

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark one)

- ☐ 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 March 31, 2022
OR
☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
OR
☐ SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report
For the transition period from _____ to _____

Commission File Number: 001-33900



DESWELL INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

British Virgin Islands
(Jurisdiction of incorporation or organization)

10B, Edificio Associacao Industrial De Macau
32 Rua do Comandante Mata e Oliveira, Macao
Special Administrative Region, PRC
(Address of Principal Executive Offices)

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Special Administrative Region, PRC
(Name, Telephone, E-mail and/or Facsimile number and
Address of Company Contact Person)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common shares, no par value	DSWL	NASDAQ

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

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

As of March 31, 2022, there were 15,935,239 common shares of the registrant outstanding.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

☐ Yes ☒ No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

☐ Yes ☒ No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) 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 (2) has been subject to such filing requirements for the past 90 days.

☒ Yes ☐ No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

☐ Yes ☒ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule12b-2 of the Exchange Act. (Check one):

Large accelerated ☐ Accelerated filer ☐ Non-accelerated filer ☒ Emerging Growth Company ☐

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards† provided pursuant to Section 13(a) of the Exchange Act. ☐

†The term “new or revised financial accounting standard” refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

Indicate by check mark whether the registrant has filed a report on and attestation to its management’s assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 USC. 762(b)) by the registered public accounting firm that prepared or issues its audit report. ☒

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP ☒ International Financial Reporting Standards as issued by the International Accounting Standards Board ☐ Other ☐

If “Other” has been checked, indicate by check mark which financial statement item the registrant has elected to follow: Item 17 ☐ Item 18 ☐

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule12b-2 of the Exchange Act).

☐ Yes ☒ No

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INTRODUCTION

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 Annual Report. The Company undertakes no obligation to 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.

Except where the context otherwise requires and for purposes of this Report only:

- “we,” “us,” “our Company,” “our,” the “Company” or “Deswell” refers to Deswell Industries, Inc. and, in the context of describing our operations, also include our operating subsidiaries;
- “shares” refer to our common shares, no par value;
- “China” or “PRC” refers to the People’s Republic of China, excluding, for purposes of this annual report only, Taiwan, Hong Kong and Macao;
- “Hong Kong” refers to the Hong Kong Special Administrative Region of the People’s Republic of China;
- “Macao” refers to the Macao Special Administrative Region of the People’s Republic of China;
- “BVI” refers to the British Virgin Islands;
- all references to:
 - £ renminbi,” “RMB” or yuan are to the legal currency of China, of which the yuan is the base unit;
 - £ “HK dollars” or “HK\$” are to the legal currency of Hong Kong;
 - £ “MOP\$” are to the legal currency of Macao;
 - £ “U.S. dollars,” “dollars,” “\$” or “U.S.\$” are to the legal currency of the United States; and
 - £ “fiscal year,” e.g., “fiscal 2022,” are to our year ended March 31 of the year(s) indicated.

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 “Report of Independent Registered Public Accounting Firm” included elsewhere herein. The Company publishes its financial statements in United States dollars. The functional currency of the Company and its subsidiaries is the U.S. dollar.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

Our Holding Company Structure

Deswell was incorporated in the British Virgin Islands on December 2, 1993. Deswell is not an operating company but rather a holding company conducting its operations through Deswell’s subsidiaries, primarily in Macao and mainland China. This structure involves unique risks to investors and you may never directly hold equity interests in Deswell’s operating entities. You are specifically cautioned that there are significant legal and operational risks associated with being based in or having the majority of operations in China. Specifically, the PRC government recently initiated a series of regulatory actions and made a number of public statements on the regulation of business operations in China, including cracking down on illegal activities in the securities market, enhancing supervision over China-based companies listed overseas using a Variable Interest Entity structure, adopting new measures to extend the scope of cybersecurity reviews, and expanding efforts in anti-monopoly enforcement. We do not believe that our subsidiaries in Macao or mainland China are directly subject to these regulatory actions or statements, as we have not carried out any monopolistic behavior and our business does not involve the collection of personal information or implicate national security. However, since these statements and regulatory actions by the PRC government are newly published and detailed official guidance and related implementation rules have not been issued or taken effect, uncertainties exist as to how soon the regulatory bodies in China will finalize implementation measures, and the impacts the modified or new laws and regulations will have on our daily business operation, the ability to accept foreign investments and list the Company’s securities on an U.S. or other foreign exchange. For a detailed description of risks relating to doing business in China, see “ITEM 3. Key Information — Risk Factors — Risks Related to Doing Business in China.”

The Holding Foreign Companies Accountable Act

The Holding Foreign Companies Accountable Act (the “HFCAA”) enacted in 2020, provides that if the auditor of a U.S. listed company’s financial statements is not subject to Public Company Accounting Oversight Board (the “PCAOB”) inspections for three consecutive “non-inspection” years, the Securities and Exchange Commission (the “SEC”) is required to prohibit the securities of such issuer from being traded on a U.S. national securities exchange, such as NYSE and Nasdaq, or in U.S. over-the-counter markets. On December 16, 2021, the PCAOB issued a report to notify the SEC of its determinations that it is unable to inspect or investigate completely registered public accounting firms headquartered in Mainland China, and identifies the registered public accounting firms in Mainland China that are subject to such determinations. Our auditor is identified by the PCAOB and is subject to the determination. Under the HFCAA, if the SEC determines that we have filed audit reports issued by a registered public accounting firm that has not been subject to inspection by the PCAOB for three consecutive years beginning in 2021, or for two consecutive years if proposed changes to the law are enacted, the SEC shall prohibit our shares from being traded on Nasdaq. The threat of being delisted, may materially and adversely affect the value of your investment. These risks could result in a material adverse change in our operations and the value of our shares, significantly limit or completely hinder our ability to continue to offer securities to investors, or cause the value of such securities to significantly decline or become worthless. For more details, see “ITEM 3. Key Information — Risk Factors — Risks Related to Doing Business in China — Our auditor, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.” and “ITEM 3. Key Information — Risk Factors — Risks Related to Doing Business in China — We could be delisted if we are unable to meet the PCAOB inspection requirements in time.”

Cash Flows through Our Organization

Deswell, the British Virgin Islands entity listed in the U.S., controls its operating subsidiaries in Macao and mainland China, through a number of British Virgin Islands subsidiaries and a Samoa subsidiary of Deswell (the “Intermediate Holding Companies”). See ITEM 4. “Information of the Company - Organizational Structure” for more details.

The funds of Deswell, the Intermediate Holding Companies and Macao subsidiaries are deposited in banks located in Hong Kong and Macao. The intercompany fund transfer between Deswell, the Intermediate Holding Companies and Macao subsidiaries is not limited by the laws of Hong Kong and Macao.

For the three years ended March 31, 2020, March 31, 2021 and March 31, 2022, Deswell paid dividends of \$2.39 million, \$2.86 million and \$3.19 million respectively to its investors. Deswell expects to pay cash dividends on a semi-annual basis based on the Company’s six-month results. Whether future dividends will be declared will depend upon the Company’s future growth and earnings, of which there can be no assurance. See ITEM 8. “Dividend Policy” for more details.

The cross-border transfer of funds from the Intermediate Holding Companies to its Chinese subsidiaries is legal and compliant with the laws and regulations of China. The Intermediate Holding Companies are permitted to provide funding to their subsidiaries in mainland China in the form of shareholder loans or capital contributions, subject to satisfaction of applicable government registration, approval and filing requirements of the respective jurisdiction. There are no quantity limits on capital contributions by the Intermediate Holding Company to the subsidiaries in mainland China under the PRC regulations. Historically, cash proceeds raised from overseas financing activities by Deswell have been first transferred to the Intermediate Holding Companies. Whenever we need to make capital contributions to the PRC subsidiaries by contributing any of such net proceeds, and convert the contributed proceeds into RMB, we will need to increase the PRC subsidiary’s registered capital by registering and/or filing the increase with the Ministry of Commerce or one of its local branches, the State Administration of Foreign Exchange (“SAFE”) or one of its local branches, or an authorized bank.

Current PRC regulations permit our PRC subsidiaries to pay dividends to their holding companies only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. Each of our PRC subsidiaries is required to set aside at least 10% of its after-tax profits after making up previous years' accumulated losses each year, if any, to fund certain statutory reserve funds until the total amount set aside reaches 50% of its registered capital. In addition, it may allocate a portion of its after-tax profits based on PRC accounting standards to discretionary reserve funds at its discretion. These reserves are not distributable as cash dividends. In addition, if any of our operating subsidiaries incurs debt on its own behalf in the future, the instruments governing such debt may restrict its ability to pay dividends. For more details, see "ITEM 5. Operating and Financial Review and Prospects — Liquidity and Capital Resources — Restricted net assets" To the best of our knowledge, current PRC regulations do not prohibit or limit using cash generated from one subsidiary to fund another subsidiary's operations. We currently do not have our own cash management policy and procedures that dictate how funds are transferred.

For the years ended March 31, 2020, 2021 and 2022, no dividend or distribution was made to Deswell or the Intermediate Holding Companies by our PRC subsidiaries. Accordingly, no withholding tax was recorded in the corresponding period.

For more details, see "ITEM 3. Key Information — Risk Factors — Risks Related to Doing Business in China — Due to restrictions under PRC law on distributions of dividends by our subsidiaries in the PRC, we may be forced to reduce the amount of, or not be able to pay, dividends to our shareholders.", "ITEM 3. Key Information — Risk Factors — Risks Related to Doing Business in China — PRC regulation of loans to and direct investment in PRC entities by offshore holding companies and governmental control of currency conversion may delay or prevent us from making loans to our PRC subsidiaries or making additional capital contributions to our wholly foreign-owned subsidiaries in China, which could materially and adversely affect our liquidity and our ability to fund and expand our business." and "ITEM 3. Key Information — Risk Factors — Risks Related to Doing Business in China — Restrictions on the convertibility of RMB into foreign currency may limit our ability to transfer excess funds or dividends to the Company's subsidiaries outside China."

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 Litigation 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 cautionary statements provided in this ITEM 3.

Summary of Risk Factors

- Our business operations may be materially and adversely affected by the outbreak of COVID-19.
- Uncertainty and adverse changes in the economy and financial markets have had, and could continue to have, an adverse impact on our business and operating results.
- We could suffer losses from corrupt or fraudulent business practices.
- We are, and have been, dependent on a few major customers, the loss of, or substantial reduction in orders from, which would substantially harm our business and operating results.
- Our gross margins fluctuate from year to year and may be adversely affected by a number of factors.
- We believe we were a passive foreign investment company, or "PFIC," for our fiscal year ended March 31, 2022 under U.S. income tax laws and may be a PFIC for years after fiscal 2022. If we were a PFIC in fiscal 2022, or are a PFIC in later years, U.S. investors could suffer adverse U.S. federal income tax consequences in such years.
- Changes in currency exchange rates have and could continue to influence our financial results significantly.
- If OEMs stop or reduce their manufacturing outsourcing, our business could suffer.

- We could experience credit problems with our customers, which could adversely impact our operating results and financial condition and could adversely reduce our future revenues.
- Because material amounts of our funds are held in banks where only limited protection on deposit accounts is required, the failure of any bank in which we deposit our funds could result in a loss of those funds to the extent exceeding the amounts protected and could, depending on the amount involved, affect our ability to continue in business.
- Our industry is extremely competitive, with aggressive pricing dynamics, and if we are not able to continue to provide competitive products and services, we may lose business.
- We have no long-term contracts to obtain plastic resins and our profit margins and operating results could suffer from an increase in resin prices.
- Shortages of components and materials used in our production of electronics products may delay or reduce our sales and increase our costs.
- We face inventory risks of obsolescence and impairment charges by providing turnkey manufacturing of electronic products.
- Our insurance coverage may not be adequate to cover losses related to major accidents, forces of nature or product liability risks.
- Our customers are dependent on shipping companies for delivery of our products and interruptions to shipping could materially and adversely affect our business and operating results.
- Protecting, seeking licenses for, or asserting claims over, intellectual property could be costly.
- We are dependent on customers operating in highly competitive markets and the inability of our customers to succeed in their markets can adversely impact our business, operating results and financial condition.
- Compliance with current and future environmental regulations may be costly and could impact our future operating results adversely.
- In the future, we may be required to write down long-lived assets and these impairment charges would adversely affect our future operating results.
- A material failure of internal control over financial reporting could materially impact the Company's financial results.
- Potential new accounting pronouncements or changes in interpretation by NASDAQ may adversely impact our future financial position and results of operations in the future.
- Our exemptions from certain of the reporting requirements under the Exchange Act limits the protections and information afforded to investors.
- 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.
- Adverse changes in political and economic policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could reduce the demand for our services and materially and adversely affect our competitive position.
- There may be a lack of remedies and impartiality under the Chinese legal system that prevents us from enforcing the agreements under which we operate our factories.
- You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing actions in the PRC against the Company, or our officers and our directors based on foreign laws.
- If our business licenses in China were not renewed, we would be required to move our operations out of China, which would impair our financial results, competitiveness and market position and jeopardize our ability to continue operations.
- The performance and reliability of the internet infrastructure and fixed telecommunication in China may affect our business operations.
- Due to restrictions under PRC law on distributions of dividends by our subsidiaries in the PRC, we may be forced to reduce the amount of, or not be able to pay, dividends to our shareholders.

- PRC regulation of loans to and direct investment in PRC entities by offshore holding companies and governmental control of currency conversion may delay or prevent us from making loans to our PRC subsidiaries or making additional capital contributions to our wholly foreign-owned subsidiaries in China, which could materially and adversely affect our liquidity and our ability to fund and expand our business.
- Uncertainties with respect to the PRC legal system could adversely affect us.
- Permissions required from the PRC authorities for our operations.
- Under China's EIT Law, we may be classified as a "resident enterprise" for PRC tax purposes, which may subject us to PRC enterprise income tax for any dividends we receive from our Chinese subsidiaries and to PRC income tax withholding for any dividends we pay to our non-PRC stockholders.
- Transactions between our subsidiaries may be subject to scrutiny by the PRC tax authorities. A finding that any of our China subsidiaries owe additional taxes, late payment interest or other penalties could adversely affect our operating results materially.
- Controversies affecting China's trade with the United States could harm our operations or depress our stock price.
- Heightened tensions in international relations, particularly between the United States and China, may adversely impact our business, financial condition, and results of operations.
- The economy of China has been experiencing significant growth, leading to inflation and increased labor costs. Increases in labor costs of workers in the PRC generally, and in the Province where our manufacturing facilities are located particularly, have had and can be expected to continue to have a material and adverse effect on our operating results.
- Future relocation of certain manufacturing lines may not be successful.
- Restrictions on the convertibility of RMB into foreign currency may limit our ability to transfer excess funds or dividends to the Company's subsidiaries outside China.
- Political and economic instability of Hong Kong and Macao could harm our operations.
- The PRC's national labor law restricts our ability to reduce our workforce if we conclude that we need to make future reductions.
- Power shortages in China could affect our business.
- China's U.S. stock market issues may raise investors' concerns.
- Our auditor, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.
- We could be delisted if we are unable to meet the PCAOB inspection requirements in time.
- Because our operations are international, we are subject to significant worldwide political, economic, legal and other uncertainties
- We depend on our executive officers, senior managers and skilled personnel.
- The concentration of share ownership in our senior management allows them to control the outcome of matters requiring shareholder approval.
- Our board's ability to amend our charter without shareholder approval could have anti-takeover effects that could prevent a change in control.
- Legislation enacted in the BVI as to Economic Substance may affect our operations.

General Risk Factors

Our business operations may be materially and adversely affected by the outbreak of COVID-19.

Since the end of 2019, COVID-19, a disease caused by a novel strain of coronavirus, has spread globally, and the World Health Organization declared the COVID-19 outbreak a pandemic in March 2020. Any such outbreak of epidemic illness or other adverse public health developments in China could materially and adversely affect our business, financial condition and results of operations as our Company's principal operations are located in China. Further, this outbreak has impacted the entire world, and has affected the global economy as well.

The COVID-19 outbreak has led to governments and other authorities around the world, including China, to impose measures intended to control its spread, including quarantines, restrictions on travel and public gatherings, and temporary closure of certain businesses and facilities. While still evolving, the COVID-19 pandemic, as well as efforts to contain it, has caused significant economic and financial disruptions around the world, including disruption on manufacturing operations, logistics and global supply chains and significant volatility and disruption of financial markets. Since early 2022, there has been a recurrence of COVID-19 outbreaks in certain provinces of China due to the Omicron variant and its sub-variants. As a result, similar emergency measures may have been implemented to contain further spread of COVID-19. Although currently in China, many restrictions have been lifted and the level of business activities are being restored in response to the significant decrease of new reported cases both in China and globally, the above mentioned conditions may continue and worsen in the near or longer term.

The global spread of COVID-19 continues to significantly increase economic and demand uncertainty, with increased fears of a global recession in the near future. Despite the Chinese government's efforts in reviving China's economy, China's economy experienced a significant slowdown in 2020 due to the COVID-19 outbreak, and while economic activity appeared to be rebounding in 2021, there remains uncertainty on how soon economic activity in China will rebound to the level prior to the COVID-19 pandemic. The global economy may continue to deteriorate in the future and have an adverse impact on China's economy, which may, among other things, exacerbate turbulence in commodity market, discourage or disrupt investment and production, increase total inventories of products in the industry, affect prices, and cause other adverse impacts on the industry we are in. An economic downturn including financial market disruption, or a market perception that this situation may occur or develop, may also cause increase of financing costs, or reduce or even diminish available sources of financing for operation or expansion.

The extent to which COVID-19 continues to impact raw material prices in 2022 and into 2023 will depend on the rate of inflation and future developments of the outbreak, including new information concerning the global severity of and actions taken to contain the outbreak, which are highly uncertain and unpredictable. We cannot foresee whether the continued outbreak of COVID-19 will be effectively contained, nor can we predict the severity and duration of its impact even with a vaccine now more widely available. If the continued outbreak of COVID-19, including any new strains of the virus or if additional waves of the virus hit China, is not effectively and timely controlled, our business operations and financial condition may be materially and adversely affected as a result of the deteriorating market outlook, the slowdown in China's economic growth, weakened liquidity and financial condition of our customers and other factors that we cannot foresee. Any of these factors, and other factors beyond our control, could have an adverse effect on the overall business environment, cause uncertainties in the regions where we conduct business, cause our business to suffer in ways that we cannot predict adversely impacting our employees and customers, and materially and adversely impact our business, financial condition and results of operations.

To date, our manufacturing facilities are under normal operations. We have been proactively following antivirus measures from provincial government agencies to protect the health and safety of our employees and such measures have helped in maintaining our steady production. However, we cannot assure that future closures or reductions of our operations or production may not be necessary in upcoming months as a result of business interruptions arising from protective measures being taken by governmental agencies or of other consequences of the COVID-19 outbreak and the impact of COVID-19 may exacerbate other risk factors discussed herein affecting our business, any of which could have a material effect on us. The emergence of the COVID-19 cases caused by the Omicron variants in the Yangtze Delta region in early 2022 also negatively affected the supply of certain parts for our productions. Our supply chain potentially exposes us to multiple potential sources of delivery failure or component shortages.

Uncertainty and adverse changes in the economy and financial markets have had, and could continue to have, an adverse impact on our business and operating results.

With COVID-19 infections still on the rise and inadequate vaccination progress in many countries and amid the war in Ukraine, causing rising energy, food and commodity prices, soaring inflation and tightening monetary policies stances by major central banks, the global growth outlook has weakened. The global economy is only projected to expand by 3.1 percent in 2022 based on the World Economic Situation and Prospects as of Mid-2022, published by the United Nations on May 18, 2022, compared to the project growth of 5.4 percent in 2021. Potential new waves of the pandemic and continued and/or intensification of the war in Ukraine have led to revised downward growth forecasts and a slowdown of the global economy may undermine a full, inclusive and sustainable recovery from the pandemic. With the global economic slowdown and the war in Ukraine, we are seeing increased prices with effects on food, energy and commodity prices, we believe that the global economy is facing a confluence of risks, such as shortages, an escalation of trade disputes, an abrupt tightening of global financial conditions, and intensifying climate risks. While economic activity in the commodity exporting countries, notably fuel exporters, was gradually recovering in 2021, the pandemic and war in Ukraine have effected this recovery and growth remains susceptible to volatile commodity prices. Our customers that were affected by commodity exports, in turn, were more conservative in ordering our products and services. There are continuing concerns over price instability, geopolitical issues, availability and cost of credit, stability of financial markets and sovereign nations. Uncertainty or adverse changes in the economy could negatively impact:

- the demand for our customers’ products,
- the amount, timing and stability of their orders to us,
- the financial strength of our customers and suppliers,
- our customers’ and suppliers’ ability or willingness to do business with us,
- our suppliers’ and customers’ ability to fulfill their obligations to us,
- the ability of our customers, our suppliers or us to obtain credit, secure funds or raise capital, or
- the prices at which we can sell our products and services, which, in turn, could adversely affect
- our ability to manage inventory levels effectively or collect receivables,
- our cash flow position,
- our net sales, gross margins and operating results; or
- otherwise adversely impact our results of operations, financial condition and liquidity.

We could suffer losses from corrupt or fraudulent business practices.

Corruption and other fraudulent practices remain a concern in China. We could suffer losses from fraudulent practices if we are not successful in implementing and maintaining preventative measures.

Risks Relating to Our Business and Industry

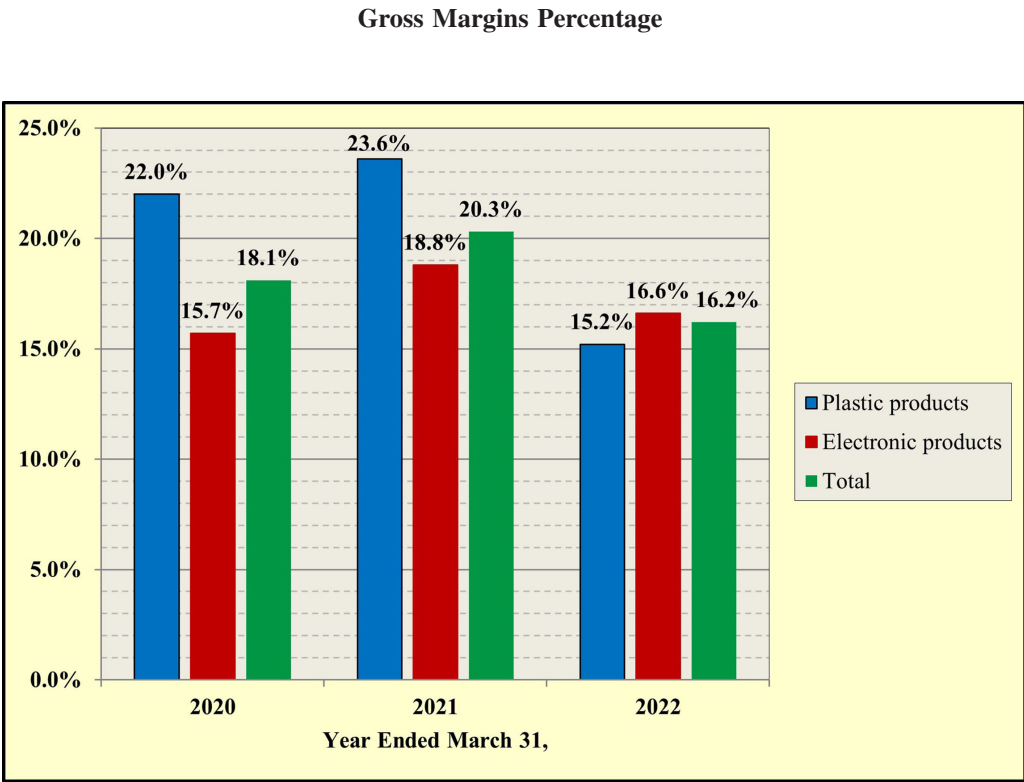
We are, and have been, dependent on a few major customers, the loss of, or substantial reduction in orders from, which would substantially harm our business and operating results.

Historically, we have depended, currently depend, and expect to continue to depend, on a small number of customers for a significant percentage of our net sales. During the year ended March 31, 2022, we had two major customers, each accounting for more than 10% of our net sales and together for 31.7% of our net sales. If our major customers experience a decline in the demand for their products as a result of the prevailing economic environment, COVID-19 or other factors, the products or services that we provide to them could be reduced or even terminated. The loss of any of our major customers or a substantial reduction in orders from any of them would adversely impact our sales and operating results unless and until we were able to increase sales from other existing customers or add sales from new customers.

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 has fluctuated in the past and may fluctuate in future. We cannot assure you that present or future customers will not cease using us as the source of the injection-molded plastic parts and components we manufacture, for electronic manufacturing services of electrical products and subassemblies or significantly change, reduce or delay the amount of products and services ordered from us.

Our gross margins fluctuate from year to year and may be adversely affected by a number of factors.

The following chart shows, for the years indicated, our gross margins from our two principal operating segments and for our Company as a whole:



We expect gross margins generally and for specific products to continue to fluctuate from year to year. Fluctuations in our margins have been affected, often adversely, and may continue to be affected, by numerous factors, including:

- our cost of raw materials, especially our cost of electronic components due to changes in the prices, availability and long lead time of components and parts needed for the manufacturing of electronic products;
- costs of labor, particularly in recent years, when such costs have increased substantially as a consequence of increasing governmental regulation directed at labor practices and policies;
- the appreciation of the exchange rate of the RMB, in which we pay our labor and manufacturing costs, against the U.S. dollar, in which we present our financial statements;
- changes in our customer mix or the mix of higher and lower margin products, or a combination of both in any year;
- price increases for products which, for competitive reasons, we choose to allow as concessions in an effort to maintain our customer base;
- increases in value-added taxes as result of changes in the value-added tax policy of the Chinese government for various categories of export products; and
- increased costs to conform our products to consumer and product safety laws and regulations of the various countries in which our products are sold.

If we cannot maintain stability in our gross margins, our operating results could suffer, dividend payments to shareholders may be decreased or eliminated, our financial position may be harmed and our stock price may fall.

We believe we were a passive foreign investment company, or “PFIC,” for our fiscal year ended March 31, 2022 under U.S. income tax laws and may be a PFIC for years after fiscal 2022. If we were a PFIC in fiscal 2022, or are a PFIC in later years, U.S. investors could suffer adverse U.S. federal income tax consequences in such years.

The determination of whether we are a passive foreign investment company, or PFIC, in any taxable year is made on an annual basis after the close of that year and depends on the composition of our income and the nature and value of our assets. Specifically, we will be classified as a PFIC if, after applying relevant look-through rules with respect to the income and assets of subsidiaries, either (i) 75% or more of our gross income for such taxable year is passive income, or (ii) 50% or more of the value of our assets (based on an average of the quarterly values of the assets during such year) is attributable to assets that either produce passive income or are held for the production of passive income (the “PFIC asset test”).

We believe that we were a PFIC for our year ended on March 31, 2022 and may also be a PFIC in subsequent tax years. If we are a PFIC for any year during a U.S. Holder’s holding period of our common shares, then such U.S. Holder generally could be subject to adverse U.S. tax consequences including the requirement to treat any “excess distribution” received on our common shares, or any gain realized upon a disposition of such common shares, as ordinary income and to pay an interest charge on a portion of such distributions or gain.

Because of the complexity of the issues regarding our classification as a PFIC, U.S. investors are urged to consult their own tax advisors for guidance as to our PFIC status. For further discussion of the adverse U.S. federal income tax consequences arising from the classification as a PFIC, please see “United States Federal Income Tax — Passive Foreign Investment Company (PFIC)” in ITEM 10 Additional Information beginning on page 56 of this Report.

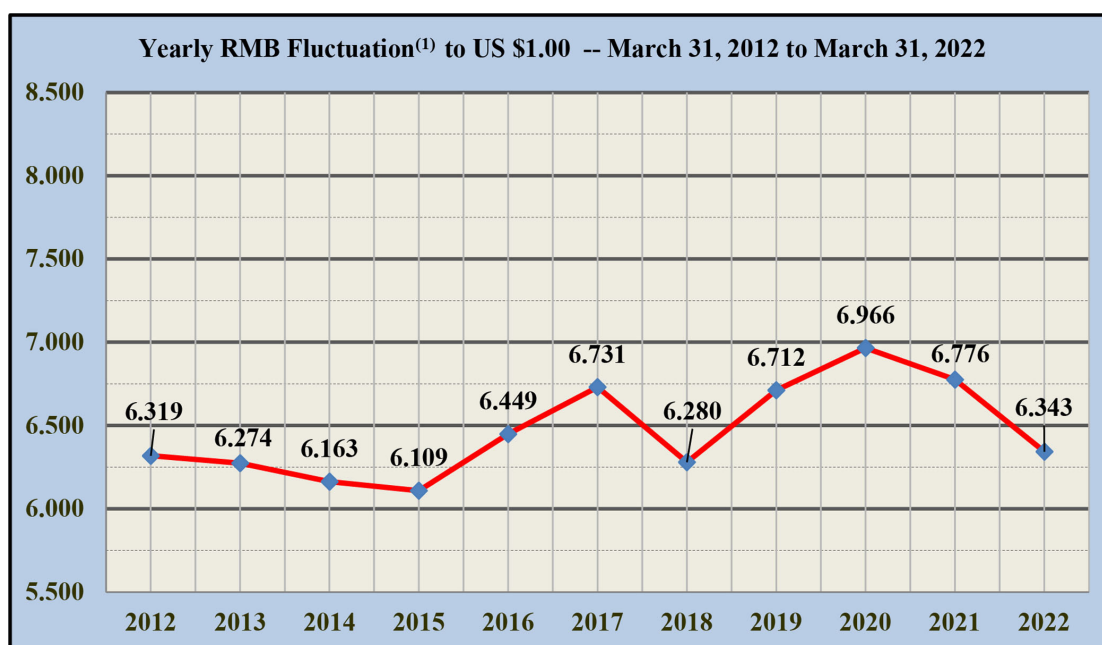
Changes in currency exchange rates have and could continue to influence our financial results significantly.

Our sales are mainly in United States dollars and Hong Kong dollars and our expenses are mainly in United States dollars, Hong Kong dollars and Chinese RMB.

The Hong Kong dollar has been pegged to the U.S. dollar at approximately 7.80 and is relatively stable. The Hong Kong 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 and has not in the past presented a material currency exchange risk. Although announcements by Hong Kong’s central bank indicate its intention to maintain the currency peg between the Hong Kong dollar and the U.S. dollar, if Hong Kong does change and follows China to a floating currency system or otherwise changes the exchange rate system of Hong Kong dollars to U.S. dollars, our margins and financial results could be adversely affected.

Between 1994 and July 2005, the market and official RMB rates were unified and the value of the RMB was essentially pegged to the U.S. dollar and was relatively stable. On July 21, 2005, the People’s Bank of China adjusted the exchange rate of RMB to the U.S. dollar by linking the RMB to a basket of currencies and simultaneously setting the exchange rate of RMB to U.S. dollars, from 1:8.27, to a narrow band of around 1:8.11.

The chart below illustrates the fluctuations since the July 31, 2005 adjustment of the RMB to the U.S. dollar by showing the exchange ratio at the end of each of Deswell’s fiscal years from March 31, 2006 to March 31, 2022. Because most of the Company’s labor costs are incurred in China and therefore paid in RMB, the adverse effect on Deswell’s business and financial results from increasing labor costs has in previous years been exacerbated by the appreciation in the exchange rate to the U.S. dollar.



(1) RMB (yuan) to U.S. dollar data presented in this chart are the midpoint rates on March 31 of the year indicated as reported by “Historical Exchange Rates” at <http://www.oanda.com/currency/historical-rates/>.

The appreciation and depreciation in the exchange ratio of the RMB to the U.S. dollar increases and decreases, respectively, our costs and expenses to the extent paid in RMB. Of all of the costs and expenses for the PRC entities, which accounted for 94.5% of the Company total, about 37.0%, 36.9% and 31.9% were in RMB during the years ended March 31, 2020, 2021 and 2022, respectively.

Since the PRC government enacted reform in its RMB exchange rate regime, the RMB has appreciated against the U.S. dollar since 2007 to 2015, resulting an adverse effect on the Company’s financial results. However, this trend has become unstable since 2015 to 2018. The RMB then has become depreciated again the U.S. dollar since 2018 to early 2020. The Company’s financial results have been benefited from this depreciation trend. Nonetheless, there is no overturn in the U.S.-China relations since the inauguration of Joseph Biden as the new U.S. President. In fact, the Biden administration continues to place sanctions on Chinese telecom companies, financial sanctions on Chinese officials and challenge China’s human rights policy and administration over Hong Kong. It is difficult to predict how the situation between the United States and Chinese government will develop, which in turn affect the exchange rate between the dollar and RMB.

If OEMs stop or reduce their manufacturing outsourcing, our business could suffer.

Our revenues depend on outsourcing by OEMs to us and to other contract manufacturers for which we manufacture end-products or parts and components. Current and prospective customers continuously evaluate our capabilities against other providers as well as against the merits of manufacturing products themselves. Our business would be adversely affected if OEMs decide to perform these functions internally. Similarly, we depend on new outsourcing opportunities to militate against lost revenues arising from the decline in demand for our customers’ products as a consequence of prevailing global economic conditions, and our business would be adversely affected if we are not successful in gaining additional business from these opportunities or if OEMs do not outsource additional manufacturing business.

We could experience credit problems with our customers, which could adversely impact our operating results and financial condition and could adversely reduce our future revenues.

We manufacture and sell injection-molded plastic parts and components and provide manufacturing services for electrical products and subassemblies to companies and industries that have in the past, and may in the future, experience financial difficulty, particularly in light of recent conditions in the credit markets and the overall worldwide economy. For information on the concentration of our credit risk, see Note 15 of Notes to Consolidated Financial Statements included later in this Report.

If our customers experience financial difficulty, we could have problems recovering amounts owed to us from these customers, or demand for our products and services from these customers could decline. If one or more of our customers, particularly customers to which we have extended substantial credit and which have become material account debtors on our accounts receivables, were to become insolvent or otherwise were unable to pay for the products or services provided by us on a timely basis, or at all, our operating results and financial condition could be adversely affected. Such adverse effects could include one or more of the following:

- provision or increased provision for credit losses,
- a charge for inventory write-offs,
- a reduction in revenue,
- decreases in cash, and
- increases in working capital requirements.

Because material amounts of our funds are held in banks where only limited protection on deposit accounts is required, the failure of any bank in which we deposit our funds could result in a loss of those funds to the extent exceeding the amounts protected and could, depending on the amount involved, affect our ability to continue in business.

At March 31, 2022, we had cash on hand of \$13.5 million and time deposits with original maturity over three months of \$4.4 million, which were invested in interest bearing investments at banks or other financial institutions. Of that amount, approximately \$2.6 million was held in banks and other financial institutions in Hong Kong, \$4.5 million in Macao and \$10.8 million in the PRC. The Hong Kong government provides deposit protection up to a maximum amount of HK\$500,000 (approximately U.S.\$63,723 based on the midpoint exchange rate for June 30, 2022 reported by “Historical Exchange Rates” at <http://www.oanda.com/fx-for-business/historical-rates>) for each depositor in any individual bank in Hong Kong, and the Macao government provides deposit protection up to a maximum amount of MOP\$500,000 (approximately U.S.\$61,867 based on the midpoint exchange rate for June 30, 2022 reported by “Historical Exchange Rates” at <http://www.oanda.com/fx-for-business/historical-rates>) for each depositor with any individual bank in Macao. We understand that in the event of a bank failure of a bank in the PRC, a PRC-government agency is to provide some, unspecified, protections of deposit accounts to individual depositors. After three interest rate hikes in 2011, there were recommendations in early 2012 from China’s economists that a formal insurance system from China’s central bank is necessary to protect depositors’ assets. On May 1, 2015, the new “Deposit Insurance Regulations” became effective in the PRC and provide that the maximum protection would be up to RMB500,000 (including principal and interest) per depositor per insured financial institution. Depending upon the amounts of funds we have on deposit in a Hong Kong, Macao or PRC financial institution that fails, our inability to have immediate access to our cash, and the lack of deposit protection in excess of applicable protection limits, could impair our operations, and, if we are not able to access needed funds to pay our suppliers, employees and other creditors, we may be unable to continue in business.

Our industry is extremely competitive, with aggressive pricing dynamics, and if we are not able to continue to provide competitive products and services, we may lose business.

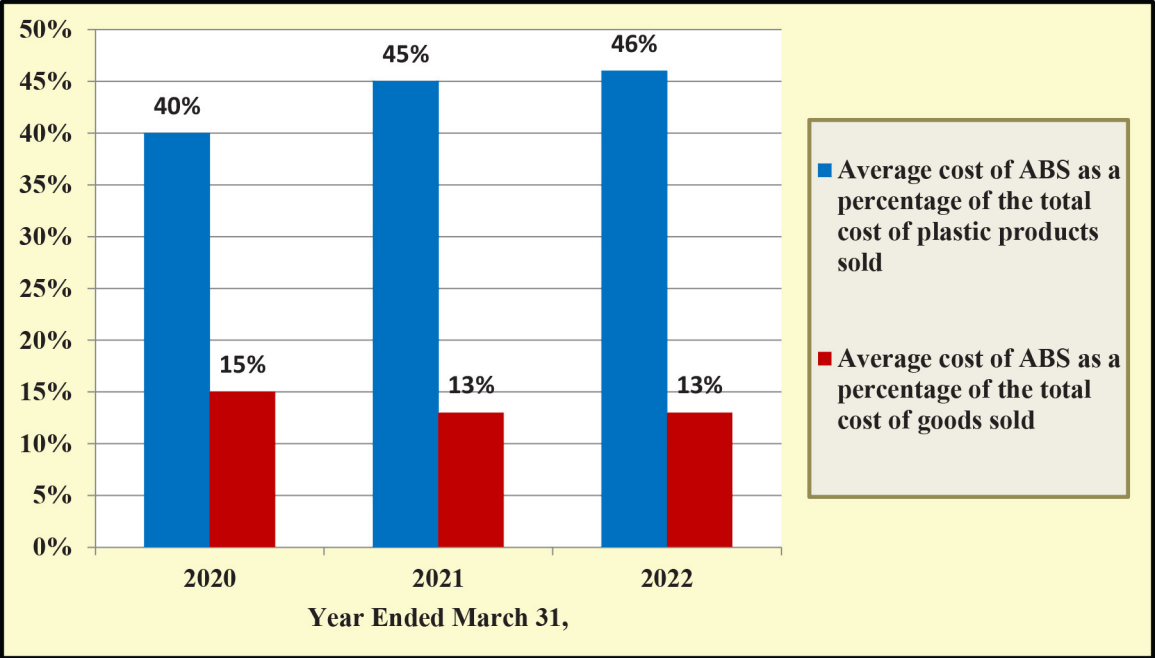
We compete with a number of different companies in production of injection-molded plastic parts and components, electrical products and subassemblies and metallic molds and accessories. For example, we compete with Asian-based manufacturers and/or suppliers of injection-molded plastic parts and components, major global electronic manufacturing services (“EMS”) providers, other smaller EMS companies that have a regional or product-specific focus, and original design manufacturers with respect to some of the services that we provide. We also compete with our current and prospective customers, who evaluate our capabilities in light of their own capabilities and cost structures. Our market segments are extremely competitive, many of our competitors have achieved substantial market share and many have lower cost structures and greater manufacturing, financial or other resources than we do. We face particular competition from Asian-based competitors, including Taiwanese EMS providers which compete in our end markets. If we are unable to provide comparable manufacturing services and improved products at lower cost than the other companies in our market, our net sales could decline.

Uncertainty and adverse changes in the economy and financial markets may also increase the competitive environment in our market segments which could also impact our operating results. In addition, the EMS industry is currently experiencing excess manufacturing capacity and has seen increased competition. To stay technologically competitive, we have replaced some of our existing manufacturing machineries with up to date and advanced ones in order to enhance efficiency, precision, quality as well as productivity.

Nonetheless, the above factors have exerted and will continue to exert additional pressures on pricing for injection-molded plastic parts and components and for our electronic manufacturing services, thereby increasing the competitive pressures in our market segments generally. We may not be able to compete successfully against our current and future competitors, and the competitive pressures we face may have a material adverse effect on us.

We have no long-term contracts to obtain plastic resins and our profit margins and operating results 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, 2020, 2021 and 2022:



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. Over the past several years, oil prices have experienced significant volatility. In addition, 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 operating margins. A significant increase in resin prices in the future could likewise adversely affect our operating margins and results of operations.

Shortages of components and materials used in our production of electronics products may delay or reduce our sales and increase our costs.

From time to time, we have experienced shortages of some of the electronic components that we need and use in our electronics manufacturing market segment. These shortages can result from strong demand for those components or from problems experienced by suppliers. These unanticipated component shortages could result in curtailed production or delays in production, which may prevent us from making scheduled shipments to customers. Our inability to make scheduled shipments could cause us to experience a reduction in sales, increase in inventory levels and costs, and could adversely affect relationships with existing and prospective customers. Component shortages may also increase our cost of goods sold because we may be required to pay higher prices for components in short supply and redesign or reconfigure products to accommodate substitute components. As a result, component shortages could adversely affect our operating results. Our performance depends, in part, on our ability to incorporate changes in component costs into the selling prices for our products.

Certain of the electronic products we manufacture, particularly those for customers whose orders are widely spaced at irregular intervals for small lots of customized products, require components from single-source or customer-designated suppliers. Shortages of specific components often result in the suppliers allocating available quantities among their customers based on volume and purchasing history. Generally, we lack sufficient bargaining power with these suppliers to assure a stable supply of needed components. Delays in our obtaining, or our inability to obtain, these materials could slow production, delay shipments to our customers, increase our costs and hamper our operating results.

We face inventory risks of obsolescence and impairment charges by providing turnkey manufacturing of electronic products.

We conduct most of the manufacturing of electronic products for our customers on a “turnkey” basis, where we mainly take care of materials procurement, as well as product design and development for customers’ selection and collaboration. Turnkey manufacturing involves greater resource investment and inventory risk management than consignment manufacturing, where the customer provides the components and materials needed to manufacture the products it orders. If we fail to manage our inventory effectively, we may bear the risk of fluctuations in materials costs, scrap and excess inventory, all of which can have an adverse impact on our business, financial condition and results of operations. In addition, delays, cancellations or reductions of orders by our customers could result in an excess of materials. An excess of components and materials would increase our costs of maintaining inventory and may increase the risk of inventory obsolescence and impairment charges, which may increase our costs and decrease operating margins and otherwise harm our operating results.

Periods in which we receive rapid increases in orders with the lengthening of lead times by suppliers could cause a shortage of materials needed for us to fulfill orders received from customers expecting normal or accelerated delivery. A shortage of materials could lengthen production schedules and costs substantially, particularly for orders from our customers placed for short-term or rapid delivery and could force us to seek and purchase needed components at premium prices, which would increase our costs of goods sold and reduce our operating margins.

Our insurance coverage may not be adequate to cover losses related to major accidents, forces of nature or product liability risks.

Risks associated with our business include risk of damage to our stock in trade, goods and merchandise, furniture and equipment and factory buildings in China. At March 31, 2022, we maintained fire, casualty and theft insurance aggregating approximately \$141 million covering damages to fixed and movable assets, equipment, manufacturing facilities in China and furniture and fixtures at our facilities. 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, forces of nature, such as major earthquakes, which are common in China, or other natural disasters. We may experience difficulty or delays in receiving compensation from the insurance companies and may not receive insurance proceeds adequate to compensate us fully for a potential loss. Although we maintain insurance addressing damage to and destruction to our facilities and equipment, we do not have business interruption insurance.

Despite quality assurance measures, there remains a risk that defects may occur in our products. The occurrence of any defects in our products could give rise to liability for damages caused by such defects. They could, moreover, impair the market’s acceptance of our products. At March 31, 2022, we had only limited product liability insurance. Although we have not experienced any product quality claims from significant customers, if future claims do arise, costs to defend, adverse judgments or amounts we may be forced to pay in settlement would increase our expenses. If we incur losses which are not covered under our insurance, or the amount of compensation that we receive from the insurer is significantly less than the actual loss, our financial condition and results of operations could be materially and adversely affected.

Our customers are dependent on shipping companies for delivery of our products and interruptions to shipping could materially and adversely affect our business and operating results.

Generally, we sell our products F.O.B. Hong Kong or F.O.B. China and our customers are responsible for the transportation of products from Hong Kong or China to their final destinations. Our customers rely on a variety of carriers for product transportation through various world ports. A work stoppage, strike or shutdown of one or more major ports or airports could result in shipping delays materially and adversely affecting our customers, which in turn could have a material adverse effect on our business and operating results. Similarly, an increase in freight surcharges due to rising fuel costs or general price increases could materially and adversely affect our business and operating results.

Protecting, seeking licenses for, or asserting claims over, intellectual property could be costly.

We usually rely on trade secrets, industry expertise and the sharing with us by our customers of their intellectual property. However, there can be no assurance that intellectual property that we use in our business does not violate rights in such property belonging to others. We may be notified that we are infringing patents, copyright or other intellectual property rights owned by other parties. In the event of an infringement claim, we may be required to spend a significant amount of money to develop a non-infringing alternative or to obtain licenses. We may not be successful in developing alternatives or in obtaining licenses on reasonable terms, if at all. Any litigation, even without merit, could result in substantial costs and could adversely affect our business and operating results.

Our strategy has been to evaluate trade names and trademarks, and to consider seeking patents, where we believe that such trade names, trademarks or patents would be available and adequate to protect our rights to products or processes that we consider material to our business. To the extent we do seek to obtain trade names, trademarks or patents, we may be required to institute litigation in order to enforce them or other intellectual property rights to protect our business interests. Such litigation could result in substantial costs and could adversely affect sales, financial results and growth.

We are dependent on customers operating in highly competitive markets and the inability of our customers to succeed in their markets can adversely impact our business, operating results and financial condition.

The end markets we serve can experience major swings in demand which, in turn, can significantly impact our operations. Our financial performance depends on our customers' ability to compete and succeed in their markets, which have been, and could continue to be, affected directly by prevailing global economic conditions. The majority of our customers' products are characterized by rapid changes in technologies, increased standardization of technologies and shortening of product lifecycles. In many instances, our customers have experienced severe revenue erosion, pricing and margin pressures, and excess inventories during recent years.

Compliance with current and future environmental regulations may be costly and could impact our future operating results adversely.

The laws and regulations related to environmental protection have been tightening in recent years in China and in our end markets, requiring production facilities that may cause pollution or produce other toxic materials to take steps to protect the environment and establish an environmental protection and management system. When an entity fails to adopt preventative measures or control facilities that meet the requirements of environmental protection standards, it is subject to suspension of production or operations and for payment of fines. Compliance with relevant laws and regulations can be costly and disrupt operations.

Our operations create some environmentally sensitive waste that may increase in the future depending on the nature of our manufacturing operations. The general issue of the disposal of hazardous waste has received increasing attention from Chinese national and local governments and foreign governments and agencies and has been subject to increasing regulation. Currently, relevant Chinese environmental protection laws and regulations impose fines on discharge of waste materials and empower certain environmental authorities to close any facility which causes serious environmental problems. Although it has not been alleged that we have violated any current environmental regulations by China government officials, the Chinese government could amend its current environmental protection laws and regulations. Our business and operating results could be materially and adversely affected if we were to increase expenditures to comply with environmental regulations affecting our operations.

In addition, we could face significant costs and liabilities in connection with product take-back legislation, which enables customers to return a product at the end of its useful life and charge us with financial and other responsibility for environmentally safe collection, recycling, treatment and disposal. We also face increasing complexity in our product design and procurement operations as we adjust to requirements relating to the materials composition of electronic products. If our products are not compatible with such requirements, we could experience the loss of revenue, damages to our reputation, diversion of resources, monetary penalties, and legal action. Other environmental regulations may require us to reengineer our products to utilize components that are more environmentally compatible. Such reengineering and component substitution may result in additional costs to us. Although we currently do not anticipate any material adverse effects based on the nature of our operations and the effect of such laws, there is no assurance that such existing laws or future laws will not have a material adverse effect on us.

In the future, we may be required to write down long-lived assets and these impairment charges would adversely affect our future operating results.

As of March 31, 2022, our balance sheet included approximately \$27.0 million in long-lived assets. Under applicable accounting rules, we review long-lived assets, such as property, plant, and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Valuation of our long-lived assets requires us to make various assumptions and these assumptions are used to forecast future, undiscounted cash flows. If actual market conditions differ or our forecasts change, we may be required to reassess long-lived assets and could record an impairment charge. If we are required to take substantial impairment charges in future periods, our earnings would be decreased or our losses would be increased in the period or periods in which the charges occur.

A material failure of internal control over financial reporting could materially impact the Company’s financial results.

In designing and evaluating its internal control over financial reporting, management recognizes that any internal control or procedure, no matter how well designed and operated, can provide only reasonable assurance of achieving desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Management believes that the Company’s internal control over financial reporting currently provides reasonable assurance of achieving their control objectives. However, no system of internal controls can be designed to provide absolute assurance of effectiveness. See ITEM 15 “Controls and Procedures” later in this Report. A material failure of internal control over financial reporting could materially impact the Company’s reported financial results and the market price of its stock could significantly decline. Additionally, adverse publicity related to a material failure of internal control over financial reporting could have a negative effect on the Company’s reputation and business.

Potential new accounting pronouncements or changes in interpretation by NASDAQ may adversely impact our future financial position and results of operations in the future.

We prepare our financial statements in conformity with the generally accepted accounting principles of the United States of America “U.S. GAAP.” A change in these accounting principles and policies, especially as interpreted by the Securities and Exchange Commission and The NASDAQ Stock Market, may have an impact on our future financial position and results of operations. Historically, regulatory changes, such as the requirement of the Financial Accounting Standards Board to expense stock options grants, and other legislative initiatives have increased our general and administrative costs and future changes could have a similar adverse impact on our financial results.

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 amended (the “Exchange Act”). As a foreign private issuer, we are exempt or excluded 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;
- 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); and
- Regulation FD, the SEC’s rules regulating disclosure of information by publicly traded companies and other issuers and requiring that when an issuer discloses material nonpublic information to certain individuals or entities such as stock analysts, or holders of the issuer’s securities who may trade on the basis of the information, the issuer must make public disclosure of that information.

In addition, because we are a “controlled company” under the NASDAQ Marketplace Rules, certain of the corporate governance standards of The NASDAQ Stock Market that are applied to domestic companies having securities included on The NASDAQ Stock Market are not applicable to us. For example, as a controlled company we are exempt from certain corporate governance provisions of sections 5600 *et seq.* of NASDAQ’s Marketplace Rules. We rely on exemptions from the following NASDAQ Marketplace Rules:

- *Rule 5605(b)(1)*: Our board is not comprised of a majority of independent directors.
- *Rule 5605(d)*: Our board does not have a compensation committee and compensation of our Chief Executive Officer and other executive officers is neither determined nor recommended to the board by a majority of our independent directors. For information regarding why we do not have an independent compensation committee, see the discussion under “Other Committees; NASDAQ Compliance” in ITEM 6 “Directors and Senior Management” of this Report.
- *Rule 5605(e)*: Nominees for appointment as our directors are not selected or recommended by either a majority of our independent directors, or a nominating committee composed solely of independent directors, and we do not have a formal written charter addressing the nominations process.

Because of these exemptions or exclusions, investors are not afforded the same protections or information generally available to investors in public companies organized in the United States and having securities included on the NASDAQ Stock Market.

Risks Relating to Doing Business in China

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.

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. 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.

Adverse changes in political and economic policies of the PRC government could have a material adverse effect on the overall economic growth of China, which could reduce the demand for our services and materially and adversely affect our competitive position.

The PRC economy differs from the economies of most developed countries in many respects, including the amount of government involvement, the level of development, the growth rate, the control of foreign exchange and allocation of resources. Although the Chinese economy is no longer a planned economy, the PRC government continues to exercise significant control over China's economic growth through direct allocation of resources, monetary and tax policies, and a host of other government policies such as those that encourage or restrict investment in certain industries by foreign investors, control the exchange between RMB and foreign currencies, and regulate the growth of the general or specific market. Some of the government measures while benefiting the overall Chinese economy, may have a negative effect on and materially and adversely affect our financial conditions, results of operation and our overall competitive position.

While the PRC economy has grown significantly over the past several decades, the growth has been uneven across different periods, regions and among various economic sectors of China, and the rate of growth has been slowing. Any slowdown in the economic growth of China could lead to reduced demand, which could materially and adversely affect our business's financial condition and results of operations.

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

We do not own the land on which our factories in China are located. We occupy our manufacturing facilities under land use agreements or under tenancy agreements with the local Chinese government. These 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 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.

You may experience difficulties in effecting service of legal process, enforcing foreign judgments or bringing actions in the PRC against the Company, or our officers and our directors based on foreign laws.

We are incorporated in the BVI and have subsidiaries incorporated in the BVI, Macao, Hong Kong, Samoa and China. We conduct substantially all of our operations in China and a substantial portion of our assets are located in China. In addition, many of our executive officers and directors do not reside in the U.S. Some or all of the assets of these persons are not located in the U.S. As a result, it may not be possible for you to effect service of process within the U.S. or elsewhere outside of China upon us or our directors and executive officers, including with respect to matters arising under U.S. federal securities laws or applicable state securities laws.

It may also be difficult or impossible for you to bring an action against us or against our directors and executive officers in the BVI or in China in the event that you believe that your rights have been infringed under the securities laws or otherwise. There is uncertainty as to whether the courts of the BVI or China would (i) recognize or enforce judgments of U.S. courts against us or our executive officers and directors that are predicated upon the civil liability provisions of the securities laws of the U.S. or the securities laws of any state in the U.S., or (ii) entertain original actions brought in the BVI or China against us or our executive officers and directors that are predicated upon the federal securities laws of the U.S. or the securities laws of any state in the U.S. Even if you are successful in bringing an action of this kind, the laws of the BVI and of China may render you unable to enforce a judgment against our assets or the assets of our directors and executive officers.

The recognition and enforcement of foreign judgments are provided for under the PRC Civil Procedures Law. PRC courts may recognize and enforce foreign judgments in accordance with the requirements of the PRC Civil Procedures Law and other applicable laws, regulations and interpretations based either on treaties between China and the country where the judgment is made or on principles of reciprocity between jurisdictions. China does not have any treaties or other forms of written arrangement with the U.S. that provide for the reciprocal recognition and enforcement of foreign judgments. In addition, according to the PRC Civil Procedures Law, the PRC courts will not enforce a foreign judgment against us or our officers and directors if they decide that the judgment violates the basic principles of PRC laws or national sovereignty, security or the public interest. As a result, it is uncertain whether and on what basis a PRC court would enforce a judgment rendered by a court in the U.S.

As a result of all of the above, our shareholders may have more difficulty in protecting their interests through actions against our management, officers, directors or major shareholders than would shareholders of a corporation incorporated in a jurisdiction in the U.S.

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

Our activities in China require business licenses, the scope of which is limited to our present activities, and require 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, grant or renew our licenses or grant or renew licenses to expand our existing activities. 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 financial results would be substantially impaired, our competitiveness and market position would be materially jeopardized and we may not be able to continue operations.

The performance and reliability of the internet infrastructure and fixed telecommunication in China may affect our business operations.

Almost all access to the internet in China is maintained through state-owned telecommunication operators under the administrative control and regulatory supervision of the Ministry of Industry and Information Technology, or the MIIT. Our business operations depend on the performance and reliability of the internet infrastructure and the fixed telecommunication service provided in China. The internet infrastructure in China may not support the demands associated with continued growth in internet usage generally or for our business purposes and we may not have access to alternative networks in the event of disruptions, failures or other problems.

Due to restrictions under PRC law on distributions of dividends by our subsidiaries in the PRC, we may be forced to reduce the amount of, or not be able to pay, dividends to our shareholders.

Under the PRC Income Tax Law and the implementation rules, only distributable profits earned by PRC entities can be distributed. The calculation of distributable profits under accounting principles and financial regulations applicable to PRC enterprises differs in many ways from U.S. GAAP. Our subsidiaries in the PRC are also required to reserve 10% of their profits for future development and staff welfare, which amounts are not distributable as dividends. These rules and possible changes to them could restrict our PRC subsidiaries from repatriating funds ultimately to us and our stockholders as dividends.

Under the unified enterprise income tax law (“EIT Law”), profits of the PRC entities earned on or after January 1, 2008 and distributed to the Company are subject to withholding tax at a rate of 10%, unless the Company is deemed a resident enterprise for tax purposes, or is incorporated in a country which has a tax treaty with PRC that provides for a different withholding arrangement. As a result of this PRC withholding tax, amounts available to us in earnings distributions from our PRC enterprises have been reduced. Since we derive the funds distributed to shareholders from our subsidiaries in the PRC, the reduction in amounts available for distribution from our PRC enterprises could, depending on the income generated by our PRC subsidiaries, force us to reduce, or possibly eliminate, the dividends we have paid to our shareholders historically. For this reason, or other factors, we may decide not to declare dividends in the future. If we do pay dividends, we will determine the amounts when they are declared and even if we do declare dividends in the future, we may not continue them in any future period.

PRC regulation of loans to and direct investment in PRC entities by offshore holding companies and governmental control of currency conversion may delay or prevent us from making loans to our PRC subsidiaries or making additional capital contributions to our wholly foreign-owned subsidiaries in China, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

Our manufacturing operations are located in China through our PRC subsidiaries. If we plan to expand the operations in China, we may need to make loans to our PRC subsidiaries subject to the approval from governmental authorities and limitation of amount, or we may make additional capital contributions to our wholly foreign-owned subsidiaries in China.

Any loans to our wholly foreign-owned subsidiaries in China, which are treated as foreign-invested enterprises under PRC law, are subject to PRC regulations and foreign exchange loan registrations. For example, loans by the Company to our wholly foreign-owned subsidiaries in China to finance their activities cannot exceed statutory limits, i.e., the difference between its total amount of investment and its registered capital, or certain amount calculated based on elements including capital or net assets, the cross-border financing leverage ratio and the macro prudential coefficient under relevant PRC laws and the loans must be registered with the local counterpart of the State Administration of Foreign Exchange, or SAFE, or filed with SAFE in its information system.

If we choose to finance our wholly foreign-owned subsidiaries in China by means of capital contributions, the capital contributions must through record-filing procedures from competent administration for market regulation. SAFE issued the Circular on the Management Concerning the Reform of the Payment and Settlement of Foreign Currency Capital of Foreign-Invested Enterprises, or SAFE Circular 19, which took effect on June 1, 2015. SAFE Circular 19 allows for the use of RMB converted from the foreign currency-denominated capital for equity investments in the PRC provided that such usage shall fall into the scope of business of the foreign-invested enterprise, which will be regarded as the reinvestment of foreign-invested enterprise. In addition, SAFE promulgated the Circular Regarding Further Promotion of the Facilitation of Cross-Border Trade and Investment on October 23, 2019, or SAFE Circular 28, pursuant to which all foreign-invested enterprises can make equity investments in the PRC with their capital funds in accordance with the law. The Circular Regarding Further Optimizing the Cross-border RMB Policy to Support the Stabilization of Foreign Trade and Foreign Investment jointly promulgated by the PBOC, NDRC, the Ministry of Commerce, the State-owned Assets Supervision and Administration Commission of the State Council, the China Banking and Insurance Regulatory Commission and SAFE on December 31, 2020 and effective on February 4, 2021 allows the non-investment foreign-invested enterprises to make domestic reinvestment with RMB capital in accordance with the law on the premise that they comply with prevailing regulations and the invested projects in China are authentic and compliant. In addition, if a foreign-invested enterprise uses RMB income under capital accounts to conduct domestic reinvestment, the invested enterprise is not required to open a special deposit account for RMB capital.

Due to the restrictions imposed on loans in foreign currencies extended to any PRC domestic companies, we may not be able to make such loans to the subsidiaries of our wholly foreign-owned subsidiaries in China.

Because of these restrictions and requirements, we cannot assure you that we will be able to complete the necessary government registrations or record-filings on a timely basis, with respect to any regulated future loans to our PRC subsidiaries or future capital contributions by us to our wholly foreign-owned subsidiaries in China. As a result, uncertainties exist as to our ability to provide prompt financial support to our PRC subsidiaries. If we fail to complete such registrations or record-filings, our ability to use foreign currency to finance our PRC operations may be negatively affected, which could materially and adversely affect our liquidity and our ability to fund and expand our business.

Uncertainties with respect to the PRC legal system could adversely affect us.

Our manufacturing operations are located in China through our PRC subsidiaries. Our operations in China are governed by PRC laws and regulations. Our PRC subsidiaries are subject to laws and regulations applicable to foreign investment in China. The PRC legal system is a civil law system based on written statutes. Unlike the common law system, prior court decisions may be cited for reference but have limited precedential value. The PRC legal system is evolving rapidly, and the interpretation of many laws, regulations and rules may contain inconsistencies and enforcement of these laws, regulations and rules involves uncertainties.

When our PRC subsidiaries encounter business disputes with other parties, we may have to resort to administrative and court proceedings to enforce our legal rights. If our administrative and court proceedings in China are protracted, it may result substantial costs and diversion of management attention. Since PRC administrative and court authorities have significant discretion in interpreting and implementing statutory and contractual terms, it may be more difficult to evaluate the outcome of administrative and court proceedings and the level of legal protection we enjoy than in more developed legal systems. These uncertainties may impede our ability to enforce the contracts we have entered into and could materially and adversely affect our business and results of operations. Furthermore, the PRC legal system is based, in part, on government policies and internal rules, some of which are not published in a timely manner, or at all, but which may have retroactive effect. As a result, we may not always be aware of any potential violation of these policies and rules. Such unpredictability towards our contractual, property and procedural rights could adversely affect our operations.

The PRC government has significant oversight over the conduct of our business and it has recently indicated an intent to exert more oversight over offerings that are conducted overseas and/or foreign investment in China-based issuers. Any such action could significantly limit or completely impede our ability to offer or continue to offer securities to investors and cause the value of such securities to significantly decline or be worthless.

Permissions required from the PRC authorities for our operations.

We conduct our business primarily through our PRC subsidiaries in China. Our operations in China are governed by PRC laws and regulations. As of the date of this annual report, our PRC subsidiaries have obtained the required licenses and permits from the PRC government authorities that are material for the business operations in China, including business certificates, plants safety certificates and pollutant discharge permits. Given the uncertainties of interpretation and implementation of relevant laws and regulations and the enforcement practice by relevant government authorities, we may be required to obtain additional licenses, permits, filings or approvals for our operations in China in the future. We may be adversely affected by the complexity, uncertainties and changes in PRC regulations.

On the other hand, under current PRC laws, regulations and regulatory rules, as of the date of this annual report, Deswell and our PRC subsidiaries (i) are not required to obtain permissions from the China Securities Regulatory Commission, or the CSRC, (ii) are not required to go through cybersecurity review by the Cyberspace Administration of China, or the CAC, and (iii) have not been asked to obtain or were denied such permissions by any PRC authority.

However, the PRC government has recently indicated an intent to exert more oversight and control over offerings that are conducted overseas and/or foreign investment in China-based issuers. The approval of and filing with the CSRC or other PRC government authorities may be required in connection with our offshore offerings under PRC law, and, if required, we cannot predict whether or for how long we will be able to obtain such approval or complete such filing.

Under China’s EIT Law, we may be classified as a “resident enterprise” for PRC tax purposes, which may subject us to PRC enterprise income tax for any dividends we receive from our Chinese subsidiaries and to PRC income tax withholding for any dividends we pay to our non-PRC stockholders.

Under the PRC’s EIT Law, an enterprise established outside of China whose “de facto management bodies” are located in China is considered a “resident enterprise” and is subject to the 25% enterprise income tax rate on its worldwide income.

All of our manufacturing operations are conducted and managed in the PRC. Our corporate structure, illustrating our incorporation in BVI and our ownership of companies inside and outside of China, is set forth on page 29 of this Report. If the PRC tax authorities determine that our holding company structure utilizing companies outside of China is a “resident enterprise” for PRC enterprise income tax purposes, we may be subject to an enterprise income tax rate of 25% on our worldwide taxable income. The “resident enterprise” classification also could subject us to a 10% withholding tax on any dividends we pay to our non-PRC stockholders if the relevant PRC authorities determine that such income is PRC-sourced income. If we are classified as a “resident enterprise” and we incur these tax liabilities, our financial results would be negatively impacted accordingly.

Transactions between our subsidiaries may be subject to scrutiny by the PRC tax authorities. A finding that any of our China subsidiaries owe additional taxes, late payment interest or other penalties could adversely affect our operating results materially.

The PRC’s EIT Law emphasizes the requirement of an arm’s-length basis for transfer pricing transactions between related parties. It requires enterprises with transactions between related parties, such as transactions between our subsidiaries located inside and outside of China, to prepare transfer pricing documentation that includes the basis for determining pricing, the computation methodology and detailed explanations. We could face material and adverse consequences if the PRC tax authorities determine that transactions between our subsidiaries do not represent arm’s-length pricing and are thereby deemed tax avoidance, or determine that related documentation does not meet the requirements of the EIT Law. Such determinations could result in increased tax liabilities of the affected subsidiaries and potentially subject them to late payment interest and other penalties.

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

Historically, the United States has been the major or significant geographical area of our product sales in terms of shipping destinations. The United States was our number four market in fiscal years ended March 31, 2021 and 2022. See ITEM 4 “Information on the Company — Customers and Marketing” on page 35 of this Report for information regarding our net sales as a percentage of total sales to customers by geographic area. During fiscal year 2020, the U.S.-China relation during the Trump-administration had hit a low point. The United States fell out of the top three significant geographical markets of the Company’s products. Following the swearing in of Joseph Biden as the new United States President in January 2021, the United States and China held the first high-level meeting in March 2021, however the meeting ended in heated arguments. Since then, our understanding is there has been no meeting between the two countries, though several telephone conversations between high-level officials from both sides.

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. Recently, political and trade friction between the United States and China has escalated.

In July 2018 and again in September 2018, the United States imposed tariffs on a wide range of products and other goods from China. Over the four years that have followed since, the two countries have been embroiled in countless back-and-forth negotiations, introduced foreign technology restrictions, fought several WTO cases, consequently leading U.S.-China trade tensions to the brink of a full-blown trade war. So far, the U.S. has slapped tariffs on US\$550 billion worth of Chinese products. China, in turn, has set tariffs on US\$185 billion worth of U.S. goods. For many months, neither China nor the United States showed signs of wanting to back down. But finally, on January 15, 2020, the first signs of a truce were seen, when the two sides signed the Phase One Deal, which officially agreed to the rollback of tariffs and expansion of trade purchases. China agreed to expand purchases of certain U.S. goods and services by an additional US\$200 billion for the two-year period from January 1, 2022, through December 31, 2021 as part of the Phase One Deal; however, China purchased only 57% of this committed amount. The two countries have provided minimal updates on extending the Phase One Deal or negotiating a Phase Two Deal and it remains uncertain if or when a new deal will be reached.

Most of the elevated tariffs imposed at the height of the U.S.-China trade war have remained in place and affect over half of all trade flows between the two countries. Inside the United States, it is argued that the tariffs on China could harm the U.S. economy. Though President Joseph Biden, after taking office, has admitted that he disagreed with Donald Trump’s approach to China, he is not in a hurry to reverse his predecessor’s policies. His administration had suggested that it is open to using tariffs to fight China’s unfair trade practices.

The trade controversy between the United States and China is still evolving, and we cannot predict future trade policy. However, future tariffs could cover more or all of our products, resulting in an adverse effect on our operations, including customer demand, or on the prevailing market price of our common shares.

Heightened tensions in international relations, particularly between the United States and China, may adversely impact our business, financial condition, and results of operations.

Recently there have been heightened tensions in international relations, particularly between the United States and China, but also as a result of the war in Ukraine and sanctions on Russia. These tensions have affected both diplomatic and economic ties among countries. Heightened tensions could reduce levels of trade, investments, technological exchanges, and other economic activities between the major economies. The existing tensions, and any further deterioration in the relationship between the United States and China may have a negative impact on the general, economic, political, and social conditions in both countries and, given our reliance on the Chinese market, adversely impact our business, financial condition, and results of operations.

Actual or threatened war, terrorist activities, political unrest, civil strife, and other geopolitical uncertainty could have similar adverse effect. Any one or more of these events may hamper our operation adversely, affect our sales results, potentially for a prolonged period of time, which could materially and adversely affect our business, financial conditions, and results of operations.

The economy of China has been experiencing significant growth, leading to inflation and increased labor costs. Increases in labor costs of workers in the PRC generally, and in the Province where our manufacturing facilities are located particularly, have had and can be expected to continue to have a material and adverse effect on our operating results.

We generate all revenues from sales of products that we manufacture at our facilities located in Dongguan, Guangdong Province, in the PRC. The economy in China has grown significantly over the past 20 years, which has resulted in an increased inflation and the average cost of labor.

China’s annual inflation rate jumped to 2.1 percent in April 2022 and stayed there in May 2022. This is the highest since November 2021, amid logistics disruptions caused by strict COVID-19 measures. However, the Company’s actual cost of operations has significantly exceeded the overall inflation rate in China. The rapid growth of China’s economy in the past few years has in general increased the Company’s operating costs, including energy prices and labor costs. These increased costs have adversely affected the Company’s cost of operations, caused the Company to increase its prices, and resulted in the loss of some customers.

There is no fixed minimum wage which is applicable to all of China; local governments in China adopt different amounts based on the situation in their area. China’s Guangdong Province, where our manufacturing facilities are located, raised minimum wages by approximately 10% in December 2021. Effective May 1, 2015, minimum wage levels across Guangdong Province, including Dongguan, where our manufacturing facilities are located, were increased by an average of 15.3%. Effective December 2021, the Guangdong Provincial Government increased the Province’s statutory minimum wage by around RMB180 per month. The Provincial Government sets different tiers of minimum wages according to the developmental status of the Province’s urban clusters. In the City of Dongguan, where our manufacturing facilities are located, the minimum wage increased by 10.0%.

In China, regional governments are authorized to set their own minimum wages according to local conditions. Increases in wages also result in increases in our and other employer’s contributions for various mandatory social welfare benefits for Chinese employees that are based on percentages of their salaries. Continuing material increases in our cost of labor will continue to increase our operating costs and will adversely affect our financial results unless we pass on such increases to our customers by increasing the prices of our products and services. The effect of increases in the prices of our products and services would make our products more expensive in global markets, such as the United States and the European Union. This could result in the loss of customers, who may seek, and be able to obtain, products and services comparable to those we offer in lower-cost regions of the world. If we do not increase our prices to pass on the effect of increases in our labor costs, our margins and financial results would suffer.

Future relocation of certain manufacturing lines may not be successful.

The outcome of the trade controversy between the United States and China is not predictable as of this time. In order to mitigate the uncertainties caused by the issue, we have been studying the feasibility of reallocating part of our production to Southeast Asian countries since 2018. Last year, we engaged an internationally-recognized professional service firm to provide advice and assistance in the completion of required statutory procedures for the incorporation of a wholly foreign invested enterprise in Vietnam (the “FIE”). However, we were advised that our proposed investment plan might not fulfil the requirement for the application of the certificate of origin in Vietnam, the incorporation procedures in Vietnam were suspended.

We are exploring the possibilities to reallocate part of our production to other Southeast Asian countries. We may face difficulties and possibly be unsuccessful in the future. We may fail to select appropriate manufacturing plants in other Southeast Asian countries. Some of our competent and experienced employees and management may not be willing to relocate and work in other Southeast Asian countries. The quality of the products manufactured and assembled in other Southeast Asian countries may not be accepted by our customers. A new manufacturing plant in other Southeast Asian countries could require significant management attention and could result in a diversion of resources away from our existing business. We may also need to obtain approvals and licenses from relevant government authorities to comply with applicable laws and regulations, which could result in increased costs and delays.

Restrictions on the convertibility of RMB into foreign currency may limit our ability to transfer excess funds or dividends to the Company’s subsidiaries outside China.

Our manufacturing operations are conducted by our subsidiaries located in China and funds are frequently transferred into our subsidiaries in China. Thus, any future restrictions on currency exchanges may limit our ability to transfer excess funds or dividends outside China. Although the PRC government introduced regulations in 1996 to allow greater convertibility of RMB for current account transactions, significant restrictions still remain, including primarily the restriction that foreign-invested enterprises may only buy, sell and/or remit foreign currencies at those banks authorized to conduct foreign exchange business after providing valid commercial documents. The Chinese regulatory authorities may impose more stringent restrictions on the convertibility of RMB, especially with respect to foreign exchange transactions.

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

Our administration and accounting offices are located in Macao, formerly a Portuguese Colony, and some of our customers and suppliers are located in Hong Kong, formerly a British Crown Colony. Sovereignty over Macao and Hong Kong was transferred to China effective on December 20, 1999 and July 1, 1997, respectively. Since their transfers, Macao and Hong Kong have become Special Administrative Regions of China, enjoying a high degree of autonomy except for foreign and defense affairs. Moreover, China’s political system and policies are not practiced in Macao or Hong Kong. Under the principle of “one country, two systems,” Macao and Hong Kong maintain legal systems that are different from that of China. Macao’s legal system is based on the Basic Law of the Macao Special Administrative Region and, similarly, Hong Kong’s legal system is based on the Basic Law of the Hong Kong Special Administrative Region. It is generally acknowledged as an open question whether Hong Kong’s future prosperity in its role as a hub and gateway to China will be diminished. The continued stability of political, economic or commercial conditions in Macao and Hong Kong remain uncertain, and any instability could have an adverse impact on our business.

The PRC’s national labor law restricts our ability to reduce our workforce if we conclude that we need to make future reductions.

In June 2007, the National People’s Congress of the PRC enacted labor legislation, called the Labor Contract Law, and that law became effective on January 1, 2008. The law formalized workers’ rights concerning overtime hours, pensions, layoffs, employment contracts and the role of trade unions. Considered one of the strictest labor laws in the world, among other things, this law requires an employer to conclude an “open-ended employment contract” with any employee who either has worked for the employer for 10 years or more or has had two consecutive fixed-term contracts. An “open-ended employment contract” is in effect a lifetime, permanent contract, which is terminable only in specified circumstances, such as a material breach of the employer’s rules and regulations, or for a serious dereliction of duty. Such employment contracts with qualifying workers would not be terminable if, for example, we determined to downsize our workforce in the event of an economic downturn. Under the 2007 law, downsizing by 20% or more may occur only under specified circumstances, such as a restructuring undertaken pursuant to China’s Enterprise Bankruptcy Law, or where a company suffers serious difficulties in production and/or business operations. Also, if we lay off more than 20 employees or 10% at one time, we have to communicate with the labor union of our Company and report to the District Labor Bureau. Deswell’s entire staff, who are employed to work exclusively within the PRC, is covered by the law. In response to prevailing business conditions, we decreased our workforce further by 140 in the fiscal year ended March 31, 2022 after decreasing our workforce by 25 and 100 in the fiscal year ended March 31, 2021 and 2020, respectively. However, we may incur much higher costs under China’s Labor Contract Law if we are forced to downsize our workforce in the future. Accordingly, this law can be expected to exacerbate the adverse effect of unfavorable economic conditions on our results of operations and financial condition.

Power shortages in China could affect our business.

We consume substantial amounts of electricity in our manufacturing processes at our production facilities in China. In the past, we have experienced a number of power shortages at our production facilities in China, though we are sometimes given advance notice of such power shortages. In relation to these power shortages we have a backup power system. However, there can be no assurance that in the future our backup power system will be completely effective in the event of a power shortage, particularly if that power shortage is over a sustained period of time and/or we are not given advance notice of it. Any power shortage, brownout or blackout for a significant period of time may disrupt our manufacturing, and as a result, may have an adverse impact on our business.

China’s U.S. stock market issues may raise investors’ concerns.

Since 2017, a series of Chinese companies listed on the New York Stock Exchange and NASDAQ saw their share prices substantially drop after going public, as compared to Non-Chinese companies. The difference in performance is thought to be due to heightened concerns over standards of corporate governance. The SEC made repeated mention of emerging markets, including China, in a warning to investors over the book-keeping standards of foreign companies listed in the U.S., that there could be substantially great risk that disclosures will be incomplete or misleading. These issues and the past performances of Chinese companies could make the U.S. stock markets less attractive to all sorts of companies from China or could lead to possible decreases in Chinese concept share valuations. As a result, investors may suffer losses as Deswell’s main operations are located in China.

Our auditor, like other independent registered public accounting firms operating in China, is not permitted to be subject to inspection by the Public Company Accounting Oversight Board, and as such, investors may be deprived of the benefits of such inspection.

Our independent registered public accounting firm that issues the audit reports included in our annual reports filed with the SEC, as an auditor of companies that are traded publicly in the United States and a firm registered with the Public Company Accounting Oversight Board (United States), or PCAOB, is required by the laws of the United States to undergo regular inspections by PCAOB to assess its compliance with the laws of the United States and professional standards. Because our auditor is located in China, a jurisdiction where PCAOB is currently unable to conduct inspections without the approval of the PRC authorities, our auditor, like other independent registered public accounting firms operating in China, is currently not inspected by PCAOB.

Inspections of other firms that PCAOB has conducted outside of China have identified deficiencies in those firms’ audit procedures and quality control procedures, which may be addressed as part of the inspection process to improve future audit quality.

The inability of PCAOB to conduct inspections of independent registered public accounting firms operating in China makes it more difficult to evaluate the effectiveness of our auditor’s audit procedures or quality control procedures. As a result, investors may be deprived of the benefits of PCAOB inspections.

We could be delisted if we are unable to meet the PCAOB inspection requirements in time.

The HFCAA, which was signed into law on December 18, 2020, states if the SEC determines that we have filed audit reports issued by a registered public accounting firm that has not been subject to inspection for the PCAOB for three consecutive years beginning in 2021, the SEC shall prohibit our shares from being traded on a national securities exchange or in the over-the-counter trading market in the United States. On December 2, 2021, the SEC adopted final amendments implementing the disclosure and submission requirements of the HFCAA, pursuant to which the SEC will identify an issuer as a “Commission-Identified Issuer” if the issuer has filed an annual report containing an audit report issued by a registered public accounting firm that the PCAOB has determined it is unable to inspect or investigate completely, and will then impose a trading prohibition on an issuer after it is identified as a Commission-Identified Issuer for three consecutive years. On December 16, 2021, the PCAOB issued a report to notify the SEC of its determination that the PCAOB is unable to inspect or investigate completely registered public accounting firms headquartered in mainland China and Hong Kong. The PCAOB identified our auditor as one of the registered public accounting firms that the PCAOB is unable to inspect or investigate completely. Therefore, we expect to be identified as a “Commission-Identified Issuer” shortly after the filing of this annual report on Form 20-F.

Whether the PCAOB will be able to conduct inspections of our auditor before the issuance of our financial statements on the annual report on Form 20-F for the year ending March 31, 2024 which is due by July 31, 2024, or at all, is subject to substantial uncertainty and depends on a number of factors out of our and our auditor’s control. If our shares are prohibited from trading in the United States, there is no certainty that we will be able to list on additional non-U.S. exchange to facilitate the trading in our securities. Such a prohibition would substantially impair your ability to sell or purchase our shares when you wish to do so, and the risk and uncertainty associated with delisting would have a negative impact on the price of our shares. Also, such a prohibition would significantly affect our ability to raise capital on terms acceptable to us, or at all, which would have a material adverse impact on our business, financial condition, and prospects.

On June 22, 2021, the U.S. Senate passed a bill which would reduce the number of consecutive non-inspection years required for triggering the prohibitions under the HFCAA from three years to two. On February 4, 2022, the U.S. House of Representatives passed a bill which contained, among other things, an identical provision. If this provision is enacted into law and the number of consecutive non-inspection years required for triggering the prohibitions under the HFCAA is reduced from three years to two, then our shares could be prohibited from trading in the United States in 2023.

Risks Relating to Our Corporate Structure

Because our operations are international, we are subject to significant worldwide political, economic, legal and other uncertainties.

We are incorporated in the BVI and have subsidiaries incorporated in the BVI, Macao, Hong Kong, Samoa and China. Our administrative and accounting office is located in Macao. We manufacture all of our products in China. As of March 31, 2022, approximately 58.1% of the net book value of our total identifiable assets was located in China. We sell our products to customers principally in China, the United States, Hong Kong, Europe (the United Kingdom, Norway and Holland) and Canada. Our international operations may be subject to significant political and economic risks and legal uncertainties, including:

- changes in economic and political conditions and in governmental policies,
- changes in international and domestic customs regulations,
- wars, civil unrest, acts of terrorism and other conflicts,
- changes in tariffs, trade restrictions, trade agreements and taxation,
- difficulties in managing or overseeing foreign operations, and
- limitations on the repatriation of funds because of foreign exchange controls.

The occurrence or consequences of any of these factors may restrict our ability to operate in the affected region and negatively impact our operations in that region, or as a whole.

We depend on our executive officers, senior managers and skilled personnel.

Our success depends largely upon the continued services of our executive officers as well as upon our ability to attract and retain qualified technical, manufacturing and marketing personnel. Generally, our executive officers and senior managers are not bound by employment or non-competition agreements and we cannot assure you that we will be able to retain them. The loss of service of any of our officers or key management personnel could have a material adverse effect on our business and operating results. We do not have key person insurance on our executive officers. We believe that our future success will depend, in part, on our ability to attract and retain highly skilled executive, technical and management personnel and if we are not able to do so, our business and operating results could be harmed.

The concentration of share ownership in our senior management allows them to control the outcome of matters requiring shareholder approval.

As of June 30, 2022, the Chairman of the Board of Directors of the Company, Richard Pui Hon Lau, beneficially owned approximately 60.0% of our outstanding common shares, allowing Mr. Lau to control 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. As of June 30, 2022, members of our senior management and Board of Directors as a group, including Mr. Lau, beneficially owned approximately 69.7% of our outstanding common shares. There are no agreements, understandings, or commitments among the members of our senior management and Board of Directors to vote their shares in any specific manner, or to vote collectively for or against any matter that may come before the 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 BVI, many provisions of our Memorandum and Articles of Association, which are the terms used in the BVI 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 certain provisions of our charter documents without shareholder approval, including its ability to create and issue further common shares, 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.

Legislation enacted in the BVI as to Economic Substance may affect our operations

The Economic Substance (Companies and Limited Partnership) Act 2018 (the "Act") has been enacted in the BVI and came into force on January 1, 2019. The Act requires certain BVI legal entities carrying on relevant activities to demonstrate adequate economic substance in the BVI.

All entities are required to provide information to enable the International Tax Authority in the BVI to monitor whether the relevant entity is carrying on relevant activities and, if so, whether it is complying with the economic substance requirements. The information will be uploaded by the entity's registered agent and integrated into the BVI's existing Beneficial Ownership Secure Search (BOSS) system.

Penalties will be imposed for failure to provide required information or for operating an entity in breach of the economic substance requirements, which may include substantial fines, imprisonment and eventually the entity may be deregistered.

During the year ended March 31, 2022, we have provided the information requested by the BVI registered agent. No further information or follow-up action is requested by BVI registered agent or the International Tax Authority in the BVI as of the date of this Report. We will continue to submit the information requested by the BVI registered agent annually.

If any one of the BVI entities in our Group commences activities which may be considered to be a "relevant activity" under the Act, we will take appropriate advice to ensure that such entity complies with the relevant economic substance requirements with respect to that activity.

ITEM 4. INFORMATION ON THE COMPANY

History and Development of the Company

Deswell Industries, Inc. was founded in 1987 in Hong Kong and moved its manufacturing operations to China in 1990 to take advantage of lower overhead cost, competitive labor rate and tax concessions available in Shenzhen, China as compared with Hong Kong.

We were incorporated in December 1993 as a limited liability International Business Company under the British Virgin Islands International Business Companies Act, 1984 (the “IBC Act”). Effective on January 1, 2007, the BVI repealed the IBC Act, and simultaneously with such repeal, we were automatically re-registered under the BVI’s corporate law replacing the IBC Act, the BVI Business Companies Act, 2004 (the “BVI BC Act”).

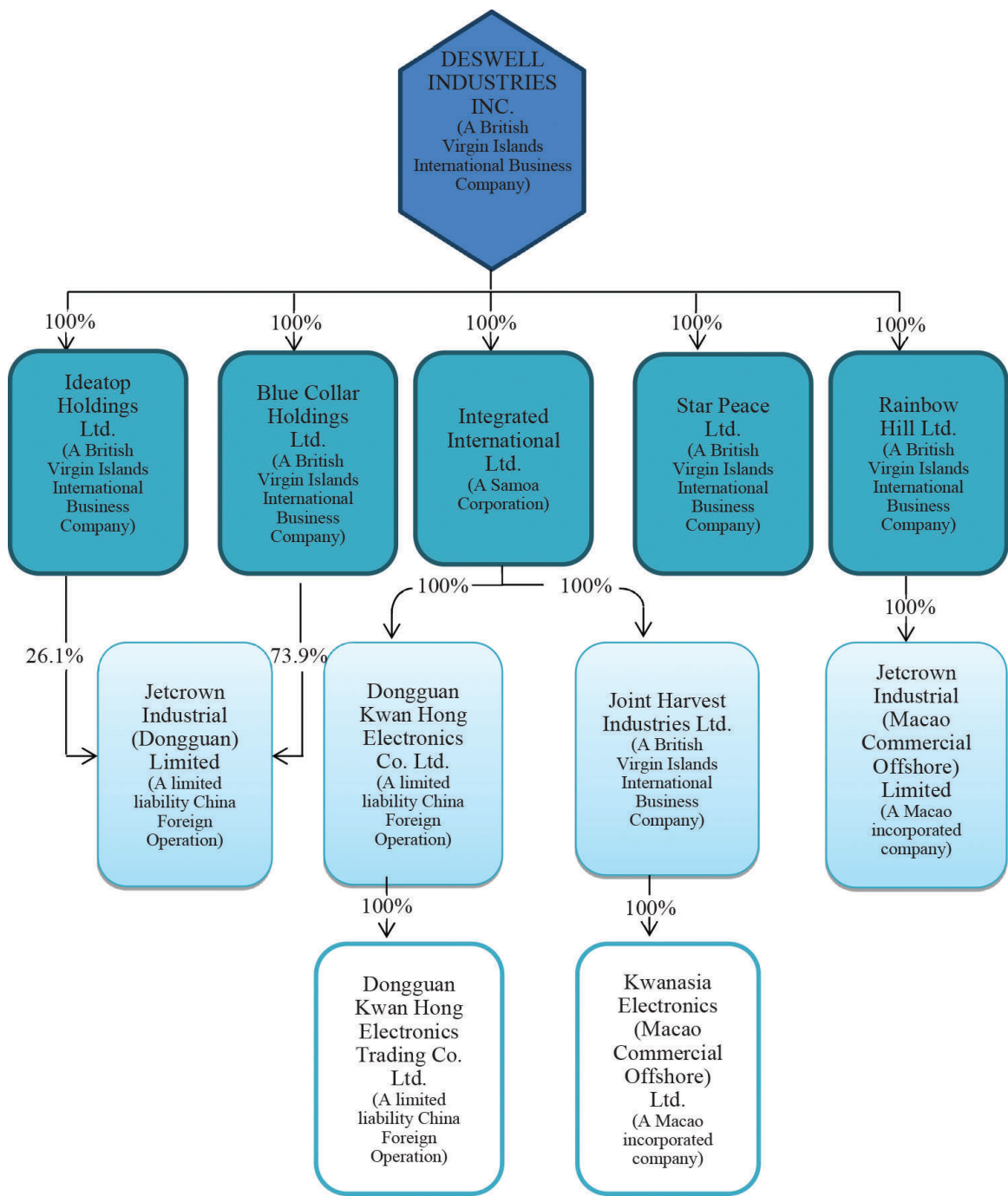
The Company’s registered agent in the BVI is Harneys Corporate Services Limited, P.O. Box 71, Craigmuir Chambers, Road Town, Tortola, British Virgin Islands. The Company’s principal administrative office is located in 10B Edificio Associacao Industrial De Macau, 32 Rua do Comandante Mata e Oliveira, Macao, and its telephone number is (853) 2832-2096 and its facsimile number is (853) 2832-3265. Our principal manufacturing facilities and operations are currently based in Dongguan, Guangdong, China.

Important Events in Deswell’s Development

During the year ended March 31, 2015, the Company gradually outsourced manufacturing of the metal components used in assembly of the Company’s audio products. As of March 31, 2015, all of the metallic components used in assembly of the Company’s audio products were provided by third party suppliers. The operating results of the metallic parts business unit are reported as discontinued operations for all periods presented. We have historically reported the results of the metallic parts business as a separate segment. The continuing cash flows subsequent to the unit’s closure were not significant.

Organizational Structure

The following diagram illustrates the organizational structure of the Company and its active subsidiaries at March 31, 2022.



Capital Expenditures

Principal capital expenditures and divestitures made by Deswell during the three year periods ended March 31, 2020, 2021 and 2022 included the following (dollar amounts in thousands):

	Year ended March 31,		
	2020	2021	2022
Purchase of property, plant and equipment	\$507	\$551	\$1,504
Proceeds from the sale of property, plant and equipment, net of transaction costs.	\$188	\$81	\$50

Our major capital expenditures in fiscal 2022 included:

- \$132,000 for leasehold improvements;
- \$1,202,000 for plant and machinery for plastic and electronic products;
- \$44,000 for motor vehicles; and
- \$126,000 for furniture, fixtures and equipment.

Our major capital expenditures in fiscal 2021 included:

- \$166,000 for leasehold improvements;
- \$222,000 for plant and machinery for plastic and electronic products;
- \$97,000 for motor vehicles; and
- \$66,000 for furniture, fixtures and equipment.

Our major capital expenditures in fiscal 2020 included:

- \$77,000 for leasehold improvements;
- \$275,000 for plant and machinery for plastic and electronic products;
- \$64,000 for motor vehicles; and
- \$91,000 for furniture, fixtures and equipment.

All of the foregoing capital expenditures were financed principally from internally generated funds and our current plan is to continue to use internally generated funds principally to finance future capital expenditures.

The Company has constructed its own manufacturing plant and dormitory buildings in Houjie, Dongguan China with an aggregate of approximately 1.3 million square feet of land. Management believes that the current plant facility has sufficiently met the Company’s existing requirements. Thus, the Company has postponed additional construction, consisting of previously planned additions of two dormitory units and two other buildings. We may choose to inaugurate this last phase of construction if additional production capacity is required in the future.

Availability of Additional Information.

The SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC. Such information is available at <http://www.sec.gov>. The Company’s website is <http://www.deswell.com>.

Business Overview

We are 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. We conduct all of our manufacturing activities at separate plastics, electronics and metallic operation factories located in the People’s Republic of China.

We produce a wide variety of plastic parts and components that are used in the manufacture of consumer and industrial products, using different plastic injection technologies, such as film injection, integrated injection and insert injection. The products include:

- plastic components of electronic entertainment products;
- plastic components for power tools, accessories and outdoor equipment;
- cases for flashlights, telephones, printers, scanners;
- parts for industrial components;

- parts for indoor control switches;
- parts for audio equipment;
- cases and key tops for personal organizers and remote controls;
- double injection caps;
- parts for medical products such as apparatus for blood tests;
- laser key caps;
- automobile components; and
- plastic components of automatic robot (mop & vacuum).

Electronic products manufactured by the Company include:

- sophisticated professional audio equipment including digital and analogue mixing consoles, amplifiers, signal processors, audio interfaces, network audio equipment and speaker enclosures;
- high performance consumer audio products, such as multi-channel receivers-amplifiers, wired and wireless audio streaming products;
- complex printed circuit board assemblies using surface mount technology (“SMT”), automatic insertion (“AI”) and pin-through-hole (“PTH”) interconnection technologies; and
- IoT products.

Historically, metal products manufactured by the Company included metallic molds and necessary parts used in audio equipment, telephones, copying machines, pay telephones, multimedia stations, automatic teller machines, vending machines, and more. As manufacturing of metallic components is a production process that may emit pollutants, during the year ended March, 31, 2015 the Company gradually outsourced manufacturing of the metal components used in assembly of the Company’s audio products. Since March, 2015, all the metallic components used in assembly of the Company’s audio products were provided by third party suppliers.

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 or assemble high-end plastic and metallic accessory 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, this advantage has been difficult to maintain as a result of increased competition and increased production overheads during the last three fiscal years.

Industry Overview

Management believes that the injection molding 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 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 38.8%, 30.6% and 27.2% of the Company’s total sales during the years ended March 31, 2020, 2021, and 2022, respectively. At March 31, 2022, the Company conducted its plastic manufacturing operations in approximately 1,070,000 square feet of factory space in its factory located in Dongguan, China.

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 50 days, depending on the size and complexity of the mold. Mold making requires specialized machines and is capital intensive. At March 31, 2022, the Company used 30 EDMs (electrical discharge machines), 32 CNC (computer numerical control) milling machines and 83 NC (numerical control) milling machines in the mold-making process.

The customer generally bears the cost of producing the molds and, as is customary in the industry, the customer owns them. However, the Company maintains and stores the molds at its factory for use in production and it is Deswell’s policy generally not to make molds for customers unless the customer undertakes to store its molds at the Company’s factory and uses Deswell to manufacture the related parts. In that way, the Company seeks to use its mold-making expertise to create dependence on it for the customer’s parts requirements. Through its Export Tooling Department, Deswell produces molds for export to customers and thus does not use those molds to manufacture related parts.

During the year ended March 31, 2022, the Company made an average of approximately 6 to 8 molds each month. The average weight of the molds produced by the Company is about 1,300 pounds costing an average of \$8,800 per set. 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,” below. 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, 2022, the Company had approximately 167 injection molding machines, ranging from 50 to 1,600 tons of clamping force, with most machines in the range of from 86 to 380 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 can be conducted 24 hours a day, five to seven days per week, other than during 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.

During the year ended March 31, 2020, the Company disposed of 18 plastic injection molding machines and did not add any new machines.

During the year ended March 31, 2021, the Company disposed of 10 old plastic injection molding machines and did not add any new machines.

During the year ended March 31, 2022, the Company disposed of 5 old plastic injection molding machines and added two new 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 223,000 square feet of factory space at March 31, 2022 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, IPBX and commercial telephone units, network education platforms, IP switches and routers. Assemblies consist of printed circuit boards (“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, 2020, 2021, and 2022, manufacturing of electronic products accounted for approximately 61.2%, 69.4% and 72.8% respectively, of the Company’s total sales.

In assembling printed circuit boards the Company purchases printed circuit boards, surface mounted components and chips and uses automatic insertion and pin-through-hole interconnection technologies to assemble various components onto the PCBs. Before delivery, completed PCBs are checked by in-circuit testers and outgoing quality assurance inspections are performed.

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.

BGA is a method of mounting an integrated circuit or other component to a PCB. Rather than using pins that consume a large area of the PCB, the component is attached to the circuit board with small balls of solder at each contact. This method allows for greater component density and is used in more complex PCBs.

SMT is the automatic process of printed circuit board assembly in which components are mounted 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 and the components are then placed onto the solder paste and fused to the melting point of the paste to establish a strong solder joint between components and the printed circuit board. The SMT process allows miniaturization of PCBs, cost savings and shorter lead paths between components (which results in faster signal speed and improved reliability). Additionally, it allows components to be placed on both sides of the printed circuit board, a major factor for the purpose of miniaturization.

Manufacturing operations include PCB assembly, wiring and testing. The process is completed by assembling the PCBs into a plastic or metal housing that comprises the finished product. Quality assurance is then conducted in accordance with the customers’ requirements before the shipment.

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 final assembly and before shipment, the Company conducts quality assurance inspections in accordance with the customers’ Acceptable Quality Level, or AQL, requirements.

In 1995, the Company earned ISO 9001 certifications for both its plastic and electronic products manufacturing operations. 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 9001 is the ISO level appropriate for manufacturers like the Company. The Company’s receipt of ISO 9001 certification demonstrates that the Company’s manufacturing operations meet the established world standards.

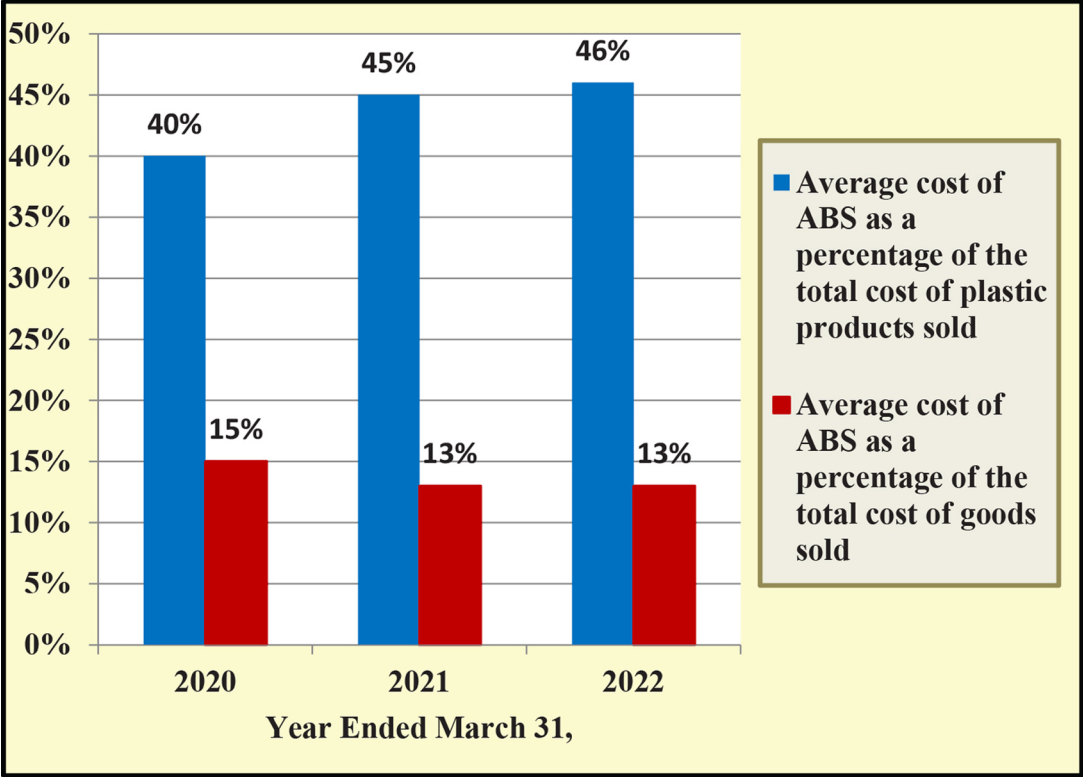
In August 2004, the Company’s plastic injection manufacturing plant in Dongguan also obtained ISO 14001 certification, which evidences that the Company’s environmental management standards meet established international standards. ISO 14000 is a series of international standards on environmental management. ISO 14001 is the most well-known of these standards and is often seen as the cornerstone standard of the ISO 14000 series. In January 2006, the Company’s electronic manufacturing plant also obtained ISO 14001 certification.

In July 2006, Deswell obtained ISO/TS 16949 Certification for its plastic injection manufacturing plant. ISO/TS 16949 is an ISO Technical Specification aligning existing American (QS-9000), German (VDA6.1), French (EAQF) and Italian (AVSQ) automotive quality systems standards within the global automotive industry. Together with ISO 9001:2008, ISO/TS 16949 specifies the quality system requirements for the design/development, production, installation and servicing of automotive related products. ISO/TS 16949 has been accepted as an equivalent to QS-9000, VDA6.1, AVSQ, and EAQF. ISO/TS 16949 does not replace QS-9000; but is optional and eliminates the need for multiple certifications.

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). The chart below shows Deswell’s average cost of ABS as a percentage of the total cost of plastic products sold and as a percentage of total cost of goods sold during its last three fiscal years.



Because plastic resins are commodity products, the Company has no long-term supply agreements for plastic resins. The Company selects its suppliers based on price, lead time, the brand name or those that are appointed by its customers. Most of its plastic resins are obtained from suppliers in Mainland China and Hong Kong. Deswell normally maintains a two to three month inventory supply.

The Company used in excess of 7,506,000 pounds of plastic resins during the year ended March 31, 2022. Management believes that the Company’s large volume purchases of plastic resin have generally resulted in lower unit raw material costs and generally have 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. Over the past several years, oil prices have experienced significant volatility and remain extremely uncertain. Sustained increases in oil prices could result in higher costs for plastic resins.

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.

The Company purchases a wide variety of component parts from numerous suppliers and is not dependent upon any single supplier for any essential component. The Company purchases from suppliers in China, Hong Kong, Taiwan, Singapore, the United Kingdom and the United States. At various times there have been shortages of parts in the electronics industry, and certain components, including integrated circuits, diodes, transistors and other semiconductors, have been subject to allocations by their suppliers, particularly if they are complex and/or customized for a particular use. 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.

For a discussion of various risks we face associated with obtaining needed components used in our manufacture of electronic products, please see “Shortages of components and materials used in our production of electronics products may delay or reduce our sales and increase our costs” and “We face inventory risks of obsolescence and impairment charges by providing turnkey manufacturing of electronic products” beginning on page 16 of the Risk Factor section of this Report.

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.

Customers and Marketing

The Company’s customers are OEMs and contract manufacturers. The Company sells its products principally in China, the United States, Hong Kong and Europe (the United Kingdom, Norway and Holland) and Canada. 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 16 of Notes to Consolidated Financial Statements for the dollar amounts of export sales by geographic area for each of the years ended March 31, 2020, 2021 and 2022. Net sales as a percentage of total sales to customers by geographic area consisted of the following for the years ended March 31, 2020, 2021 and 2022:

Geographical Area	Year ended March 31,		
	2020	2021	2022
			%
China	41.5%	38.4%	40.1
United States	17.2	12.1	12.2
Europe	15.0	14.7	15.6
Hong Kong	9.5	12.5	13.5
United Kingdom	7.4	5.0	7.8
Canada	4.1	7.3	6.4
Others	5.3	10.0	4.4
			%
Total	100.0%	100.0%	100.0

We believe that our reported sales by geographic area do not necessarily reflect the final destinations of our products or the actual nationalities of our customers. For example, we have reported product sales in China amounting to 40.1% of our total net sales for the year ended March 31, 2022 because China is where our customers directed us to deliver the products. However, we believe that these sales were to offshore customers using local China shipping destinations, which in turn, transshipped our products offshore.

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, exhibitions and conventions. Collecting information from trade shows, as well as websites, Deswell’s marketing staff contacts existing and potential customers directly by telephone, mail, fax, e-mail via the Internet and in person, stressing Deswell’s capability as a complete solution provider for plastic injection mold design, tooling and molding as well as an electronics manufacturing services, or EMS, provider of advanced technology manufacturing processes and flexible logistic services.

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, electronic products and metallic products are primarily made on credit terms, with payment in United States dollars or Hong Kong dollars expected within 30 to 90 days of shipment. In certain cases, primarily new customers of electronic products, sales are supported by 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 material difficulty in being paid by its customers, there can be no assurance that the Company’s favorable collection experience will continue.

Customers

The Company’s success depends 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.

Historically, the Company has depended, currently depends, and expects to continue to depend, on a small number of customers for a significant percentage of its net sales. The following table sets forth Deswell’s major customers which accounted for 10% or more of its net sales during fiscal 2020, 2021 and 2022:

	Year ended March 31,		
	2020	2021	2022
Customer B	12.0%	19.3%	20.1%
Customer C	*%	10.0%	11.6%
Customer D	11.6%	11.2%	*%
Customer E	18.7%	*%	*%
Customer F	*%	11.2%	*%

* Less than 10% in the year indicated.

If the Company’s major customers experience a decline in the demand for their products as a result of the prevailing economic environment or other factors, the products or services that we provide to them could be reduced or even terminated. The loss of any of our major customers or a substantial reduction in orders from any of them would adversely impact our sales and operating results unless and until we were able to replace the customer or order with one or more of comparable size.

The Company’s sales are based on purchase orders and there are no long-term contracts with any of Deswell’s customers. The percentage of sales to the Company’s customers has fluctuated in the past and may fluctuate in future. Substantial decreases in sales to, or the loss of major customers, have adversely impacted Deswell’s sales and financial performance.

Present or future customers could cease to use Deswell as the source of the injection-molded plastic parts and components it manufactures for electronic manufacturing services of electrical products and subassemblies or for metallic molds and accessories or significantly change, reduce or delay the amount of products and services ordered. The Company’s sales may decline and its financial results will suffer if orders from its largest customers, or orders from other substantial customers, cease or are significantly reduced, unless Deswell can maintain strong relationships with longstanding customers or add sales from new customers.

As the global epidemic trend continues to stabilize, travelling restrictions have been lifted by some countries. However, the PRC government is still adopting a zero-COVID policy to prevent any spread of the coronavirus in its communities. As a result, some major cities in China have been put under full or partial lockdowns or district-based controls.

Though the Company’s two principal manufacturing plants are not located in the cities under lockdowns, our staff are required to be quarantined in designated hotels for 14 to 21 days when they travel from Hong Kong to the PRC cities. (Effective from June 29, 2022, the length of the quarantine was reduced to seven days and three days home health monitoring).

These border entry restrictions create challenges for productivity and connectivity, and could affect our ability to enhance, develop, and support existing products, detect and prevent production deficiencies, as well as exploring new business opportunities. The Company is complying with the health and safety protocols established by the government and has taken steps to safeguard its employees and business operations. These steps include well-planned travel arrangements among the Company’s management team, actively cleaning and sanitizing open public areas to ensure the continuity and smooth supervision over plant production and administration under pandemic conditions.

During the year ended March 31, 2022 the Company did not experience a significant negative impact from COVID-19 on its operations, or capital and financial position. We did not record material asset impairments, inventory charges or bad debt provision related to COVID-19 during the year ended March 31, 2022. We will continue to evaluate the nature and extent of the impact of the COVID-19 outbreak on our financial condition, results of operations and cash flows.

Competition

We compete with a number of different companies in production of injection-molded plastic parts and components, electrical products and subassemblies and metallic molds and accessories. For example, we compete with major global EMS providers, other smaller EMS companies that have a regional or product-specific focus, and original design manufacturers with respect to some of the services that we provide. We also compete with our current and prospective customers, who can manufacture internally and who evaluate our capabilities in light of their own capabilities and cost structures. Our market segments are extremely competitive, many of our competitors have achieved substantial market share and many have lower cost structures and greater manufacturing, financial or other resources than we do. We face particular competition from Asian-based competitors, including Taiwanese EMS providers who compete in our end markets.

The Company believes that competition for plastic injection molding, contract electronic manufacturing and parts manufacturing businesses are based on price, quality, service and the ability to deliver products in a timely and reliable basis.

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.”

Property, Plants and Equipment

Macao

The Company leases Units 10B and 10C Edificio Associacao Industrial De Macau, No. 32-36 Rua do Comandante Mata e Oliveira, Macao from an unaffiliated party, each being for a term of two years to May 2022. The premises are used as trading, administrative and accounting offices for the Company’s plastic injection business and electronic & metallic business, respectively. The monthly rent is approximately \$4,500.

Southern China

In January 2000, the Company acquired under a land-lease agreement with the local government an aggregate of approximately 1.3 million square feet of land to construct its own manufacturing plant and dormitory buildings in Houjie, Dongguan, China. Under the land-lease agreement, the Company has the right to use the land for 50 years. On this land, Deswell has through March 31, 2022 constructed approximately

- 1,070,000 square feet of factory space,
- 91,000 square feet of amenity space,
- 133,000 square feet of office building space, and
- 470,000 square feet of dormitory space.

Deswell now uses this facility for its plastic manufacturing operations.

Manufacturing facilities and warehouses identified to be idle during the year were leased to third parties for rental income. Rental income of \$1,560,000, \$2,026,000 and \$2,418,000 was earned during the years ended March 31, 2020, 2021, and 2022, respectively.

In July 2003, the Company acquired under a land-lease agreement with a third party an aggregate of approximately 244,000 square feet of land and approximately 420,000 square feet of buildings, including six blocks of dormitory buildings, a canteen, a factory building, a car park and a guard room, at Chang An, Dongguan, China, which was previously named Kwan Hong Building. The land use period is for 50 years from February 1, 2003 to January 31, 2053. The Company uses the facilities for its electronic products manufacturing operations.

The Company believes that its existing offices and manufacturing space, and 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.

Material Effects of Government Regulations

See discussion of increasing minimum wage levels in Guangdong Province and corresponding increases in employer contributions for mandatory social welfare benefits for Chinese employees on page 24 of this Report.

ITEM 4A. UNRESOLVED STAFF COMMENTS

Not applicable to Deswell.

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,” and “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.”

Operating Results

The following discussion should also be read in conjunction with the consolidated financial statements and notes thereto included following ITEM 18 of 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.

The manufacturing of the metallic components is a production process which may emit pollutants. During the year ended March 31, 2015, the Company gradually outsourced manufacturing of the metal components used in assembly of the Company’s audio products. As of March 31, 2015, all of the metallic components used in assembly of the Company’s audio products were provided by third party suppliers. The Company carries out all of its manufacturing operations in Southern China, where it has been able to take advantage of the lower overhead costs and 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 easily manage its manufacturing operations from Macao, and facilitates transportation of its products through Hong Kong.

PRC Income Taxes

In accordance with the PRC Income Tax Law, the standard income tax rate for all subsidiaries operating in the PRC is 25%.

Business Segment Information

Deswell’s operations are generally organized in two segments: plastic injection molding, which we sometimes refer to as the “plastics segment,” and electronic products assembling. The Company’s reportable segments are strategic business units that offer different products and services. See Note 16 of Notes to Consolidated Financial Statements. The following table sets forth selected consolidated financial information presented as a percentage of net sales by segment for each of the three years in the period ended March 31, 2022:

	Year ended March 31, 2020			Year ended March 31, 2021			Year ended March 31, 2022		
	Plastic Injection Molding Segment	Electronic Segment	Total	Plastic Injection Molding Segment	Electronic Segment	Total	Plastic Injection Molding Segment	Electronic Segment	Total
Net sales	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Cost of sales	78.0	84.3	81.9	76.4	81.2	79.7	84.8	83.4	83.8
Gross profit	22.0	15.7	18.1	23.6	18.8	20.3	15.2	16.6	16.2
Selling, general and administrative expenses	18.2	10.3	13.4	21.1	10.6	13.9	18.4	8.9	11.5
Corporate expense	-	-	2.0	-	-	2.0	-	-	1.6
Other income (expenses), net	(2.3)	0.4	(0.7)	3.0	(0.5)	0.6	0.1	0.1	0.1
Operating income (loss)	1.5	5.8	2.0	5.5	7.7	5.0	(3.1)	7.8	3.2
Non-operating Income (expense), net	(6.1)	(2.0)	(3.6)	24.8	1.2	8.4	21.3	0.5	6.2
Income (loss) before income taxes	(4.6)	3.8	(1.6)	30.3	8.9	13.4	18.2	8.3	9.4
Income taxes (benefit)	0.7	0.5	0.6	1.1	0.6	0.7	(1.0)	0.1	(0.2)
Net income (loss)	(5.3)	3.3	(2.2)	29.2	8.3	12.7	19.2	8.2	9.6

The Company used to include corporate expenses, which mainly included directors’ remuneration, legal and professional expenses and corporate insurance, in the segment of plastic injection. Commencing from fiscal year ended March 31, 2018, the corporate expenses are separately disclosed in the segment information for a more precise presentation of the financial performance of each segment.

Year ended March 31, 2022 (Fiscal 2022) Compared to Year Ended March 31, 2021 (Fiscal 2021)

Net Sales - The Company’s net sales for the year ended March 31, 2022 were \$85,980,000, an increase of \$21,094,000 or 32.5% as compared to \$64,886,000 in the corresponding period in fiscal 2021. The increase was related to increases in sales revenues of \$3,480,000 in our plastic segment, and of \$17,614,000 in our electronic segment, respectively, as compared with the respective net sales from these segments in the corresponding period of the prior fiscal year.

The revenue increase in the plastic segment was mainly due to an increase in orders of \$5,615,000 for robotic mops and vacuum cleaners for automatic floor cleaning stations from a new customer, and of \$1,238,000 for office equipment, and tooling products, offsetting a decrease in orders of \$2,050,000 for plastic and gardening tool boxes, and other gardening tool accessories, as well as a decrease of \$1,138,000 for motor vehicle products and telephone equipment from other existing customers.

The revenue increase in the electronic segment was mainly due to an increase of \$8,252,000 in orders for home entertainment products, and \$7,752,000 in orders for professional audio instruments of mixing consoles and digital audio workstations from other existing customers.

Gross Profit - Gross profit for the year ended March 31, 2022 was \$13,952,000, representing a gross profit margin of 16.2%. This is compared with the overall gross profit and gross profit margin of \$13,166,000 or 20.3% for the year ended March 31, 2021.

Gross profit in the plastic segment decreased by \$1,136,000 to \$3,545,000 or 15.2% of net sales for the year ended March 31, 2022, as compared to \$4,681,000 or 23.6% of net sales for the same period in the prior fiscal year. The decrease in gross profit and margin for the plastic segment was mainly due to the decreases in sales revenues from major clients with different product mix requiring higher raw materials consumption, as well as the relatively higher spoilage rate resulting from production of the products for the new customer.

Gross profit in the electronic segment increased by \$1,922,000 to \$10,407,000 or 16.6% of net sales for the year ended March 31, 2022, as compared to \$8,485,000 or 18.8% of net sales in the prior fiscal year. The gross margin decrease is attributed to increases in raw materials cost as a result of the continuing scarcity of and surging demand from the automotive industry for primary materials such as semi-conductor chips, when compared with last fiscal year.

Selling, General and Administrative Expenses - SG&A expenses for the year ended March 31, 2022 slightly increased by \$957,000 to \$11,267,000 or 13.1% of total net sales, as compared to \$10,310,000 or 15.9% of total net sales for the year ended March 31, 2021.

Corporate expenses slightly increased by \$84,000 to \$1,395,000 for the year ended March 31, 2022, as compared to \$1,311,000 for the year ended March 31, 2021 related to a slight increase in professional fees.

SG&A expenses in the plastic segment increased by \$103,000 to \$4,302,000 or 18.4% of net sales for the year ended March 31, 2022, compared to \$4,199,000 or 21.1% of net sales for fiscal 2021. The increase was primarily related to increases of \$70,000 in selling expense, and of \$43,000 in local government taxes and charges, as compared with the same period in the prior fiscal year.

SG&A expenses in the electronic segment increased by \$770,000 to \$5,570,000 or 8.9% of net sales for the year ended March 31, 2022, compared to \$4,800,000 or 10.7% of net sales for fiscal 2021. The increase was mainly due to increases of \$628,000 in staff costs and welfare, of \$68,000 in audit, legal and professional fees, as well as \$84,000 in local government taxes and charges, when compared to prior fiscal year. However, SG&A expense as a percentage of sales was relatively lower than fiscal 2021 as total sales revenues increased during fiscal 2022.

Other Income, Net - Other income was \$74,000 for the year ended March 31, 2022, as compared to other income of \$405,000 in the prior fiscal year.

On a segment basis, other income attributable to the plastic segment for the year ended March 31, 2022 was \$15,000, as compared to other income of \$614,000 for the prior fiscal year. Other income was lower in fiscal 2022 mainly due to a reversal of provision of \$148,000 for doubtful receivables, and a gain of \$57,000 on sales of materials, offsetting an exchange loss of \$165,000 during fiscal 2022, as compared to an exchange gain of \$1,003,000 and a provision of \$438,000 for doubtful debts in fiscal 2021.

Other income attributable to the electronic segment for the year ended March 31, 2022 was \$59,000, as compared with other expense of \$209,000 for the prior fiscal year. The increase in other income was mainly due to a decrease of \$248,000 in exchange loss and a gain of \$92,000 on sales of materials as compared to last fiscal year, offsetting a reversal of \$40,000 of provision for doubtful debts during the year ended March 31, 2021.

Operating Income - Operating income was \$2,759,000 for the year ended March 31, 2022, as compared to operating income of \$3,261,000 in the prior fiscal year.

Corporate expenses of \$1,395,000 and \$1,311,000 were incurred during the fiscal year of 2022 and 2021, respectively.

On a segment basis, the operating loss in the plastic segment was \$742,000 in the year ended March 31, 2022, as compared to operating income of \$1,096,000 in fiscal 2021. The decrease in operating income in the plastic segment was mainly due to reduced gross profit and margin, as well as decrease in other income as described above.

The electronic segment reported operating income of \$4,896,000 in the year ended March 31, 2022, compared to operating income of \$3,476,000 in fiscal 2021. The increase in operating income was mainly due to the increase in sales, lower SG&A expense as a percentage of sales, and an increase in other income, as described above.

Non-Operating Income – Non-operating income for the year ended March 31, 2022 was \$5,308,000, as compared to a non-operating income of \$5,445,000 in last fiscal year. The slight decrease in non-operating income was primarily due to increases of \$740,000 from realized gain on sale of marketable securities, and \$183,000 from rental income, offsetting a decrease of \$1,138,000 in unrealized gain on marketable securities, as compared to fiscal 2021.

Income Taxes – Current tax expense for the year ended March 31, 2022 was \$402,000. The Company had a deferred tax benefit of \$567,000. This is compared to a current tax expense of \$322,000 and a deferred tax provision of \$153,000 in last fiscal year.

On a segment basis, there was current tax expense of \$69,000 and a deferred tax benefit of \$308,000 in the plastic segment for the year ended March 31, 2022, as compared to a current tax expense of \$60,000 and a deferred tax provision of \$153,000 during the last fiscal year. In the electronic segment, there was current tax expense of \$333,000 and a deferred tax benefit of \$259,000 for the year ended March 31, 2022, as compared to current tax expense of \$262,000 in fiscal 2021.

Net Income – The Company had net income of \$8,232,000 for the year ended March 31, 2022, as compared to net income of \$8,231,000 for the year ended March 31, 2021. The increase in net income was mainly due to the increase in sales, offsetting by the decrease in gross margin as described above.

Net income for the plastic segment for the year ended March 31, 2022 was \$4,468,000, as compared to net income of \$5,810,000 for fiscal 2021. The decrease in net income in the plastic segment was mainly due to a decrease in gross margin as described above.

Net income for the electronic segment for the year ended March 31, 2022 was \$5,159,000, as compared to net income of \$3,732,000 for fiscal 2021. The increase in net income in the electronic segment was mainly attributable to an increase in sales, a lower SG&A expense as percentage of sales than prior fiscal year, and an increase in other income as described above.

Year ended March 31, 2021 (Fiscal 2021) Compared to Year Ended March 31, 2020 (Fiscal 2020)

Net Sales - The Company's net sales for the year ended March 31, 2021 were \$64,886,000, a decrease of \$482,000 or 0.7% as compared to \$65,368,000 in the corresponding period in fiscal 2020. The decrease was related to a decrease in sales revenues of \$5,488,000 in our plastic segment, offsetting an increase of \$5,006,000 in sales revenues in our electronic segment, as compared with the respective net sales from these segments in the corresponding period of the prior fiscal year.

The revenues decrease in the plastic segment was mainly due to a decrease in orders of \$3,588,000 from existing customers for printing, telephone and office equipment, and of \$1,699,000 for tooling products from other existing customers.

The revenue increase in the electronic segment was mainly due to an increase of \$3,543,000 in orders for home entertainment products, and 14,426,000 in orders for professional audio instruments of signal processors, mixing consoles and other equipment from other existing customers.

Gross Profit - Gross profit for the year ended March 31, 2021 was \$13,166,000, representing a gross profit margin of 20.3%. This is compared with the overall gross profit and gross profit margin of \$11,864,000 or 18.1% for the year ended March 31, 2020.

Gross profit in the plastic segment decreased by \$884,000 to \$4,681,000 or 23.6% of net sales for the year ended March 31, 2021, as compared to \$5,565,000 or 22.0% of net sales for the same period in the prior fiscal year. The decrease in gross profit for the plastic segment was mainly due to the decrease in sales revenue. However, as a percentage of sales, the slight increase in gross margin was mainly due to relatively lower raw materials costs incurred.

Gross profit in the electronic segment increased by \$2,186,000 to \$8,485,000 or 18.8% of net sales for the year ended March 31, 2021, as compared to \$6,299,000 or 15.7% of net sales in the prior fiscal year. The increase in gross profit and margin was mainly attributed to increases in sales revenues, increased percentage of sales of ODM products and savings in raw materials costs due to less wastage as a result of newly acquired state-of-the-art machineries and better trained front-line workers when compared with last fiscal year.

Selling, General and Administrative Expenses - SG&A expenses for the year ended March 31, 2021 slightly increased by \$284,000 to \$10,310,000 or 15.9% of total net sales, as compared to \$10,026,000 or 15.3% of total net sales for the year ended March 31, 2020.

Corporate expenses slightly increased by \$17,000 to \$1,311,000 for the year ended March 31, 2021, as compared to \$1,294,000 for the year ended March 31, 2020. There was a slight increase in bank charges and insurance.

SG&A expenses in the plastic segment decreased by \$425,000 to \$4,199,000 or 21.1% of net sales for the year ended March 31, 2021, compared to \$4,624,000 or 18.2% of net sales for fiscal 2020. The decrease was primarily related to the decrease of \$324,000 in staff costs and welfare, and \$117,000 in utilities cost as compared with the same period in the prior fiscal year.

SG&A expenses in the electronic segment increased by \$692,000 to \$4,800,000 or 10.7% of net sales for the year ended March 31, 2021, compared to \$4,108,000 or 10.3% of net sales for fiscal 2020. The increase was mainly due to increase of \$654,000 in staff costs and welfare when compared to prior fiscal year.

Other Income (Expenses), Net - Other income was \$405,000 for the year ended March 31, 2021, as compared to other expenses of \$425,000 in the prior fiscal year.

On a segment basis, other income attributable to the plastic segment for the year ended March 31, 2021 was \$614,000, as compared to other expense of \$584,000 for prior fiscal year. Other income in fiscal 2021 was mainly due to an exchange gain of \$1,003,000 and a provision of \$438,000 for credit losses during fiscal 2021, as compared to an exchange loss of \$588,000 and a provision of \$218,000 for credit losses, offsetting a gain of \$219,000 on sales of materials in fiscal 2020.

Other expenses attributable to the electronic segment for the year ended March 31, 2021 were \$209,000, as compared with other income of \$159,000 for the prior fiscal year. The decrease in other income was mainly due to a decrease of \$519,000 in exchange income and an increase of \$117,000 for reversal of doubtful debts during the year ended March 31, 2021 as compared to last fiscal year.

Operating Income - Operating income was \$3,261,000 for the year ended March 31, 2021, as compared to operating income of \$1,413,000 in the prior fiscal year.

Corporate expenses of \$1,311,000 and \$1,294,000 were incurred during the fiscal year of 2021 and 2020, respectively.

On a segment basis, the operating income in the plastic segment was \$1,096,000 in the year ended March 31, 2021, as compared to an operating income of \$357,000 in fiscal 2020. The increase in operating income in the plastic segment was mainly due to the improvement in gross margin and other income as described above.

The electronic segment reported an operating income of \$3,476,000 in the year ended March 31, 2021, compared to an operating income of \$2,350,000 in fiscal 2020. The increase in operating income was mainly due to the increase in gross profit as described above.

Non-Operating Income (Expense) – Non-operating income for the year ended March 31, 2021 was \$5,445,000, as compared to a non-operating expense of \$2,360,000 in last fiscal year. The increase in non-operating income was primarily due to increases of \$7,190,000 on change of the fair value of marketable securities, \$303,000 from realized gain on sale of marketable securities and \$462,000 from rental income as compared to fiscal 2020.

Income Taxes – Income tax for the year ended March 31, 2021 was \$322,000 as well as a deferred tax provision of \$153,000. This is compared to an income tax expense of \$264,000 and a deferred tax benefit of \$109,000 in last fiscal year.

On a segment basis, there was income tax expense of \$60,000 and a deferred tax provision of \$153,000 in the plastic segment for the year ended March 31, 2021, as compared to an income tax expense of \$73,000 and a deferred tax benefit of \$109,000 during the last fiscal year. The income tax expense of the electronic segment was \$262,000 for the year ended March 31, 2021, as compared to \$191,000 in fiscal 2020.

Net Income (Loss) – The Company had net income of \$8,231,000 for the year ended March 31, 2021, as compared to a net loss of \$1,320,000 for the year ended March 31, 2020. The increase in net income was mainly due to the increase in non-operating income as described above.

Net income for the plastic segment for the year ended March 31, 2021 was \$5,810,000, as compared to net loss of \$1,379,000 for fiscal 2020. The increase in net income in the plastic segment was mainly due to an increase in non-operating income as described above.

Net income for the electronic segment for the year ended March 31, 2021 was \$3,732,000, as compared to net income of \$1,353,000 for fiscal 2020. The increase in net income in the electronic segment was mainly attributable to increases in gross profit and in non-operating income as described above.

Seasonality

The following table sets forth certain unaudited financial information sequentially on a semi-annual basis for the each of the years ending March 31, 2020, March 31, 2021, and March 31, 2022 (in thousands):

	Year ended March 31,					
	2020		2021		2022	
	H1	H2	H1	H2	H1	H2
Net sales	\$37,713	\$27,655	\$27,690	\$37,196	\$39,782	\$46,198
Gross profit	6,544	5,320	5,595	7,571	6,420	7,532
Operating income	1,156	257	959	2,302	1,183	1,576
Net income (loss)	1,249	(2,569)	1,532	6,699	4,298	3,934

Impact of Inflation

Historically, the Company focused upon increasing transaction volume in order to compensate for inflation in China, where virtually all of the Company’s assets and employees are located and inflation in China had little impact on Deswell. However, inflation in China has recently affected the Company significantly.

The inflation rate in China jumped to 2.1% in April 2022 and stayed at that level in May of 2022. This is the highest since November 2021, amid the logistics disruptions caused by strict COVID-19 measures. However, the Company’s actual cost of operations has significantly exceeded the overall inflation rate in China. The rapid growth of China’s economy in general has in the past few years increased the Company’s operating costs, including energy prices and labor costs. These increased costs have adversely affected the Company’s cost of operations, caused the Company to increase its prices, and resulted in the loss of some customers.

There is no fixed minimum wage which is applicable to all of China; local governments in China adopt different amounts based on the situation in their area. China’s Guangdong Province, where our manufacturing facilities are located, raised minimum wages by approximately 10% in December 2021. Effective May 1, 2015, minimum wage levels across Guangdong Province, including Dongguan, where our manufacturing facilities are located, were increased by an average of 15.3%. Effective December 1, 2021, the Guangdong Provincial Government increased the Province’s statutory minimum wage by around RMB180 per month. The Provincial Government sets different tiers of minimum wages according to the developmental status of the Province’s urban clusters. In the City of Dongguan, where our manufacturing facilities are located, the minimum wage was raised to RMB1,900 per month from RMB1,720 per month since July 1, 2018. Regions may want to freeze local wages in order to maintain their economic competitiveness amid the economic slowdown.

Increases in wages also result in increases in our and other employer’s contributions for various mandatory social welfare benefits for Chinese employees that are based on percentages of their salaries. Continuing material increases in our cost of labor will continue to increase the Company’s operating costs and will adversely affect Deswell’s financial results unless it passes on such increases to customers by increasing the prices of products and services. The effect of increases in the prices of products and services would make the Company’s products more expensive in global markets, such as the United States and the European Union. This could result in the loss of customers, who may seek, and be able to obtain, products and services comparable to those Deswell offers in lower-cost regions of the world. If the Company does not increase prices to pass on the effect of increases in labor costs, Deswell’s margins and profitability would suffer.

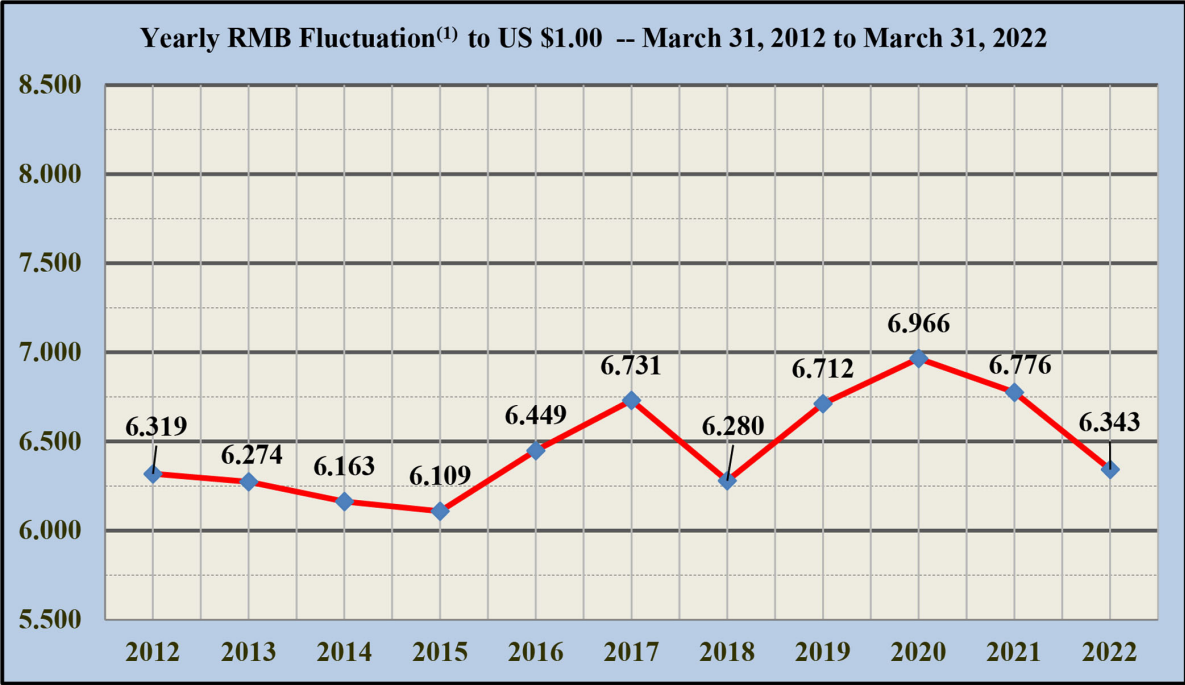
Because most of the Company’s labor costs are incurred in China and therefore paid in RMB, Deswell’s business and financial results will be affected by the exchange rate of RMB to the U.S. dollar, as is discussed in “Exchange Rates” immediately below.

Exchange Rates

The Company’s sales are mainly in United States dollars and Hong Kong dollars and its expenses are mainly in United States dollars, Hong Kong dollars and Chinese RMB.

The Hong Kong dollar has been pegged to the U.S. dollar at approximately 7.80 and relatively stable. The Hong Kong 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 and has not in the past presented a material currency exchange risk. Although announcements by Hong Kong’s central bank indicate its intention to maintain the currency peg between the Hong Kong dollar and the U.S. dollar, if Hong Kong does change and follows China to a floating currency system or otherwise changes the exchange rate system of Hong Kong dollars to U.S. dollars, our margins and financial results could be adversely affected.

Between 1994 and July 2005, the market and official RMB rates were unified and the value of the RMB was essentially pegged to the U.S. dollar and was relatively stable. On July 21, 2005, the People’s Bank of China adjusted the exchange rate of RMB to the U.S. dollar by linking the RMB to a basket of currencies and simultaneously setting the exchange rate of RMB to U.S. dollars, from 1:8.27, to a narrow band of around 1:8.11. The following chart illustrates the fluctuations since the July 31, 2005 adjustment of the RMB to the U.S. dollar by showing the exchange ratio at the end of each of Deswell’s fiscal years from March 31, 2006 to March 31, 2022.



(1) RMB (yuan) to U.S. dollar data presented in this chart are the midpoint rates on March 31 of the year indicated as reported by “Historical Exchange Rates” at <http://www.oanda.com/currency/historical-rates/>.

Since 2018 the RMB has become depreciated against the U.S. dollar, and the Company’s results have benefited from this depreciation rate. However, since then, the RMB has fallen against the U.S. dollar to its 18-month low of 6.7110 in May 2022 amid the COVID-19 lockdowns in key Chinese cities. Despite the global economy’s softening, the China Central Bank is running restrained monetary policies, eschewing sharp rate cuts, which may further contribute to the RMB’s weakness.

Since the U.S. President Joseph Biden took office in January 2021, the Biden administration has considered lifting some of the trade tariffs on Chinese goods to respond to domestic dissatisfaction with current inflation in the United States. However, there appears to still be hesitation by the Biden administration on the on-going tariff issue, while on the other hand, China has not changed its trade behavior due to the U.S. trade sanctions leading to a continued large trade deficit between the U.S. and China.

Further, it is forecasted that the volatility of the U.S. dollar and RMB exchange rate will continue in 2022 due to various factors, such as ongoing uncertainty from the coronavirus pandemic, the monetary policies by the U.S. Federal Reserve and the China Central Bank, the trade imbalance between the U.S. and China, and the ongoing war between Russia and Ukraine together with its impact on China's relations with its international allies.

We did not hedge our currency risk during the years ended March 31, 2020, 2021 and 2022 and at March 31, 2022, we had no open forward currency contracts. We continually review our hedging strategy and there can be no assurance that hedging techniques we may implement will be successful or will not result in charges to our results of operations.

Liquidity and Capital Resources

Capital resources

To date, we have financed our operations primarily through cash generated by operating activities and historical equity financing activities. As of March 31, 2020, 2021 and 2022, we had cash and cash equivalents of US\$22.5 million, US\$20.2 million and US\$13.5 million, respectively. Our cash and cash equivalents primarily consist of cash on hand and fixed deposits. We believe that our cash and cash equivalents and our anticipated cash flows from operations will be sufficient to meet our current and anticipated needs for general corporate purposes for at least the next 12 months.

Fiscal year 2022

For the year ended March 31, 2022, net cash used in operating activities totaled \$183,000, including net income of \$8,232,000 and depreciation and amortization expenses of \$1,736,000. For the year ended March 31, 2021, net cash provided by operations totaled \$3,296,000, including net income of \$8,231,000 and depreciation and amortization expenses of \$1,755,000. Accounts receivable increased by \$3,339,000 as compared to balances at March 31, 2021, primarily as a result of an increase in sales during the fiscal year. Inventories increased by \$7,601,000 over levels at March 31, 2021, mainly because of relatively higher level of raw materials maintained during the fiscal year relating to increased sales turnover. Accounts payable increased by \$316,000 over levels at March 31, 2021, primarily because of the increase in materials purchases.

Net cash used in investing activities amounted to \$3,432,000 for the year ended March 31, 2022 while net cash used in investing activities in fiscal year 2021 amounted to \$2,723,000. Capital expenditures during these periods totaled \$1,504,000 and \$551,000, respectively.

In fiscal year 2022, there was an increase in fixed deposits with original maturity over three months of \$1,654,000 and an increase in fixed deposits over twelve months of \$26,000. Also during fiscal year 2022, we acquired marketable securities for \$11,543,000 and received \$11,245,000 in cash proceeds from the sale of marketable securities.

Net cash used in financing activities for the year ended March 31, 2022 was \$3,143,000, which was mainly used to fund dividend payments to shareholders. Net cash used in financing activities for the year ended March 31, 2021 was \$2,864,000, which was used to fund dividend payments to shareholders.

Fiscal year 2021

For the year ended March 31, 2021, net cash provided by operating activities totaled \$3,296,000, including net income of \$8,231,000 and depreciation and amortization expenses of \$1,755,000. For the year ended March 31, 2020, net cash provided by operations totaled \$13,121,000, including net loss of \$1,320,000 and depreciation and amortization expenses of \$1,973,000. Accounts receivable increased by \$2,804,000 as compared to balances at March 31, 2020, primarily as a result of an increase in sales during the fiscal year. Inventories increased by \$7,615,000 over levels at March 31, 2020, mainly because of relatively higher level of raw materials maintained during the fiscal year relating to increased sales turnover. Accounts payable increased by \$4,918,000 over levels at March 31, 2020, primarily because of the increase in materials purchases.

Net cash used in investing activities amounted to \$2,723,000 for the year ended March 31, 2021 while net cash used in investing activities in fiscal year 2020 amounted to \$2,656,000. Capital expenditures during these periods totaled \$551,000 and \$507,000, respectively.

In fiscal year 2021, there was an increase in fixed deposits over three months of \$1,917,000 and an increase in fixed deposits over twelve months of \$427,000. Also during fiscal year 2021, we acquired marketable securities for \$6,059,000 and received \$6,150,000 in cash proceeds from the sale of marketable securities.

Net cash used in financing activities for the year ended March 31, 2021 was \$2,864,000, which was mainly used to fund dividend payments to shareholders. Net cash used in financing activities for the year ended March 31, 2020 was \$2,322,000, which was used to fund dividend payments to shareholders.

Restricted net assets

Our cash and cash equivalents at March 31, 2022 were unrestricted and held for working capital purposes. Our direct PRC subsidiaries are, however, subject to PRC restrictions on distributions to equity holders. Under existing PRC foreign exchange regulations, payments of current account items, including profit distributions, interest payments, and trade- and service-related foreign exchange transactions can be made in foreign currencies without prior the SAFE approval as long as certain routine procedural requirements are fulfilled. Therefore, our PRC subsidiaries are allowed to pay dividends in foreign currencies to us without prior the SAFE approval by following certain routine procedural requirements. However, current PRC regulations permit our PRC subsidiaries to pay dividends to us only out of their accumulated profits, if any, determined in accordance with Chinese accounting standards and regulations. Each of our PRC subsidiary is required to set aside at least 10% of its after-tax profits after making up previous years' accumulated losses each year, if any, to fund certain statutory reserve funds until the total amount set aside reaches 50% of its registered capital. In addition, it may allocate a portion of its after-tax profits based on PRC accounting standards to discretionary reserve funds at its discretion. These reserves are not distributable as cash dividends. Historically, our PRC subsidiaries have not paid dividends to us, and it will not be able to pay dividends until it generates accumulated profits. Furthermore, capital account transactions, which include foreign direct investment and loans, must be approved by and/or registered with the SAFE, its local branches and certain local banks.

The restricted net assets of our PRC subsidiaries amounted to US\$58.9 million, US\$57.9 million and US\$58.9 million as of March 31, 2020, 2021 and 2022, respectively.

At March 31, 2022, the Company had cash and cash equivalents of \$13,465,000. At that date, the Company had no committed credit facilities. The Company expects that working capital requirements and capital additions will continue to be funded through cash on hand and internally generated funds. However, the Company may choose to obtain additional debt or equity financing if it believes it to be appropriate and available on reasonable terms. The Company's working capital requirements are expected to increase in line with the growth in the Company's business.

At March 31, 2022, the Company had capital commitments totaling approximately \$211,000, mainly for leasehold improvements, plant and machineries, vehicles, and computer packages, all of which are expected to be disbursed during the year ending March 31, 2023.

Future liquidity needs will depend on fluctuations in levels of inventory, accounts receivable and accounts payable, the timing of capital expenditures for new equipment, the extent to which we utilize operating leases for new facilities and equipment, and the levels of shipments and changes in the volumes of customer orders.

Trend Information

Other than as disclosed elsewhere in this annual report, we are not aware of any trends, uncertainties, demands, commitments or events for the period from April 1, 2021 to March 31, 2022 that are reasonably likely to have a material effect on our net revenues, income, profitability, liquidity or capital resources, or that caused the disclosed financial information to be not necessarily indicative of future operating results or financial conditions.

Critical Accounting Estimates

This discussion and analysis of financial condition and results of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP). The preparation of these financial statements requires the Company to make estimates, judgments, and assumptions that can have a meaningful effect on the reporting of consolidated financial statements. For more information on our significant accounting policies, refer to Note 2 of Notes to Consolidated Financial Statements included in Part III, Item 18, in this Report

Critical accounting estimates are defined as those reflective of significant judgments, estimates and uncertainties, which may result in materially different results under different assumptions and conditions. The Company believes the following are its critical accounting estimates:

Inventories

Our inventories are stated at the lower of cost or the estimated market value. Cost is determined on the weighted average basis. Work-in-progress and finished goods inventories consist of raw materials, direct labor and overhead associated with the manufacturing process.

The Company periodically performs an analysis of inventory to determine obsolete or slow-moving inventory and determine if its cost exceeds the market value. The market value of the inventories are estimated based on the current market situation and historical experience on similar inventories.

Any changes in the assumptions would increase or decrease the amount of inventories write-down or the related reversals of write-down. The changes in the write-down would affect the Company’s profit or loss during the year.

Impairment of long-lived assets

Our long-lived assets are included in impairment evaluations when events and circumstances exist that indicate the carrying value of these assets may not be recoverable. In accordance with ASC No. 360, “Property, Plant and Equipment,” the Company assesses the recoverability of the carrying value of long-lived assets by first grouping its long-lived assets with other assets and liabilities at the lowest level for which identifiable cash flows largely independent of the cash flows of other assets and liabilities (the asset group) and, secondly, estimating the undiscounted future cash flows that are directly associated with and expected to arise from the use of and eventual disposition of such asset group. The Company estimates the undiscounted cash flows over the remaining useful life of the primary asset within the asset group. If the carrying value of the asset group exceeds the estimated undiscounted cash flows, the Company records an impairment charge to the extent the carrying value of the long-lived asset exceeds its fair value. The Company determines fair value through quoted market prices in active markets or, if quotations of market prices are unavailable, through the performance of internal analysis using a discounted cash flow methodology. The undiscounted and discounted cash flow analyses based on a number of estimates and assumptions, including the expected period over which the asset will be utilized, projected future operating results of the asset group, discount rate and long-term growth rate.

Since the market value of the assets cannot be obtained reliably, we evaluate the impairment of the long-lived assets by comparing the carrying value of the assets to an estimate of future undiscounted cash flows expected to be generated from the use of the assets and their eventual disposition based on the historical trends and existing macroeconomic conditions.

Any changes in these estimates can have a significant impact on the assessment of fair value which could result in material impairment losses.

Allowance for credit losses

The Company estimated the expected credit losses for accounts receivable with similar risk characteristics on a pool basis. For each pool, the Company first estimated its recovery period based on relevant historical accounts receivable collection information. Then it estimated the credit allowances based on the recovery period and the historical distribution of each aging bucket.

As of the date of this Report, COVID-19 pandemic continues to evolve. If our customers fail to manage the demand, supply and operational challenges resulted from the impact of COVID-19 pandemic, their financial performance and position may be deteriorated, which would impact our financial performance. Accordingly, the Company expects these judgments and estimates may be subject to change, which could materially impact future periods.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

Directors and Senior Management

The directors and executive officers of the Company at June 30, 2022 are as follows:

Name	Age	Position(s) with Company
Richard Pui Hon Lau	78	Chairman of the Board of Directors
Edward So Kin Chung	49	Chief Executive Officer
Chin Pang Li	77	Executive Director of Manufacturing and Administration for Plastic Operations and Member of the Board of Directors
Hung-Hum Leung	76	Non-Executive Director and Member of Audit Committee
Allen Yau-Nam Cham	75	Non-Executive Director and Chairman of Audit Committee
Wing-Ki Hui	78	Non-Executive Director and Member of Audit Committee
Herman Wong Chi Wah	44	Chief Financial Officer

Richard Pui Hon Lau. Mr. Lau served as Chief Executive Officer and Chairman of the Board of Directors of the Company and its predecessors since their inception in 1987 until February 2007, at which time he retired as Chief Executive Officer. Mr. Lau remains as Chairman of the Board.

Edward So Kin Chung. Mr. So has been in the electronic manufacturing industry internationally and in China for more than 23 years and has been with Deswell for 16 years. He was previously appointed the Managing Director of the electronics division. Previously, Mr. So spent five years at Peavey Electronics in increasing roles of responsibility and prior to that was employed at HSBC. Mr. So holds a Bachelor's degree in Electrical and Electronic Engineering from the University of Hong Kong, and Master's in Business Administration from Royal Holloway, University of London.

Chin Pang 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, a position which he held until March 31, 2006. As Executive Director of Manufacturing and Administration for Plastic Operations, Mr. Li is in charge of the 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.

Hung-Hum Leung. Mr. Leung has been a non-executive 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. (since 2007 known as China Properties Investment Holdings Limited), 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.

Allen Yau-Nam Cham. Mr. Cham has been a non-executive director of the Company and member of the Audit Committee since August 2003. He has over 20 years of experience in the securities industry. He obtained his Bachelor of Science degree from St. Mary's University, Halifax, Canada, Bachelor of Engineering (Electrical) degree from Nova Scotia Technical College, Halifax, Canada and Master of Business Administration degree from University of British Columbia, Canada.

Wing-Ki Hui. Mr. Hui has been a non-executive director of the Company and member of the Audit Committee since October 2004. Since 1995 he has been the Operation Director of the Electronic Products Division of Tomorrow International Holdings Limited, a company listed on the Hong Kong Stock Exchange engaged in manufacturing of consumer electronics and printed circuit boards. Prior to serving in this capacity, Mr. Hui was Executive Director of Sharp Brave International Holdings Limited from 1991 to 1995 and Director of Sharp Brave Electronics Co., Ltd. from 1984 to 1995. Mr. Hui possesses over 20 years of experience in the electronic manufacturing industry, and is a graduate of South East Electronic College in Hong Kong.

Herman Wong Chi Wah. Mr. Wong joined the Company as Chief Financial Officer effective on April 1, 2011. During the 10 years immediately before joining Deswell, Mr. Wong worked for Deloitte Touche Tohmatsu, an international public accounting and auditing firm, where he most recently served as senior manager. During his tenure at Deloitte Touch Tohmatsu, he worked in an auditing capacity with a variety of Hong Kong listed companies and multinational corporations as well as working on several initial public offerings for Hong Kong listed companies. Mr. Wong received his Bachelor of Business Administration in Accounting from Hong Kong Polytechnic University.

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, provided that Mr. Lau's beneficial ownership allows him to determine who is elected as a director or executive officer of the Company.

There are no arrangements or understandings with major shareholders, customers, suppliers or others, pursuant to which any member of the board of directors or senior management was selected as a director or member of senior management.

Compensation of Directors and Executive Officers

Executive Officers

The amount of compensation (cash benefits) paid by the Company and its subsidiaries was approximately \$1,892,000 during the year ended March 31, 2022 to all directors and to executive officers as a group for services in all service capacities. These amounts exclude amounts paid by the Company or its subsidiaries as dividends to directors and executive officers in their capacity as shareholders of the Company for the year ended March 31, 2022.

During the year ended March 31, 2022, no options to purchase shares of common stock were granted to the Company's directors and officers.

See the discussion under "We depend on our executive officers, senior managers and skilled personnel." in ITEM 3 "Key Information – Risk Factors" on page 27 of this Report.

Directors

Our policy is to pay directors who are not employees of the Company or any of its subsidiaries \$2,000 per month for services as a director, and to reimburse directors for all reasonable expenses incurred in connection with their services as a director and member of Board committees.

The Board has determined that Messrs. Hung-Hum Leung, Allen Yau-Nam Cham and Wing-Ki Hui are each “independent” within the meaning of Rule 5605(a)(2) of the NASDAQ Marketplace Rules.

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.

Audit Committee

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. Hung-Hum Leung, Allen Yau-Nam Cham and Wing-Ki Hui, each of whom is an independent director within the meaning of that term under Rule 5605(a)(2) of the NASDAQ Marketplace Rules. Mr. Allen Yau-Nam Cham currently acts as the Chairman of the Audit Committee.

Other Committees; NASDAQ Compliance

Various corporate governance practices required of public companies with securities listed on The NASDAQ Stock Market are not required of “controlled companies” such as Deswell. Of the corporate governance practices required under NASDAQ’s MarketPlace Rules, Deswell does not have a compensation committee or a nominating committee consisting of independent directors; does not have a formal written charter addressing the nominations process; does not have nominees to its board selected or recommended by a majority of its independent directors; and does not have the compensation of its Chief Executive Officer and other executive officers determined or recommended to the board by a majority of its independent directors. See “Our exemptions from certain of the reporting requirements under the Exchange Act limits the protections and information afforded to investors” on page 18 in the Risk Factors section of this Report for a further discussion of how our SEC reporting and corporate governance practices differ from those applicable to U.S. domestic issuers and U.S. NASDAQ-listed companies. The reason that Deswell does not have a compensation committee or a nominating committee consisting of independent directors is that, as a “controlled company,” the Company is not required to have such committees, and nevertheless maintain the listing of its common shares on the NASDAQ Global Market.

Employees

At March 31, 2022, the Company employed 990 persons on a full-time basis, of which 9 were located in Macao and 981 were located in or travel to and from China. Of the Company’s employees in China, at March 31, 2022:

- 397 were engaged in plastic injection molding manufacturing, and
- 584 were engaged in contract electronic manufacturing.

The Company has not experienced significant labor stoppages. Management believes that relations with the Company’s employees are satisfactory.

Share and Option Ownership of Directors and Senior Management

For information concerning the beneficial ownership of the Company’s common shares, including options, by directors and senior management and major shareholders, see ITEM 7 of this Report.

Employee Stock Option Plans

On August 20, 2003, the Board approved the adoption of the 2003 Stock Option Plan permitting the Company to grant options to purchase up to an additional 900,000 common shares to employees, officers, directors, consultants and advisors of the Company. On September 30, 2003 shareholders approved the 2003 plan. On August 1, 2005, the Company’s Board of Directors, subject to shareholder approval, approved amendments to the 2003 Stock Option to increase by 500,000 shares in the number of shares that can be optioned and sold under the 2003 Stock Option Plan, bringing to a total of 1,400,000 shares the number of common shares that can be optioned and sold under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual Shareholders’ Meeting held on September 19, 2005.

On August 17, 2007, the Company’s Board of Directors, subject to shareholder approval, approved amendments to the 2003 Stock Option to increase by 400,000 shares in the number of shares that can be optioned and sold under the 2003 Stock Option Plan, bringing to a total of 1,800,000 shares the number of common shares that can be optioned and sold under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual Shareholders’ Meeting held on October 9, 2007.

On August 13, 2010, the Company’s Board of Directors, subject to shareholder approval, approved amendments to the 2003 Stock Option Plan to increase by 800,000 shares in the number of shares that can be optioned and sold under the 2003 Stock Option Plan, bringing to a total of 2,600,000 shares the number of common shares that can be optioned and sold under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual shareholders’ Meeting held on September 16, 2010.

On August 7, 2013, the Company’s Board of Directors, subject to shareholder approval, approved amendments to the 2003 Stock Option Plan to increase by 900,000 shares the number of shares that can be optioned and sold under the 2003 Stock Option Plan, bringing to a total of 3,500,000 shares the number of common shares that can be optioned and sold under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual shareholders’ Meeting held on September 11, 2013.

The Company’s option plans are administered by the Board of Directors, which determines the terms of options granted, including the exercise price, the number of shares subject to the option and the option’s exercisability. The exercise price of all options granted under the option plans must be at least equal to the fair market value of such shares on the date of grant. The maximum term of options granted under the option plans is 10 years.

Through June 30, 2022, options to purchase an aggregate of 5,669,000 shares had been granted under all of Deswell’s option plans. At June 30, 2022, there were options to purchase an aggregate of 400,000 common shares outstanding, and 1,318,000 shares were available for future grant under Deswell’s option plans.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

Major Shareholders

The Company is not directly owned or controlled by another corporation or by any foreign government. The following table sets forth, as of June 30, 2022, the beneficial ownership of the Company’s common shares by each person known by the Company to beneficially own 5% or more of the common shares of the Company and by each of the Directors and Senior Management of the Company who beneficially own in excess of one percent of the Company’s common shares.

Name of beneficial owner or identity of group	Shares beneficially owned ⁽¹⁾	
	Amount	Percent
Richard Pui Hon Lau	9,673,556 (2)	60.0
Chin Pang Li	1,625,750 (3)	10.1
Herman Wong Chi Wah	30,000 (4)	*
Edward So Kin Chung	50,000 (5)	*
Hung-Hum Leung	-	-
Allen Yau-Nam Cham	-	-
Wing-Ki Hui	-	-

* Less than 1%.

- (1) Based on 15,935,239 shares outstanding on June 30, 2022. However, in accordance with Rule 13d-3(d)(1) under the Securities Exchange Act of 1934, shares not outstanding but which are the subject of currently exercisable options have been considered outstanding for the purpose of computing the percentage of outstanding shares owned by the listed person holding such options, but are not considered outstanding for the purpose of computing the percentage of shares owned by any of the other listed persons.
- (2) Consists of 9,473,556 shares held of record by Mr. Lau and options to purchase 200,000 shares granted to Mr. Lau under the Company’s stock option plans. Mr. Lau’s options are exercisable at an exercise price of \$2.09 per share, with a term expiring on July 29, 2024.
- (3) Consists of 1,425,750 shares held of record by Mr. Li and options to purchase 200,000 shares granted to Mr. Li under the Company’s stock option plans. Mr. Li’s options are exercisable at an exercise price of \$2.09 per share, with a term expiring on July 29, 2024.
- (4) Consists of 30,000 shares held of record by Mr. Wong.
- (5) Consists of 50,000 shares held of record by Mr. So.

Change in the Percentage Ownership Held by Major Shareholders

The following table reflects the percentage of beneficial ownership of Deswell’s common shares by its major (five percent or more) shareholders during the past three years:

	Percentage Ownership at June 30, ⁽¹⁾		
	2020	2021	2022
Richard Pui Hon Lau	54.8	57.9	60.0
Chin Pang Li	10.1	10.1	10.1

(1) Based on 15,915,239 shares outstanding at June 30, 2020, 15,915,239 shares outstanding at June 30, 2021, and 15,935,239 shares outstanding at June 30, 2022: In accordance with Rule 13d-3(d) (1) under the Securities Exchange Act of 1934, common shares not outstanding at the specified date but which were the subject of options exercisable within 60 days of the specified date are considered outstanding for the purpose of computing the percentage of outstanding common shares owned by the listed person holding such options, but are not considered outstanding for the purpose of computing the percentage of common shares owned by any of the other listed persons.

All of the holders of the Company’s common shares (including Deswell’s major shareholders) have equal voting rights with respect to the common shares held. As of June 30, 2022, approximately 10 holders of record, who, management believes, held for more than 3,000 beneficial owners, held Deswell’s common shares. According to information supplied to the Company by its transfer agent, at June 30, 2022, 8 holders of record with addresses in the United States held approximately 12.8 million of our outstanding common shares.

Related Party Transactions

Deswell had no transactions of the kind specified in ITEM 7.B. of Form 20-F from April 1, 2017 through June 30, 2022, the latest practical date prior to filing of this Annual Report.

It is Deswell’s policy that all transactions between Deswell and any interested director or executive officer be approved by a majority of the disinterested directors and be on terms that are no more favorable than would be available from an independent third party.

ITEM 8. FINANCIAL INFORMATION

Financial Statements

Our Consolidated Financial Statements are set forth under ITEM 18 “Financial Statements.”

Legal Proceedings

The Company is not involved in any material legal proceedings.

Export Sales

Information regarding our export sales is provided in ITEM 4 “Information on the Company – Business Overview – Customers and Marketing.”

Dividend Policy

The Company declared and paid dividends during the year ended March 31,

- 2020 aggregating \$2,387,386, \$1,114,067 of which was based on results for the last six months of the year ended March 31, 2019; and \$1,273,219 of which was based on results of the first six months of the year ended March 31, 2020.
- 2021 aggregating \$2,864,743, \$1,432,372 of which was based on results for the last six months of the year ended March 31, 2020; and \$1,432,371 of which was based on results of the first six months of the year ended March 31, 2021.
- 2022 aggregating \$3,185,048, \$1,591,524 of which was based on results for the last six months of the year ended March 31, 2021; and \$1,593,524 of which was based on results of the first six months of the year ended March 31, 2022.

The Company declared a dividend of \$0.07 on June 10, 2019, which was based on the results of the last six months of the year ended March 31, 2019. The dividend was paid on July 12, 2019.

The Company declared a dividend of \$0.08 on November 15, 2019, which was based on the results of the first six months of the year ended March 31, 2020. The dividend was paid on December 13, 2019.

The Company declared a dividend of \$0.09 on June 11, 2020, which was based on the results of the last six months of the year ended March 31, 2020. The dividend was paid on July 10, 2020.

The Company declared a dividend of \$0.09 on November 10, 2020, which was based on the results of the first six months of the year ended March 31, 2021. The dividend was paid on December 10, 2020.

The Company declared a dividend of \$0.10 on June 10, 2021, which was based on the results of the last six months of the year ended March 31, 2021. The dividend was paid on July 9, 2021.

The Company declared a dividend of \$0.10 on November 22, 2021, which was based on the results of the first six months of the year ended March 31, 2022. The dividend was paid on December 22, 2021.

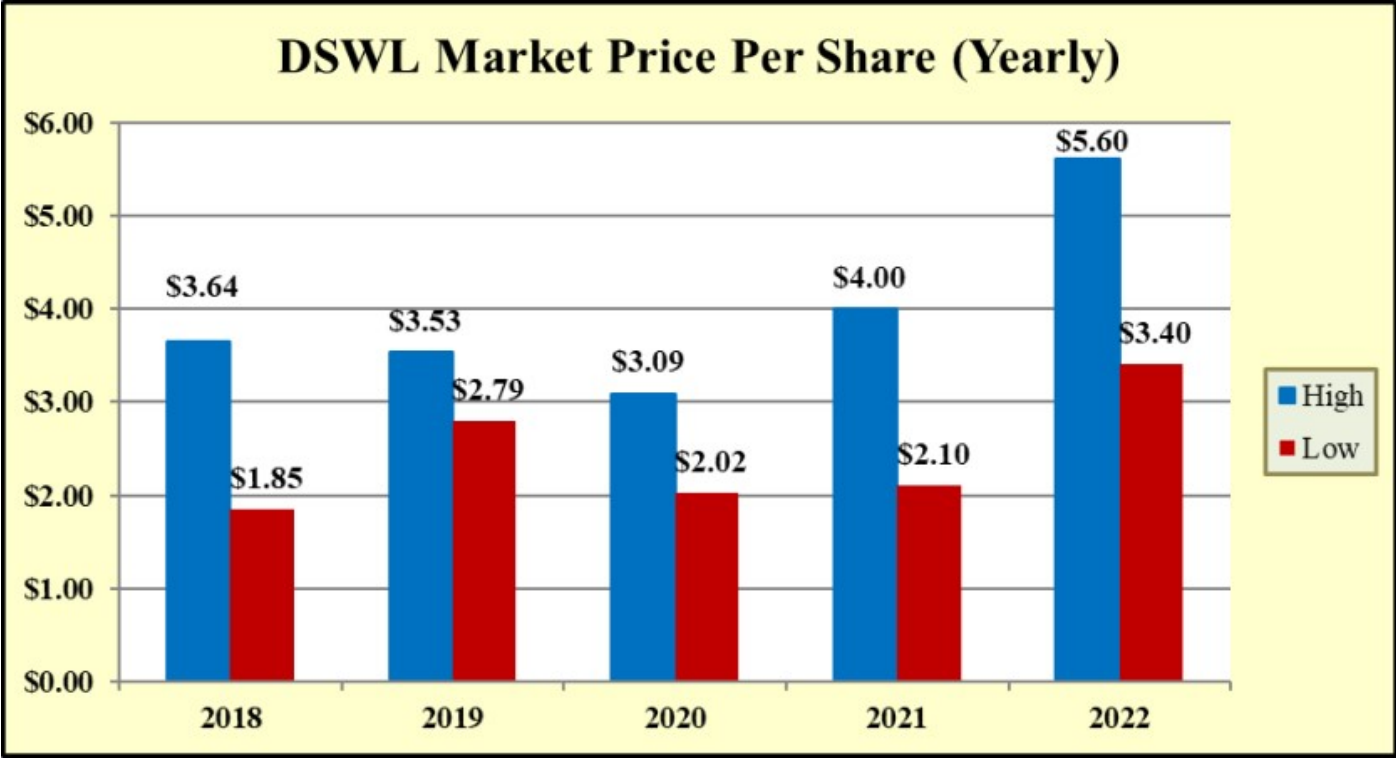
The Company declared a dividend of \$0.10 on June 16, 2022, which was based on the results of the last six months of the year ended March 31, 2022. The dividend was paid on July 15, 2022.

The Company’s financial results are released semi-annually. The Company expects to pay cash dividends on a semi-annual basis based on the Company’s six-month results. Whether future dividends will be declared will depend upon the Company’s future growth and earnings, of which there can be no assurance, and the Company’s cash flow needs for future development, which growth, earning or cash flow needs may be adversely affected by one or more of the factors discussed in ITEM 3 “Key Information — Risk Factors.” Accordingly, there can be no assurance that future cash dividends on the Company’s common shares will be declared, what the amounts of such dividends will be or whether such dividends, once declared for a specific period will continue for any future period or at all.

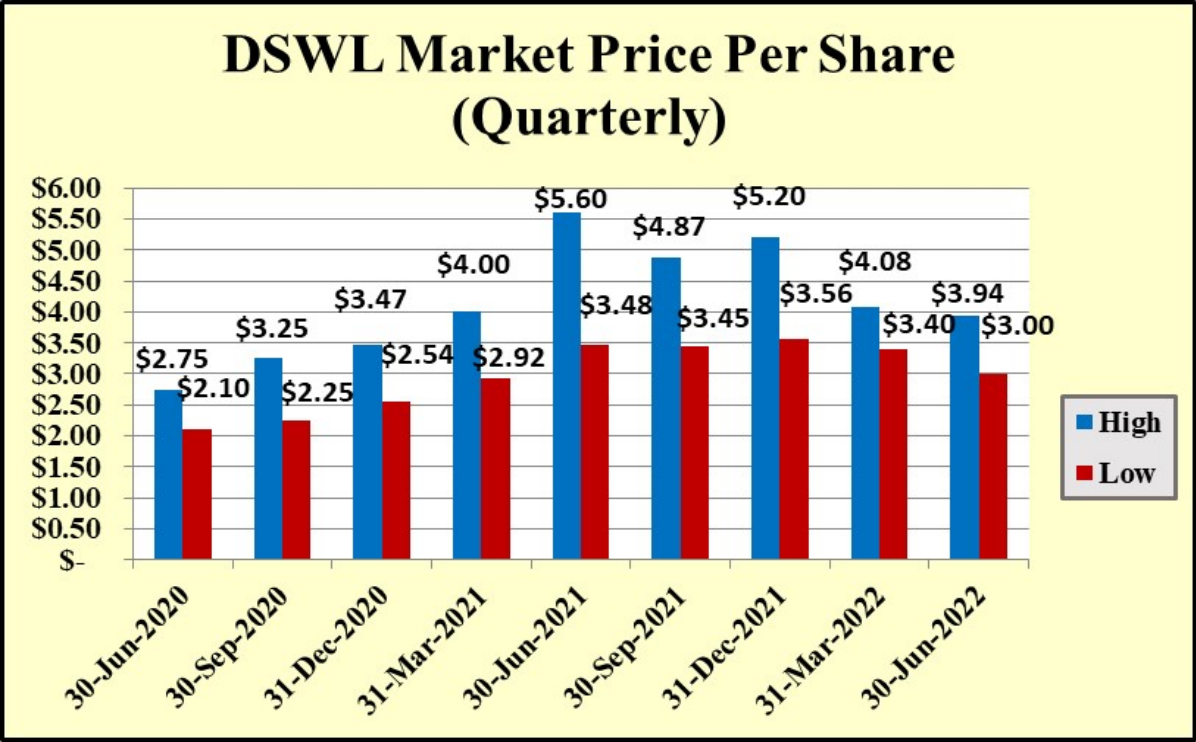
ITEM 9. THE OFFER AND LISTING

The Company’s shares are traded exclusively on the NASDAQ Global Market under the symbol “DSWL.”

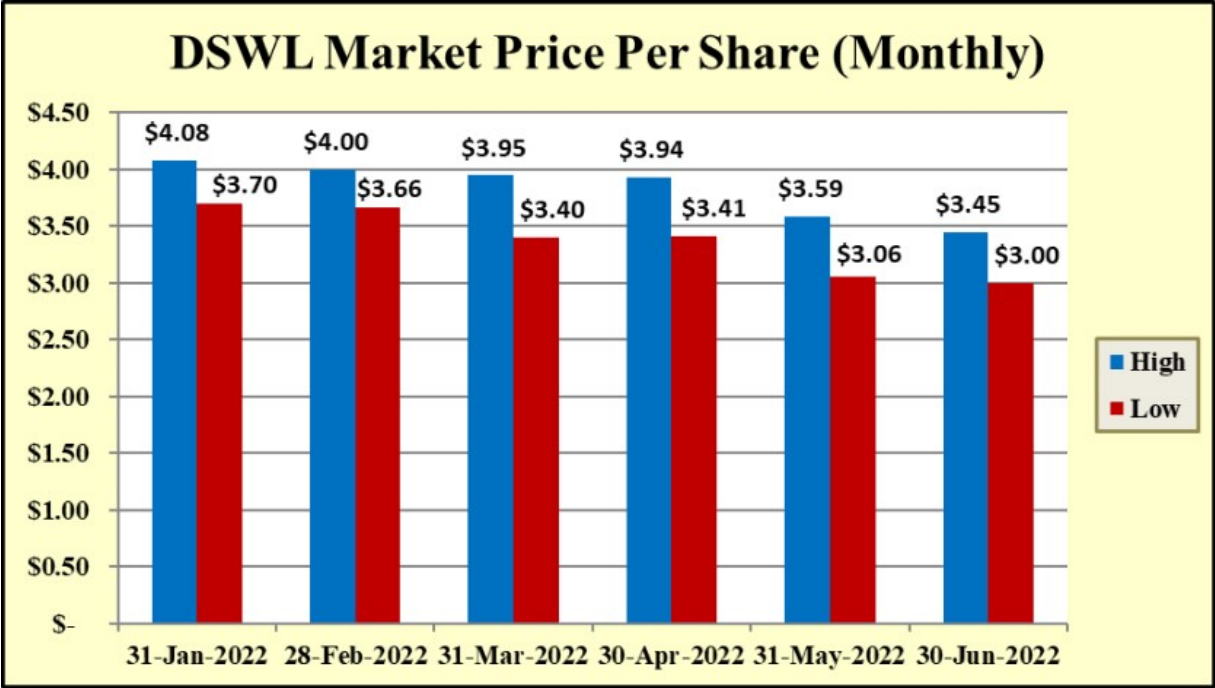
The following chart shows the annual high and low market prices as reported by The NASDAQ Global Market for each of Deswell’s fiscal years in the five-year period ended March 31, 2022:



The following chart shows the high and low market prices as reported by the NASDAQ Global Market for each of the quarters in the two-year period ended March 31, 2022 and for the quarter ended June 30, 2022:



The following chart shows the high and low market prices as reported by the NASDAQ Global Market during each of the months in the six-month period ended June 30, 2022:



ITEM 10. ADDITIONAL INFORMATION

Memorandum and Articles of Association

Effective December 13, 2007, we amended and restated our Memorandum and Articles of Association (collectively the “2007 Charter”), the instruments governing a company organized under the law of the BVI, which are comparable in purpose and effect to certificates or articles of incorporation and bylaws of corporations organized in a state of the United States.

Effective March 26, 2010, we amended Regulation 6.15 of our Articles of Association to reduce the number of our outstanding common shares that must be present in person or by proxy in order to hold any meeting of shareholders from no less than 50 percent to no less than 33⅓ percent and on March 30, 2010 an amended and restated Memorandum and Articles of Association was registered which incorporated the March 26, 2010 amendment into a restated Memorandum and Articles of Association.

Under our 2007 Charter, as amended through March 26, 2010 and applicable to the date of this Report (“our Charter”):

- our shares are eligible for a direct registration system operated by a securities depository in accordance with NASDAQ Marketplace Rule 5210(c) (formerly Rule 4350(1)).
- various consequential amendments were made to our Memorandum and Articles of Association in accordance with the advice from our U.S. and BVI counsel so as to (a) be consistent with the BVI BC Act, the BVI BC Act having come into force on January 1, 2004 superseding in certain respects the IBC Act, the relevant legislation which had previously governed us and (b) to make conforming changes resulting from the transition of the NASDAQ Stock Market’s operations on August 1, 2006 to that of a national securities exchange in the United States.
- certain special provisions of our Memorandum and Articles of Association that we adopted in preparation for our initial public offering of securities in the United States.
- provisions were added in recognition of, and to assure compliance with, certain laws, rules and regulations of the United States applicable to us, including the Sarbanes-Oxley Act of 2002, and the Marketplace Rules of the NASDAQ Stock Market.
- Holders of our shares:
 - £ are entitled to one vote for each whole share on all matters to be voted upon by shareholders, including the election of directors.
 - £ do not have cumulative voting rights in the election of directors.
 - £ are entitled to receive dividends if and when declared by our board of directors out of funds legally available under BVI law.
 - £ all of common shares are equal to each other with respect to liquidation and dividend rights.
 - £ in the event of our liquidation, all assets available for distribution to the holders of our common shares are distributable among them according to their respective holdings.

Objects and Purposes

Our objects and purposes are described in Clause 5 of our Memorandum of Association and are generally to engage in any act or activity that is not prohibited under the laws of the BVI.

Directors

Regulation 12.4 of our Articles of Association provides that except as otherwise provided in the BVI BC Act – the BVI corporate law that governs BVI companies like Deswell – no agreement or transaction between the Company and one or more of its directors or any person in which any director has a financial interest or to whom any director is related, including as a director of that other person, is void or voidable for this reason only or by reason only that the director is present at the meeting of directors or at the meeting of the committee of directors that approves the agreement or transaction or that the vote or consent of the director is counted for that purpose if the material facts of the interest of each director in the agreement or transaction and his interest in or relationship to any other party to the agreement or transaction are disclosed in good faith or are known by the other directors and such agreement or transaction has been approved by the irrevocable vote of a majority of the Company’s directors, including at least one Independent Director. In addition, the favorable vote of a majority of the directors, including at least one Independent Director, shall be required to approve any transaction or agreement between the Company and any officer of the Company or any person or entity holding ten percent or more of the outstanding Shares.

Our Articles of Association (Regulation 7.11) provide that the directors may by a resolution of directors, fix the emoluments of directors with respect to services to be rendered in any capacity to the Company.

BVI law and our Articles of Association provide that the management of the business and the control of Deswell shall be vested in the directors, who in addition to the powers and authorities expressly conferred by the Articles of Association, may also exercise all such powers, and do all such acts and things, as may be done by Deswell and are not by the Articles of Association or BVI law expressly directed or required to be exercised or done by a meeting of shareholders. Our Articles of Association provide that the directors may by resolution exercise all the powers of Deswell to borrow money and to mortgage or charge its undertakings and property or any part thereof, to issue debentures, debenture stock and other securities whenever money is borrowed or as security for any debt, liability or obligation of Deswell or of any third party.

BVI law and our Memorandum and Articles of Association do not contain an age limit requirement for our directors. Under our Articles of Association, no shares are required for director's qualification.

Rights, Preferences and Restrictions of Authorized and Outstanding Shares and Changes to Rights of Shareholders

Deswell has one class and series of shares authorized or outstanding: common shares, no par value per share. Our authorized capital consists of 30,000,000 common shares, no par value per share, of which 15,935,239 common shares were outstanding on June 30, 2022.

Holders of our common shares are entitled to one vote for each whole share on all matters to be voted upon by shareholders, including the election of directors. Holders of our common shares do not have cumulative voting rights in the election of directors. All of our common shares are equal to each other with respect to liquidation and dividend rights. Holders of our common shares are entitled to receive dividends if and when declared by our board of directors out of funds legally available under BVI law. In the event of our liquidation, all assets available for distribution to the holders of our common shares are distributable among them according to their respective holdings. Holders of our common shares have no preemptive rights to purchase any additional, unissued common shares. There are no provisions of the Articles of Association or Memorandum that impose conditions with respect to changes in Deswell capital that are more stringent than is required by applicable law.

Calling Annual General Meetings and Extraordinary General Meetings of Shareholders

BVI law does not require a company, such as Deswell, to have an annual meeting. Our Articles of Association do, however, require an annual meeting of shareholders for the election of directors and for such other business as may come before the meeting (Regulation 6.3).

Under BVI law, unless otherwise provided by a company's Memorandum or Articles of Association, the directors may call meetings of shareholders at any time (Regulation 6.1) and, upon the written request of shareholders entitled to exercise ten percent or more of the voting rights in respect of the matter for which the meeting is requested, the directors shall convene a meeting of shareholders (Regulation 6.2).

BVI law and our Articles of Association state that the directors may fix the date that notice is given of a meeting of shareholders, whether extraordinary or annual, as the record date for determining those shares that are entitled to vote at the meeting (Regulation 6.5).

BVI law and our Articles of Association provide that notice of all meetings of shareholders, stating the time, place and purposes thereof, shall be given not fewer than seven days before the date of the proposed meeting to those persons whose names appear as shareholders in our share register on the date of the notice and are entitled to vote at the meeting (Regulation 6.8).

Limitations on Share Ownership

BVI law and our Memorandum and Articles of Association do not impose any limitations on the right of anyone to own, hold or exercise voting rights to our common shares.

Potential Anti-Takeover Deterrence

Neither our Memorandum nor Articles of Association contain provisions that would have an effect of delaying, deferring or preventing a change in control of Deswell and that would operate only with respect to a merger, acquisition or corporate restructuring involving Deswell or any of its subsidiaries. However, pursuant to our Memorandum and Articles of Association and pursuant to the laws of the BVI, our board of directors without shareholder approval may amend our Memorandum and Articles of Association, which could have the effect of changing the rights of shareholders, provided that a majority of our independent directors do not vote against the amendment and provided further that our directors may not make an amendment:

- (a) to restrict the rights or powers of the shareholders to amend the Memorandum or the Articles;
- (b) to change the percentage of shareholders required to pass a Resolution of Shareholders to amend the Memorandum or the Articles;
- (c) where the Memorandum or the Articles cannot be amended by the Shareholders;
- (d) change Clause 7 of our Articles of Association conferring the rights of our shareholders to one vote per share, the right to equal share in dividend paid by the company, or to surplus assets on liquidation; or
- (e) change Clause 9 of our Articles of Association which sets forth rights of our shareholders and directors to amend our Memorandum and Articles of Association.

Our directors’ ability to amend our Memorandum and Articles of Association, without shareholder approval in certain circumstances, 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.

Ownership Information

Neither our Memorandum nor Articles of Association provide that information about our shareholders, even those owning significant percentages of our shares, must be disclosed publicly.

Differences from United States Law

The laws of the BVI governing the provisions of our Memorandum and Articles of Association discussed above are not significantly different than the laws governing similar provisions in the charter documents of Delaware companies, other than with respect to amending our Memorandum and Articles of Association without shareholder approval and with respect to potential anti-takeover deterrence. Delaware law requires shareholders to approve amendments to a corporation’s Certificate of Incorporation, with limited exceptions, and contains provisions restricting the rights of a Delaware corporation with a class of voting stock listed on a national exchange or held of record by more than 2,000 stockholders to engage in a business combination with an “interested stockholder” for a period of three years after the date of the transaction in which the person became an interested stockholder unless the business combination is approved in the manner prescribed under Delaware law.

Material Contracts

During the two years immediately preceding the filing of this Report, neither the Company nor any of its subsidiaries entered into any material contract, other than contracts in the ordinary course of business.

Taxation

United States Federal Income Tax Consequences

The discussion below is for general information only and is not, and should not be interpreted to be, tax advice to any holder of our common shares. Each holder or a prospective holder of our common shares is urged to consult his, her or its own tax advisor.

General

This section is a general summary of the material United States federal income tax consequences to U.S. Holders, as defined below, of the ownership and disposition of our common shares as of the date of this Report. This summary is based on the provisions of the Internal Revenue Code of 1986, as amended, or the Code, the applicable Treasury regulations promulgated and proposed thereunder, judicial decisions and current administrative rulings and practice, all of which are subject to change, possibly on a retroactive basis. The summary applies to you only if you hold our common shares as a capital asset within the meaning of Section 1221 of the Code. In addition, this summary generally addresses certain U.S. federal income tax consequences to U.S. Holders if we were to be classified as a PFIC. The United States Internal Revenue Service, or the IRS, may challenge the tax consequences described below, and we have not requested, nor will we request, a ruling from the IRS or an opinion of counsel with respect to the United States federal income tax consequences of acquiring, holding or disposing of our common shares. This summary does not purport to be a comprehensive description of all the tax considerations that may be relevant to the ownership of our common shares. In particular, the discussion below does not cover tax consequences that depend upon your particular tax circumstances nor does it cover any state, local or foreign law, or the possible application of non-income tax (such as the United States federal estate or gift tax). You are urged to consult your own tax advisors regarding the application of the United States federal income tax laws to your particular situation as well as any state, local, foreign and non-income tax consequences of the ownership and disposition of the common shares. In addition, this summary does not take into account any special United States federal income tax rules that apply to a particular U.S. or Non-U.S. holder of our common shares, including, without limitation, the following:

- a dealer in securities or currencies;
- a trader in securities that elects to use a market-to-market method of accounting for its securities holdings;
- a financial institution or a bank;
- an insurance company;
- real estate investment trust;
- regulated investment companies;

- a partnership or other pass-through entity for U.S. federal income tax purposes;
- a tax-exempt organization;
- a person that holds our common shares in a hedging transaction or as part of a straddle or a conversion transaction;
- a person whose functional currency for United States federal income tax purposes is not the U.S. dollar;
- a person liable for alternative minimum tax;
- a person that owns, or is treated as owning, 10% or more, by voting power or value, of our common shares;
- certain former U.S. citizens and residents who have expatriated; or
- a person who receives our shares pursuant to the exercise of employee stock options or otherwise as compensation.

U.S. Holders

For purposes of the discussion below, you are a “U.S. Holder” if you are a beneficial owner of our common shares who or which is:

- an individual United States citizen or resident alien of the United States (as specifically defined for United States federal income tax purposes);
- a corporation, or other entity treated as a corporation for United States federal income tax purposes, created or organized in or under the laws of the United States, any State or the District of Columbia;
- an estate whose income is subject to United States federal income tax regardless of its source; or
- a trust (x) if a United States court can exercise primary supervision over the trust’s administration and one or more United States persons are authorized to control all substantial decisions of the trust or (y) if it was in existence on August 20, 1996, was treated as a United States person prior to that date and has a valid election in effect under applicable Treasury regulations to be treated as a United States person.

If a partnership, or other entity treated as a partnership for United States federal income tax purposes holds our common shares, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership. If you are a partner of a partnership holding our common shares, you should consult your tax advisor.

Passive Foreign Investment Company (PFIC)

A U.S. Holder generally will be subject to a special tax regime if we are a PFIC at any time during which such Holder has held our shares.

A foreign corporation will be treated as a PFIC for United States federal income tax purposes if, after applying relevant look-through rules with respect to the income and assets of its subsidiaries, 75% or more of its gross income consists of certain types of passive income (the “income test”) or 50% or more of the gross value of its assets (based on an average of the quarterly values of the assets during such year) is attributable to assets that produce passive income or are held for the production of passive income (the “asset test”). For this purpose, passive income generally includes dividends, interest, royalties, rents (other than rents and royalties derived in the active conduct of a trade or business and not derived from a regulated person), annuities and gains from assets that produce passive income. An actual determination of PFIC status is factual in nature and cannot be made until the close of the applicable tax year.

The legislative history of the PFIC provisions states that Congress intended that “[i]n applying the PFIC asset test { ..., the total value of a publicly-traded foreign corporation’s assets generally will be treated as equal to the sum of the aggregate value of its outstanding stock plus its liabilities.” We do not believe there are currently any rules that provide further guidance on this issue. Therefore, based on the average ratio of our passive assets to our market cap plus our current liabilities (“Market Cap Value”) at the end of each quarter (“Testing Quarter”) of our fiscal year ended March 31, 2022, we believe that we are a PFIC for such year. We have not conducted an appraisal of the fair market value of all of our assets, including our plant and equipment. However, in the absence of specific guidance, it is at best unclear that such an appraisal, even if it resulted in a fair market value in excess of our market cap, would satisfy the IRS as to our PFIC status.

If we are treated as a PFIC, unless one of the elections described below is made, a special tax regime will apply to both (a) any “excess distribution” by us (generally, the U.S. Holder’s ratable share of distributions in any year that are greater than 125% of the average annual distributions received by such U.S. Holder in the three preceding years or its holding period, if shorter) and (b) any gain recognized on the sale or other disposition of your common shares. Under the PFIC regime, any excess distribution and recognized gain will be treated as ordinary income. The U.S. federal income tax on such ordinary income is determined under the following steps: (i) the amount of the excess distribution or gain is allocated ratably over the U.S. Holder’s holding period for our common shares; (ii) tax is determined for amounts allocated to the first year in the holding period in which we were classified as a PFIC and all subsequent years (except the year in which the excess distribution was received or the sale occurred) by applying the highest applicable tax rate in effect in the year to which the income was allocated; (iii) an interest charge is added to this tax calculated by applying the underpayment interest rate to the tax for each year determined under the preceding sentence from the due date of the income tax return for such year to the due date of the return for the year in which the excess distribution or sale occurs; and (iv) amounts allocated to a year prior to the first year in the U.S. Holder’s holding period in which we were classified as a PFIC or to the year in which the excess distribution or the disposition occurred are taxed as ordinary income and no interest charge applies. The interest charge is non-deductible by individuals but is generally deductible by corporations.

Under certain attribution rules, if we are a PFIC, U.S. Holders will generally be deemed to own their proportionate share of our direct or indirect equity interest in any company that is also a PFIC (a “Subsidiary PFIC”), and will be subject to U.S. federal income tax on their proportionate share of (a) any “excess distributions,” as described above, on the stock of a Subsidiary PFIC and (b) a disposition or deemed disposition of the stock of a Subsidiary PFIC by us or another Subsidiary PFIC, both as if such U.S. Holders directly held the shares of such Subsidiary PFIC. In addition, U.S. Holders may be subject to U.S. federal income tax on any indirect gain realized on the stock of a Subsidiary PFIC on the sale or disposition of our common shares held by such U.S. Holders. Accordingly, U.S. Holders should be aware that they could be subject to tax even if no distributions are received and no redemptions or other dispositions of our common shares held by them are made.

A U.S. Holder may generally avoid the PFIC regime by making a “qualified electing fund” election which generally provides that, in lieu of the foregoing treatment, our earnings, on a pro rata basis, would be currently included in their gross income for U.S. federal income tax purposes. However, we may be unable or unwilling to provide information to our U.S. Holders that would enable them to make a “qualified electing fund” election; thus, such election may not be available.

In addition, U.S. Holders may generally avoid the PFIC regime by making the “mark-to-market” election with respect to our common shares as long as we are a PFIC and our common shares are considered to be readily tradable on an established securities market within the United States. “Mark-to-market,” in this context, means including in ordinary income each taxable year the excess, if any, of the fair market value of our common shares over your adjusted tax basis in such common shares as of the end of each year. This “mark-to-market” election generally enables a U.S. Holder to avoid the deferred tax amount or interest charge that would otherwise be imposed on them if we were to be classified as a PFIC. However, if we are a PFIC, a mark-to-market election would not be available with respect to stock of a Subsidiary PFIC. You should consult your tax advisors as to the availability and desirability of a mark-to-market election, as well as the impact of such election on interests in any Subsidiary PFIC.

If we are treated as a PFIC at any time that you hold our shares but cease to be classified as a PFIC in a later year, we will continue to be classified as a PFIC with respect to you unless you make a deemed sale election in a timely manner to be taxed as if you sold your shares at their fair market value. In this case, you would pay tax on the gain on the deemed sale treated as ordinary income and an interest charge, and no loss will be allowed to you. A timely deemed sale election can also be made with respect to any of our Subsidiary PFIC, in which case you will be taxed on the amount of gain treated as ordinary income and pay an interest charge as if the stock of such subsidiary had been actually sold or disposed of by us while we were a PFIC and you held our shares. If we subsequently become a PFIC, you will again be subject to the general PFIC rules discussed herein.

If we are treated as a PFIC, each U.S. Holder will be required to make an annual return on IRS Form 8621 (unless an exception applies) or its successor, reporting, among other things, distributions received and gain realized with respect to each PFIC in which such holder holds a direct or indirect interest, and may be required to provide other information as specified by the IRS.

An actual determination of PFIC status is highly factual in nature. Given the complexity of the issues that may result if we are classified as or become a PFIC, you are urged to consult your own tax advisors with respect to the tax consequences to you, including any reporting obligations that may be imposed on you, in the event that this should occur, in view of your particular circumstances.

In addition, certain U.S. Holders that are individuals, estates and certain trusts whose income exceeds certain thresholds will be required to pay a 3.8% Medicare surtax on “net investment income” including interest, dividends and capital gains. U.S. Holders should consult with their own tax advisors regarding the effect, if any, of such tax on their ownership and disposition of our shares.

Non-U.S. Holders

If you are not a U.S. Holder, you are a “Non-U.S. Holder.”

Distributions on Our Common Shares

You generally will not be subject to U.S. federal income tax, including withholding tax, on distributions made on our common shares unless:

- you conduct a trade or business in the United States and
- the distributions are effectively connected with the conduct of that trade or business (and, if an applicable income tax treaty so requires as a condition for you to be subject to U.S. federal income tax on a net income basis in respect of income from our common shares, such distributions are attributable to a permanent establishment that you maintain in the United States).

If you meet the two tests above, you generally will be subject to tax in respect of such dividends in the same manner as a U.S. Holder as described above (other than with respect to the Medicare tax described above). In addition, any effectively connected dividends received by a non-U.S. corporation may also, under certain circumstances, be subject to an additional “branch profits tax” at a 30 percent rate or such lower rate as may be specified by an applicable income tax treaty.

Sale, Exchange or Other Disposition of Our Common Shares

Generally, you will not be subject to U.S. federal income tax, including withholding tax, in respect of gain recognized on a sale or other taxable disposition of our common shares unless:

- your gain is effectively connected with a trade or business that you conduct in the United States (and, if an applicable income tax treaty so requires as a condition for you to be subject to U.S. federal income tax on a net income basis in respect of gain from the sale or other disposition of our common shares, such gain is attributable to a permanent establishment maintained by you in the United States), or
- you are an individual Non-U.S. Holder and are present in the United States for at least 183 days in the taxable year of the sale or other disposition, and certain other conditions exist.

You will be subject to tax in respect of any gain effectively connected with your conduct of a trade or business in the United States generally in the same manner as a U.S. Holder as described above (other than with respect to the Medicare tax described above). Effectively connected gains realized by a non-U.S. corporation may also, under certain circumstances, be subject to an additional “branch profits tax” at a rate of 30 percent or such lower rate as may be specified by an applicable income tax treaty.

Backup Withholding and Information Reporting

Payments, including dividends and proceeds of sales, in respect of our common shares that are made in the United States or by a United States related financial intermediary will be subject to United States information reporting rules. In addition, such payments may be subject to United States federal backup withholding tax. You will not be subject to backup withholding provided that:

- you are a corporation or other exempt recipient, or
- you provide your correct United States federal taxpayer identification number and certify, under penalties of perjury, that you are not subject to backup withholding.

Amounts withheld under the backup withholding rules may be credited against your United States federal income tax, and you may obtain a refund of any excess amounts withheld under the backup withholding rules by filing the appropriate claim for refund with the IRS in a timely manner.

British Virgin Islands Tax Consequences

Under the BVI BC Act of the BVI as currently in effect, a holder of common equity, such as our shares, who is not a resident of the BVI is exempt from BVI income tax on dividends paid with respect to the common equity and all holders of common equity are not liable to the BVI for income tax or capital gains tax on gains realized on sale or disposal of such shares. The BVI does not impose a withholding tax on dividends paid by a company incorporated under the BVI BC Act.

There are no capital gains, gift or inheritance taxes levied by the BVI on companies, like the Company, which were originally incorporated under the IBCA Act. In addition, our common shares are not subject to transfer taxes, stamp duties or similar charges. There is no income tax treaty or convention currently in effect between the United States and the BVI.

Documents on Display

Deswell is subject to the information requirements of the Securities and Exchange Act of 1934, and, in accordance with the Securities Exchange Act of 1934, Deswell files annual reports on Form 20-F within four months of its fiscal year end, and submits other reports and information under cover of Form 6-K with the SEC. You may read and copy this information at the SEC’s public reference room at 100 F Street, NE, Washington DC, 20549. Recent filings and reports are also available free of charge through the EDGAR electronic filing system at <http://www.sec.gov>. You can also request copies of the documents, upon payment of a duplicating fee, by writing to the public reference section of the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room or accessing documents through EDGAR.

As a foreign private issuer, Deswell is exempt from the rules under the Securities Exchange Act of 1934 prescribing the furnishing and content of proxy statements to shareholders.

Exchange Controls

There are no exchange control restrictions on payments of dividends on the Company’s common shares or on the conduct of the Company’s operations either in Macao, where the Company’s principal executive offices are located, or the BVI, where the Company is incorporated. Other jurisdictions in which the Company conducts operations may have various exchange controls. There are no material BVI laws which impose foreign exchange controls on the Company or that affect the payment of dividends, interest or other payments to non-resident holders of the Company’s common shares. BVI law and the Company’s Memorandum and Articles of Association impose no limitations on the right of nonresident or foreign owners to hold the Company’s Securities or vote the Company’s common shares.

To the extent that the Company may decide to pay cash dividends in the future, such dividends will be determined by resolution of the directors of the Company. The directors may authorize a distribution by way of a dividend at a time and of an amount they think fit if they are satisfied, on reasonable grounds, that, immediately after the distribution, the value of the Company’s assets will exceed its liabilities and the Company will be able to pay its debts as they fall due (i.e. a balance sheet and cash flow test). As the Company is a holding company, the amount available for distribution will be limited by the amount of dividends that can be declared and paid to it by its subsidiaries. Dividends declared by subsidiaries will be based on the profits reported in their statutory accounts prepared in accordance with generally accepted accounting principles in the relevant countries, primarily Macao and China, which differ from U.S. GAAP. To date these controls, with the exception of a requirement that 10% of profits to be reserved for future developments and staff welfare in China, have not had and are not expected to have a material impact on the Company’s financial results.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

At March 31, 2020, 2021 and 2022, the Company had no open forward exchange contracts or option contracts. Cash and cash equivalents on hand at March 31, 2022 of \$13,465,000 were held in the following currencies:

	Equivalent U.S. Dollar Holdings (in thousands)
United States dollars	\$3,028
Chinese RMB	6,080
Hong Kong dollars	4,154
Macao dollars	176
Japanese yen	22
Euro	2
Pound sterling	1
Others	2
	<u>\$13,465</u>

See discussion of Exchange Rate Fluctuation in ITEM 5 Operating and Financial Review and Prospects.

Interest Rate Risk

Our interest expenses and income are sensitive to changes in interest rates, as all of our cash reserves and borrowings are subject to interest rate changes. Cash on hand of \$4,354,000 as of March 31, 2022 was invested in short-term interest bearing investments. As such, interest income will fluctuate with changes in short term interest rates. As of March 31, 2022, we had neither long-term debt nor short-term bank loans outstanding on our credit facilities.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Disclosures under ITEMS 12A to 12D(2) of Form 20-F with respect to debt securities, warrants and rights, other securities, and American depository shares are not required when Form 20-F is used as an annual report and, in any event, are not applicable to Deswell. Disclosures under ITEMS 12D(3) and 12D(4) of Form 20-F are required even when Form 20-F is used as an annual report. Deswell has no American Depositary Receipts deposited or outstanding.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

Not Applicable to Deswell.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Not Applicable to Deswell.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company’s management, with the participation of its Chief Executive Officer and Chief Financial Officer, conducted an evaluation of our disclosure controls and procedures as required by paragraph (b) of Rule 13a-15 or 15d-15 under the Exchange Act as of March 31, 2022.

Based on this evaluation, the Company’s management, including its Chief Executive Officer and Chief Financial Officer, concluded that as of March 31, 2022 such disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by the Company in reports it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company’s management, including the Company’s Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Report of Management on Internal Control over Financial Reporting

Deswell’s management is responsible for establishing and maintaining adequate internal control over financial reporting. Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, a control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with general accepted accounting principles. The Company’s internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of our Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of our Company are being made only in accordance with authorizations of management and directors of our Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our Company’s assets that could have a material effect on the financial statements.

Deswell’s management, including its Chief Executive Officer and Chief Financial Officer, assessed the effectiveness of our internal control over financial reporting as of March 31, 2022. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) in Internal Control Integrated Framework (2013).

Based on the assessment, Deswell’s management, including its Chief Executive Officer and Chief Financial Officer, concluded that, as of March 31, 2022, the Company’s internal control over financial reporting was effective based on above described criteria.

Changes in Internal Controls

There were no changes in the Company’s internal controls during the period covered by this Report that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Deswell’s Board of Directors has determined that at least one person serving on the Audit Committee is an “audit committee financial expert” as defined under ITEM 16A(b) of Form 20-F. Mr. Allen Yau-Nam Cham is an “audit committee financial expert.” Mr. Allen Yau-Nam Cham is independent, as that term is defined in 17 CFR 240.10A-3. There have been no amendments or waivers with respect to the code of ethics during the last fiscal year.

ITEM 16B. CODE OF ETHICS

The Company has adopted a Code of Ethics for its Chief Executive Officer and Senior Financial Officers (the “Code of Ethics”), which applies to the Company’s principal executive officer and to its principal financial and accounting officers. A copy of the Code of Ethics is included as Exhibit 11.1 to this Annual Report on Form 20-F. The Code of Ethics supplements the Company’s Code of Business Conduct and Ethics applicable to directors, officers and employees generally, available on the Company’s website at <http://www.deswell.com>.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Deswell’s principal accountants for the audit of its financial statements for the years ended March 31, 2021 and March 31, 2022 were BDO China Shu Lun Pan Certified Public Accountants LLP (“BDO China”). The following table presents the aggregate fees for professional services and other services rendered to Deswell by BDO China for the years ended March 31, 2021 and 2022.

	Year ended March 31,	
	2021	2022
	(in thousands)	
Audit fees ⁽¹⁾	\$208	\$217
Audit-related fees ⁽²⁾	-	-
Tax fees ⁽³⁾	-	-
All other fees ⁽⁴⁾	-	-
	<u>\$208</u>	<u>\$217</u>

- (1) Audit Fees consist of fees billed for the annual audit of our consolidated financial statements. They also include fees billed for other audit services, which are those services that only the external auditor reasonably can provide, and include the provision for consents relating to the review of documents filed with the SEC.
- (2) There were no other audit-related fees billed by the principal accountant during the last two fiscal years for assurance and related services that were reasonably related to the performance of the audit not reported under “Audit Fees” above.
- (3) There were no tax fees billed by the principal accountant during the last two fiscal years for advice services.
- (4) There were no other fees billed by the principal accountant during the last two fiscal years for products and services provided.

Audit Committee Pre-approval Policies and Procedures

The Audit Committee’s policy is to pre-approve all audit and permissible non-audit related services provided by the independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services. Management will periodically report to the Audit Committee regarding the extent of services provided and the fees for the services performed by the independent auditors in accordance with this pre-approval policy. The Audit Committee may also pre-approve particular services on a case-by-case basis.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR THE AUDIT COMMITTEE.

As of the date of this Report, Deswell is not availing itself of an exemption from the independence standards contained in paragraph (b)(1)(iv) of Rule 10A-3 under the Securities Exchange Act of 1934 (except paragraph (b)(1)(iv)(B) of that Rule), the general exemption contained in paragraph (c)(3) of that Rule, or the last sentence of paragraph (a)(3) of that Rule.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATE PURCHASERS

Not applicable to Deswell.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

Not applicable to Deswell.

ITEM 16G. CORPORATE GOVERNANCE

For information regarding whether our corporate governance standards differ from those applied to U.S. domestic issuers and the reason why we do not have an independent compensation committee, see the discussion under “Other Committees; NASDAQ Compliance” in ITEM 6 “Directors and Senior Management” of this Report.

ITEM 16H. MINE SAFETY DISCLOSURE

Not applicable to Deswell.

ITEM 16I. DISCLOSURE REGARDING FOREIGN JURISDICTIONS THAT PREVENT INSPECTIONS

Not applicable to Deswell.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not Applicable to Deswell.

ITEM 18. FINANCIAL STATEMENTS

The following financial statements are filed as part of this Report:

	Page
Report of Independent Registered Public Accounting Firm – BDO China Shu Lun Pan Certified Public Accountants LLP, Shenzhen, People’s Republic of China PCAOB ID #1818	F-1
Consolidated Balance Sheets	F-3
Consolidated Statements of Comprehensive Income (Loss)	F-4
Consolidated Statements of Shareholders’ Equity	F-5
Consolidated Statements of Cash Flows	F-6
Notes to Consolidated Financial Statements	F-7

All other schedules for which provisions are made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable, and therefore have been omitted.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
Deswell Industries, Inc.

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Deswell Industries, Inc. and its subsidiaries (the “Company”) as of March 31, 2022 and 2021, the related consolidated statements of comprehensive income (loss), shareholders’ equity, and cash flows for each of the three years in the period ended March 31, 2022, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company at March 31, 2022 and 2021, and the results of its operations and its cash flows for each of the three years in the period ended March 31, 2022, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of the critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing separate opinions on the critical audit matter or on the accounts or disclosures to which it relates.

Allowance for credit losses

As described in Note 2 to the consolidated financial statements, management estimates the lifetime expected credit losses for accounts receivable with similar risk characteristics on a pool basis after considering the historical collection information and the historical distribution of each aging bucket of respective accounts receivable, and adjusted for the forward-looking information. The principal considerations for our determination that performing procedures relating to the accounts receivable allowances is a critical audit matter are (i) the significant judgment by management when determining the amount of current expected credit losses (“CECL”) of the Company’s accounts receivable at March 31, 2022; and (ii) a high degree of auditor judgment, subjectivity, and effort in performing procedures to evaluate management’s estimate and significant assumptions related to the CECL.

The primary procedures we performed to address this critical audit matter included:

- Obtaining an understanding and evaluating the design and implementation of controls over the Company’s valuation of accounts receivable;
- Obtaining an understanding of management’s process and methodology used to develop the estimate of CECL;
- Obtaining and inspecting relevant underlying documentation, including customer correspondence, historical collection trends, age of trade receivables, and realization analyses to assess the Company’s estimated allowance for credit losses;
- Testing the mathematical accuracy of the quantitative calculations used by the Company in determining the CECL with underlying data;
- Obtaining and inspecting the Company’s economic conditions analysis by pool compared to economic outlook market reports to evaluate the forward-looking risk factors applied by the Company; and
- Performing a retrospective review of accounts receivable by comparing subsequent actual credit losses with historical estimates to evaluate management’s ability to reasonably estimate the allowance.

/s/ BDO China Shu Lun Pan Certified Public Accountants LLP

We have served as the Company’s auditor since 2012.

Shenzhen, People’s Republic of China
July 28, 2022

DESWELL INDUSTRIES, INC.

CONSOLIDATED BALANCE SHEETS
(U.S. dollars in thousands)

	2021	March 31, 2022
ASSETS		
Current assets:		
Cash and cash equivalents	\$20,223	\$13,465
Time deposits with original maturities over three months	2,700	4,354
Time deposit with original maturities over twelve months - current	-	1,564
Marketable securities (note 3)	22,373	24,499
Accounts receivable, less allowances for credit losses of \$1,351 and \$268 at March 31, 2021 and 2022, respectively (note 2)	14,708	18,195
Inventories (note 4)	16,193	23,819
Prepaid expenses and other current assets (note 5)	2,489	1,926
Total current assets	78,686	87,822
Property, plant and equipment, net (note 6)	27,323	27,017
Deferred tax assets (note 8)	-	259
Time deposits with original maturities over twelve months	1,851	313
Total assets	\$107,860	\$115,411
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$9,522	\$9,838
Accrued payroll and employee benefits	7,107	7,611
Customer deposits	1,683	2,343
Other accrued liabilities (note 7)	2,016	2,950
Income taxes payable	886	1,232
Total current liabilities	\$21,214	\$23,974
Deferred income tax liabilities (note 8)	957	659
Total liabilities	\$22,171	\$24,633
Commitments and contingencies (note 10)		
Shareholders' equity:		
Common shares nil par value; authorized 30,000,000 shares as of March 31, 2021 and 2022; 17,061,810 and 17,081,810 shares issued as of March 31, 2021 and 2022; 15,915,239 and 15,935,239 shares outstanding as of March 31, 2021 and 2022	\$53,143	\$53,202
Treasury stock at cost; 1,146,571 shares as of March 31, 2021 and 2022 (note 12)	(2,821)	(2,821)
Additional paid-in capital	7,989	7,973
Accumulated other comprehensive income	5,316	5,316
Retained earnings	22,062	27,108
Total shareholders' equity	85,689	90,778
Total liabilities and shareholders' equity	107,860	115,411

See accompanying notes to consolidated financial statements.

DESWELL INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(U.S. dollars in thousands, except per share data)

		<u>Year ended March 31,</u>	
	<u>2020</u>	<u>2021</u>	<u>2022</u>
Net sales	\$65,368	\$64,886	\$85,980
Cost of sales	53,504	51,720	72,028
Gross profit	11,864	13,166	13,952
Selling, general and administrative expenses	10,026	10,310	11,267
Other (expenses) income, net (note 13)	(425)	405	74
Operating income	1,413	3,261	2,759
Non-operating (expenses) income, net (note 14)	(2,360)	5,445	5,308
(Loss) income, before income taxes	(947)	8,706	8,067
Income tax expense (benefit) (note 8)	373	475	(165)
Net (loss) income attribute to Deswell Industries, Inc.	(1,320)	8,231	8,232
Other comprehensive income (loss)	-	-	-
Total comprehensive (loss) income attributable to Deswell Industries, Inc.	<u>\$(1,320)</u>	<u>\$8,231</u>	<u>\$8,232</u>
Net (loss) income per share attributable to Deswell Industries, Inc. (note 2)			
Basic:			
Net (loss) income per share	<u>\$(0.08)</u>	<u>\$0.52</u>	<u>\$0.52</u>
Weighted average common shares outstanding (shares in thousands)	<u>15,914</u>	<u>15,915</u>	<u>15,929</u>
Diluted:			
Net (loss) income per share	<u>\$(0.08)</u>	<u>\$0.51</u>	<u>\$0.51</u>
Weighted average common shares outstanding (shares in thousands)	<u>15,914</u>	<u>16,047</u>	<u>16,135</u>

DESWELL INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(U.S. dollars in thousands, except per share data)

	Common stock		Treasury Stock		Additional paid-in capital	Accumulated other comprehensive income	Retained earnings	Total Shareholders' Equity
	Shares	Amount	Shares	Amount				
Balance at March 31, 2019	17,031,810	\$53,063	(1,146,571)	\$(2,821)	\$8,005	\$5,316	\$20,401	\$83,964
Exercise of stock options	30,000	80	-	-	(16)	-	-	64
Net loss	-	-	-	-	-	-	(1,320)	(1,320)
Dividends (\$0.15 per share)	-	-	-	-	-	-	(2,386)	(2,386)
Balance at March 31, 2020	17,061,810	\$53,143	(1,146,571)	\$(2,821)	\$7,989	\$5,316	\$16,695	\$80,322
Net income	-	-	-	-	-	-	8,231	8,231
Dividends (\$0.18 per share)	-	-	-	-	-	-	(2,864)	(2,864)
Balance at March 31, 2021	17,061,810	\$53,143	(1,146,571)	\$(2,821)	\$7,989	\$5,316	\$22,062	\$85,689
Exercise of stock options	20,000	59	-	-	(16)	-	-	43
Net income	-	-	-	-	-	-	8,232	8,232
Dividends (\$0.2 per share)	-	-	-	-	-	-	(3,186)	(3,186)
Balance at March 31, 2022	17,081,810	\$53,202	(1,146,571)	\$(2,821)	\$7,973	\$5,316	\$27,108	\$90,778

See accompanying notes to consolidated financial statements.

DESWELL INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(U.S. dollars in thousands)

	<u>Year ended March 31,</u>		
	<u>2020</u>	<u>2021</u>	<u>2022</u>
Cash flows from operating activities			
Net (loss) income	\$(1,320)	\$8,231	\$8,232
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	1,973	1,755	1,736
Provision for (reversal of) credit losses, net	297	397	(148)
Allowance for obsolete inventories, net	426	-	(25)
(Gain) loss on disposal of property, plant and equipment	(29)	(22)	24
Unrealized holding loss (gain) on marketable securities	5,179	(2,010)	(872)
Gain on sales of marketable securities	(29)	(333)	(1,073)
Deferred income tax expense (benefit)	92	206	(557)
Scrip dividend received	(175)	(19)	-
Exchange loss (gain) arising from marketable securities	531	(661)	117
Changes in operating assets and liabilities:			
Accounts receivable	3,136	(2,804)	(3,339)
Inventories	4,026	(7,615)	(7,601)
Prepaid expenses and other current assets	254	(737)	563
Accounts payable	(1,649)	4,918	316
Accrued payroll and employee benefits	401	1,030	504
Customer deposits	(126)	511	660
Other accrued liabilities	56	298	934
Income taxes payable	78	151	346
Net cash provided by (used in) operating activities	<u>13,121</u>	<u>3,296</u>	<u>(183)</u>
Cash flows from investing activities			
Purchase of property, plant and equipment	(507)	(551)	(1,504)
Proceeds from sale of property, plant and equipment, net of transaction costs	188	81	50
Purchase of marketable securities	(2,121)	(6,059)	(11,543)
Proceeds from sales of marketable securities	1,620	6,150	11,245
Increase of fixed deposits with original maturities over three months	(412)	(1,917)	(1,654)
Increase of fixed deposits with original maturities over twelve months	<u>(1,424)</u>	<u>(427)</u>	<u>(26)</u>
Net cash used in investing activities	<u>(2,656)</u>	<u>(2,723)</u>	<u>(3,432)</u>
Cash flows from financing activities			
Dividends paid	(2,386)	(2,864)	(3,186)
Proceeds from exercise of stock options	64	-	43
Net cash used in financing activities	<u>(2,322)</u>	<u>(2,864)</u>	<u>(3,143)</u>
Net increase (decrease) in cash and cash equivalents	8,143	(2,291)	(6,758)
Cash and cash equivalents, beginning of year	<u>14,371</u>	<u>22,514</u>	<u>20,223</u>
Cash and cash equivalents, end of year	<u>\$22,514</u>	<u>\$20,223</u>	<u>\$13,465</u>
Supplementary disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$-	\$-	\$-
Income taxes	<u>\$160</u>	<u>\$236</u>	<u>\$68</u>

See accompanying notes to consolidated financial statements.

1. Organization and Basis of Financial Statements

Deswell Industries, Inc. was incorporated in the British Virgin Islands on December 2, 1993.

The principal activities of the Company comprise the manufacturing and sales of injection-molded plastic parts and components and electronic products assembling. The manufacturing activities are subcontracted to subsidiaries operating in the People’s Republic of China (“PRC”). The selling and administrative activities were originally performed in the Hong Kong Special Administrative Region (“Hong Kong”) of the PRC. From August 2003, these activities were moved to the Macao Special Administrative Region (“Macao”) of the PRC.

As the Company is a holding company, the amount of any dividends to be declared by the Company will be dependent upon the amount which can be distributed from its subsidiaries. Dividends from subsidiaries are declared based on profits as reported in their statutory accounts.

COVID-19 Considerations

As the global epidemic trend continued to be stabilized, travelling restrictions have been lifted by some countries. However, the PRC government is still adopting zero-COVID policy to prevent any spread of the coronavirus in the community. It resulted some major cities in China being under fully or partially lockdowns or district-based controls.

Though the Company’s two principal manufacturing plants are not located in the cities under lockdowns, our staff are required to be quarantined in designated hotels for 14 to 21 days when they travel from Hong Kong to the PRC cities. (Effective from June 29, 2022, the length of the quarantine was reduced to seven days and three days home health monitoring).

These border entry restrictions create challenges for productivity and connectivity, and could affect our ability to enhance, develop, and support existing products, detect and prevent production deficiencies, as well as exploring new business opportunities. The Company is complying with the health and safety protocols established by the government and have taken steps to safeguard the employees and business operations. These steps include well-planned travel arrangements among the Company’s management team, actively cleaning and sanitizing open public areas to ensure the continuity and smooth supervision over plant production and administration under pandemic conditions.

During the year ended March 31, 2022 the Company did not experience a significant negative impact of COVID-19 on its operations, capital and financial position. We did not record material asset impairments, inventory charges or bad debt provision related to COVID-19 during the year ended March 31, 2022. We will continue to evaluate the nature and extent of the impact of the COVID-19 outbreak on our financial condition, results of operations and cash flows.

2. Summary of Significant Accounting Policies

Principles of consolidation-The consolidated financial statements, prepared in accordance with generally accepted accounting principles in the United States of America, include the assets, liabilities, revenues, expenses and cash flows of all subsidiaries. Intercompany balances, transactions and cash flows are eliminated on consolidation.

Cash and cash equivalents-Cash and cash equivalents include cash on hand, cash accounts, interest bearing savings accounts and time certificates of deposit with a maturity of three months or less when purchased.

Marketable securities-All marketable securities are classified as trading securities and are stated at fair market value. Market value is determined by the most recently traded price of the security at the balance sheet date. Net realized and unrealized gains and losses on trading securities are included in non-operating income. The cost of investments sold is based on the average cost method. Interest and dividend income earned are included in non-operating income.

2. Summary of Significant Accounting Policies - continued

Inventories - Inventories are stated at the lower of cost or market. Cost is determined on the weighted average basis. Work-in-progress and finished goods inventories consist of raw materials, direct labor and overhead associated with the manufacturing process. The Company periodically performs an analysis of inventory to determine obsolete or slow-moving inventory and determine if its cost exceeds the estimated market value. Write down of potentially obsolete or slow-moving inventory are recorded based on management’s analysis of inventory levels.

Property, plant and equipment-Property, plant and equipment is stated at cost including the cost of improvements. Maintenance and repairs are charged to expense as incurred. Depreciation and amortization are provided on the straight line method based on the estimated useful lives of the assets as follows:

Leasehold land and buildings	30 - 50 years
Plant and machinery	5 - 15 years
Furniture, fixtures and equipment	4 - 5 years
Motor vehicles	3 - 5 years
Leasehold improvements	2 - 5years

Leases-The Company determines if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use (“ROU”) assets, other current liabilities and operating lease liabilities in the consolidated balance sheets. ROU assets represent the Company’s right to use an underlying asset for the lease term, and lease liabilities represent the Company’s obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. As most of the Company’s leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. It uses the implicit rate when readily determinable. The operating lease ROU asset also includes any lease payments made and excludes lease incentives. The Company’s lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for lease payments is recognized on a straight-line basis over the lease term.

When the Company is the lessor, minimum contractual rental from leases is recognized on a straight-line basis over the non-cancelable term of the lease. With respect to a particular lease, actual amounts billed in accordance with the lease during any given period may be higher or lower than the amount of rental revenue recognized for the period. Straight-line rental revenue commences when the customer assumes control of the leased premises. Accrued straight-line rents receivable represents the amount by which straight-line rental revenue exceeds rents currently billed in accordance with lease agreements. If later, the billing amount exceeds the straight-line rental revenue, the variance will be credited to accrued straight-line rents receivable. Contingent rental revenue is accrued when the contingency is removed.

Impairment of long-lived assets-Long-lived assets are included in impairment evaluations when events and circumstances exist that indicate the carrying value of these assets may not be recoverable. In accordance with ASC No. 360, “Property, Plant and Equipment”, the Company assesses the recoverability of the carrying value of long-lived assets by first grouping its long-lived assets with other assets and liabilities at the lowest level for which identifiable cash flows largely independent of the cash flows of other assets and liabilities (the asset group) and, secondly, estimating the undiscounted future cash flows that are directly associated with and expected to arise from the use of and eventual disposition of such asset group. The Company estimates the undiscounted cash flows over the remaining useful life of the primary asset within the asset group. If the carrying value of the asset group exceeds the estimated undiscounted cash flows, the Company records an impairment charge to the extent the carrying value of the long-lived asset exceeds its fair value. The Company determines fair value through quoted market prices in active markets or, if quotations of market prices are unavailable, through the performance of internal analysis using a discounted cash flow methodology. The undiscounted and discounted cash flow analyses based on a number of estimates and assumptions, including the expected period over which the asset will be utilized, projected future operating results of the asset group, discount rate and long-term growth rate.

2. Summary of Significant Accounting Policies - continued

Revenue recognition –

Revenue from contracts with customers is recognized using the following five steps pursuant ASC Topic 606, Revenue from Contracts with Customers: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when, or as, the Company satisfies a performance obligation.

Products sales

The Company recognizes revenue upon transfer of control of its products to the customer, which typically occurs upon delivery. The Company’s main performance obligation to its customers is the delivery of products in accordance with purchase orders. Each purchase order defines the transaction price for the products purchased under the arrangement. Acceptance of delivery of the products is evidenced by goods receipt notes signed by the customer. The Company has no remaining obligations after the customer’s acceptance of the products.

Under the terms of the contracts or purchase orders between the Company and the customer, the control of the products is transferred to the customer upon the signing of the goods receipt notes and the customer has no rights to return the products (other than for defective products). Some customers examine and pick up the products at our plant while some local customers instruct us to deliver the products to their plants nearby. Some overseas customers instruct us to deliver the products to the named port of shipment. Delivery of the products occurs at that point of time when the control of the products is transferred to the customer.

The selling price, which is specified in the purchase orders, is fixed. Under the terms of the purchase orders, upon the sale of the products to the customer and the signing of the good receipts notes, the Company has the legally enforceable right to receive full payment of the sales price. The customer’s obligation to pay the Company is not dependent on the customer selling the products or collecting cash from their customers (or end customers). The customer is required to pay under normal sales terms. The Company’s normal payment terms range from 30 days to 90 days and its sales arrangements do not have any material financing components. In addition, the Company’s customer arrangements do not produce contract assets or liabilities that are material to its consolidated financial statements. The Company permits the return of damaged or defective products and accounts for these actual returns as deduction from sales. Product returns to the Company were insignificant during past years.

Incremental costs to fulfill the Company’s customer arrangements are expensed as incurred, as the amortization period is less than one year.

The Company’s sales are net of value added tax (“VAT”) and business tax and surcharges collected on behalf of tax authorities in respect of product sales. VAT and business tax and surcharges collected from customers, net of VAT paid for purchases, is recorded as a liability in the consolidated balance sheets until it is paid to the tax authorities.

Outbound freight and Handling costs:

The Company accounts for product outbound freight and handling costs as fulfillment activities and present the associated costs in selling expenses in the period in which it sells the product.

2. Summary of Significant Accounting Policies - continued

Disaggregation of Revenues:

The following table disaggregates product sales by business segment and by geography, which provides information as to the major source of revenue. See Note 16 for additional description of our reportable business segments.

	<u>Year ended March 31, 2020</u>		
	Injection molded Plastic parts	Electronic Products	Total
Net sales			
United States of America	\$1,265	\$9,963	\$11,228
PRC	22,567	4,530	27,097
United Kingdom	159	4,693	4,852
Hong Kong	1,202	4,986	6,188
Europe	153	9,674	9,827
Canada	-	2,681	2,681
Others	7	3,488	3,495
Total net sales	\$25,353	\$40,015	\$65,368
	<u>Year ended March 31, 2021</u>		
	Injection molded Plastic parts	Electronic Products	Total
Net sales			
United States of America	\$1,349	\$6,512	\$7,861
PRC	17,081	7,824	24,905
United Kingdom	15	3,244	3,259
Hong Kong	1,248	6,890	8,138
Europe	169	9,395	9,564
Canada	-	4,680	4,680
Others	3	6,476	6,479
Total net sales	\$19,865	\$45,021	\$64,886
	<u>Year ended March 31, 2022</u>		
	Injection molded Plastic parts	Electronic Products	Total
Net sales			
United States of America	\$1,014	\$9,446	\$10,460
PRC	20,430	14,018	34,448
United Kingdom	26	6,710	6,736
Hong Kong	1,666	9,927	11,593
Europe	209	13,212	13,421
Canada	-	5,503	5,503
Others	-	3,819	3,819
Total net sales	\$23,345	\$62,635	\$85,980

2. Summary of Significant Accounting Policies - continued

Allowance for credit losses - Effective on April 1, 2020, the Company adopted Accounting Standards Update (ASU) 2016-13, “Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments” (“ASU 2016-13”) under a modified retrospective transition. This guidance replaces the existing “incurred loss” methodology, and introduces an expected loss approach using macroeconomic data, referred to as a current expected credit losses (“CECL”) methodology. Under the incurred loss methodology, credit losses are only recognized when the losses are probable of having been incurred. The CECL methodology requires that the full amount of expected credit losses for the lifetime of the financial instrument be recorded at the time it is originated or acquired, considering relevant historical experience, current conditions and reasonable and supportable macroeconomic forecasts that affect the collectability of financial assets, and adjusted for changes in expected lifetime credit losses subsequently, which may require earlier recognition of credit losses.

The Company estimated the expected credit losses for accounts receivable with similar risk characteristics on a pool basis. For each pool, the Company considers the historical credit loss experience, current economic conditions, supportable forecasts of future economic conditions, and any recoveries in assessing the lifetime expected credit losses. Other key factors that influence the expected credit loss analysis include payment terms offered in the normal course of business to customers and industry-specific factors that could impact the Company’s receivables. Additionally, macroeconomic factors are also considered. As at April 1, 2020, the Company assessed and concluded that the adoption did not have a material impact on the opening balance of retained earnings in the consolidated financial statements.

Accounts receivable, net, as of March 31, 2021 and 2022 consisted of the following:

	<u>March 31,</u>	
	<u>2021</u>	<u>2022</u>
Accounts receivable	\$16,059	\$18,463
Less: Allowance for credit losses	(1,351)	(268)
Accounts receivable, net	<u>\$14,708</u>	<u>\$18,195</u>

The movement of allowance for credit losses for the years ended March 31, 2020, 2021 and 2022 was as follows:

	<u>Year ended March 31,</u>		
Allowance for credit losses	<u>2020</u>	<u>2021</u>	<u>2022</u>
Balance at beginning of the year	\$658	\$954	\$1,351
Provision for (reversal of) credit losses, net	297	397	(148)
Written off	(1)	-	(935)
	<u>\$954</u>	<u>\$1,351</u>	<u>\$268</u>

The provision and reversal of credit losses for the years were charged to other income (expenses), net in consolidated statements of comprehensive income (loss).

Shipping and handling cost- Shipping and handling costs related to the delivery of finished goods are included in selling expenses. During the years ended March 31, 2020, 2021 and 2022, shipping and handling costs expensed to selling expenses were \$481, \$523 and \$524, respectively.

Income taxes- Income taxes are provided on an asset and liability approach for financial accounting and reporting of income taxes. Any PRC tax paid by subsidiaries during the year is recorded. Deferred income taxes are recognized for all significant temporary differences at enacted rates and classified as non-current. A valuation allowance is provided to reduce the amount of deferred tax assets if it is considered more likely than not that some portion of, or all, the deferred tax asset will not be realized. The Company classifies interest and/or penalties related to unrecognized tax benefits, if any, as a component of income tax provisions.

2. Summary of Significant Accounting Policies - continued

The Company adopted the provisions of ASC No. 740 “Income Taxes” (“ASC 740”), which clarifies the accounting for uncertainty in income taxes recognized by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. ASC 740 also provides accounting guidance on de-recognition, classification, interest and penalties, disclosure and transition.

Foreign currency translation-The consolidated financial statements of the Company are presented in U.S. dollars as the Company is incorporated in the British Virgin Islands where the currency is the U.S. dollar. The Company’s subsidiaries conduct substantially all of their business in U.S. dollars, Hong Kong dollars or Chinese Renminbi. Notwithstanding this, U.S. dollar is considered by management to be the most appropriate functional currency of the Company’s subsidiaries because most of our customers contracted with our subsidiaries in U.S. dollars.

All transactions in currencies other than the functional currency during the year are translated at the exchange rates prevailing on the transaction dates. Monetary items existing at the balance sheet date denominated in currencies other than the functional currencies are translated at period end rates. Gains and losses resulting from the translation of foreign currency transactions and balances are included in the consolidated statement of comprehensive income (loss).

The exchange rates between the Hong Kong dollars and the U.S. dollar were approximately 7.7904, 7.7904 and 7.7904 as of March 31, 2020, 2021 and 2022, respectively. The exchange rates between the Chinese Renminbi and the U.S. dollar were approximately 7.0246, 6.4819 and 6.3924 as of March 31, 2020, 2021 and 2022, respectively. Aggregate net foreign currency transaction (loss) gain included in other income (expenses) were, \$(505), \$567 and \$(352) for the years ended March 31, 2020, 2021 and 2022, respectively.

Post-retirement and post-employment benefits - The Company and its subsidiaries contribute to a state pension scheme in respect of its Chinese employees.

Stock-based compensation - The Company adopts ASC No. 718, “Compensation – Stock Compensation”, which requires that share-based payment transactions with employees, such as share options, be measured based on the grant-date fair value of the equity instrument issued and recognized as compensation expense over the requisite service period, with a corresponding addition to equity. Under this method, compensation cost related to employee share options or similar equity instruments is measured at the grant date based on the fair value of the award and is recognized over the period during which an employee is required to provide service in exchange for the award, which generally is the vesting period.

There were no stock options granted during the year ended March 31, 2020, 2021 and 2022.

Net (loss) income per share - Basic net (loss) income per share is computed by dividing net (loss) income available to common shareholders by the weighted average number of common shares outstanding during the period. Diluted net (loss) income per share gives effect to all dilutive potential common shares outstanding during the period. The weighted average number of common shares outstanding is adjusted to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In computing the dilutive effect of potential common shares, the average stock price for the period is used in determining the number of treasury shares assumed to be purchased with the proceeds from the exercise of options.

Basic net (loss) income per share and diluted net (loss) income per share calculated in accordance with ASC No. 260, “Earnings Per Share”, are reconciled as follows (shares in thousands):

	Year ended March 31,		
	2020	2021	2022
Net (loss) income attributable to Deswell Industries, Inc.	<u>\$(1,320)</u>	<u>\$8,231</u>	<u>\$8,232</u>
Basic weighted average common shares outstanding	<u>15,914</u>	<u>15,915</u>	<u>15,929</u>
Basic net (loss) income per share	<u>\$(0.08)</u>	<u>\$0.52</u>	<u>\$0.52</u>

2. Summary of Significant Accounting Policies - continued

	Year ended March 31,		
	2020	2021	2022
Basic weighted average common shares outstanding	15,914	15,915	15,929
Effect of dilutive securities – Options	-	132	206
Diluted weighted average common and potential common shares outstanding	15,914	16,047	16,135
Diluted net (loss) income per share	\$(0.08)	\$0.51	\$0.51

During the year ended March 31, 2020, 470,000 outstanding stock options were not included in the computation of diluted net loss per share, because to do so would have had an antidilutive effect due to our net loss for the year ended March 31, 2020.

Use of estimates -The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company’s significant accounting estimates and assumptions include, but are not limited to, those used for assessment for impairment of long-lived assets, allowance for credit losses, inventory valuation for excess and obsolete inventories, and depreciation lives of property and equipment. Management evaluates these estimates and assumptions on a regular basis. Actual results could differ from those estimates.

Fair value of financial instruments -The fair value of a financial instrument is defined as the exchange price that would be received from an asset or paid to transfer a liability (as exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date. The carrying amounts of financial assets and liabilities, such as cash and cash equivalents, time deposits, accounts receivable, prepaid expenses and other current assets, accounts payable, and other current liabilities, approximate their fair values because of the short maturity of these instruments and market rates of interest.

Fair value measurements - The Company has adopted ASC No. 820, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. It does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information.

It establishes a three-level valuation hierarchy of valuation techniques based on observable and unobservable inputs, which may be used to measure fair value and include the following:

- Level 1 - Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt and equity securities and derivative contracts that are traded in an active exchange market, as well as certain securities that are highly liquid and are actively traded in over-the-counter markets.
- Level 2 - Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques based on significant unobservable inputs, as well as instruments for which the determination of fair value requires significant management judgment or estimation.

Classification within the hierarchy is determined based on the lowest level of input that is significant to the fair value measurement.

2. Summary of Significant Accounting Policies - continued

Non-recurring fair value measurements - Long-lived assets are measured at fair value on a non-recurring basis using mostly Level 3 inputs as defined in the fair value hierarchy. These assets are not measured at fair value on an ongoing basis, but are subject to fair value adjustments only in certain circumstances. Assets that are written down to fair value when impaired and retained investments are not subsequently adjusted to fair value unless further impairment occurs.

Fair value of long-lived assets, including real estate, are determined by estimating the amount and timing of net future cash flows (which are unobservable inputs) and discounting them using a risk-adjusted rate of interest. The Company estimates future cash flows based on its experience and knowledge of the market. Significant increases or decreases in actual cash flows may result in valuation changes. For real estate, fair values are based on discounted cash flow estimates which reflect current and projected lease profiles and available industry information about capitalization rates and expected trends in rents and occupancy and are corroborated by external appraisals.

Recently Adopted Accounting Pronouncements

In December 2019, the FASB issued ASU 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes*. ASU 2019-12 will simplify the accounting for income taxes by removing certain exceptions to the general principles in Topic 740. The amendments also improve consistent application of and simplify GAAP for other areas of Topic 740 by clarifying and amending existing guidance. For public business entities, the amendments in this ASU are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2020. Effective April 1, 2021, the Company adopted ASU 2019-12, which did not have a material impact on the Company’s consolidated financial statements.

In October 2020, the FASB issued ASU 2020-10 *“Codification Improvements”*, which improves consistency by amending the Accounting Standards Codification to include all disclosure guidance in the appropriate disclosure sections and clarifies the application of various provisions in the Codification by amending and adding new headings, cross referencing to other guidance, and refining or correcting terminology. The amendments are effective for annual periods beginning after December 15, 2020 for public business entities. Effective April 1, 2021, the Company adopted ASU 2019-12, which did not have a material impact on the Company’s consolidated financial statements.

Recent Accounting Pronouncements Not Yet Adopted

In July 19, 2021, the FASB issued ASU 2021-05, *Leases (Topic 842): Lessors—Certain Leases with Variable Lease Payments*. This ASU amends the lease classification requirements for lessors to align them with practice under ASC Topic 840. Lessors should classify and account for a lease with variable lease payments that do not depend on a reference index or a rate as an operating lease if both of the following criteria are met: 1. The lease would have been classified as a sales-type lease or a direct financing lease in accordance with the classification criteria in ASC paragraphs 842-10-25-2 through 25-3; and 2. The lessor would have otherwise recognized a day-one loss. When a lease is classified as operating, the lessor does not recognize a net investment in the lease, does not derecognize the underlying asset, and, therefore, does not recognize a selling profit or loss. The amendments in this update are effective for fiscal years beginning after December 15, 2021 for all entities, and interim periods within those fiscal years for public business entities. The Company is evaluating the impact of the adoption of ASU 2021-05, but does not expect it to have a material impact on its consolidated financial statements.

In March 31, 2022, the FASB issued ASU 2022-02, *Financial Instruments – Credit Losses (Topic 326): Troubled Debt Restructurings and Vintage Disclosures*, which eliminates the TDR accounting model for creditors that have already adopted Topic 326, which is commonly referred to as the current expected credit loss (CECL) model. For entities that have adopted Topic 326, ASU 2022-02 takes effect in reporting periods beginning after Dec. 15, 2022. The Company is evaluating the impact of the adoption of ASU 2022-02, but does not expect it to have a material impact on its consolidated financial statements.

3. Marketable Securities

The Company acquired equity securities listed in Hong Kong and Australian Securities Exchange.

	March 31,	
	2021	2022
Cost	<u>\$22,842</u>	<u>\$24,096</u>
Market value	<u>\$22,373</u>	<u>\$24,499</u>

Included in non-operating (expenses) income, net were unrealized (loss) gain for the years ended March 31, 2020, 2021 and 2022 of \$(5,179), \$2,010 and \$872 respectively.

Net proceeds from sale of marketable securities for the years ended March 31, 2020, 2021 and 2022 were \$1,620, \$6,150 and \$11,245 respectively and realized gain from sales of marketable securities for the years ended March 31, 2020, 2021 and 2022 were \$29, \$333 and \$1,073 respectively. For the purposes of determining realized gains and losses, the cost of securities sold was determined based on the average cost method.

The marketable securities were classified as Level 1 of the hierarchy established under ASC No. 820 because the valuations were based on quoted prices for identical securities in active markets.

4. Inventories

Inventories, net of allowances, by major categories are summarized as follows:

	March 31,	
	2021	2022
Raw materials	\$11,554	\$16,970
Work-in-progress	2,646	3,904
Finished goods	1,993	2,945
	<u>\$16,193</u>	<u>\$23,819</u>

Obsolescence allowance for inventory is as follows:

	Year ended March 31		
	2020	2021	2022
Balance at beginning of the year	\$3,890	\$4,316	\$4,307
Additional charges (written off), net	426	(9)	(25)
Balance at the end of the year	<u>\$4,316</u>	<u>\$4,307</u>	<u>\$4,282</u>

5. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	March 31,	
	2021	2022
Value added tax recoverable	\$333	\$27
Rental and utility deposit	35	25
Advance to suppliers	266	260
Prepayment	840	649
Dividend receivable	122	115
Others	893	850
	<u>\$2,489</u>	<u>\$1,926</u>

6. Property, Plant and Equipment, net

Property, plant and equipment, net consist of the following:

	March 31,	
	<u>2021</u>	<u>2022</u>
At cost:		
Leasehold land and buildings	\$32,233	\$32,233
Plant and machinery	36,915	37,313
Furniture, fixtures and equipment	11,073	10,748
Motor vehicles	1,540	1,583
Leasehold improvements	4,074	4,201
Impairment	(2,846)	(2,781)
	<u>82,989</u>	<u>83,297</u>
Less: accumulated depreciation and amortization	(55,666)	(56,280)
Net book value	<u>\$27,323</u>	<u>\$27,017</u>

Included in furniture, fixtures and equipment is computer software with net values of \$36 and \$28 as of March 31, 2021 and 2022, respectively.

Cost of leasehold land and buildings consist of the following:

	March 31,	
	<u>2021</u>	<u>2022</u>
Land use right of state-owned land and buildings erected thereon (a)	\$28,077	\$28,077
Long term leased land and buildings erected thereon (b)	4,156	4,156
	<u>\$32,233</u>	<u>\$32,233</u>

- (a) The land use rights of state-owned land and buildings erected thereon represent land and buildings located in the PRC on which an upfront lump-sum payment has been made for the right to use the land and building with terms of 50 years expiring in 2050.
- (b) Long term leased land and buildings erected thereon represent land and buildings on collectively-owned land located in the PRC on which an upfront lump-sum payment has been made for the right to use the land and building for a term of 50 years to 2053. Dongguan Chang An Xiaobian District Co-operation, the lessor, is the entity to whom the collectively-owned land has been granted. According to existing PRC laws and regulations, collectively-owned land is not freely transferable unless certain application and approval procedures are fulfilled by the Dongguan Chang An Xiaobian District Co-operation to change the legal form of the land from collectively-owned to state-owned. As of March 31, 2022, the Company is not aware of any steps being taken by the Dongguan Chang An Xiaobian District Co-operation for such application.

Included in leasehold land and buildings is property on operating lease with net values of \$7,042 and \$6,819 as of March 31, 2021 and 2022, respectively. Details of the property on lease are as follows:

	March 31,	
	<u>2021</u>	<u>2022</u>
Cost	\$10,623	\$10,623
Less: accumulated depreciation and amortization	(3,581)	(3,804)
Net book value	<u>\$7,042</u>	<u>\$6,819</u>

During the years ended March 31, 2020, 2021 and 2022, the Company had no impairment on its property, plant and equipment. Depreciation of property, plant and equipment were \$1,973, \$1,755 and \$1,736 during the years ended March 31, 2020, 2021 and 2022, respectively.

7. Other Accrued Liabilities

Other accrued liabilities consist of the following:

	March 31,	
	2021	2022
Accrued expenses	\$574	\$1,645
Others	1,442	1,305
	<u>\$2,016</u>	<u>\$2,950</u>

8. Income Taxes

Net (loss) income before taxes of, \$(947), \$8,706 and \$8,067 were solely attributed by non-U.S. operations for the years ended March 31, 2020, 2021 and 2022, respectively.

Under current BVI law, the Company’s income is not subject to taxation in the British Virgin Islands. Subsidiaries operating in Hong Kong and the PRC are subject to income taxes as described below, and the subsidiaries operating in Macao are exempted from income taxes. Under the current Samoa Law, subsidiary incorporated in Samoa is not subject to profit tax as it has no business operations in Samoa.

The provision for current income taxes of the subsidiaries operating in Hong Kong has been calculated by applying the current rate of taxation of 16.5% (2020:16.5%, 2021:16.5%) to the estimated taxable income arising in or derived from Hong Kong, if applicable.

Effective from January 1, 2021, profit in excess of Macau Patacas (“MOP\$”) \$600 derived from subsidiaries incorporated in Macau are subject to Macau Complementary Tax of 12%.

In accordance with the PRC Income Tax Law, the standard income tax for all subsidiaries operating in the PRC is 25%.

The provision for income taxes consists of the following:

	Year ended March 31,		
	2020	2021	2022
Current tax			
- PRC	\$265	\$295	\$249
- Macau	-	26	153
Deferred tax	108	154	(567)
	<u>\$373</u>	<u>\$475</u>	<u>\$(165)</u>

Reconciliation between the provision for income taxes computed by applying the statutory tax rate in the PRC to income before income taxes and the actual provision for income taxes is as follows:

	Year ended March 31,		
	2020	2021	2022
Provision for income taxes at statutory tax rate in the PRC	\$(236)	\$2,177	\$2,017
Tax rate differential on entities not subject to PRC income tax	1,281	(740)	(602)
Effect of income for which no income tax is chargeable	(850)	(934)	(1,670)
Effect of expense for which no income tax is deductible	139	75	188
Net change in valuation allowances	39	(103)	(62)
Over provision of income tax in previous years	-	-	(36)
Effective tax	<u>\$373</u>	<u>\$475</u>	<u>\$(165)</u>

8. Income Taxes - continued

The net deferred income tax consists of the following:

	March 31,	
	2021	2022
Deferred income tax assets	\$-	\$259
Deferred income tax liabilities	(957)	(659)
Net deferred income tax liabilities	<u>\$(957)</u>	<u>\$(400)</u>

The components of net deferred income tax are as follows:

	March 31,	
	2021	2022
Deferred income tax assets (liabilities) :		
Net operating loss carry forwards	\$-	\$43
Provision of employee benefits	565	1,150
Depreciation and amortization	(661)	(1,172)
Revenue and cost of sales recognized for financial reporting purpose before being recognized for tax purpose	(811)	(382)
Others	55	4
Less: Valuation allowances	(105)	(43)
Net deferred income tax liabilities	<u>\$(957)</u>	<u>\$(400)</u>

The Company operates through the PRC entities and the valuation allowance is considered on each individual basis.

The Company’s assessment is that it is not more likely than not that these deferred tax assets will be realized.

The net operating loss attributable to those PRC entities can only be carried forward for a maximum period of five years. Tax losses of non-PRC entities can be carried forward indefinitely.

Under the PRC Income Tax Law and the implementation rules, profits of the PRC entities earned on or after January 1, 2008 and distributed by the PRC entities to the Company are subject to a withholding tax at a rate of 10%, unless the Company will be deemed as a resident enterprise for tax purposes. Since the Company intends to reinvest the earnings of the PRC entities in operations in the PRC, the PRC entities do not intend to declare dividends to their immediate non-PRC established holding companies in the foreseeable future. Accordingly, no deferred taxation on undistributed earnings of the PRC entities has been recognized as of March 31, 2022.

The Company has adopted the provisions of ASC 740 on April 1, 2007. The evaluation of a tax position in accordance with ASC 740 begins with a determination as to whether it is more-likely-than-not that a tax position will be sustained upon examination based on the technical merits of the position. A tax position that meets the more-likely-than-not recognition threshold is then measured at the largest amount of benefit that if greater than 50 percent likely of being realized upon ultimate settlement for recognition in the financial statements. The Company classifies interest and/or penalties related to unrecognized tax benefits as a component of income tax provisions; however, as of March 31, 2021 and 2022, there is no interest and penalties related to uncertain tax positions.

A reconciliation of the beginning and ending amount of total unrecognized tax benefits is as follows:

	Year ended March 31,		
	2020	2021	2022
Balance at the beginning of the year	\$482	\$735	\$886
Increase related to current year tax positions	253	151	346
Balance at end of the year	<u>\$735</u>	<u>\$886</u>	<u>\$1,232</u>

8. Income Taxes – continued

At March 31, 2021 and 2022, there are \$886 and \$1,232 of unrecognized tax benefits that if recognized, would affect the annual effective tax rate. For the year ended March 31, 2020, 2021 and 2022, the Company did not recognize any interest and penalties related to unrecognized tax benefits.

The Company is currently unable to provide an estimate of a range of the total amount of unrecognized tax benefits that is reasonably possible to change significantly within the next twelve months.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or its withholding agent. The statute of limitations extends to five years under special circumstances, which are not clearly defined. In the case of a related party transaction, the statute of limitations is ten years. There is no statute of limitations in the case of tax evasion.

In accordance with Guo Shui Fa [2009] No.2, the PRC tax authorities have the right to deem the Company for a tax amount based on the transfer pricing contemporaneous documentations (the “Contemporaneous Documentations”) or a basis that they considered reasonable. The amount of income taxes payable at March 31, 2021 and 2022 includes the deemed profit tax estimated by the management based on the Contemporaneous Documentations.

9. Lease

Operating leases as lessor

We have non-cancellable agreements to lease our factory buildings to tenants under operating lease. The lease terms are between 1 month to 36 months. The leases do not contain contingent payments. At March 31, 2022, the minimum future rental income to be received is as follows:

Year ending March 31, 2023	\$1,233
Year ending March 31, 2024	628
Year ending March 31, 2025	<u>205</u>
Total minimum future rental income	<u><u>\$2,066</u></u>

The following table represents lease income recognized in the consolidated statements of comprehensive income (loss):

	<u>March 31,</u>	
	<u>2021</u>	<u>2022</u>
Operating lease income	\$2,026	\$2,418
Other information:		
Operating cash flows from operating leases as lessor	1,954	2,539

Operating leases as lessee

The Company leases premises and warehouses under various operating leases, certain of which contain escalation clauses. As of March 31, 2021, the Company had 2 operating lease arrangements with lease terms over 1 year and future total lease payments of \$81. As of March 31, 2022, the Company had no operating lease arrangement with lease terms over 1 year. The Company did not recognize any ROU assets and operating lease liabilities in the consolidated balance sheets. Rental expenses under operating leases included in the consolidated statements of comprehensive income (loss) were \$74, \$71 and \$77 for the years ended March 31, 2020, 2021 and 2022, respectively.

9. Lease - continued

The following table represents lease costs recognized in the Company’s consolidated statements of comprehensive income (loss) for the year ended March 31, 2022. Lease costs are included in cost of sales, selling, general and administrative expense on the Company’s consolidated statements of comprehensive income (loss).

	<u>March 31,</u>	
	<u>2021</u>	<u>2022</u>
Operating lease costs	\$71	\$111
Total leases costs	71	111
	<u>March 31,</u>	
	<u>2021</u>	<u>2022</u>
Supplemental cash flow information for our leases was as follows		
Operating cash paid for operating lease		
Operating cash flows from operating leases	\$71	\$111

10. Commitments and Contingencies

The Company leases premises and warehouses under non-cancelable operating lease agreements. See note 9 for future minimum lease payments under non-cancelable operating lease agreements with initial terms of one year or more.

At March 31, 2022, the Company had capital commitments for purchase of plant and machinery, and leasehold improvement totaling \$211, which are expected to be disbursed during the year ending March 31, 2023.

11. Employee Benefits

The Company contributes to a state pension plan run by the Chinese government in respect of its employees in the PRC. The expense of \$640, \$165 and \$784 included in the consolidated statements of comprehensive income (loss) related to this plan, which is calculated at the range of 8% to 14% of the average monthly salary, was provided for the years ended March 31, 2020, 2021 and 2022, respectively.

12. Stock Option Plan

On March 15, 1995, the Company adopted the 1995 Stock Option Plan that permits the Company to grant options to officers, directors, employees and others to purchase up to 1,012,500 shares of Common Stock. On September 29, 1997, the Company approved an increase of 549,000 shares making a total of 1,561,500 shares of common stock available under the stock option plan. On January 7, 2002, the Company adopted the 2001 Stock Option Plan to purchase an additional 1,125,000 shares of Common Stock. On September 30, 2003, the Company adopted the 2003 Stock Option Plan to purchase an additional 900,000 shares of Common Stock. On September 19, 2005, the Company’s shareholders approved an increase of 500,000 shares making a total of 1,400,000 shares of common stock available under the 2003 Stock Option Plan. On August 17, 2007, the Company’s Board of Directors, subject to shareholders’ approval, approved an increase of 400,000 shares making a total of 1,800,000 shares of common stock available under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual Shareholders’ Meeting held on October 9, 2007. On August 13, 2010, the Company’s Board of Directors, subject to shareholders’ approval, approved an increase of 800,000 shares making a total of 2,600,000 shares of common stock available under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual Shareholders’ Meeting held on September 16, 2010.

On August 7, 2013, the Company’s Board of Directors, subject to shareholder approval, approved amendments to the 2003 Stock Option Plan to increase by 900,000 shares the number of shares that can be optioned and sold under the 2003 Stock Option Plan, bringing to a total of 3,500,000 shares the number of common shares that can be optioned and sold under the 2003 Stock Option Plan. The Company’s shareholders approved this amendment at the Company’s Annual shareholders’ Meeting held on September 11, 2013.

As of March 31, 2022, options to purchase an aggregate of 5,669,000 common shares had been granted under the stock option plans. Options granted under the stock option plans vest immediately and are exercisable for a period of up to 10 years commencing on the date of grant, at a price equal to at least the fair market value of the Common Stock at the date of grant, and may contain such other terms as the Board of Directors or a committee appointed to administer the plan may determine. A summary of the option activity (with weighted average prices per option) is as follows:

12. Stock Option Plan - continued

	Year ended March 31,								
	2020			2021			2022		
	Number of stock options	Weighted Average Exercise price	Grant Date Fair Value	Number of stock options	Weighted Average Exercise price	Grant Date Fair Value	Number of stock options	Weighted Average Exercise price	Grant Date Fair Value
Outstanding at beginning of the year	500,000	\$2.1	\$0.51	470,000	\$2.1	\$0.51	470,000	\$2.1	\$0.51
Exercised during the year	(30,000)	\$2.14	\$0.55	-	\$-	\$-	(20,000)	\$2.14	\$0.549
Cancelled during the year	-	\$-	\$-	-	\$-	\$-	(50,000)	\$2.14	\$0.549
Outstanding and exercisable at the end of the year	<u>470,000</u>	\$2.1	\$0.51	<u>470,000</u>	\$2.1	\$0.51	<u>400,000</u>	\$2.09	\$0.50
Range of exercise price per share	\$2.09 to \$2.14			\$2.09 to \$2.14			\$2.09		

During the years ended March 31, 2020, 2021 and 2022, the Company recognized employee stock-based compensation expense of \$nil, \$nil and \$nil, respectively. No options were granted for the years ended March 31, 2020, 2021 and 2022. The weighted average remaining contractual life of the share options outstanding at March 31, 2022 was 2.3 years. At March 31, 2021 and 2022, there were 1,268,000 and 1,318,000 options available for future grant under the plans, respectively.

As of March 31, 2022, the Company had outstanding stock options to acquire an aggregate of 400,000 shares of common stock with an intrinsic value of \$628. Of those outstanding options, 400,000 shares had vested as of March 31, 2022, representing an intrinsic value of \$628. As of March 31, 2021, the Company had outstanding stock options to acquire an aggregate of 470,000 shares of common stock with an intrinsic value of \$673. Of those outstanding options, 470,000 shares had vested as of March 31, 2021, representing an intrinsic value of \$673.

13. Other (expenses) income, net

Other (expenses) income, net consist of the following:

	Year ended March 31,		
	2020	2021	2022
Gain (loss) on disposal of property, plant and equipment, net	\$29	\$22	\$(24)
Foreign exchange (loss) gain, net	(505)	567	(352)
(Provision for) reversal of credit losses, net	(297)	(397)	148
Others	348	213	302
Other (expenses) income, net	<u>\$(425)</u>	<u>\$405</u>	<u>\$74</u>

14. Non-operating (expenses) income, net

Non-operating income (expenses), net consist of the following:

	Year ended March 31,		
	2020	2021	2022
Dividend income from marketable securities	\$1,049	\$802	\$974
Interest income from bank deposits	218	235	245
Unrealized (loss) gain from marketable securities	(5,179)	2,010	872
Realized gain from sales of marketable securities	29	333	1,073
Rental income, net of depreciation charges	1,564	2,026	2,209
Others	(41)	39	(65)
Non-operating (expenses) income, net	<u>\$(2,360)</u>	<u>\$5,445</u>	<u>\$5,308</u>

15. Operating Risk

Concentrations of Credit Risk and Major Customers - A substantial percentage of the Company’s sales are made to a small number of customers and are typically sold either under letter of credit or on an open account basis. Details of customers accounting for 10% or more of total net sales for each of the three years ended March 31, 2020, 2021 and 2022 are as follows:

	Percentage of net sales Year ended March 31,		
	2020	2021	2022
Customer B	12.0%	19.3%	20.1%
Customer C	*%	10.0%	11.6%
Customer D	11.6%	11.2%	*%
Customer E	18.7%	*%	*%
Customer F	*%	11.2%	*%

* Less than 10%

Sales to the above customers relate to both injection-molded plastic parts and electronic products.

Debtors accounting for 10% or more of total accounts receivable at March 31, 2021 and 2022, respectively, are as follows:

	Percentage of accounts receivable at March 31,	
	2021	2022
Customer B	10.1%	10.5%
Customer D	17.1%	*%
Customer E	*%	17.6%
Customer F	12.7%	*%

* Less than 10%

There were \$1, \$nil and \$935 accounts receivable written off during the years ended March 31, 2020, 2021 and 2022, respectively. There were net provision for (reversal of) credit losses of \$297, \$397 and (\$148) during the years ended March 31, 2020, 2021 and 2022, respectively. At March 31, 2021 and 2022, allowances for credit losses were \$1,351 and \$268, respectively.

Concentrations of Suppliers - For the years ended March 31, 2020, 2021 and 2022, the Company had no single suppliers contributed over 10% of total purchase.

Country risk - The Company has significant investments in the PRC. The operating results of the Company may be adversely affected by changes in the political and social conditions in the PRC, and by changes in Chinese government policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods taxation, among other things. There can be no assurance, however, those changes in political and other conditions will not result in any adverse impact.

Investment price risk - The Company is exposed to equity price risk on marketable securities. The Company’s marketable securities are investment listed on the Stock Exchange of Hong Kong and the Australia Securities Exchange. Decisions to buy and sell securities are based on daily monitoring of the performance of individual securities compared to that of the Index and other industry indicators, as well as the Company’s liquidity needs. The Company believes the exposure to investment price risk from the Company’s investment activities is acceptable in the Company’s circumstances.

16. Segment Information

The Company has two reportable segments: plastic injection molding and electronic products assembling. The Company’s reportable segments are strategic business units that offer different products and services. They are managed separately because each business requires different technology and marketing strategies. Most of the businesses were acquired as a unit, and the management at the time of the acquisition was retained.

The Company used to include the corporate expenses, which mainly comprised of directors’ remuneration, legal and professional expenses and corporate insurance expenses, in the segment of plastic injection. Commencing from this year, the corporate expenses are separately disclosed in the segment information for a more precise presentation of the financial performance of each segment.

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. The Company accounts for intersegment sales and transfers as if the sales or transfers were to third parties, that is, at current market prices.

Contributions of the major activities, profitability information and asset information of the Company’s reportable segments for the years ended March 31, 2020, 2021 and 2022 are as follows:

	Year ended March 31,								
	2020			2021			2022		
			Income			Income			Income
	NetIntersegment	Intersegment	(loss) before income tax	NetIntersegment	Intersegment	(loss) before income tax	NetIntersegment	Intersegment	(loss) before income tax
Segment:	sales	sales		sales	sales		sales	sales	
Injection molded plastic parts	\$25,531	\$(178)	\$(1,197)	\$20,325	\$(461)	\$6,025	\$23,586	\$(241)	\$4,229
Electronic products	40,077	(62)	1,544	45,022	-	3,992	62,635	-	5,233
Segment total	\$65,608	\$(240)	\$347	\$65,347	\$(461)	\$10,017	\$86,221	\$(241)	\$9,462
Reconciliation to consolidated totals:									
Sales eliminations	(240)	240	-	(461)	461	-	(241)	241	-
Corporate expenses			\$(1,294)			\$(1,311)			\$(1,395)
Consolidated totals:									
Net sales	\$65,368	\$-		\$64,886	\$-		\$85,980	\$-	-
(Loss) income before income taxes			\$(947)			\$8,706			\$8,067

	Year ended March 31,					
	2020		2021		2022	
	Interest income from bank deposits	Interest expenses	Interest income from bank deposits	Interest expenses	Interest income from bank deposits	Interest expenses
Segment:						
Injection molded plastic parts	\$204	\$-	\$213	\$-	\$221	\$-
Electronic products	14	-	22	-	24	-
Consolidated total	\$218	\$-	\$235	\$-	\$245	\$-

	Year ended March 31,								
	2020			2021			2022		
			Depreciation and amortization			Depreciation and amortization			Depreciation and amortization
	Identifiable assets	Capital expenditure		Identifiable assets	Capital expenditure		Identifiable assets	Capital expenditure	
Segment:									
Injection molded plastic parts	\$66,741	\$251	\$1,754	\$73,209	\$269	\$1,540	\$74,373	\$783	\$1,402
Electronic products	28,638	256	219	34,651	282	215	41,038	721	334
Consolidated Totals	\$95,379	\$507	\$1,973	\$107,860	\$551	\$1,755	\$115,411	\$1,504	\$1,736

16. Segment Information - continued

The breakdown of sales by destination is analyzed as follows:

	Year ended March 31,		
	2020	2021	2022
Net sales			
United States of America	\$11,228	\$7,861	\$10,460
PRC	27,097	24,905	34,448
United Kingdom	4,852	3,259	6,736
Hong Kong	6,188	8,138	11,593
Europe	9,827	9,564	13,421
Canada	2,681	4,680	5,503
Others	3,495	6,479	3,819
Total net sales	\$65,368	\$64,886	\$85,980

The location of the Company’s long-lived assets is as follows:

	March 31,	
	2021	2022
Hong Kong and Macao	\$233	\$99
PRC	27,090	26,918
Total long-lived assets	27,323	27,017

17. Condensed Financial Information of Deswell Industries, Inc.

The condensed financial statements of Deswell Industries, Inc. have been prepared in accordance with accounting principles generally accepted in the United States of America. Under the PRC laws and regulations, Deswell Industries, Inc.’s PRC subsidiaries are restricted in their ability to transfer certain of their net assets to Deswell Industries, Inc. in the form of dividend payments, loans or advances. The amounts restricted include paid-in capital and statutory reserves, as determined pursuant to PRC generally accepted accounting principles, totaling \$57,864 (equivalent to RMB377 million) and \$58,900 (equivalent to RMB376 million) as of March 31, 2021 and 2022, respectively.

Balance sheets

	March 31,	
	2021	2022
Assets		
Current assets:		
Cash and cash equivalents	\$4,574	\$227
Prepaid expenses and other current assets	45	45
Amounts due from subsidiaries	11,751	12,533
Total current assets	16,370	12,805
Investments in subsidiaries	71,005	79,666
Total assets	<u>\$87,375</u>	<u>\$92,471</u>
Liabilities and shareholders’ equity		
Current liabilities:		
Accrued payroll and employee benefits	\$1,573	\$1,573
Other accrued liabilities	113	120
Total current liabilities	1,686	1,693
Total shareholders’ equity	85,689	90,778
Total liabilities and shareholders’ equity	<u>\$87,375</u>	<u>\$92,471</u>

Statements of comprehensive income (loss)

	Year ended March 31,		
	2020	2021	2022
Equity in earnings of subsidiaries	\$115	\$9,442	\$8,661
Operating expenses	1,435	1,211	429
(Loss) income before income taxes	(1,320)	8,231	8,232
Income taxes	-	-	-
Net (loss) income	(1,320)	8,231	8,232
Share of other comprehensive income (loss) of subsidiaries	-	-	-
Total comprehensive (loss) income	<u>\$(1,320)</u>	<u>\$8,231</u>	<u>\$8,232</u>

17. Condensed Financial Information of Deswell Industries, Inc. - continued

Statements of cash flows

	Year ended March 31,		
	2020	2021	2022
Cash flows from operating activities			
Net (loss) income	\$(1,320)	\$8,231	\$8,232
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Equity in earnings of subsidiaries	(115)	(9,442)	(8,661)
Changes in operating assets and liabilities:			
Prepaid expenses and other current assets	(1)	(3)	-
Amounts due from subsidiaries	4,116	7,774	(782)
Other accrued liabilities	(21)	(24)	7
Net cash provided by operating activities	2,659	6,536	(1,204)
Cash flows from financing activities			
Dividends paid	(2,387)	(2,864)	(3,186)
Proceeds from exercise of stock options	64	-	43
Net cash used in financing activities	(2,323)	(2,864)	(3,143)
Net increase in cash and cash equivalents	336	3,672	(4,347)
Cash and cash equivalents, beginning of year	566	902	4,574
Cash and cash equivalents, end of year	\$902	\$4,574	\$227

a) Basis of presentation

In Deswell Industries, Inc.-only financial statements, Deswell Industries, Inc.’s investments in subsidiaries are stated at cost plus its equity interest in undistributed earnings of subsidiaries since inception. Accordingly, such financial statements should be read in conjunction with the Company’s consolidated financial statements.

Deswell Industries, Inc. records its investments in its subsidiaries under the equity method of accounting as prescribed in ASC 323 “Investment-Equity Method and Joint Ventures”. Such investment is presented on the balance sheets as “Investments in subsidiaries” and share of the subsidiaries’ profit or loss as “Equity in earnings (loss) of subsidiaries”, on the statements of comprehensive income (loss).

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles have been condensed or omitted.

b) Related party transactions

For the years ended March 31, 2020 and 2021, related party transactions were mainly composed of \$90 paid to Jetcrown Industrial (Macao Commercial Offshore) Limited as service fee for each of the years.

No service fee was paid to Jetcrown Industrial (Macao Commercial Offshore) Limited for the year ended March 31, 2022.

ITEM 19. EXHIBITS

The following documents are filed as exhibits herewith:

Exhibit No.	Description
1.1	Memorandum and Articles of Association (as amended and restated on 13th December, 2007) (incorporated by reference to Exhibit 1.1 to registrant’s Registration Statement on Form 8-A filed with the SEC on December 31, 2007).
1.2	Amendment to Regulation 6.15 of registrant’s Articles of Association as filed with the Registrar of Corporate Affairs of the British Virgin Islands on March 26, 2010 (incorporated by reference to Exhibit 1.2 to registrant’s Amendment No. 1 to Registration Statement on Form 8-A filed with the SEC on March 31, 2010).
2.1	Form of common share certificate (incorporated by reference to Exhibit 4.1 of Amendment No. 1 to Deswell’s Registration Statement on Form F-1 filed with the SEC on July 13, 1995).
4.1	2001 Stock Option Plan (incorporated by reference to Exhibit A to the Company’s Proxy Statement for its 2001 Annual Meeting of Stockholders filed with the SEC under cover of Form 6-K on December 12, 2001.)
4.2	2003 Stock Option Plan of Deswell Industries, Inc. (as adopted August 20, 2003 and amended August 1, 2005, August 17, 2007 and August 13, 2010) (incorporated by reference to Annex A to the Company’s Proxy Statement furnished to the SEC on Form 6-K on August 16, 2010).
8.1	Diagram of the Company’s operating subsidiaries and affiliates - (see page 29 of this Report)
11.1	Code of Ethics (incorporated by reference to Exhibit 11.1 of registrant’s Form 20-F for the year ended March 31, 2004, filed with the SEC on July 16, 2004)
12.1	Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934
12.2	Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) under the Securities Exchange Act of 1934
13.1	Certification Pursuant To 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act Of 2002
15.1	Consent of BDO China Shu Lun Pan Certified Public Accountants LLP to incorporation of its report on the Company’s consolidated financial statements into Registrant’s Registration Statements on Form S-8.
101*	Financial information from registrant for the year ended March 31, 2022 formatted in eXtensible Business Reporting Language (XBRL): (a) Consolidated Balance Sheets as of March 31, 2021 and 2022; (b) Consolidated Statements of Comprehensive Income (Loss) for the Years Ended March 31, 2020, 2021 and 2022; (c) Consolidated Statements of Shareholders Equity for the Years Ended March 31, 2020, 2021 and 2022; (d) Consolidated Statements of Cash Flows for the Years Ended March 31, 2020, 2021 and 2022; and (e) Notes to Consolidated Financial Statements

*Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused the undersigned to sign this Annual Report on its behalf.

DESWELL INDUSTRIES, INC.

By:/s/ Edward So Kin Chung
Edward So Kin Chung,
Chief Executive Officer
Date: July 28, 2022

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER REQUIRED BY RULE 13A-14(A)
OR RULE 15D-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, EDWARD SO KIN CHUNG, certify that:

1. I have reviewed this Annual Report on Form 20-F of Deswell Industries, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company for the company and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and

5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: July 28, 2022

/s/ Edward So Kin Chung
Edward So Kin Chung,
Chief Executive Officer

**CERTIFICATION OF CHIEF FINANCIAL OFFICER REQUIRED BY RULE 13A-14(A)
OR RULE 15D-14(A) UNDER THE SECURITIES EXCHANGE ACT OF 1934**

I, HERMAN WONG, certify that:

1. I have reviewed this Annual Report on Form 20-F of Deswell Industries, Inc.
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the company for the company and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

(c) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(d) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and

5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: July 28, 2022

/s/ Herman Wong

Herman Wong,

Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Annual Report of Deswell Industries, Inc. (the “Company”) on Form 20-F for the year ended March 31, 2022 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), the undersigned hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of our knowledge, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 28, 2022
/s/ Edward So Kin Chung
Edward So Kin Chung,
Chief Executive Officer

Date: July 28, 2022
/s/ Herman Wong
Herman Wong
Chief Financial Officer

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Deswell Industries, Inc.

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (File Nos. 333-110236, 333-130738, 333-147790, 333-171314, and 333-199739) of Deswell Industries, Inc. (the “Company”) of our report dated July 28, 2022, relating to the consolidated financial statements, which appear in the Company’s Annual Report on Form 20-F for the year ended March 31, 2022.

/s/ BDO China Shu Lun Pan Certified Public Accountants LLP

Shenzhen, People’s Republic of China
July 28, 2022