

# Letter to Shareholders

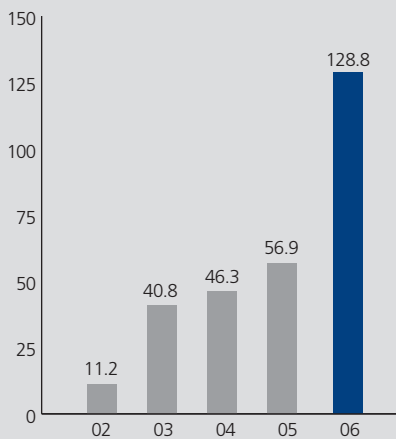
"I am pleased to report that profit attributable to shareholders for the financial year 2006 rose to US\$128.8 million, the highest achieved in our nearly 30 years of operations."

Allan WONG Chi Yun, Chairman



## Profit Attributable to Shareholders in Last 5 Years

US\$ million



# +126.4%

## Dear Shareholders,

I am pleased to report that profit attributable to shareholders for the financial year 2006 rose to US\$128.8 million, the highest achieved in our nearly 30 years of operations. This excellent result was supported by record performances from our Electronic Learning Products (ELP) and Contract Manufacturing Services (CMS) businesses, as well as the successful turnaround in profitability of the Telecommunication Products (TEL) business, as we rationalised its US operations.

## Results

Revenue for the Group increased by 17.9% over the financial year 2005 to US\$1,204.6 million. Profit attributable to shareholders increased by 126.4% to US\$128.8 million. Earnings per share increased by 117.9% to US54.9 cents. The continued increase in profitability, together with the Group's very strong balance sheet, has allowed the Board of Directors to propose a final dividend of US26.0 cents per share, giving a total dividend for the year of US32.0 cents per share, as compared to US13.0 cents per share for the financial year 2005.

## Operations

In the financial year 2005, we began to re-engineer the entire US operations of the TEL business, in response to a decline in revenue. During the financial year 2006 we continued this process, in particular focusing on making the supply chain more efficient, discontinuing unprofitable businesses, strengthening marketing and developing an entirely new range of cordless phones that is much more in tune with the needs of our customers and consumers. As a result of these efforts, profitability of the US operations has recovered. This is despite a fall in revenue as we streamlined the product lines.

In Europe, by contrast, we continued to make significant progress in growing our revenue, as we leveraged our close relationships with Original Design Manufacturing (ODM) customers, who are major fixed line telephone operators and leading brand names in the region. This, together with inroads made into new markets such as Scandinavia and Eastern Europe, saw our sales increase in Europe rise by 49.4%, to account for 28.3% of the total TEL revenue.

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The tremendous momentum behind the ELP business continued in the financial year 2006, led by the highly successful V.Smile range, which has rapidly established itself as a favourite with retailers and consumers since its launch in 2004. Sales of consoles have continued to grow and together with the introduction of V.Smile Pocket in 2005, the portable version of V.Smile, have led to a greater installed base. As a result, sales of software have increasingly been driving sales growth in the ELP business.

We have not only broadened the V.Smile range through V.Smile Pocket, but also through a growing number of software ("Smartridges"). We are now adding new avenues of growth by expanding the range of accessories and by targeting younger and older age groups through V.Smile Baby and V.Flash, which will be on the shelves by the end of the calendar year 2006. These products are part of the strategy to sustain V.Smile's growth momentum.

Although V.Smile has undoubtedly been the centre of attention since its launch, we are also committed to enhancing our traditional ELPs, which still account for a significant part of the total ELP revenue. As educational toys remains a growing segment in the US toys market, our traditional products give us further opportunities to leverage our strengths in product design and technology adaptation to grow revenue and market share.



5.8GHz Analog Cordless Phones



V.Flash™ Home Edutainment System

The record revenue achieved by the CMS business during the financial year 2006 reflects a second successive year of outperformance of the global electronic manufacturing services (EMS) market, which remains in a healthy growth cycle. We retain our focus on small and medium sized customers to which we provide a highly flexible and reliable service that runs from product design to full production.

Growth at CMS came largely from increased orders from existing customers and the business was successful in improving its cost structure, enabling it to maintain stable margins. In addition, a new organisational structure was

implemented with the aim of strengthening our competitiveness in the EMS market further. With more management attention dedicated to individual customers, the flexibility and effectiveness of our service has been enhanced despite the continued expansion of the business.

### Outlook

Clearly, the remarkable results of VTech in the financial year 2006 reflect the Group's success in executing its strategies well. Going forward, we will continue to focus on our core businesses, identify opportunities in our chosen market segments and execute our strategies carefully. I believe the Group is in very good shape and well-poised for further growth in the financial year 2007, with all initiatives on track.

In our TEL business, having restored profitability, we are targeting higher revenue as growth in Europe continues and we rebuild sales in North America.

In Europe, our core competences in manufacturing and technology give us considerable scope to gain market share as our ODM customers seek cost effective and high quality products for consumers. In the second half of the calendar year 2006, we will start to deliver VoIP cordless phones to our ODM customers in Europe, establishing a position in a market of a longer term potential.

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In the United States, we are regaining shelf space with the revamped product lines. The new product line-up shows a marked improvement in industrial design and cost, which enables us to meet customers' expectations and consumers' needs better. It also strengthens our competitiveness in the marketplace. We intend to launch a series of next-generation cordless phones in spring 2007 and we will continue to build our presence in the VoIP cordless telephony market in the United States.

The ELP business will continue to grow, building on its leadership in Europe and its growing market share in North America as the V.Smile platform expands and more new products are added to our traditional ELP ranges. Through V.Smile Baby and V.Flash, the V.Smile range encompasses children from the age of 9 months to the pre-teens. We intend to strengthen our leadership position in the educational video game category by investing in R&D to ensure a robust pipeline of product innovations. We will continue to support our products with advertising, PR, trade promotion and point of sales displays to ensure their success with the consumer. At the same time, we will take care to ensure that the expansion is well managed and that costs are kept well under control.

The global EMS industry is forecast to remain on an uptrend and we expect our CMS business to continue to grow with the industry. We are taking great care to manage growth at this business, devoting considerable effort to maintaining the exceptional levels of quality and service which are fundamental to its success. The new, customer oriented organisational structure will be supported by expanded manufacturing facilities. The R&D service offered to our customers is expected to drive further growth for the CMS business.

This overall optimistic outlook must be tempered with caution as rising interest rates may affect global economy and dampen consumer confidence. Furthermore, our success in the ELP and CMS businesses, together with the continuous growth of the TEL business in Europe, is likely to invite more competition. To stay ahead of our rivals, we thus need to ensure that our strategies are well executed.

All of our businesses did well in countering the pressure of rising production costs during the financial year 2006. Oil prices remained high throughout the financial year, resulting in high prices for plastics, an important raw material for many of our products. Labour costs rose in southern China, our manufacturing base, following the raising of the minimum wage and the appreciation of the Renminbi against the US dollar.

It is likely that these trends will continue and hence impose further cost pressures on the Group during the financial year 2007. Indeed, recently, we have seen rises in component prices such as printed circuit boards and integrated circuits that may have an impact on our businesses. We will

therefore have to continue to make progress in cost control in order to achieve sustainable growth.

In this regard, our new plant at Qingyuan city, the northern Guangdong province, is expected to deliver cost savings over time. The facility commenced operations in November 2005 and will allow us to transfer certain operations, particularly the labour and electricity intensive plastics production, to this lower cost environment.

### **Appreciation**

Clearly, the success we have achieved would not have been possible without the commitment and dedication of everyone at the Group. I would therefore like to thank my fellow directors and senior management, as well as all VTech employees for their hard work. As we enter our 30th anniversary, I would also like to extend a special thanks to our suppliers, bankers, shareholders and other business partners for their support during the past 30 years, which has helped transform VTech into the Group it is today.



**Allan WONG Chi Yun**  
Chairman

Hong Kong, 21st June 2006



5.8GHz Cordless Answering System