DESWELL INDUSTRIES INC
Form 20-F
July 09, 2002

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

[ ] Registration Statement Pursuant to Section 12(b) or (g) of the Securities Exchange Act of 1934

OR

[*] Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the Fiscal Year Ended:	Commission File Number:
March 31, 2002	0-26448

DESWELL INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

British Virgin Islands
(Jurisdiction of incorporation or organization)

Unit 516-517
Hong Leong Industrial Complex
4 Wang Kwong Road
Kowloon Bay, Kowloon, Hong Kong
(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act:

Common shares, $0.01 par value per share

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: NONE

As of March 31, 2002, there were 5,580,331 common shares of the registrant outstanding.

Indicate by check mark whether the registrant: (i) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (ii) has been subject to such filing requirements for the past 90 days.

Yes [X] No

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Indicate by check mark which financial statement item the registrant has elected to follow:

Item 17 ___ Item 18 [X]

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This Annual Report on Form 20-F contains forward-looking statements. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. Factors that might cause such a difference include, but are not limited to those discussed in the section entitled Risk Factors under Item 3. -- Key Information.

Readers should not place undue reliance on forward-looking statements, which reflect management's view only as of the date of this Report. The Company undertakes no obligation to publicly revise these forward-looking statements to reflect subsequent events or circumstances. Readers should also carefully review the risk factors described in other documents the Company files from time to time with the Securities and Exchange Commission.

As used in this Report, "we," "our," "us," "Deswell" or the "Company" refers to Deswell Industries, Inc. and its subsidiaries unless the context otherwise indicates.

FINANCIAL STATEMENTS AND CURRENCY PRESENTATION

The Company prepares its consolidated financial statements in accordance with generally accepted accounting principles in the United States of America and publishes such statements in United States dollars. See "Independent Auditors' Report" included elsewhere herein. The Company publishes its financial statements in United States dollars as the Company is incorporated in the British Virgin Islands, where the currency is the United States dollar, and the functional currency of the Company's subsidiaries is the Hong Kong dollar, whose exchange rate has been fixed at approximately 7.80 Hong Kong dollars to $1.00 since 1983. All dollar amounts ("$") set forth in this Report are in United States dollars, the references to HK$ refer to Hong Kong dollars and RMB to Chinese renminbi.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISORS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

SELECTED FINANCIAL DATA(1)

The selected consolidated financial data set forth below should be read in conjunction with our consolidated financial statements and notes thereto included elsewhere in this Report. The selected income statement data for each of the three fiscal years in the period ended March 31, 2002, and the balance sheet data as of March 31, 2001 and 2002 are derived from our audited consolidated financial statements included in this Report. The selected income statement data for the years ended March 31, 1998 and 1999, and the balance sheet data as of March 31, 1998, 1999 and 2000 are derived from our audited consolidated financial statements, which are not included in this Report.

(IN THOUSANDS, EXCEPT PER SHARE AND PERCENTAGE DATA)

INCOME STATEMENT DATA	YEAR ENDED MARCH 31,				
	1998	1999	2000	2001	2002
Net sales	$66,169	$53,439	$60,958	$80,847	$83,320
Cost of sales	36,246	32,179	38,262	52,596	54,448

Gross profit	29,923	21,260	22,696	28,251	28,872
Selling, general and administrative expenses	14,067	10,364	11,970	15,414	14,939
Operating income	15,856	10,896	10,726	12,837	13,933
Interest expense	(2)	(306)	(3)	(6)	(26)
Other income, net	1,094	939	898	915	877
Income before income taxes	16,948	11,529	11,621	13,746	14,784
Income taxes	688	462	890	315	535
Income before minority interests	16,260	11,067	10,731	13,431	14,249
Minority interests	3,289	1,575	433	621	925
Net income	$12,971	$9,492	$10,298	$12,810	$13,324
Basic earnings per share(2)(3)	$ 2.59	$ 1.73	$ 1.90	$ 2.38	$ 2.38
Average number of shares outstanding--basic(2)	5,006	5,478	5,412	5,376	5,602
Diluted earnings per share(3)	$2.40	$1.72	$1.89	$2.36	$2.36
Average number of shares outstanding--diluted(2)	5,394	5,524	5,449	5,435	5,644
STATISTICAL DATA:					
Gross margin	45.2%	39.8%	37.2%	34.9%	34.7%
Operating margin	24.0%	20.4%	17.6%	15.9%	16.7%
Dividends per share	$0.70	$1.08	$0.88	$0.88	$1.29

BALANCE SHEET DATA	AT MARCH 31,				
	1998	1999	2000	2001	2002
Working capital	$35,968	$41,066	$44,727	$47,356	$54,922
Total assets	59,144	64,273	71,841	83,466	94,744
Long-term debt, less current portion	--	--	--	--	--
Total debt	--	--	--	--	482
Shareholders' equity	45,211	48,767	53,031	63,877	69,651

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(1) Our consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America and are stated in U.S. dollars. See "Financial Statements and Currency Presentation."

(2) Basic EPS excludes dilution from potential common shares and is computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution from potential common shares.

(3) Net income per share amounts presented above are calculated without regard to the effects of the three-for-two stock split payable on July 22, 2002 (see Note 15 of Notes to Consolidated Financial Statements). Net income per share information calculated on a post stock split basis is as follows:

Basic:					
Net income per share	$1.73	$1.16	$1.27	$1.59	$1.59
Weighted average common shares	7,509	8,217	8,118	8,064	8,403
Diluted:					
Net income per share	$1.60	$1.15	$1.26	$1.57	$1.57
Weighted average common shares	8,091	8,286	8,174	8,153	8,466

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RISK FACTORS

We may from time to time make written or oral forward-looking statements. Written forward-looking statements may appear in this document and other documents filed with the Securities and Exchange Commission, in press releases, in reports to shareholders, on our website, and other documents. The Private Securities Reform Act of 1995 contains a safe harbor for forward-looking statements on which we rely in making such disclosures. In connection with this "safe harbor" we are hereby identifying important factors that could cause actual results to differ materially from those contained in any forward-looking statements made by us or on our behalf. Any such statement is qualified by reference to the following cautionary statements:

WE FACE NUMEROUS RISKS AS A RESULT OF OUR OPERATIONS IN CHINA AND HONG KONG.

Our manufacturing facilities are located in China. As a result, our operations and assets are subject to significant political, economic, legal and other uncertainties associated with doing business in China, which are discussed in more detail below.

The Chinese government could change its policies toward or even nationalize private enterprise, which could result in the total loss of our investment in that country.

Over the past several years, the Chinese government has pursued economic reform policies including the encouragement of private economic activity and greater economic decentralization. The Chinese government may not continue to pursue these policies or may significantly alter them to our detriment from time to time without notice. Changes in policies by the Chinese government resulting in changes in laws, regulations, or their interpretation, or the imposition of confiscatory taxation, restrictions on currency conversion or imports and sources of supply could materially and adversely affect us. The nationalization or other expropriation of private enterprises by the Chinese government could result in the total loss of our investment in that country.

There may be a lack of remedies and impartiality under the Chinese legal system that prevents us from enforcing the tenancy agreements under which we operate our factories.

We operate our factories under tenancy agreements with the local Chinese government. These tenancy agreements may be difficult to enforce in China, which could force us to accept terms that may not be as favorable as those provided in our tenancy agreements. Unlike the U.S., China has a civil law system based on written statutes in which judicial decisions have little precedential value. The Chinese government has enacted some laws and regulations dealing with matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. However, their experience in implementing, interpreting and enforcing these laws and regulations is limited, and our ability to enforce commercial claims or to resolve commercial disputes is unpredictable. These matters may be subject to the exercise of considerable discretion by agencies of the Chinese government, and forces unrelated to the legal merits of a particular matter or dispute may influence their determination.

If our business licenses in China are not renewed, we would be required to move our operations out of China, which would impair our profitability, competitiveness and market position and jeopardize our ability to continue operations.

Our activities in China require business licenses. This requires a review and approval of our activities by various national and local agencies of Chinese government. The Chinese government may not continue to approve our activities or grant or renew our licenses. Our inability to obtain needed approvals or licenses could prevent us from continuing to conduct operations in China. If for any reason we were required to move our manufacturing operations outside of China, our profitability would be substantially impaired, our competitiveness and market position would be materially jeopardized and we may not be able to continue operations.

A fire, severe weather, flood, or other act of God could cause significant damage to our properties in China and disrupt our business operations.

Firefighting and disaster relief or assistance in China are primitive by Western standards. At March 31, 2002, we maintained fire, casualty and theft insurance aggregating approximately US$33,448,000 covering certain

of our stock in trade, goods and merchandise, furniture and equipment and factory buildings in China. The proceeds of this insurance may not be sufficient to cover material damage to, or the loss of, any of our factories due to fire, severe weather, flood, or other act of God or cause. We do not maintain any business interruption insurance.

Possible changes and uncertainties in economic policies in the Special Economic Zones of China in which we operate could harm our operations by eliminating benefits we currently enjoy.

As part of its economic reform, China has designated certain areas, including Shenzhen where we have certain manufacturing facilities, as Special Economic Zones. Foreign enterprises in these areas benefit from greater economic autonomy and more favorable tax treatment than enterprises in other parts of China. Changes in the policies or laws governing Special Economic Zones could eliminate these benefits. Moreover, economic reforms and growth in China have been more successful in certain provinces than others, and the continuation or increase of these disparities could affect the political or social stability of China.

Uncertain applications of Chinese tax laws could subject us to greater taxes in China.

Under applicable Chinese law, we have been afforded a number of tax concessions by the Chinese taxing authorities and have avoided paying taxes on a substantial portion of our operations in China by reinvesting all or part of the profits attributable to our Chinese plastic manufacturing subsidiary for at least five years. The Chinese tax system is subject to substantial uncertainties and was subject to significant changes enacted on January 1, 1994, the interpretation and enforcement of which are still uncertain. Currently, under the Chinese tax system we can obtain tax breaks by reinvesting profits of certain of our subsidiaries in China. We are considering the reinvestment of a portion of our profits of $4,000,000, from our Chinese plastic manufacturing subsidiary for the year ended December 31, 2001 and, if we make such reinvestment, we expect we will only be subject to taxes of 7.5% on these operations for the remaining profits for tax year ended December 31, 2001. For the tax year commencing January 1, 2002, the Company will be subject to taxes of 10% on these operations. Changes in Chinese tax laws or their interpretation or application may, subject us to greater Chinese taxation in the future.

We could suffer losses from corrupt or fraudulent business practices. Conducting business in China is inherently risky.

Corruption, extortion, bribery, pay-offs, theft, and other fraudulent practices are common in China. We could suffer losses from these practices if we are not successful in implementing and maintaining preventative measures.

Controversies affecting China's trade with the United States could harm our operations or depress our stock price.

While China has been granted permanent most favored nation trade status in the United States, controversies between the United States and China may arise that threaten the status quo involving trade between the United States and China. These controversies could adversely affect our business by, among other things, causing our products in the United States to become more expensive, which could result in a reduction in the demand for our products by customers in the United States. Political or trade friction between the United States and China, whether or not actually affecting our business, could also adversely affect the prevailing market price of our common shares.

Changes in currency rates involving the Hong Kong dollar or Chinese yuan could increase our expenses or cause economic or political problems affecting our business.

Our sales are predominately denominated in Hong Kong dollars. The Chinese government may not continue to maintain the present currency exchange mechanism, which fixes the Hong Kong dollar at approximately 7.80 to each United States dollar. If the currency exchange mechanism between the Hong Kong dollar and the U.S. dollar is changed, our results of operations and financial condition could be materially adversely affected. Any material increase in the value of the Hong Kong dollar or Chinese yuan relative to the U.S. dollar would increase our expenses. A devaluation of the Hong Kong dollar or yuan relative to the U.S. dollar would be likely to reduce our expenses. However, any benefits we receive from devaluation could be offset if the devaluation results in inflation or political unrest.

Political and economic instability of Hong Kong could harm our operations.

Our executive and sales office, and several of our customers and suppliers are located in Hong Kong, formerly a British Crown Colony. Sovereignty over Hong Kong was transferred effective July 1, 1997 to China. The continued stability of political, economic or commercial conditions in Hong Kong remains uncertain, and any instability could have an adverse impact on our business.

WE ARE DEPENDENT ON A FEW MAJOR CUSTOMERS AND HAVE NO LONG-TERM CONTRACTS WITH THEM. OUR SALES WOULD SUBSTANTIALLY DECREASE AND WE WOULD SUFFER DECREASES IN NET INCOME OR LOSSES IF WE LOSE ANY OF OUR MAJOR CUSTOMERS, IF THEY SUBSTANTIALLY REDUCE THEIR ORDERS OR IF THEY ARE UNABLE TO PAY US.

Historically, a substantial percentage of our sales have been to a small number of customers. Our four largest customers during the year ended March 31, 2002 were Inter-Tel Incorporated, Kyocera Mita Industrial Co. (H.K.) Limited, VTech Telecommunications Limited and Epson Precision (H.K.) Limited. Each of these customers individually accounted for 10% or more of our total net sales during the year ended March 31, 2002 and accounted for an aggregate of 71.4%, 69.3% and 58.0%, respectively, of our total net sales during the years ended March 31, 2000, 2001 and 2002, respectively. Our sales are based on purchase orders and we have no long-term contracts with any of our customers and the percentage of sales to any of our customers may fluctuate from time to time. The loss of any one of our largest customers or a substantial reduction in orders from any of them would adversely impact our sales and decrease our net income or cause us to incur losses unless and until we were able to replace the customer or order with one or more of comparable size. In addition, a substantial portion of our sales is made on credit and our results of operations would be adversely affected if a major customer were unable to pay for our products or services.

WE HAVE NO LONG-TERM CONTRACTS TO OBTAIN PLASTIC RESINS AND OUR PROFIT MARGINS AND NET INCOME COULD SUFFER FROM AN INCREASE IN RESIN PRICES.

The primary materials used by us in the manufacture of our plastic injection molded products are various plastic resins. The following table shows our cost of plastic resins as a percentage of our cost of plastic products sold and as a percentage of our total costs of goods sold for the years ended March 31, 2000, 2001 and 2002:

	Year ended March 31,		
	2000	2001	2002
Resins cost as a % of plastic products sold	55%	58%	52%
Resins cost as a % of total cost of goods sold	31%	32%	25%

We have no long-term contracts with our resin suppliers. Accordingly, our financial performance is dependent to a significant extent on resin markets and the ability to pass through price increases to our customers. The capacity, supply and demand for plastic resins and the petrochemical intermediates from which they are produced are subject to cyclical price fluctuations, including those arising from supply shortages. Consequently, resin prices may fluctuate as a result of changes in natural gas and crude oil prices and the capacity, supply and demand for resin and petrochemical intermediates from which they are produced. We have found that increases in resin prices are difficult to pass on to our customers. In the past increases in resin prices have increased our costs of goods sold and adversely affected our profit margins. A significant increase in resin prices in the future could likewise adversely affect our profit margins and results of operations.

WE ARE FACING INCREASING COMPETITION, WHICH HAS HAD AN ADVERSE EFFECT ON OUR GROSS PROFIT MARGINS.

Over the last few years we have been forced to lower our prices as a result of increasing competition in our market segments. This has resulted in lower gross profit margins, which have declined

- 0.6%, from 34.9% during the year ended March 31, 2001 to 34.7% during the year ended March 31, 2002,

- 6.2%, from 37.2% during the year ended March 31, 2000 to 34.9% during the year ended March 31, 2001; and

- 6.5%, from 39.8% during the year ended March 31, 1999 to 37.2% during the year ended March 31, 2000.

If we are forced to continue to lower our prices and are unable to offset this decrease by increasing our sales volumes, our net sales and gross margins will decline. If we cannot stem the decline in our gross margins, our financial position may be harmed and our stock price may decrease.

POLITICAL INSTABILITY, AND CHANGES IN IMPORT/EXPORT REGULATIONS, TARIFFS AND FREIGHT RATES IN COUNTRIES OTHER THAN CHINA WHERE WE DO BUSINESS COULD CAUSE OUR PROFIT MARGINS TO DECLINE.

Because of the international nature of our operations and customers, our business is subject to political and economic risks beyond those involving China, including political instability, and changes in import/export regulations, tariffs and freight rates. Changes in tariff structures or other trade policies could adversely affect our suppliers or customers or decrease the cost of supplies for our competitors. Japan's trade surplus has forced a revaluation of the Japanese yen on international markets that may have the effect of making material or components that we use to manufacture our products more expensive.

OUR LOSS OF CERTAIN MEMBERS OF OUR SENIOR MANAGEMENT COULD CAUSE DISRUPTIONS IN OUR BUSINESS AND HARM OUR CUSTOMER RELATIONSHIPS THEREBY ADVERSELY AFFECTING SALES.

We depend to a large extent on the abilities and continued participation of

- Richard Lau, our Chairman of the Board and Chief Executive Officer;

- C. P. Li, our Executive Director, General Manager in charge of our day-to-day manufacturing and administrative operations for plastic products, and Chief Financial Officer;

- C. W. Leung, Executive Director of Engineering in charge of the mold division and engineering for our plastic manufacturing operations;

- S. K. Lee, our Director of Administration and Marketing and General Manager in charge of our day-to-day administrative and marketing operations for electronic products;

- M. C. Tam, our Director of Engineering and Manufacturing, in charge of manufacturing and operations for electronic products; and

- Dickson Lam, our Director of Marketing for plastic and electronic products.

Messrs. Lau, Li and Leung founded our company and have played integral roles in the management, growth and development of our company in general and our plastic injection molding business in particular. They have developed and maintain relationships with several of our key customers in our plastic injection molding business. Mr. S. K. Lee and Mr. M. C. Tam founded our electronic products manufacturing business and have developed and continue to manage it since we acquired the business from them. Mr. Dickson Lam has developed and maintains several key relationships with our key customers in our electronic and plastic injection products manufacturing business. We have no employment contracts with any of these executives and their loss would require us to find executives suitable to replace them, which could be difficult and disruptive to our business. Customers with whom they have relationships may cease to deal with us or choose to use a competitor for a greater portion of their business, resulting in our loss of sales.

THE CONCENTRATION OF SHARE OWNERSHIP IN OUR SENIOR MANAGEMENT ALLOWS THEM TO CONTROL OR SUBSTANTIALLY INFLUENCE THE OUTCOME OF MATTERS REQUIRING SHAREHOLDER APPROVAL.

Our senior management as a group, each of whom are also members and constitute a majority of our board of directors, directly or indirectly through an affiliated company beneficially own more than 45% of our shares at March 31, 2002 . As a result, acting together they may be able to control, and they can substantially influence, the outcome of all matters requiring approval by our shareholders, including the election of directors and approval of significant corporate transactions. This ability may have the effect of delaying or preventing a change in control of Deswell, or causing a change in control of Deswell that may not be favored by our other shareholders.

OUR BOARD'S ABILITY TO AMEND OUR CHARTER WITHOUT SHAREHOLDER APPROVAL COULD HAVE ANTI-TAKEOVER EFFECTS THAT COULD PREVENT A CHANGE IN CONTROL.

As permitted by the law of the British Virgin Islands, our Memorandum and Articles of Association, which are the terms used in the British Virgin Islands for a corporation's charter and bylaws, may be amended by our board of directors without shareholder approval provided that a majority of our independent directors do not vote against the amendment. This includes amendments to increase or reduce our authorized capital stock. Our board's ability to amend our charter documents without shareholder approval could have the effect of delaying, deterring or preventing a change in control of Deswell, including a tender offer to purchase our common shares at a premium over the then current market price.

OUR EXEMPTIONS FROM CERTAIN OF THE REPORTING REQUIREMENTS UNDER THE EXCHANGE ACT LIMITS THE PROTECTIONS AND INFORMATION AFFORDED TO INVESTORS.

We are a foreign private issuer within the meaning of rules promulgated under the Securities Exchange Act of 1934. As a foreign private issuer, we are exempt from certain provisions applicable to United States public companies including:

- the rules under the Exchange Act requiring the filing with the Commission of quarterly reports on Form 10-Q or current reports on Form 8-K;

- the sections of the Exchange Act regulating the solicitation of proxies, consents or authorizations in respect to a security registered under the Exchange Act;

- and the sections of the Exchange Act requiring insiders to file public reports of their stock ownership and trading activities and establishing insider liability for profits realized from any "short-swing" trading transaction (i.e., a purchase and sale, or sale and purchase, of the issuer's equity securities within less than six months).

Because of these exemptions, investors are not afforded the same protections or information generally available to investors in public companies organized in the United States.

ITEM 4. INFORMATION ON THE COMPANY

HISTORY AND DEVELOPMENT OF DESWELL

The Company was incorporated in December 1993 as a limited liability International Business Company under the laws of the British Virgin Islands. The Company's corporate administrative matters are conducted in the British Virgin Islands through its registered agent, HWR Services Limited, P.O. Box 71, Craigmuir Chambers, Road Town, Tortola, British Virgin Islands. The Company's principal executive offices are located and its business is principally administered in Hong Kong at Unit 516-517, Hong Leong Industrial Complex, No. 4, Wang Kwong Road, Kowloon Bay, Kowloon, Hong Kong, and its telephone number is (852) 2796-6993 and its facsimile number is (852) 2796-7741.

Deswell developed from the initial incorporation of Jetcrown Industrial Limited, a Hong Kong limited liability company ("Jetcrown"), in February 1987. Richard Lau, C. P. Li and C. W. Leung founded Jetcrown to manufacture injection-molded plastic parts for OEMs and contract manufacturers. Jetcrown is the ultimate predecessor of the Company as restructured in March 1994. In January 1990, Jetcrown Industrial (Shenzhen) Limited, a limited liability China foreign operation ("Jetcrown Shenzhen"), was organized to conduct the Company's manufacturing operations in China and Jetcrown's manufacturing operations were relocated to China in 1990. Marcon Enterprises Limited, a British Virgin Islands International Business Company ("Marcon"), was organized in July 1991 to hold the beneficial ownership of Jetcrown Shenzhen and to supervise the latter's manufacturing operations. Richtex Services Limited, a Hong Kong limited liability company, was organized in November 1991 to serve as Marcon's local agent and to discharge Marcon's duties to supervise the manufacturing operations of Jetcrown Shenzhen.

In October 1992, the Company purchased a controlling interest of the outstanding stock of Kwanasia Electronics Company Limited, a Hong Kong limited liability company ("Kwanasia") and an independent contract manufacturer of electronic products, components and subassemblies, from two former shareholders. In December 1994, the Company increased its interest in Kwanasia to 51% of the outstanding Kwanasia shares by purchasing the requisite stock from Mr. S. K. Lee and Mr. M. C. Tam, Kwanasia's then remaining two shareholders. Messrs. Lee and Tam still own, in equal shares, 39% of the capital stock of Kwanasia's parent corporation and continue to serve as the executives in charge of administrative and manufacturing operations, respectively, for the Company's contract manufacturing operations for electronic products and subassemblies. See Item 10 Directors and Executive Officers. The total price paid by the Company in 1994 for its majority interest in Kwanasia's shares was approximately $517,000, which was paid in cash. At the time majority control of Kwanasia was acquired by the Company, Kwanasia had one active operating subsidiary, Bright Ace Limited ("Bright Ace"), a Hong Kong limited liability company. Bright Ace had been inactive since April 2001 and was struck off from the Companies Registry of Hong Kong in October 2002.

Kwanasia originally conducted the Company's contract electronic manufacturing operations through a joint venture enterprise (organized as a limited liability China company) called Shenzhen Kwanam Electronics, Co., Ltd. ("Shenzhen Kwanam"). Shenzhen Kwanam was initially established as a 70%-30% joint venture company pursuant to a Joint Venture Agreement (the "Joint Venture Agreement") between Kwanasia and Commercial Trading Corporation ("CTC"), an independent Chinese party. However, the parties to the Joint Venture Agreement subsequently elected to modify such arrangement. Such modification took various forms but in each case essentially provided that Kwanasia and its successor (through the subsidiaries which held the joint venture interest) would have in substance a 100% economic interest in the joint venture enterprise, subject to a RMB60,000 (approximately $7,200 at May 30, 1996) annual payment by it to CTC. In May 1996, Kwanasia and CTC agreed that Kwanasia would purchase CTC's 30% interest in Shenzhen Kwanam (the "Buy-out Agreement") for RMB180,000 (approximately $22,000 at May 30, 1996, the day the purchase price was paid). This transaction was completed during the year ended March 31, 1998 and resulted in Shenzhen Kwanam becoming a wholly owned subsidiary. Following a reorganization in electronic operations and its move into a new manufacturing plant in Dongguan, China, the manufacturing operations of Shenzhen Kwanam were switched to another wholly owned subsidiary, Dongguan Kwan Hong Electronics Co. Ltd. ("Kwan Hong") commencing April 1, 1999. Kwan Hong was initially established as an 85%-15% joint venture company pursuant to a Joint Venture Agreement dated January 31, 1997 between Kwanasia and Dongguan Cheung On Lang Wang Electronics Development Company ("Lang Wang"), an independent Chinese party. Pursuant to a subsequent supplemental agreement signed on February 27, 1997 between

Kwanasia and Lang Wang, both parties agreed that Kwanasia would have in substance a 100% economic interest in the joint venture enterprise with Lang Wang guaranteed an annual rental income for the buy out.

The Company's incorporation in the British Virgin Islands in December 1993 was part of a restructuring in which Deswell Industries, Inc. was organized to become the ultimate parent holding company of the companies engaged in actual business operations and to the spin off to Messrs. Lau, Li and Leung other companies that hold real estate in Hong Kong. This restructuring, which was completed in March 1994 involved the following steps. First, on December 13, 1993, the Company (i) allotted a total of 2,539 common shares to provide the initial capital of the Company and (ii) acquired the entire issued share capital of Leesha Holdings Limited, the former ultimate parent company, in exchange for which it issued a total of 3,387,304 common shares. These shares were issued in equal portions to Messrs. Lau, Li and Leung, the former shareholders of Leesha Holdings Limited. Second, on March 22, 1994, the Company acquired the entire issued share capitals of Jetcrown, Marcon (including its interest in Jetcrown Shenzhen) and Richtex from Leesha Enterprises Limited, a wholly owned subsidiary of Leesha Holdings Limited and a second-tier holding company, in exchange for which the Company issued an aggregate of 7,618 common shares in equal proportions to Messrs. Lau, Li and Leung. Third, also on March 22, 1994, the Company acquired Leesha Enterprises Limited's 50.00005% interest in Kwanasia in exchange for the issue of 2,539 common shares in the Company in equal proportions to Messrs. Lau, Li and Leung and the assignment of a debt due to Jetcrown of approximately $465,000 relating to the original purchase of Kwanasia. Finally, on March 22, 1994, the Company made a distribution in specie of the entire share capital of Leesha Holdings Limited to Messrs. Lau, Li and Leung. The immediate effect of this restructuring was that the Company wholly owned Jetcrown, Marcon (which wholly owned Jetcrown Shenzhen) and Richtex and also owned 51% of the outstanding capital stock of Kwanasia (which, in turn, wholly-owned Bright Ace and had a 100% economic interest in Shenzhen Kwanam). Messrs. Lee and Tam owned the balance of Kwanasia. In 1995, this restructuring was fine-tuned for tax purposes, with the Company forming two new corporations, Union International Limited (which changed its name to Integrated International Limited on May 1, 1996) ("Integrated") and Oriental Enterprises Limited (which changed its name to Bright Oriental Enterprises Limited on May 1, 1996) ("Oriental Enterprises"), both corporations organized under the laws of Western Samoa. Integrated issued its shares proportionately to Deswell and Messrs. Lee and Tam in exchange for all outstanding capital stock of Kwanasia respectively held by them, with the result that Integrated is now 51%-owned by Deswell and 49%-owned by Messrs. Lee and Tam. Integrated in turn owns all of the outstanding capital stock of Kwanasia (which, in turn, continues to wholly own Bright Ace). As part of the fine-tuning, Oriental Enterprises was organized as a wholly-owned subsidiary of Integrated and it was assigned Kwanasia's joint venture interest in Shenzhen Kwanam and assumed Kwanasia's rights and responsibilities under the Shenzhen Kwanam joint venture. With the completion during the year ended March 31, 1998 of the purchase of CTC's 30% joint venture interest in Shenzhen Kwanam pursuant to the Buy-out Agreement, Shenzhen Kwanam became a wholly owned subsidiary of Oriental Enterprises.

In October 1996, Integrated acquired a 64.9% interest in Kwanta Precision Metal Products Co., Ltd. ("Kwanta"), a corporation organized under the laws of Hong Kong, for $64,000, which was paid in cash. In April and July, 1999, Integrated acquired the remaining 35.1% interest in Kwanta for $6,000, which was paid in cash. Kwanta manufactures metallic molds and accessory parts for use in audio equipment, copying machines and fax machines. Kwanta supplies metallic molds for the Company's plastic and electronic operations and manufactures metal parts for OEMs and contract manufacturers, including the Company.

In January 1999, the Company organized Star Peace Limited, a British Virgin Islands International Business Company, in order to hold securities the Company acquires for investment.

In January, 2000, the Company organized Blue Collar Holdings Limited, a British Virgin Islands International Business Company to hold the beneficial ownership of Jetcrown Industrial (Dongguan) Limited ("Jetcrown Dongguan"). Jetcrown Dongguan, a limited liability China Foreign Enterprise registered in January 2000, was organized to conduct the Company's plastic injection molding manufacturing operations in Dongguan, China. Jetcrown Dongguan commenced production in July 2000.

In April 2000, Integrated organized Digiwave Limited (originally named Wisetop Technology Limited), a limited liability Hong Kong Company, to carry on original design manufacturing, or ODM, in connection with our electronic manufacturing business.

In June 2000, the Company organized Jetcrown Industrial Sdn. Bhd., a limited liability Malaysian Company, to establish a representative office in Dongguan, China to handle our overseas plastic injection product sales. On May 22, 2001, the Company's representative office successfully obtained a registration certificate to allow it to do business from the Chinese Government and it commenced business in August 2001.

In August 2001, the Company organized Jetcrown & Kwanasia (OEM) Specialist Limited ("J&K OEM"), a limited liability Hong Kong Company, to conduct marketing for Deswell's plastic and electronic businesses. The capital stock of J&K OEM is owned 51% by Deswell, 39% by Dickson Lam, Deswell's Director of Marketing for plastic and electronic products, and 10% by two other individuals, who are not otherwise related to Deswell.

CAPITAL EXPENDITURES

Principal capital expenditures and divestitures made by Deswell during the three years in the period ended March 31, 2002 include the following:

	2000	2001	2002
Purchase of property, plant and equipment	$6,019,000	$13,926,000	$4,397,00
Proceeds from the sale of property, plant and equipment	176,000	113,000	$ 276,00

Principal capital expenditures currently in progress relate to improvements we are constructing on the land we purchased in Dongguan, China to build a new factory. The construction of our new Dongguan factory and dormitories will consist of three to four phases. The pace of its development depends on our financial situation and future operating results. We estimate that we will spend an aggregate of approximately $12 million for the first phase of construction, which comprised approximately 330,000 square feet of factory space, 70,000 square feet for an amenity center and 80,000 square feet of dormitory space, and which began in October 2001 and is expected to be completed in August 2002. Completion of interior build-out is expected to take another three months, and therefore the new factory built from the Phase I portion of activity is expected to be ready for use by the end of December 2002. Following completion of space built through Phase I, we estimate spending an aggregate of approximately $4.5 million for the second phase of construction, which will comprise an additional 110,000 square feet of factory space and 70,000 square feet of dormitory space, and which will begin in August 2002 and is expected to take approximately five months. Baring unforeseen delays, we expect that the new factory from the Phase II portion of construction will commence operation in April 2003. Deswell has not yet authorized construction of additional phases of this project and will make those decisions based on its future operating results.

These capital expenditures were financed and are being financed mainly from internally generated funds.

BUSINESS OVERVIEW

INTRODUCTION TO DESWELL

The Company is an independent manufacturer of injection-molded plastic parts and components, electronic products and subassemblies and metallic molds and accessory parts for original equipment manufacturers, or "OEMs" and contract manufacturers. The Company conducts all of its manufacturing activities at separate plastics, electronics and metallic operation factories located in the People's Republic of China.

The Company produces a wide variety of plastic parts and components that are used in the manufacture of consumer and industrial products, including

- cases and key tops for calculators and personal organizers;
- cases for flashlights, telephones, paging machines, projectors and alarm clocks;
- grips and rods for fishing tackle; and
- toner cartridges and cases for photocopy machines.

Electronic products manufactured by the Company include

- complex printed circuit board assemblies using surface mount ("SMT") and pin-through-hole ("PTH") interconnection technologies and
- finished products which include

  > telecommunication products such as special purpose telephones used as a private automated branch exchange, a network terminal and an internet phone, for each of which we also manufacture the plastic parts;,

  > telephone answering machines, and

  > sophisticated professional audio equipments such as power amplifiers, mixers and digital signal processors and DVD players.

Since mid 1999, Deswell's electronics research and development team has also developed new products such as full-duplex conference speakerphones, tele-video monitoring systems and digital color cameras.

Metal products manufactured by Deswell include metallic molds and accessory parts used in audio equipment, telephones and copying machines.

As part of its manufacturing operations, the Company consults with its customers in the design of plastic parts and the design and production of the molds used to manufacture plastic parts, which are made by Deswell at its customers' expense, and provides advice and assistance in the design and manufacturing of printed circuit boards. The Company believes that its ability to manufacture high-end plastic and metal parts of the quality required by OEMs and contract manufacturers which furnish products and services internationally, Deswell's expertise in designing and manufacturing molds for its customers and the Company's low production costs distinguish Deswell from most other manufacturers of plastic products and provide it with a competitive advantage.

However, as a result of increased competition, Deswell has been forced to reduce the sales prices of its products during the years ended March 31, 2000, 2001 and 2002, which has resulted in lower gross profit margins during these years.

INDUSTRY OVERVIEW

Management believes that the injection molding and metal molds and parts manufacturing industries have each benefited in recent years from a trend among major users of injection molded and metal products to outsource an increasing portion of the parts requirements and to select a small number of suppliers or a sole supplier to provide those products. The Company is not aware of any empirical data defining the manufacturing industry in China, however, management believes that injection molding and metal manufacturing firms which are much smaller than the Company make up the largest segment of the industry in China. The Company's experience indicates that such smaller firms are often unable to react quickly and responsively to the diverse demands of many customers and are not capable of furnishing the level of quality that high-end plastic and metal products require. Management believes that this inability on the part of these smaller manufacturers has created opportunities for the Company to increase sales by catering to the outsourcing requirements of OEMs and contract manufacturers that manufacture such high-end products.

Similarly, as a result of the recognition by OEMs in the electronics industry of the rising costs of operating a manufacturing site and the need to add more sophisticated and expensive manufacturing processes and equipment, OEMs have turned increasingly to outside contract manufacturers. By doing so, OEMs are able to focus on research, product conception, design and development, marketing and distribution, and to rely on the production expertise of contract manufacturers. Other benefits to OEMs of using contract manufacturing include: access to manufacturers in regions with low labor and overhead costs, reduced time to market, reduced capital investment, improved inventory management, improved purchasing power and improved product quality. In addition, the use of contract manufacturers has helped OEMs manage production in view of increasingly shorter product life cycles.

OPERATIONS

Plastic Injection Molding

Plastic injection molding manufacturing accounted for 62.9%, 62.2% and 57.0% of the Company's total sales during the years ended March 31, 2000, 2001 and 2002, respectively. At March 31, 2002, the Company conducted its plastic manufacturing operations in approximately 408,500 and 114,900 square feet of factory space in its factories located in Shekou, Shenzhen, China and Dongguan, Shenzhen, China, respectively.

The Company's plastic injection molding process consists of three phases: (1) mold design and production; (2) plastic injection; and (3) finishing.

Mold design and production. The plastic injection-molding process begins when a customer provides the Company with specifications for a product or part, which specifications are often created in consultation with the Company's technical staff. Next the Company designs and produces the mold, using great care in the design process and in the selection of materials to produce the mold in an effort to create a high quality appearance of the completed product by reducing or eliminating potential flaws such as the sinkage of materials and irregularities in the knit line of joints.

The mold-making process ranges from 30 to 75 days, depending on the size and complexity of the mold. Mold making requires specialized machines and is capital intensive. At March 31, 2002, the Company used 22 EDMs (electrical discharge machines), 25 CNC (computer numerical control) milling machines and 63 NC (numerical control) milling machines in the mold-making process.

Deswell is continually adding equipment to expand its mold-making and tolling capabilities. In January 1999 the Company purchased two advanced "Makino" tooling machines, a Graphite CNC Milling Machine and a V55-A15 Vertical Machining Center, for approximately $700,000. These machines can achieve higher efficiency in mold making and are nearly four times faster than normal machines in certain applications. The machines were installed in April 1999. During July to September 1999, the Company purchased 10 sets of NC milling machines, 5 sets of EDM and 2 sets of CNC milling machines for approximately $510.000. During the period from June to November 2000, the Company purchased six sets of EDM, 14 sets of CNC milling machines and 11 sets of NC milling machines for approximately $995,000. During February to April 2002, the Company purchased 12 additional injection-molding machines with clamping force of 365 to 550 tons for approximately $1.5 million. The Company expects that these new injection-molding machines will be installed in July 2002. In March 2002, the Company also upgraded its tooling software used in the mold-making process for enhanced precision and efficiency. Molds produced by the Company generally weigh from 220 to 12,000 pounds and generally cost between $3,000 and $500,000.

The customer generally bears the cost of producing the molds and, as is customary in the industry, the customers own them. However, the Company maintains and stores the molds at its factory for use in production and it is the Company's policy not to make molds for customers unless the customer undertakes to store its molds at the Company's factory and uses the Company to manufacture the related parts. In this way, the Company seeks to use its mold-making expertise to create dependence on the Company for the customer's parts requirements.

During the year ended March 31, 2002, the Company made on average about 70 different molds every month. Management believes that the Company's skills and expertise in mold-making, coupled with having its facilities and operations in China, allow the Company to produce molds at costs substantially less than molds of comparable quality made in Japan, Korea and Taiwan.

Plastic Injection. During the mold-making process, suitable plastic resin for the particular product is selected and purchased. See "Raw Materials, Component Parts and Suppliers." The completed mold is mounted onto injection machines, which are classified according to the clamping force (the pressure per square inch required to hold a mold in place during the injection molding process). At March 31, 2002, the Company had 251 injection molding machines, ranging from 50 to 1,600 tons of clamping force, with most machines in the range of from 80 to 100 tons. Each of the Company's machines is capable of servicing a variety of applications and product configurations and the Company has machines, which permit the Company to fabricate plastic parts as small as a button and as large as a 3 ft. x 2 ft. case for a copy machine.

Using separate shifts, injection molding is generally conducted 24 hours a day, seven days per week, other than normal down time for maintenance and changing of product molds. Molding of products requiring extra concerns for appearance, such as cases for calculators, personal organizers and telephones are conducted in an isolated and dust free section of the factory. In a continuous effort to assure quality, the Company's quality control personnel inspect the products produced from each machine generally at hourly intervals during production. When defects are discovered, the Company's maintenance personnel inspect the mold and the machine to determine which is responsible. If the mold is the cause of the defect, it will be immediately removed from the machine and serviced or repaired by one of a team of technicians employed to maintain molds. The mold will then be remounted on the machine and production will continue. If the machine is the source of the defect, the Company's technicians and engineers service the machine immediately. Through this continuous vigilance to molds and machines, the

Company has experienced what it believes to be a relatively low scrap rate and has been able to maintain a high level of productivity of its injection molding machines.

Finishing. After injection molding, products are finished. Finishing consists of smoothing and polishing, imprinting letters, numbers and signs through silk screening process, pad printing or epoxy ultra violet cutting, and treating the product with an anti-fog coating for a lasting and attractive appearance. Most of these functions are conducted by hand.

Electronic Products and Assemblies

In an aggregate of approximately 298,000 square feet of factory space at March 31, 2002 located at facilities in Dongguan, China, the Company manufactures and assembles electronic products and electronic assemblies for OEMs. Finished products include consumer and sophisticated studio-quality audio equipment, telephones and telephone answering machines, computer peripherals such as local area network ("LAN") add-in cards, CD-ROM drives and sound cards, electronic toys, infrared remote controls and radar detectors. Assemblies consist of PCBs with passive (e.g., resistors, capacitors, transformers, switches and wire) and active (e.g., semiconductors and memory chips) components mounted on them. During the years ended March 31, 2000, 2001 and 2002, manufacturing of electronic products accounted for approximately 30.6%, 35.4% and 40.4%, respectively, of the Company's total sales. During the same periods, manufacturing of finished products accounted for 95%, 91% and 96%, respectively, of electronic product sales and assembling of printed circuit boards accounted for the balance of such sales during those periods.

In assembling printed circuit boards the Company purchases packaged boards with the active components already mounted and use both PTH and SMT interconnection technologies to assemble the other components onto the PCBs.

PTH is a method of assembling printed circuit boards in which component leads are inserted and soldered into plated holes in the board. While this technology is several decades old and is labor intensive, it still has a significant market, particularly for consumer product applications.

SMT is the method of assembling printed circuit boards in which components are fixed directly to the surface of the board, rather than being inserted into holes. With this process, solder is accurately stenciled in paste form on pads located on the printed circuit board. The components are then placed into the solder paste and heated to the point of melting the paste (a process called "reflow") to establish a strong solder joint. The SMT process allows for more miniaturization, cost savings and shorter lead paths between components (which results in greater signal speed). Additionally, it allows components to be placed on both sides of the printed circuit board, a major factor in the miniaturization process.

Manufacturing operations include PCB assembly and testing and, in those cases where finished products are to be provided, assembly into final product housing. While the Company has automated various aspects of the many processes, the assembly of components into electronic products remains a labor-intensive process generally requiring a high degree of precision and dexterity in the assembly stage and multiple quality control checks prior to shipment. The Company utilizes specially designed equipment and techniques to maintain its ability to assemble efficiently a wide variety of electronic products and assemblies.

Metal Parts Manufacturing

In an aggregate of approximately 120,100 square feet of factory space at March 31, 2002 located at facilities in Dongguan, China near to the facilities the Company uses to manufacture and assemble electronic products and electronic assemblies, the Company manufactures metallic molds and accessory parts for use in audio equipment, telephone and copying machines. The manufacturing by the Company of metal mold products accounted for approximately 6.5%, 2.4% and 2.6% of the Company's total sales during the years ended March 31, 2000, 2001 and 2002, respectively.

Quality Control

The Company maintains strict quality control procedures for its products. At hourly intervals, the Company's quality control personnel monitor machines and molds to assure that plastic parts are free from defects.

For electronic operations, the Company's quality control personnel check all incoming components. Moreover, during the production stage, the Company's quality control personnel check all work in process at several points in the production process. Finally, after the assembly stage, the Company randomly checks finished products.

Plastic, electronic and metal products manufactured and assembled at the Company's facilities have a low level of product defects, and aggregate returns represented less than 3% of total net sales during each of the years ended March 31, 2000, 2001 and 2002. In 1995, the Company earned ISO 9002 certifications for both its plastic and electronic products manufacturing operations. In April 2000, the Company also received ISO 9002 for its metal manufacturing operation. The "ISO" or International Organization for Standardization is a Geneva-based organization dedicated to the development of worldwide standards for quality management guidelines and quality assurance. ISO 9000, which is the first quality system standard to gain worldwide recognition, requires a company to gather, analyze, document and monitor and to make improvements where needed. ISO 9002 is the ISO level appropriate for manufacturers like the Company. The Company's receipt of ISO 9002 certification demonstrates that the Company's manufacturing operations meet the established world standards.

Raw Materials, Component Parts and Suppliers

Plastic Resins. The primary raw materials used by the Company in the manufacture of its plastic parts are various plastic resins, primarily ABS (acrylonitrile-butadiene-styrene), which in the years ended March 31, 2000, 2001 and 2002 averaged approximately 55%, 58% and 52%, respectively, of the Company's cost of plastic products sold and 31%, 32% and 25%, respectively, of the Company's total cost of goods sold. Because plastic resins are commodity products, the Company selects its suppliers primarily based on price. The Company has no long-term supply agreements for plastic resins. The Company currently obtains its plastic resins from suppliers in Hong Kong, Japan and Taiwan and normally maintains a three to four month inventory supply.

The Company used in excess of 17,200,000 pounds of plastic resins during the year ended March 31, 2002. Management believes that the Company's large volume purchases of plastic resin have generally resulted in lower unit raw material costs and generally has enabled the Company to obtain adequate shipments of raw materials. While the Company is not generally bound by fixed price contracts with its customers, the Company has found that increases in resin prices can be difficult to pass on to its customers and, as a consequence, a significant increase in resin prices could have, and in the past has had, a material adverse effect on the Company's operations.

The primary plastic resins used by the Company are produced from petrochemical intermediates derived from products of the natural gas and crude oil refining processes. Natural gas and crude oil markets have in the past experienced substantially cyclical price fluctuations as well as other market disturbances including shortages of supply and crises in the oil producing regions of the world. The capacity, supply and demand for plastic resins and the petrochemical intermediates from which they are produced are also subject to cyclical and other market factors. Consequently, plastic resin prices may fluctuate as a result of natural gas and crude oil prices and the capacity, supply and demand for resin and petrochemical intermediates from which they are produced.

Although the plastics industry has from time to time experienced shortages of plastic resins, the Company has not experienced to date any such shortages. Management believes that there are adequate sources available to meet the Company's raw material needs.

Component Parts and Supplies. The Company purchases over 500 different component parts from more than 100 suppliers and is not dependent upon any single supplier for any essential component. The Company purchases from suppliers in Japan, Taiwan, Korea, Hong Kong and elsewhere. At various times there have been shortages of parts in the electronics industry, and certain components, including PCBs and semiconductors, have been subject to limited allocations. Although shortages of parts and allocations have not had a material adverse effect on the Company's results of operations, there can be no assurance that any future shortages or allocations would not have such an effect.

Raw Metal. The primary materials used by the Company in metal molds and parts manufacturing are various metals, but purchases of raw metal were immaterial to the Company's total operations during the years ended March 31, 2000, 2001 and 2002. Typically the Company buys metals from a variety of suppliers in Hong Kong and China and has no long-term contracts with metal suppliers.

Transportation

Transportation of components and finished products to customers in Shenzhen and to and from Hong Kong and Shenzhen and Dongguan is by truck. Generally, the Company sells its products F.O.B. China or F.O.B. Hong Kong. To date, the Company has not been materially affected by any transportation problems and has found that the transition of Hong Kong to Chinese control in

July 1997 has not had an adverse impact on the Company's ability to transport goods to and from Hong Kong and China.

Customers and Marketing

The Company's customers are OEMs and contract manufacturers. The Company sells its products in Asia (Hong Kong, Japan and China), North America (the United States and Canada) and Europe (Germany, United Kingdom, France and Italy). Net sales to customers by geographic area are determined by reference to shipping destinations as directed by the Company's customers. For example, if the products are delivered to the customer in Hong Kong, the sales are recorded as generated in Hong Kong; if the customer directs the Company to ship its products to Europe, the sales are recorded as sold to Europe. See Note 14 of Notes to Consolidated Financial Statements for the dollar amounts of export sales by geographic area for each of the years ended March 31, 2000, 2001 and 2002. Net sales as a percentage of total sales to customers by geographic area consisted of the following for the years ended March 31, 2000, 2001 and 2002:

GEOGRAPHIC AREAS	2000	2001	2002
China	42.6%	54.5%	56.3%
North America ..	27.0	22.6	23.2
Hong Kong	24.1	19.2	14.0
Europe	5.1	2.2	4.9
Others	1.2	1.5	1.6
Total ..	100.0%	100.0%	100.0%

The Company markets its products and services to existing customers through direct contact with the Company's management and direct sales personnel. The Company's sales personnel attend trade shows, advertise in trade publications such as Asian Source -- Electronics and Asian Source --Components, and use direct mail catalogues and product literature. The Company's Hong Kong-based marketing staff contacts existing and potential customers by telephone, mail, fax, e-mail via the Internet and in person.

Major Customers

The table below sets forth each of the Company's customers which accounted for 10% or more of net sales during the year ended March 31, 2002 the products purchased and the percentage of total Company net sales accounted for by such customers during the years ended March 31, 2000, 2001 and 2002.

		YEAR ENDED MARC	
CUSTOMER	PRODUCT	2000	2001
Epson Precision (H.K.) Limited	Plastic components	*	13.0%
VTech Telecommunications Limited	Telephones and organizers	22.1%	17.6%
Kyocera Mita Industrial Co. (H.K.) Limited	Plastic components and assembly	24.0%	18.7%
Inter-Tel Incorporated	Telephones	25.3%	20.0%

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* Less than 10%.

The Company's success will depend to a significant extent on the success achieved by its customers in developing and marketing their products, some of which may be new. Many of the industry segments served by the Company's customers are subject to technological change, which can result in short product life cycles. The Company could be materially adversely affected if advances in technology or other factors reduce the marketability of essential products of its customers or if new products being developed by its customers do not attain desired levels of acceptance. If the Company was to lose any customers who account for a material portion of total net sales, or if any of these customers were to decrease substantially their purchases from the Company, the Company's revenues, earnings and financial position would be materially and adversely affected. The Company's dependence on these customers is expected to continue in the foreseeable future.

The Company's sales transactions with all of its customers are based on purchase orders received by the Company from time to time. Except for these purchase orders, the Company has no written agreements with its customers. Sales of plastic parts and metallic products are primarily made on credit terms, with payment in Hong Kong dollars expected within 30 to 60 days of shipment. Sales of electronic products are typically based on letters of credit and are payable in United States dollars. To date the Company has not experienced any significant difficulty in collecting accounts receivable on credit sales. Management communicates regularly with credit sale customers and closely monitors the status of payment and in this way believes it has kept the default rate low. Additionally, plastic parts deliveries are made in several installments over a lengthy period of time, which permits the Company to withhold delivery in the event of any delinquency in payment for past shipments. While the Company has not experienced any difficulty in being paid by its major customers, there can be no assurance that the Company's favorable collection experience will continue in every case or at all. The Company could be adversely affected if a major customer were unable to pay for the Company's products or services.

Competition

Management believes that the plastic injection molding, contract electronic manufacturing and metal molds and accessories industries are each highly fragmented, although it is not aware of any empirical data defining the business segments in China. Plastic injection molding and metal molds and accessories manufacturing are characterized by a large number of relatively small operators and divisions of larger companies and contract electronic manufacturing by numerous independent manufacturers whose capabilities are evaluated by customers against each other and against the merits of in-house production. Competition in each industry is intense and many competitors in each industry are larger and have greater financial and other resources than the Company.

The Company believes that competition for plastic injection molding, contract electronic manufacturing and metal molds and parts manufacturing businesses are based on price, quality, service and the ability to deliver products in a timely and reliable basis. The Company believes that it competes favorably in each of these areas in each business segment.

Patents, Licenses and Trademarks

The Company has no patents, trademarks, licenses, franchises, concessions or royalty agreements that are material to its business.

SEASONALITY

For information concerning the seasonality of the Company's business, see "Seasonality" included under Item 5 "Operating and Financial Review and Prospects."

ORGANIZATIONAL STRUCTURE

The chart below illustrates the organizational structure of the Company and its active subsidiaries at March 31, 2002.


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                                                 /   Deswell Industries, Inc.   /
                                                 /   A British Virgin Islands   /
                                                 /International Business Company/
                                                  ------------------------------
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                                                                /
        ------------------------------------------------------------------------------------------
        /                  /               /              /                /                    /
   100% /             100% /          100% /         100% /         51%    /               100% /
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/ Blue Collar  /  /    Marcon    /  / Jetcrown /  /  Richtex    /  /  Integrated  /  /Star Peace L
/Holdings Ltd. /  / Enterprises  /  /Industrial/  /  Services   /  /International /  /  (A British
/ (A British   /  /     Ltd.     /  /  Limited /  /  Limited    /  /     Ltd.     /  /Virgin Islan
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/International /  /Virgin Islands/  /   Kong   /  /  Limited    /  / Corporation) /  /   Business
/   Business   /  / International/  /  Limited /  / Liability   /   ----------------  /   Company)
/  Company)    /  /   Business   /  / Liability/  /  Company)   /          /            -----------
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   100% /             100% /                             100% /               100% /
 -------------       -------------                   ------------          ------------          -
/   Jetcrown  /     /   Jetcrown  /                 /  Kwanasia  /       /   Kwanta   /          /
/  Industrial /     /  Industrial /                 /Electronics /       / Precision  /          /
/  (Dongguan) /     /  (Shenzhen) /                 /  Company   /       /   Metal    /          /E
/   Limited   /     /   Limited   /                 /  Limited   /       /  Products  /          /
/  (A limited /     /  (A limited /                 /(A Hong Kong/       /Company Ltd /          /
/  liability  /     /  liability  /                 /  Limited   /       /(A Hong Kong/          /C
/China Foreign/     /China Foreign/                 / Liability  /       /  Limited   /           -
/  Operation) /     /  Operation) /                 /  Company)  /       / Liability  /
 -------------       -------------                   ------------        /  Company)  /
                                                            /             ------------
                                                            /
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                                                     100%   /                                     1
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/    Dongguan Kwan   /                                 /  S
/   Hong Electronics /                                 /
/      Co. Ltd.      /                                 /  C
/(A limited liability/                                 /(A
/    China Foreign   /                                 /
/     Operation)     /                                 /
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PROPERTY, PLANTS AND EQUIPMENT

HONG KONG

The Company owns Unit 516-517, Hong Leong Industrial Complex, No. 4 Wang Kwong Road, Kowloon Bay, Kowloon, Hong Kong and uses these premises for the administration and marketing offices of its plastic injection molding operations. In addition, the Company leases from unaffiliated parties Units 514, 515 and 602, Hong Leong Industrial Complex, No. 4 Wang Kwong Road, Kowloon Bay, Kowloon, Hong Kong for use as an office and warehouse for its plastic injection molding operations. The total monthly rent under the leases is approximately $3,200. These leases expire from July 2002 to February 2004.

The Company owns Unit 10-14, 19/F., Kwong Sang Hong Centre, 151-153 Hoi Bun Road, Kwun Tong, Hong Kong and uses this space for the administration and marketing offices for both its contract electronic and metal manufacturing operations.

Moreover, the Company leases from an unaffiliated party Unit 1201, 12/F., Prosperity Center, 25 Chong Yip Street, Kwun Tong, Hong Kong for use as an office for its marketing operations. The total monthly rent under the lease is approximately $1,500. The lease expires in August 2003.

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SOUTHERN CHINA

In October 2000, the Company has acquired under sale and purchase agreement with third party an aggregate of approximately 112,900 square feet of manufacturing space at Block G, Wing Village Industrial Estate, Shekou, Shenzhen, China which were previously leased by the Company for the use of its plastic injection molding operations. Deswell paid approximately $1,461,000 to acquire this property.

At March 31, 2002, the Company leased approximately 295,600 square feet of manufacturing space at Block A, 1/F-2/F, Block B, 1/F-3/F, Block C, 1/F, Block D, 1/F-5/F, Block E, 2/F-5/F, Block F, 1/F-5/F, and Block H, G/F and 2/F-5/F Wing Village Industrial Estate, Shekou, Shenzhen, China which are used for its plastic injection molding operations. These factory premises are leased from the local Chinese government and third parties under separate leases expiring from September 2002 to May 2007. The aggregate monthly rent is approximately $63,200.

In January 2000, the Company also leased approximately 56,800 square feet of manufacturing space and 37,100 square feet of ancillary dormitory space at Huangguan Industrial Estate, Houjie Town, Dongguan, Shenzhen, China, which are used for its plastic injection molding operations. Additionally, in May and August 2000, the Company leased approximately 58,100 square fee of manufacturing space and 22,400 square feet of ancillary dormitory space at Huangguan Industrial Estate, Houjie Town, Dongguan, Shenzhen China, which are used for its plastic injection molding operations. The new premises are adjacent to the factory leased in January 2000. These premises are leased from the local Chinese government and third party under separate leases expiring from February 2002 to July 2004. The aggregate monthly rental is approximately $16,600.

The Company leases space at various locations near its plastics manufacturing factories in Shekou and Dongguan, Shenzhen that it uses as dormitories for factory workers. Management estimates that the space leased for dormitories approximated 97,200 square feet and 30,600 square feet at March 31, 2002 in Shekou and Dongguan, respectively. The facilities are leased for periods of one year to two years, expiring from August 2002 to March 2003. The aggregate monthly rental is approximately $21,300. The Company has acquired under purchase and sale agreements with third parties an aggregate of approximately 24,600 square feet of additional space at various locations near its plastics manufacturing operations in Shenzhen, which are also used as dormitories for factory workers.

At March 31, 2002, the Company leased approximately

- 264,200 square feet of manufacturing space at Kwan Hong Building, Cheung On, Dongguan, China,
- 1,000 square feet of office space in Yee Ho Plaza, Nanshan, Shenzhen, China,
- 22,200 square feet of ancillary dormitory space at Lan Wang Building, Cheung On, Dongguan, China, and
- 1,800 square feet of office space in Intelligent Transport Research & Development Centre, Hangzhou, China

for its contract electronic manufacturing operations;

- 84,500 square feet of manufacturing and warehouse space in Lan Wang Building, Cheung On, Dongguan, China and
- 133,300 square feet of ancillary dormitory space at Kwan Hong Building

for both its contract electronic manufacturing and metal manufacturing operations; and

- 69,400 square feet of manufacturing space in Kwanta Building, Cheung On, Dongguan, China, and
- 44,700 square feet of ancillary dormitory space at Lan Wang Building

for its contract metal manufacturing operation. These premises are leased from third parties under separate leases expiring from February 2003 to May 2009. The aggregate monthly rental is approximately $75,100.

In addition, the Company leases approximately 133,500 square feet of space at various locations near its contract electronics and metal manufacturing factories in Dongguan, Shenzhen, which are used as staff quarters. The facilities are leased from third parties for periods of one to two years and expire from December 2002 to May 2004. The aggregate monthly rental is approximately $6,500.

The Company leases approximately 1,900 square feet of space from S. K. Lee and M.C. Tam near its office in Shenzhen that is used as staff quarters. Messrs. Lee and Tam are executive officers of the Company in charge of its contract manufacturing operations. These premises are leased for terms expiring from March 2002 to September 2003. The total monthly rental is approximately $970.

Management believes that Deswell will be able to renew each of the leases described above as it expires for periods comparable to the current term.

The Company believes that its existing offices and manufacturing space, together with manufacturing space in close proximity to its existing facilities which management believes will be available as needed for limited expansion, will be adequate for the operation of its business for at least the next two years.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Except for statements of historical facts, this section contains forward-looking statements involving risks and uncertainties. You can identify these statements by forward looking words including "expect", "anticipate", "believe" "seek", "estimate". Forward looking statements are not guarantees of Deswell's future performance or results and the Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under the section of this Report entitled Item 3. Key Information -- "Risk Factors". This section should be read in conjunction with the Company's Consolidated Financial Statements included under Item 18 of this Report.

OPERATING RESULTS

The following discussion should be read in conjunction with the consolidated financial statements and notes thereto included later in this Report. The Company prepares its financial statements in accordance with U.S. GAAP.

GENERAL

The Company's revenues are derived from the manufacture and sale of injection-molded plastic parts and components, electrical products and subassemblies and metallic molds and accessories. Jetcrown (a wholly owned subsidiary) carries on the plastics operations whereas Integrated (a 51%-owned consolidated subsidiary) carries out the electronics operations. The Company acquired a controlling interest in Integrated's predecessor in October 1992 and has included the results of the predecessor in its consolidated financial statements from the date of acquisition. Integrated acquired a 64.9% interest in Kwanta in October 1996 and the Company has included the results of Kwanta in its consolidated financial statements since the date of acquisition. In April and July 1999, Integrated acquired the remaining 35.1% interest in Kwanta.

The Company's plastics operations are the mainstay of its business and have accounted for the majority of its sales. The Company carries out all of its manufacturing operations in Southern China, where it is able to take advantage of the lower overhead costs and inexpensive labor rates as compared to Hong Kong. At the same time, the proximity of the Company's factories in Southern China to Hong Kong permits the Company to manage easily its manufacturing operations from Hong Kong, facilitates transportation of its products through Hong Kong and provides the Company's plastic manufacturing operations with access to electricity from Hong Kong and to nearby water, both of which resources are needed in abundance to manufacture plastic parts and are often inadequate elsewhere in China.

The Company's earnings have benefited from favorable overall effective income tax rates of 7.7%, 2.3% and 3.6% for the years ended March 31, 2000, 2001 and 2002, respectively. The Company is subject to Hong Kong income tax on its income arising in, or derived from, Hong Kong. Currently, under the Chinese tax system we can obtain tax breaks by reinvesting profits of certain of our subsidiaries in China. We are considering the reinvestment of a portion of our profits of $4,000,000, from our Chinese plastic manufacturing subsidiary for the year ended December 31, 2001 and, if we do so, we expect we will only be subject to taxes of 7.5% on these operations for the remaining profits for tax year ended December 31, 2001. For the tax year commencing January 1, 2002, the Company will be subject to taxes of 10% on these operations. Certain of the Company's income accrue in tax-free jurisdictions and are not subject to any income taxes. See Note 7 of Notes to consolidated financial statements for a further description of income taxes. The Company expects to continue to benefit from a low overall effective

income tax rate in the future, barring unforeseen changes in tax laws and regulations in the various jurisdictions in which it operates. See "Uncertain applications of Chinese tax laws could subject us to greater taxes in China" included under "We face numerous risks as a result of our operations in China and Hong Kong" in Item 3. Key Information -- "Risk Factors."

The following table sets forth the percentages of net sales of certain income and expense items of the Company for each of the three years in the period ended March 31, 2002.

	YEAR ENDED MARCH 31,		
	2000	2001	2002
Net sales	100.0%	100.0%	100.0%
Cost of sales	62.8	65.1	65.3
Gross profit	37.2	34.9	34.7
Selling, general and administrative expenses	19.6	19.0	18.0
Operating income	17.6	15.9	16.7
Interest expense	0.0	0.0	0.0
Other income, net	1.5	1.1	1.0
Income before income taxes	19.1	17.0	17.7
Income taxes	1.5	0.4	0.6
Income before minority interests	17.6	16.6	17.1

Minority interests	0.7	0.8	1.1
Net income	16.9%	15.8%	16.0%

YEAR ENDED MARCH 31, 2002 COMPARED TO YEAR ENDED MARCH 31, 2001

The Company's net sales for the year ended March 31, 2002, were $83,320,000, an increase of $2,473,000 or 3.1% as compared to year ended March 31, 2001. Sales to Inter-Tel Incorporated ("Inter-Tel"), Kyocera Mita Industrial Co. (H.K.) Ltd. ("Mita"), VTech Telecommunications Ltd. ("VTech") and Epson Precision (H.K.) Ltd. ("Epson"), the Company's four largest customers during the year ended March 31, 2002, represented approximately 58.0% of the net sales for the year. See Item 4. "Information on the Company -- Major Customers".

The increase in sales during the year ended March 31, 2002 was mainly related to increases in sales of electronic and metallic products of $4,311,000 offset by a decrease in sales of injection-molded plastic products of $1,838,000. This represented an increase of 13.7% and a decrease of 3.7%, respectively, as compared with the net sales during the year ended March 31, 2001. The increase in net sales in the electronics and metallic divisions was mainly due to an increase in orders from existing customers of these divisions, together with orders from new customers during the year.

Net sales to customers by geographic area are determined by reference to shipping destinations as directed by the Company's customers. During the year ended March 31, 2002, sales to China, North America, Europe and other areas increased by $2,797,000, $1,093,000, $2,291,000 and $599,000, respectively, and sales to Hong Kong and Japan decreased by $3,867,000 and $440,000, respectively, over levels for the year ended March 31, 2001.

The overall gross profit for the year ended March 31, 2002 was $28,872,000, representing a gross profit margin of 34.7%. This compares with the overall gross profit and gross profit margin of $28,251,000 and 34.9%, respectively, for the year ended March 31, 2001. The absolute and percentage decrease in the overall gross profit margin was 0.2% and 0.6%, respectively, for years ended March 31, 2002 and 2001.

Selling, general and administrative expenses for the year ended March 31, 2002 were $14,939,000, amounting to 18.0% of total net sales, as compared to $15,414,000 or 19.0% of total net sales for the year ended March 31, 2001. The decrease in selling, general and administrative expenses of $475,000 over the prior year was mainly attributed to the stricter control on these expenses.

As a result of the increase in sales revenue and a decrease in selling, general and administrative expenses, operating income was $13,933,000 for the year ended March 31, 2002, an increase of $1,096,000 or 8.5% as compared with the year ended March 31, 2001.

During the year ended March 31, 2002, the Company established a 51%-owned marketing subsidiary to strengthen its marketing capability. As a result, minority interests represent the 49% minority interest in the electronics and metallic subsidiaries and the marketing subsidiary. The increase in minority interest to $925,000 for the year ended March 31, 2002, from $621,000 for the year ended March 31, 2001, reflects the fact that the electronics and metallic businesses generated more net income in the year ended March 31, 2002 as compared to the prior year.

As a result of the above factors, net income was $13,324,000 for the year ended March 31, 2002, an increase of $514,000 or 4.0%, as compared to the year ended March 31, 2001, and net income as a percentage of net sales increased slightly to 16.0% from 15.8%.

YEAR ENDED MARCH 31, 2001 COMPARED TO YEAR ENDED MARCH 31, 2000

The Company's net sales for the year ended March 31, 2001 were $80,847,000, an increase of $19,889,000 or 32.6% as compared to year ended March 31, 2000. Sales to Inter-Tel, Mita , VTech and Epson, the Company's four largest customers during the year ended March 31, 2001, represented approximately 69.3% of the net sales for the year. See Item 4. "Information on the Company -- Major Customers".

The increase in sales was mainly related to increases in sales of injection-molded plastic products and electronic and metallic products of $10,996,000 and $8,893,000, respectively. This represented increases of 28.7% and 39.3%, respectively, as compared with comparable net sales in the prior year. The increase in net sales in both operations was attributed to the substantial increase in orders from the existing strong customer base together with orders from new customers.

Net sales to customers by geographic area are determined by reference to shipping destinations as directed by the Company's customers. During the year ended March 31, 2001, sales to China, North America, Hong Kong, Japan and other areas increased by $18,120,000, $1,795,000, $852,000, $14,000 and $400,000, respectively, and sales to Europe decreased by $1,293,000, over fiscal 2000 levels.

The overall gross profit for the year ended March 31, 2001 was $28,251,000, representing a gross profit margin of 34.9%. This compares with the overall gross profit and gross profit margin of $22,696,000 or 37.2% for the year ended March 31, 2000. The absolute and percentage decrease in the overall gross profit margin of 2.3% and 6.2%, respectively, was mainly attributable to the combined effect of an increase in resin costs and an increase in electronics component costs in the plastic and electronic divisions.

Selling, general and administrative expenses for the year ended March 31, 2001 were $15,414,000, amounting to 19.0% of total net sales, as compared to $11,970,000 or 19.6% of total net sales for the year ended March 31, 2000. The decline in selling, general and administrative expenses as a percentage of sales over the prior year was the result of spreading such expenses over increased sales during fiscal 2001.

As a result, operating income was $12,837,000 for the year ended March 31, 2001, an increase of $2,111,000 or 19.7% as compared with the prior year.

The minority interests represent the 49% minority interest in both the electronics and metallic subsidiaries. The increase in minority interest to $621,000 for the year ended March 31, 2001 from $433,000 for the year ended March 31, 2000 reflects the fact that the electronic and metallic businesses generated more profits in fiscal 2001 than fiscal 2000.

As a result of the above factors, net income was $12,810,000 for the year ended March 31, 2001, an increase of $2,512,000 or 24.4%, as compared to the year ended March 31, 2000 and net income as a percentage of net sales decreased to 15.8% from 16.9%.

SEASONALITY

The following table sets forth certain unaudited quarterly financial information for the twelve quarters in the three-year period ended March 31, 2002 (in thousands):

	YEAR ENDED MARCH 31,								
	2000				2001				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Net sales	$12,081	$16,110	$17,809	$14,958	$17,786	$24,809	$21,376	$16,876	$21,884
Gross profit	4,592	6,727	6,255	5,122	6,255	9,155	7,619	5,222	7,523
Operating income	1,925	3,450	3,201	2,150	2,820	5,071	3,337	1,609	3,956
Net income	2,113	3,336	2,944	1,905	2,757	4,011	3,589	2,453	3,369

The first calendar quarter (the fourth quarter of the fiscal year) is typically the Company's slowest sales period because, as is customary in China, the Company's manufacturing facilities in China are closed for two weeks for the Chinese New Year holidays. The Company does not experience any other significant seasonal fluctuations.

IMPACT OF INFLATION

The Company believes that inflation has not had a material effect on its business. Although the Company has found it difficult to increase the prices of its products in order to keep pace with inflation, particularly in its plastics operations, the Company believes that the location of its manufacturing operations in Southern China has resulted in a lower cost base which still provides it with a competitive advantage. Accordingly, the Company is reliant upon increasing its transaction volume in order to compensate for the effects of inflation.

EXCHANGE RATES

The Company sells most of its products and pays for most components in either Hong Kong dollars or U.S. dollars. Exchange rate fluctuations have not had a significant impact on the Company's operating results. Labor cost and overhead expenses of the Company's Hong Kong operations and China factories are paid in Hong Kong dollars and renminbi, respectively. The exchange rate of the Hong Kong dollar to the U.S. dollar has been fixed by the Hong Kong government since 1983 at approximately HK$7.80 to US$1.00 and accordingly has not represented a currency exchange risk to the U.S. dollars. The Chinese government has announced its intention to maintain this fixed exchange rate, but despite such assurances there has been uncertainty reported in this regard. There can be no assurance that the Chinese government will continue to maintain the present currency exchange mechanism and the Company could face increased currency risks if the current exchange rate mechanism is changed. If the currency exchange mechanism between the Hong Kong dollar and the U.S. dollar is changed, the Company's results of operations and financial condition could be materially adversely affected.

In 1994, China adopted a floating currency system whereby the official exchange rate is equal to the market rate. Since the market and official Yuan rates were unified, the value of the Yuan against the dollar has been essentially stable, with an average rate of 8.28 Yuan per $1.00 during Deswell's fiscal years ended March 31, 2000, 2001 and 2002. The Company believes, because its Chinese operations presently are confined to manufacturing products for export or for customers in China that are controlled by foreign investors and which pay the Company in Hong Kong dollars, that the current economic climate in China should not have a direct adverse impact on the Company's business.

The Company did not hedge its currency risk during the years ended March 31, 2000, 2001 or 2002 and at March 31, 2002, the Company had no open forward currency contracts. The Company continues to review its hedging strategy and there can be no assurance that hedging techniques implemented by the Company will be successful or will not result in charges to the Company's results of operations.

LIQUIDITY AND CAPITAL RESOURCES

For the year ended March 31, 2002, net cash generated from operations totaled $18,203,000, including net income of $13,324,000 and depreciation and amortization of $4,918,000. Accounts receivable and inventories increased by $1,111,000 and $1,191,000, respectively, over levels at March 31, 2001, primarily as a result of increases in sales and the general increase in business activities. Accounts payable increased by $3,309,000 over the March 31, 2001 level. For the year ended March 31, 2001, net cash generated from operations totaled $13,810,000, including net income of $12,810,000 and depreciation and amortization of $5,039,000. Accounts receivable and inventories increased by $5,170,000 and $1,102,000, respectively, over levels at March 31, 2000, primarily as a

result of increases in sales and the general increase in business activities. Accounts payable decreased by $1,127,000 over the March 31, 2000 level.

In February 2001, Messrs. Richard Lau, C.P. Li and C.W. Leung, the Company's senior executive officers, members of its board and principal shareholders exercised options for a total 240,000 common shares of the Company. Proceeds to Deswell totaled $2,588,000. Other employees exercised options for a total of 10,000 common shares of the Company in September 2000 with proceeds to Deswell of $158,000. In June 2002, Messrs. Lau and Leung exercised options totaling 45,000 common shares of the Company. Proceeds to Deswell from these option exercises totaled $700,000.

Net cash used in investing activities amounted to $4,994,000 and $13,672,000 for the years ended March 31, 2002 and 2001, respectively. Capital expenditures during these periods totaled $4,397,000 and $13,926,000, respectively, and were financed by cash generated from operations during each year. The capital expenditure primarily related to the acquisition of plant and machinery for the Company's production facilities in China and office equipment for the Company's administrative operations in China. Cash of $936,000 was pledged as security for the short-term borrowing facilities and $63,000 was released as deposit for customs duty in Dongguan, China during the year ended March 31, 2002.

Net cash used in financing activities for the years ended March 31, 2002 and 2001 was $7,005,000 and $1,964,000, respectively. Net cash used in financing activities during the year ended March 31, 2002 was primarily to fund the Company's dividend payments to its shareholders and to repurchase 34,100 common shares of the Company of $564,000 netting off the short-term bank borrowings of $482,000, the proceeds of $243,000 from the exercise of stock options from employees and $63,000 contribution from minority shareholders of a subsidiary. Net cash used in financing activities during the year ended March 31, 2001 was primarily to fund the Company's dividend payments to its shareholders netting off the proceeds of $2,746,000 form the exercise of stock options from directors and employee.

To date, the Company has generated sufficient funds from its operating activities to finance its operations and there has been little need for external financing. The Company had outstanding short-term borrowings of $482,000 and no long-term debt at March 31, 2002 and no outstanding short-term-borrowings or long-term debt at March 31, 2001. Deswell had no off balance sheet financing arrangements at March 31, 2002.

As a consequence of the fixed exchange rate between the Hong Kong dollar and the U.S. dollar, interest rates on Hong Kong dollar borrowings are similar to U.S. interest rates. The Hong Kong Prime Rate fluctuated during the year ended March 31, 2002, increasing from 8% at the beginning of the year to 9.5% and then decreased to 5.125% at March 31, 2002.

At March 31, 2002, the Company had cash and cash equivalents of $31,534,000 and committed credit facilities of $19,515,000, of which $2,934,000 had been used. The Company also had restricted cash of $2,762,000 and leasehold land and buildings of $1,348,000, which were pledged as collateral for those credit facilities and $99,000 pledged as deposit for customs duty in Dongguan, China. The Company expects that working capital requirements and capital additions will continue to be funded through cash on hand and internally generated funds. The Company's working capital requirements are expected to increase in line with the growth in the Company's business. The Company had capital commitments for plant and machinery of $3,363,000 as of March 31, 2002. The Company expects that internally generated funds will be sufficient to satisfy its cash needs for at least the next 12 months.

At March 31, 2002, the Company was obligated under operating leases requiring minimum rentals of $7,710,000 as follows:

	(In thousands) Year ending March 31,					
	2003	2004	2005	2006	2007	2008 and thereafter
Operating lease payments	$1,971	$1,195	$987	$1,004	$1,047	$1,506

CRITICAL ACCOUNTING POLICIES

The Company prepares its consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reporting period. On an on-going basis, the Company evaluates its estimates and judgments, including those related to intangible assets, inventories, income taxes and impairment of assets. The Company bases its estimates and judgments on historical experience and on various other factors that the Company believes are reasonable. Actual results may differ from these estimates under different assumptions or conditions.

The following critical accounting policies affect the more significant judgments and estimates used in the preparation of the Company's consolidated financial statements.

Intangible assets -- The Company makes assumptions regarding estimated future cash flows and other factors to determine the fair value of intangible assets. If these estimates or their related assumptions change in the future, the Company may be required to record an impairment charge if the estimated fair value of intangible assets are less than their recorded amount. Through March 31, 2002, the Company has not recorded an impairment charge for intangible assets. Beginning April 1, 2002, the Company will be required to adopt Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets", and will be required to analyze goodwill and other intangible assets for impairment issues during the year 2003, and on a periodic basis thereafter.

Inventories -- Inventories, consisting of raw materials, work-in-progress and finished goods, are stated at the lower of cost or market with cost determined using the first-in, first-out method. The Company makes certain obsolescence and other assumptions to adjust inventory based on historical experience and current information. The Company writes down inventory for estimated obsolete or unmarketable inventory equal to the difference between the costs of inventory and estimated market value, based upon assumptions about future demand and market conditions. These assumptions, although consistently applied, can have a significant impact on current and future operating results and financial position.

Income taxes -- The Company records a valuation allowance to reduce its deferred tax assets to the amount that the Company believes is more likely than not to be realized. In the event the Company was to determine that it would be able to realize its deferred tax assets in the future in excess of its recorded amount, an adjustment to the deferred tax asset would increase income in the period such determination was made. Likewise, should the Company determine that it would not be able to realize all or part of its net deferred tax asset in the future, an adjustment to the deferred tax asset would be charged to income in the period such determination was made.

Impairment of assets -- The Company reviews all assets on a regular basis to ensure that there is no impairment in the carrying value. If the Company determines that there has been a permanent decline in, or the Company has become unable to recover the carrying value of the asset, an impairment charge will be recorded, which will have an adverse effect upon the Company's future operating results.

RECENT CHANGES IN ACCOUNTING STANDARDS

In June 2001, the Financial Accounting Standard Board (the "FASB") issued SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 142 provides that goodwill and other intangible assets with indefinite lives will not be amortized, but will be tested for impairment on an annual basis. This statement is effective for fiscal years beginning after December 15, 2001. The Company will adopt this statement on April 1, 2002 and the management is reviewing this statement to determine what effect they will have, if any, on its financial position and results of operations.

In August 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". This statement addresses the diverse accounting practices for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company will be required to adopt this standard on April 1, 2003. The Company is reviewing the statement to determine what effect it will have, if any, on its financial position and results of operations.

In August 2001, the FASB also issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets", that is applicable to financial statements issued for fiscal years beginning after December 15,

2001. The FASBs new rules on asset impairment supersede SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of", and portions of APB Option No. 30, "Reporting the Results for Operations". The statement requires a single accounting model for long-lived assets to be disposed of and significantly changes the criteria that would have to be met to classify an asset as held-for-sale. Classification as held-for-sale is an important distinction since such assets are not depreciated and are stated at the lower of fair value and carrying amount. The statement also requires expected future operating losses from discontinued operations to be displayed in the period(s) in which the losses are incurred, rather than as of the measurement date as presently required. The Company is reviewing the statement to determine what effect it will have, if any, on its financial position and results of operations.

In April 2002, the FASB also issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13, and Technical Corrections", to update, clarify, and simplify certain existing accounting pronouncements. Specifically, SFAS No. 145: (i) Rescinds SFAS No. 4, "Reporting Gains and Losses from Extinguishment of Debt", an amendment of APB Opinion No. 30, and SFAS No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements", which amended SFAS No. 4, as these two standards required that all gains and losses from the extinguishment of debt be aggregate and, if material, classified as an extraordinary item. Consequently, such gains and losses will now be classified as extraordinary only if they meet the criteria for extraordinary treatment set forth in APB Opinion 30, Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extra-ordinary, Unusual and Infrequently Occurring Events and Transactions; (ii) Rescinds SFAS No. 44, "Accounting for Intangible Assets of Motor Carriers", an amendment of Chapter 5 of Accounting Research Bulletins No. 43 and an interpretation of APB Opinions 17 and 30, because the discrete event to which the Statement relates is no longer relevant; (iii) Amends SFAS No. 13, "Accounting for leases", to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as such transactions; (iv) Makes certain technical corrections, which the FASB deemed to be non-substantive, to a number of existing accounting pronouncements. The provisions of SFAS No. 145 related to the rescission of SFAS No. 4 and No. 64 are effective for fiscal years beginning after May 15, 2002. The provisions related to the amendment of SFAS No. 13 are effective for transactions occurring after May 15, 2002. All other provisions of SFAS No. 145 are effective for financial statements issued on or after May 15, 2002. The Company adopted SFAS No. 145 during the year ended March 31, 2002 and it did not impact the Company's financial statements.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

DIRECTORS AND SENIOR MANAGEMENT

The directors and executive officers of the Company at June 28, 2002 are as follows:

Name	Age	Position(s) with Company
Lau Pui Hon (Richard Lau)	57	Chief Executive Officer and Chairman of the Board of Directors
Li Chin Pang (C. P. Li)	56	Executive Director and General Manager of Manufacturing and Administration for Plastic Operations, Chief Financial Officer, Secretary and Member of the Board of Directors
Leung Chi Wai (C. W. Leung)	47	Executive Director of Engineering for Plastic Operations and Member of the Board of Directors
Lee Shu Kwan (S. K. Lee)	56	Director of Administration and Marketing for Electronic Operations
Tam Man Chi (M. C. Tam)	52	Director of Engineering and Manufacturing for Electronic Operations
Dickson Lam	60	Director of Marketing for Plastic and Electronics Operations
Eliza Y. P. Pang	40	Financial Controller
Stephen K. Seung	55	Member of Board of Directors and Audit Committee
Hung-Hum Leung	56	Member of Board of Directors and Audit Committee

RICHARD LAU. Mr. Lau has served as Chief Executive Officer and Chairman of the Board of Directors of the Company and its predecessors since their inception in 1987.

C. P. LI. Mr. Li has served the Company as a Member of the Board of Directors and in various executive capacities with the Company and its predecessors since their inception in 1987. He became Secretary of the Company in February 1995 and Chief Financial Officer in May 1995. As Executive Director and General Manager of Manufacturing and Administration for Plastic Operations, Mr. Li is in charge of the day-to-day manufacturing and administrative operations for the Company's plastic products. Mr. Li received his Bachelor of Science degree from Chun Yan Institute College, Taiwan in 1967.

C. W. LEUNG. Mr. Leung has served the Company as a Member of the Board of Directors and in various executive capacities with the Company and its predecessors since their inception in 1987. As Executive Director of Engineering for Plastic Operations, Mr. Leung is in charge of the mold division and engineering for the Company's plastic manufacturing operations.

S. K. LEE. Mr. Lee has served as Director of Administration and Marketing for Electronic Operations since the Company acquired its majority interest in Kwanasia, Integrated's predecessor, in 1992 and has served as the Chief Executive Officer of Kwanasia and Integrated since Kwanasia's inception in 1986. As Director of Administration and Marketing for Electronic Operations, Mr. Lee is in charge of the Company's day-to-day administrative and marketing operations for electronic products. Mr. Lee received his Bachelor of Science degree in Electronic Engineering from National Taiwan University in 1967.

M. C. TAM. Mr. Tam has served as Director of Engineering and Manufacturing for Electronic Operations since the Company acquired its majority interest in Kwanasia, Integrated's predecessor, in 1992 and has served in a similar capacity for Kwanasia and Integrated since Kwanasia's inception in 1986. As Director of Engineering and Manufacturing for Electronic Operations, Mr. Tam is in charge of the Company's day-to-day contract manufacturing activities for electronic products. Mr. Tam received his Bachelor of Science degree with a major in physics and minor in electronics from the Chinese University of Hong Kong in 1973.

DICKSON LAM. Mr. Lam joined the Company as Director of Marketing in April 1990 and assumed the title of Director of Marketing for Plastic and Electronic Operations in August 2001. From 1983 until joining the Company, Mr. Lam managed Heng Shing Industrial Company, his own plastics manufacturing company, located in Hong Kong.

ELIZA Y. P. PANG. Ms. Pang, a registered fellow member of The Association of Chartered Certified Accountants, joined the Company as Financial Controller in January 1995. Prior to joining the Company, Ms. Pang worked for three and one-half years as Accounting Officer and Accountant in the Open Learning Institute and a textile manufacturing company in Hong Kong. She also worked for six years in the audit department of two multinational accounting firms, KPMG and Ernst & Young in Hong Kong. Ms. Pang received her Professional Diploma in Accountancy and her MBA degree from The Hong Kong Polytechnic University in 1985 and 1996, respectively.

STEPHEN K. SEUNG. Mr. Seung has been a director of the Company and member of the Audit Committee since July 1995. Mr. Seung is an attorney and since 1981 has been engaged in the private practice of law in New York, New York. Mr. Seung received a B.S. degree in Engineering from the University of Minnesota in 1969, an M.S. degree in Engineering from the University of California at Berkeley in 1971, an MBA degree from New York University in 1973 and a J.D. degree from New York Law School in 1979. Mr. Seung also serves the Company as its authorized agent in the United States.

HUNG-HUM LEUNG. Mr. Leung has been a director of the Company and member of the Audit Committee since December 1999. Mr. Leung has over 25 years of experience in the manufacture of electronic products. Mr. Leung was the founder of Sharp Brave Holdings Ltd., a Hong Kong public company listed on the Hong Kong Stock Exchange, and from 1991 to 1995 served as the Chairman of Sharp Brave Holdings Ltd. Since 1995, Mr. Leung has been an independent consultant to the electronics industry. He received his Bachelor of Science degree in Physics from the National Taiwan University in 1971.

No family relationship exists among any of the named directors, executive officers or key employees. No arrangement or understanding exists between any director or officer and any other persons pursuant to which any director or executive officer was elected as a director or executive officer of the Company.

COMPENSATION OF DIRECTORS AND SENIOR MANAGERS

Executive Officers

The aggregate amount of compensation (including non-cash benefits) paid by the Company and its subsidiaries during the year ended March 31, 2002 to all directors and executive officers as a group for services in all capacities was approximately $3,104,000 and excludes amounts paid by the Company to shareholders as dividends during the year ended March 31, 2002. For information concerning the Company's policy for dividends, see Item 8. Financial Information -- Dividend Policy.

Directors

From July 1995 to September 2000, it was the Company's policy to pay each director who was not an employee of the Company or any of its subsidiaries $500 per month. Since October 2000, it has been the Company's policy to pay each director who is not an employee of the Company or any of its subsidiaries $1,000 per month. The Company also reimburses such director all reasonable expenses incurred in connection with services as a director.

BOARD PRACTICES

The directors of the Company are elected at its annual meeting of shareholders and serve until their successors take office or until their death, resignation or removal. The executive officers serve at the pleasure of the Board of Directors of the Company.

The Audit Committee meets from time to time to review the financial statements and matters relating to the audit and has full access to management and the Company's auditors in this regard. The Audit Committee

recommends the engagement or discharge of the Company's independent accountants, consults on the adequacy of the Company's internal controls and accounting procedures and reviews and approves financial statements and reports. Deswell's audit committee consists of Messrs. Stephen Seung and Hung-Hum Leung.

The Company does not have a compensation or remuneration committee.

EMPLOYEES

At March 31, 2002, the Company employed 3,819 persons on a full-time basis, of which 37 were located in Hong Kong and 3,782 in China. Of the Company's employees 2,324, 1,005 and 490 were engaged in plastic injection molding manufacturing, contract electronic manufacturing and metal molds and parts manufacturing, respectively, at March 31, 2002. The Company has not experienced significant labor stoppages. Management believes that relations with the Company's employees are satisfactory.

SHARE OWNERSHIP

SHARE OWNERSHIP OF DIRECTORS AND SENIOR MANAGEMENT

For information concerning the beneficial ownership of the Company's common shares by Directors and Senior Management and major shareholders, see Item 7 of this Report.

EMPLOYEE STOCK OPTION PLANS

In 1995, the Company adopted its 1995 Stock Option Plan permitting the Company to grant options to purchase up to 450,000 common shares to employees, officers, directors and consultants of the Company. On September 29, 1997, the Company's Board of Directors and shareholders approved an increase of 244,000 shares in the number of shares that can be optioned and sold under the Option Plan bringing to a total of 694,000 shares the number of common shares that can be optioned and sold under the Option Plan. On August 15, 2001 the Board approved the adoption of the 2001 Stock Option Plan permitting the Company to grant options to purchase up to an additional 500,000 common shares to employees, officers, directors and consultants of the Company. On January 7, 2002 shar