To Our Shareholders

Tetsuro Higashi
C.E.O., President

During the fiscal year ended March 2002, the global electronics industry, particularly the semiconductor sector, experienced a deep fall in its markets. This decline occurred amid the worst conditions ever recorded in the history of the industry, brought about by the bursting of the IT bubble and the downturn in the United States economy. Facing this extremely harsh business environment, Tokyo Electron (TEL)'s performance dropped sharply in complete contrast to the record net sales and operating income posted in the previous fiscal year. Despite various initiatives to improve earnings, consolidated net sales decreased 42.3 percent to ¥417.8 billion. Operating loss totaled ¥18.3 billion and net loss for the period amounted to ¥19.9 billion. Regardless of registering a loss, the Company decided to maintain returns to shareholders by declaring cash dividends of ¥8 per share.

Looking at the performance by division, the sales of the Semiconductor Production Equipment division decreased 47.4 percent to ¥325.7 billion. The division's sales were negatively affected by the substantial contraction in the market due to worldwide curtailment in capital investment by semiconductor and liquid crystal display (LCD) manufacturers. The Electronic Components division was similarly affected by stagnant semiconductor demand in the Japanese market. Despite efforts to combat this trend by expanding sales of leading-edge products, the division's sales declined 17.4 percent to ¥73.7 billion.

Conversely, amid this wave of declining performances, the Computer Network division's sales jumped 21.2 percent to ¥17.0 billion. This significant growth achieved in a depressed market can be mainly attributed to the use of powerful marketing efforts in constructing a product lineup focused on products related to the high-growth Internet technology and storage markets. Having proved the success of its strategies before the full-fledged start of the broadband era, the division is confident of achieving further growth.

Implementing Cost Reduction and Restructuring Operations from a Mid-Term Perspective

During the fiscal year under review, TEL carried out a series of restructuring activities and reductions in fixed costs. These measures were taken not only to improve profits during a downturn, but also to create further growth from a mid-term perspective.

To enable a quick response to fluctuations in production, the Company outsources much of its labor requirements for its design and manufacturing lines. Numbering 3,000 employees at the beginning of the fiscal year, these contracted employees were reduced by more than 70% by the end of the fiscal year.

In our domestic operations, we merged the two plants of Tokyo Electron Tohoku, the center for the Company's thermal processing systems development and manufacturing business, into one plant. This measure was taken based on the determination that the plant scale could be reduced while maintaining adequate production capability. Proof for this decision is being steadily provided by the higher efficiency of the new production system that has been introduced previously at other plants.

In the United States, the Company also implemented wide-ranging restructuring, closing Tokyo Electron Oregon, its U.S. base for manufacturing thermal processing systems and absorbing Tokyo Electron Phoenix into Tokyo Electron Massachusetts. In addition, TEL reviewed its global field engineering structure, closing a total of five service stations in Japan, the United States, and Europe.

Besides restructuring its operations, the TEL Group as a whole concentrated on cutting material, labor, and other activity expenses, achieving a reduction of more than ¥30 billion in fixed expenses compared with the previous fiscal year. While these efforts did not prevent the Company from registering a net loss, a structure is progressively being established that will contribute fully to recovery during the next upturn in the market.

Research and development expenses have not been touched in preparation for the next upward cycle. As originally planned, they remained at the same high level as in the previous fiscal year.

Creating Winning Products–The Source of Profitability

With the peaks and troughs in the industry getting steadily larger and the growing influence of the Chinese market, international competition is expected to intensify further as companies compete for survival. To be successful in this global megacompetition, equipment manufacturers must pursue the highest technology standards in the world as well as efficient operations. These are extremely difficult issues for equipment manufacturers, which are easily affected by the market's ups and downs, to address. Nevertheless, without achieving both of these requirements simultaneously, it will be impossible to become a world-class company.

In recognition of these requirements, the Company is focusing its full efforts on introducing products that are overwhelmingly differentiated and on developing next generation core technologies. To achieve these objectives, it will be important for us to collaborate with leading global chip manufacturers from an early development stage and to quickly bring to market products and technologies that meet our customers' needs. Moreover, in support of these goals, the Company will also seek strategic alliances with other suppliers.

Even amid the trying circumstances of the past fiscal year, the Company did not let up on its research activities, and launched several products. Released at the end of 2001, the Trias™SPA plasma nitridation system incorporates nitrogen in gate dielectric films using damage-free microwave plasma. During the short period since its launch, the product has attracted a great deal of attention from customers. For the next step, the Company intends to work with customers to develop further applications for the system. Among other new product launches, development of TELFORMULA™, a high-speed thermal processing system that features flexible loading of wafers, was completed during the fiscal year. The product has been acknowledged by customers, and orders are expected to start building in earnest during the current year.

In other positive news, our customers have been refitting with next-generation equipment, principally 300mm equipment, and several of our 300mm models have already gained a larger share of the market than 200mm models.

Structural Reforming Taskforce–Making TEL a Company That Can Respond Quickly to Change

Over the past few years, thanks to globalization and our technological leadership, the Company has made a significant leap in global competitiveness. However, in terms of the speed and strength necessary to emerge a victor in global megacompetition, we must recognize that the Company still harbors some weakness, as has been amply demonstrated by the sudden downturn in the market. Since it is unlikely that the undulations in the market will cease, we must achieve a structure that can respond flexibly and quickly to market changes and achieve high profitability under any market conditions. The establishment of a Structural Reforming Taskforce, with myself as its head, signifies that we are taking structural reform seriously.

One of our key reform projects is the Total Cost Down Project, which aims to fundamentally improve our design and manufacturing procedures through the deployment of “state-of-the-art” IT. Its concept is to change our way of thinking about design and manufacturing through the use of IT, reducing lead time from order to shipment by one half. The completion of this project will enable us to manufacture products in a highly efficient manner with far less assets, including human resources. The system is already being tested in Tokyo Electron Tohoku, where proof of its effectiveness is steadily emerging. We plan to begin fully introducing the system in our Japanese plants within the next two years. Among other reform projects, we are considering implementing measures to reduce cost of manufacturing and to introduce a small but highly efficient operating system in our administrative divisions. Concrete schemes are firming up and about to get under way.

Cost reduction involves the reengineering of your processes, and such fundamental reform requires time. Nevertheless, we will speed up the process of reform as much as possible.

The Fiscal Year Ahead—The Starting Line for New Growth

The past fiscal year was a difficult one for TEL as we restructured our operations, reformed our corporate structure, and implemented various other measures to battle our sudden change in fortunes. But at the same time, signs of recovery are beginning to emerge in the semiconductor production equipment market. Strategic capital investments by major chip manufacturers took the lead in resumption of investment in plant and equipment in the industry, but a genuine recovery is expected to take some time. Reflecting the positive trend, however, orders for our semiconductor production equipment are improving. In addition, capital investment in flat panel displays (FPD) production equipment has been revived by the favorable conditions in the FPD market, resulting in strong orders for both types of our FPD production equipment, which enjoy majority shares of their respective markets.

Clearly, the fiscal year ahead has begun on a brighter note. Nevertheless, the Company remains in the midst of a process of fundamental change aimed at establishing a high-profitability structure. It is a year, I think, that will require balanced efforts. We must move forward concurrently with our plans for streamlining our business to get back in the black and for achieving growth in the medium to long term. Firmly convinced of the necessity of realizing true global competitiveness, TEL is wholly committed to creating winning products and establishing a high-profitability structure. As we stand on the starting line to new profitability growth, we hope that you will look forward to our future performance as we look forward to your continued support.

Tetsuro Higashi
C.E.O., President
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