

Message from the President

Accelerating the Business Process



A handwritten signature in black ink that reads "Kiyoshi Sato". The signature is fluid and cursive.

Kiyoshi Sato
President & CEO

In the fiscal year ended March 31, 2003, there were encouraging signs of a recovery in the semiconductor industry driven primarily by digital consumer products, such as DVD players and digital cameras. Nevertheless, there continued to be little growth in the markets for personal computers (PCs) and mobile phones, which are major users of semiconductors. In response, semiconductor manufacturers remained cautious, continuing their adjustments in capital investments that they began in 2001.

In dealing with these conditions, TEL strengthened its sales and support activities in Asia, including Japan, and worked to expand sales of new products. As a result of these efforts, consolidated net sales climbed 10.2%, to ¥460.6 billion. At the same time, TEL continued its efforts to cut fixed costs, such as personnel, outsourcing, and business activity expenses. Moreover, working together, the entire organization strove to boost overall operational efficiency, including implementing measures to relocate manufacturing and R&D bases. Reflecting these efforts, operating income improved substantially from the ¥18.3 billion loss of the previous fiscal year, to a positive ¥1.1 billion. Unfortunately, due to the booking of expenses for structural reforms, an explanation of which follows, and the reversal of deferred tax assets, TEL posted a loss of ¥41.6 billion for the fiscal year under review. Despite this performance, the Company has announced cash dividends of ¥8.0 per share.

Pushing Through Structural Reforms

TEL views the next one or two years as a period of preparation for our next major growth stage. Based on the following three points, we are pushing ahead with structural reforms.

- We will readjust our asset and cost bases to suit the current

business climate.

- Further growth of our business will require an expanded product lineup, for which we will have to focus more clearly on R&D activities, while also improving the efficiency of our programs.
- To reinforce our competitive advantage in the market, we will build a structure that accelerates our business processes by enabling quick responses to the increasingly rapid changes in the business environment. We believe that speed will be the most important success factor in our semiconductor production equipment business.

Asset and Cost Reductions

One of the starting points for structural reforms is the reduction of assets and costs. In our development of global operations, which preceded the worldwide structural changes in the semiconductor industry, TEL successfully expanded its customer base while also increasing our share of individual customers' business. This achievement was reflected in sales growth. Examining these results, we can see that the contribution to semiconductor production equipment sales by our overseas segment, which was approximately 30% in the early 1990s, has risen to 70% today, reversing position with sales in Japan.

During the 1990s, capital investment in semiconductor production equipment grew at a high average rate of about 20%. In 2000, the year-over-year base growth rate ballooned to 70% more than the previous fiscal year under the influence of the IT bubble market. To cope with this growth, we proceeded to upgrade and expand our domestic manufacturing and overseas service bases. The following sharp 40% contraction in that market has had a significant impact on our current business

structure. In the fiscal year ended March 2002, we cut fixed costs, such as labor cost of contract workers and employees by about ¥30.0 billion, followed by another about ¥10.0 billion in the fiscal year under review. However, it has not been enough to produce sufficient profit levels. Looking out into the future, the markets for volume applications of semiconductors, such as PCs and mobile phones, remained sluggish, and it will take time for digital consumer products to reach the same level of demand for chips. Consequently, it is difficult to see how the market could recover to an annual growth rate of around 20% in the short term. There are also several factors that point to lower growth rates. The number of semiconductor manufacturers is declining because of the ongoing consolidations and business alliances in the industry. In addition, with the introduction of 300mm wafer production lines and increased throughput has meant that the same volume of semiconductor manufacturing can be done with fewer machines.

In consideration of these conditions, we are pressing forward with reductions in personnel and inventories and the elimination of overlapping investment to convert to a more efficient business structure. Our overall goal is to establish a structure under which we can earn sufficient profits even given the current size of the market. At the end of the fiscal year under review, we booked restructuring-related expenses of ¥20.6 billion. During the current fiscal year, we plan to reduce personnel by approximately one thousand people worldwide. In addition, we will also reorganize our R&D functions and our production and field service bases.

In addition to these measures, we will undertake a fundamental revision of our R&D, production, sales, and service operations, working to cut costs at all levels. For specific measures, please see the reports by our Executive Officers (pages 10 to 15).

Targeting Optimum Global Operations

The previously mentioned asset and cost reductions do not imply that we are going to downsize our business. Furthermore, it does not mean that we are going to cease our globalization efforts. We will continue to pursue further globalization to achieve the optimum allocation of resources. As one example, we are reorganizing our overseas R&D bases, with the Albany NanoTech Project as their core, to acquire leading-


edge technologies and strengthen our ability to bring products to market.

As part of our sales efforts, we established Tokyo Electron Shanghai in the city of the same name to boost our business development efforts in the People's Republic of China. Operations began in April 2002 with a staff of approximately 70 people. Due to rapid growth in its customer base, our support service structure expanded to approximately 150 people during the fiscal year. In the short-term, there is concern about some issues such as the influence of severe acute respiratory syndrome (SARS); but in the medium- to long-term, we anticipate growth in capital investment for semiconductor production equipment in China. To keep pace with this growth, we plan to expand our facilities and workforce as required to supply our customers with parts for semiconductor and flat panel display (FPD) production equipment, technical services, and training.

Expanding our Product Lineup

For further growth, we need to expand our product lineup, not only for the transistor formation processing market that has played such a prominent role in our history, but also in the wiring processing market. We see strong growth potential in this market because the degree of multi-layered wiring is advancing in conjunction with the increasingly high degree of sophistication and integration in devices. Despite the steady introduction of advanced new materials, such as low constant interconnect dielectric film and copper wiring, 65-nanometer design rules still pose a significant R&D challenge. In addressing this fundamental issue, we are examining the process integration possibilities, or determining how to combine different process units to meet the required specifications. We consider some of the essential factors in developing this market to be technologies and infrastructure to test and verify this integration, the ability to form business alliances with companies producing equipment that we do not, and the support of the customers that are actually designing these devices.

In addition to our dielectric etch system and SOD coater, we are focusing our efforts on developing film formation equipment and supercritical cleaning equipment. Using our products and the advanced technology evaluation and research facilities of our new Process Technology Center in Yamanashi



Prefecture as the core, we plan to work with other equipment and material manufacturers to develop an environment that assists with our customers' process integration requirements.

Further Innovations from Accelerating Business Processes

Our highest priority is on accelerating business processes. We are not seeking 20% or 30% improvements as in the past, we are looking to double and triple our pace.

Digital consumer products are the next drivers of growth in the semiconductor application market, following in the steps of PCs and mobile phones. However, because of the nature of consumer products, the product life cycle is becoming shorter. In response, semiconductor and semiconductor production equipment manufacturers must speed up all of their business processes. We expect that the turnover of digital consumer products will be two to three times faster than that of computer products. Because our operations will have to match that pace, we are considering a variety of measures to improve operational speed in each of our functions.

Effective April this year, we have replaced our former corporate senior staff (CSS) system with an executive officer system. Through its introduction, we have separated the roles of the board of directors and operating bodies more clearly than before. In addition to strengthening corporate governance, one of our goals in setting up this system is to speed up the decision-making process to enable faster determination and implementation of strategies. Executive officers are responsible for each of our business functions—R&D, manufacturing, sales, service, and administration—and have been assigned a broad scope of authority for daily business decisions. By delegating responsibility for daily operations to executive officers, I will be focusing my energies on the administration and management of the overall TEL Group. I expect that accelerating our business processes will generate new business innovations for the Group.

The Next Growth Stage

During my more than twenty years career, I have served in a variety of divisions and positions. I have worked in administration, the support services section of an overseas representa-

tive office, and the overseas product sales division in Japan. I have been the senior manager in charge of all products sold in the U.S. market and a business unit manager for our own products. My major short-term goal is to utilize my accumulated experience gained from working in and managing different sections of the value chain to establish a high profit structure through structural reforms and a quick response management organization. After building the business foundation for our next growth stage, I intend to turn my attention to promoting TEL's further development as a market leader based on new product launches and new business model development. Through these efforts, I will strive to expand shareholder value and satisfy the expectations of all stakeholders.

The torch has been passed to a new generation at TEL. At this juncture, I would ask that our shareholders support us as strongly as they have in the past.

June 2003