

Review of Operations



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V.Smile Pocket, the handheld version of V.Smile



Well-executed television, public relations and point-of-sale campaigns were also key factors in the success as they effectively conveyed the excitement, learning benefits and features to children, parents, other potential purchasers and influencers. Trade confidence in VTech was enhanced, providing a good foundation for future growth. Support from the licensors in both software development and marketing was also crucial to the outperformance.

In February 2005, the business announced the launch of the handheld version, V.Smile Pocket, using the same Smartridges. VTech also introduced 17 new Smartridges that included popular children's characters from existing and new licensors, namely HIT Entertainment, Nickelodeon and Sesame Street, adding further avenues of growth to this product platform.

Growth in Traditional Product Lines

Alongside the stunning success of V.Smile, the traditional product lines recorded respectable growth in revenue in both North America and Europe. In the financial year 2005, the Group continued to invest in strengthening the traditional product lines with a focus on the growing infant and pre-school categories. VTech remains committed to providing a broad portfolio of ELPs to consumers that combine learning and fun in new and exciting ways.

V.Smile Smartridge Library

Early Learners - Ages 3 to 5

2004 Titles
Alphabet Park
Care Bears
The Lion King
Winnie the Pooh

2005 Titles
Barney
Bob the Builder
Blue's Clues
Elmo's World
The Wiggles
Thomas & Friends

Junior Thinkers - Ages 4 to 6

2004 Titles
Little Red Riding Hood
Scooby-Doo
Spider-Man & Friends
The Little Mermaid

2005 Titles
Dora the Explorer
Finding Nemo
Sesame Street
Toy Story 2
Art Studio

Master Minds - Ages 6 to 7 or 8

2004 Titles
Learnin' Wheels
Mickey Mouse

2005 Titles
Aladdin
Batman
Cinderella
Spider-Man II
SpongeBob Squarepants
Zayzoo



Effective Cost Control

In addition to the sales increase, effective cost control contributed to the substantial rise in profitability for the ELP business. In particular, the Group faced the pressure of higher resin prices, which was mitigated by the adoption of multiple cavity moulding that enhanced operational efficiency.

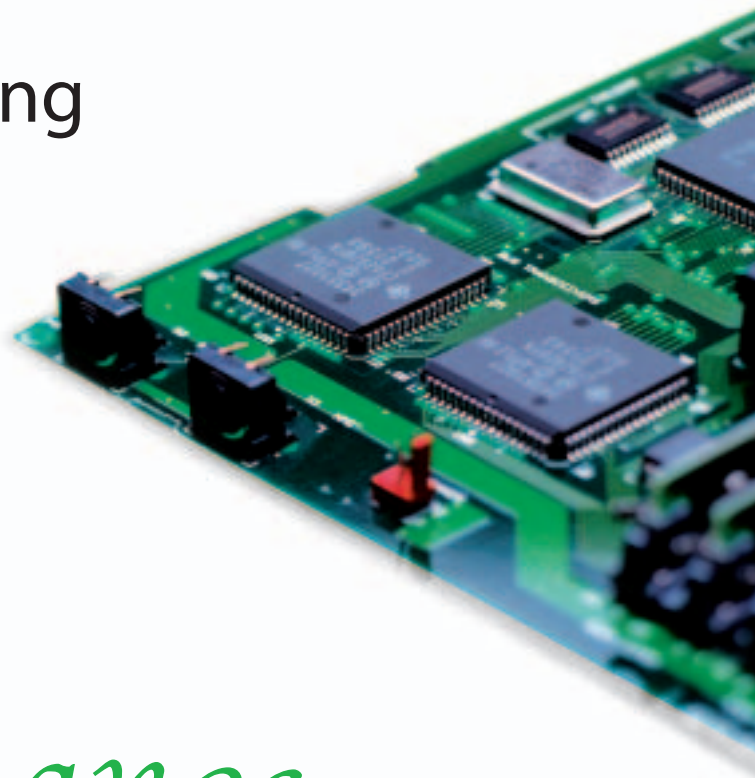
Development of New Markets

During the financial year 2005, progress was made in developing new markets such as Scandinavia, where initial sales were small but encouraging. The China market remains under development and progress has been relatively slow due to its fragmented nature, different cultural attitudes towards education and comparatively low average income levels.



Contract Manufacturing Services

❖ A Year of
Outperformance



VTech's investment in offering a comprehensive R&D service to customers also began to show results, helping to drive the outperformance of the CMS business.

The CMS business delivered encouraging results in the financial year 2005, achieving record revenue and higher profit. Revenue increased by 32.0% over the financial year 2004 to US\$128.4 million, accounting for 12.6% of Group revenue, compared to 10.6% in the financial year 2004. The percentage increase in revenue was markedly higher than the growth of the global EMS industry. This performance reflects VTech's success in delivering exceptional service to its core focus of small and medium sized customers.

Strong Demand from Existing Customers

The rise in revenue was driven by strong demand from existing customers, led by the well established power supply and professional audio equipment segments, which together accounted for over 60% of the total CMS revenue. A new customer in the industrial printing sector also contributed to the revenue growth.

Encouraging Results from R&D Investment

VTech's investment in offering a comprehensive R&D service to customers also began to show results, helping to drive the outperformance of the CMS business. In the financial year 2005, the R&D centre in Shenzhen came into full operation. As a result, the business not only helps customers improve product design from a cost and quality perspective, but also takes initial concepts from first design through to full production. During the financial year 2005, approximately 15% of CMS revenue was derived from business having an R&D element.

Geographically, Europe continued to be the largest market of the CMS business, accounting for 49.2% of the total CMS revenue, followed by the United States at 27.7% and Japan at 17.2%.

Good Overheads Control

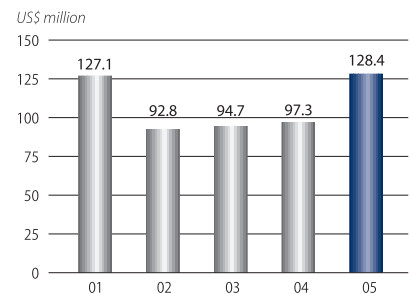
During the financial year 2005, the business was able to achieve a higher profit, despite a slight decline in gross margins due to changes in product mix and pricing pressure from customers. This was mainly because of the success in controlling fixed overheads in spite of higher volumes. Raw materials costs during the period were little changed over the previous financial year.

RoHS Compliance

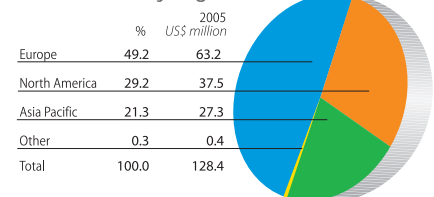
VTech is committed to supporting environmental initiatives. To comply with the Directive 2002/95/EC on RoHS, which will become mandatory in the European Union in July 2006, the CMS business had started as early as 2003 to improve its

The business received two customer awards in the financial year 2005 in recognition of its quality service.

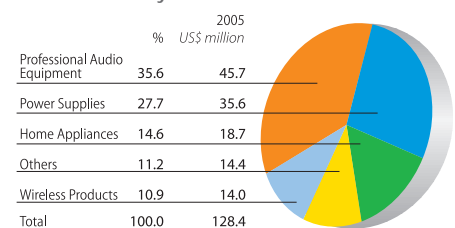
CMS Revenue in Last 5 Years



CMS Revenue by Region



CMS Revenue by Product Line



manufacturing process. In mid-2004, teams were established to work with major customers on component selection, to enable the business to speed up the process of compliance.

Currently, the business is working with four of the top five customers and it targets to achieve full compliance in the first quarter of the calendar year 2006, ahead of the industry.

