose significantly by approximately 1.2 times or 115.1% to US\$281.1 million following the well-executed roll out of the award-winning V.Smile TV Learning System. Supported by effective and efficient operations, profitability rebounded sharply. During the financial year 2005, the ELP business accounted for 27.5% of Group revenue, compared to 14.3% in the financial year 2004.

Successfully Rebuilding US Sales

The successful launch of V.Smile has allowed the business to rebuild sales and regain lost shelf space gradually in the US market, while further strengthening its leadership position in Europe. In the financial year 2005, revenue from the North American market rebounded sharply by more than 3 times or 328.1% to US\$108.3 million, accounting for 38.5% of total ELP revenue, compared to 19.4% of total ELP revenue in the financial year 2004. Revenue from the European market also showed a robust increase of 60.3% to US\$160.0 million, accounting for 56.9% of total ELP revenue.

Successful Start for V.Smile

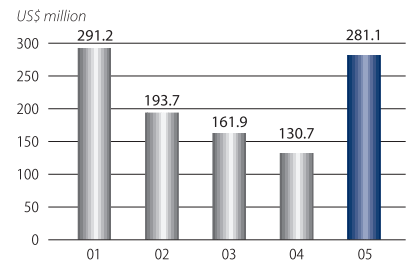
The V.Smile TV Learning System is a dynamic video game platform for children aged 3-7, comprising a console that plugs

into a television together with interchangeable software cartridges. The product hit the shelves in August 2004 with a total of 10 "Smartridges", including popular children's characters from four licensors: Disney, Marvel, Joester Loria Group - American Greetings and Warner Brothers.

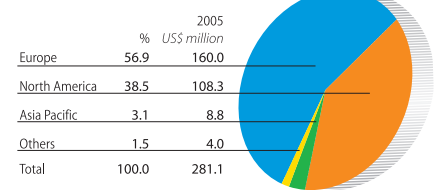
The response to V.Smile from both the trade and consumers has been overwhelmingly positive, making it a "star" in the ELP market worldwide. Not only have the consoles sold in greater volumes than our initial forecasts, but the ratio of Smartridges to consoles has also been higher.

V.Smile won more than 20 awards globally during the financial year 2005, including the "Best Educational Toy of the Year" and the "Best Overall Toy of the Year" from the US Toy Industry Association; as well as the

ELP Revenue in Last 5 Years



ELP Revenue by Region



"Toy Innovations Award 2005 - Learning Category" at the Nuremberg International Toy Fair. These are recognised as the top industry awards worldwide.

The success of V.Smile reflects its well thought-through product design and attractive software, which is educational, fun, highly interactive and animated. The system provides the same fun videogaming experience for pre-school children as that enjoyed by older children, while parents are assured of content that is neither violent nor inappropriate in other ways.

V.Smile won top industry awards in FY2005



United States

- Best Overall Toy of the Year
- Best Educational Toy of the Year



Germany

- Toy Innovations Award 2005 - Learning Category



United Kingdom

- Electronic Learning Toy of the Year

