

## To Our Stakeholders



**Hajime Sawabe** *President and CEO*

### Two Consecutive Years of Top- and Bottom-Line Growth

TDK followed up last year's improved performance with stellar results in fiscal 2004, which ended on March 31, 2004. Consolidated net sales rose 8.2% to ¥658,862 million on a strong showing from the electronic materials and components segment. Growing demand for components, fueled by expansion in the digital home appliances market and an uptick in PC and mobile phone demand, supported sales of electronic materials and electronic devices. Meanwhile, recording devices sales grew by more than 30% year on year, the result mainly of growth in the hard disk drive (HDD) market and TDK's share of heads for this market. Operating income rose 2.5 times to ¥54,322 million on improved operating margins as rationalization initiatives yielded results. Net income jumped 3.5 times to ¥42,101 million, the result of ongoing reforms to the profit structure and other factors.

### Reflecting on Exciting 108—Unfinished Business

March 2004 marked the end of Exciting 108, the medium-term management plan that has been the polestar for our business activities since April 2000. Unfortunately, a major unforeseen event in the intervening period rendered our original Exciting 108 assumptions obsolete—the bursting of the IT bubble—and meant we had to abandon hope of achieving our targets at an early stage. And our capital expenditures fell out of step with demand cycles, too. This prompted us to launch rapid, wholesale structural reforms to address various problems. Exciting 108 was thus a period in which we realigned our operations to stay in step with market changes.

But TDK has achieved much over the past two years. The resolute execution of structural reforms has brought about a renewed spirit and ability to take up two challenges: generating profits under the presumption that our top line won't grow, and raising sales without counting on market growth. The rebound in our results in fiscal 2004 is evidence of the success of our reforms. So, while we fell short of our Exciting 108 goals, we have cleared the path to eventually achieving them.

A closer look at our fiscal 2004 results, however, reveals a number of key issues. One is the degree to which we rely on HDD heads and capacitors for our earnings. Another is slow progress with structural reforms in the magnetic materials-related and recording media businesses, two of our stalwarts in the past. We also have work to do improving the profit structure in high-frequency components and semiconductors, businesses that will be crucial in the unfolding broadband era.

While implementing measures to address these issues, we will remain tightly focused in fiscal 2005 and beyond on funneling resources to three key markets: IT home electronics appliances; high-speed, large-capacity networks; and car electronics. In these three markets, we want to expand our portfolio of number-one products, particularly for finished products exhibiting growth potential.

### **An Exciting Company—a Source of Inspiration and Excitement**

TDK's commitment to making the best possible products flows as strongly through our corporate veins today as it always has. We pride ourselves on being a company recognized for its diligence and sincerity. But I also want TDK to be an Exciting Company. This means serving as a source of inspiration and excitement by executing our imperatives more resolutely and improving quality. An Exciting Company should be able to inspire people and create value for all stakeholders—shareholders, customers, suppliers, employees and societies alike. Employees are key. This vision cannot be realized if employees don't embrace this mantra and work to raise their own value. With the pride of professionals and a sense of ownership and mission, I want each and every member of TDK to do just that. Recognizing each other's value and working collectively as a team toward shared goals is equally important. The sense of fulfillment at taking up new challenges and the joy in achieving goals will be a source of newfound energy. This is the origin of an Exciting Company.

### **TDK's Continued Revival Hinges on Growth in Our Core Business**

In electronic materials and components, our core business, we have many issues to address, as I said previously. These must be viewed in the context of an electronics industry that is expected to continue to grow and our duty to contribute to society as a key member of this industry. To succeed, we must identify customer needs and provide the products they want in a timely manner.

In this vein, we are determined to expand our components business, which is distinguished by the use of TDK's advanced materials development and process technologies. And we will expand in our core business domain by enhancing our reservoir of core technology. That's what TDK has long been known for. We will align ourselves with market demand, reinforcing our presence in domains in which we have traditionally been strong. Upgrading our core business is our top priority. Only by achieving this can we say that TDK is on a true growth trajectory.

In fiscal 2004, the operating income margin was 8.2% for TDK as a whole, but lower for the core electronic components operations. Electronic components that are used in a wide variety of fields should have a high profit margin. Earnings from recording media and HDD heads, both categories where TDK can set itself apart from competitors, should augment these earnings to create what I see as an ideal profit structure. It is for this reason that I say TDK's revival hinges on growth in our core business.

### **Our Core Business—Driving New Growth**

The following concrete strategies target this new growth and will be vital to realizing our image of TDK as an Exciting Company by focusing closely on our core business.

#### **1. Offer products imbuing value that customers want**

##### **Profit—a measure of a company's value**

Profit is the difference between the value customers perceive in our products and the cost of our efforts to supply those products. Another way of looking at this equation is that profit reflects customer satisfaction and one's competitiveness. This, in my view, is the value of a company, and one specific way to gauge that value is the operating income margin. TDK's operating income margin must be at least 10%. If TDK is not generating this degree of value, we are not fully satisfying everyone with an interest in TDK, including myself, and cannot continue to make the investments that are necessary for our business. In an electronics industry embroiled in fierce competition, this principle is critical to the very survival of a company. Sooner or later, being unable to produce sufficient value will mean no longer being able to keep pace with the competition. That's why I believe that the operating profit margin is an accurate measure of a company's value.

### Increasing the proportion of new and industry-leading products

Raising sales of new products as a percentage of net sales is the first vital step for lifting the operating margin. Growth hinges on it. New products have a high profit margin and are often purchased in large quantities. It is for these reasons that I am stressing the importance of new product-driven growth. New products make a company stand out from the crowd by showcasing core technologies. At TDK, new products, excluding HDD heads, accounted for around 24% of net sales in fiscal 2004. We plan to raise this to 30% in fiscal 2005. Our other strategy is to increase the percentage of products in our sales mix that are number one in new and growing fields, not mature markets. In fiscal 2005, our aim is for number-one products to generate 50% of our total net sales.

### Smaller, higher-capacitance components change technologies and create new applications

Multilayer chip capacitors perfectly illustrate the statement that “smaller, higher-capacitance components change technologies and create new applications.” The size of components determines the technology used. And when the capacitance is increased, a different manufacturing method is required. In each case, close to 1,000 layers of ceramic material sheets no more than 1 micron thick must be stacked. Capacitors epitomize the value of developing new products. Smaller capacitors with larger capacitance can be incorporated in finished products that previously used other components. This is important because we are in an era in which smaller products can create exciting new application markets. I’m always impressed when I see what our researchers have come up with. Some capacitors are small enough to be blown away with one’s breath when talking. Smaller than the tip of a pencil, they are too small to see with the naked eye. The result of stacking tens of extremely thin layers of ultra-fine materials, these tiny components underscore TDK’s value because of the key role they play in the development of new applications and products.

### 2. Strengthening core technologies strengthens competitiveness

Making strong products stronger is a key factor that will determine our competitiveness going forward. Refining core technologies is an essential element of our drive to increase the proportion of new and number-one products. To facilitate this, we initiated a major overhaul of our R&D framework in January 2004. The organizational reforms had three objectives.

#### Enhance our standing as an e-material solution provider

TDK is fortunate in that its business domain is the electronics industry. Our markets are constantly evolving, meaning that as an electronic components company we are always kept on our toes. As a self-described e-material solution provider, our concept of solutions is shaped by market needs, by the desire to provide the products customers want when they want them. For that, we are stepping up efforts to develop materials and hone the process technologies that use them.

#### A more market-oriented approach in R&D divisions

TDK’s research divisions have many highly skilled researchers. In the digital era, R&D will have a major bearing on our results and it is these researchers who will determine the success of our R&D. Researchers must naturally understand customer requirements. But they must also set standards for deciding whether a research theme will create value for TDK—whether the investment in R&D is recoverable, for example. To equip researchers with the background knowledge they need to make such judgments, we are assigning them to production lines so they can get a feel for front-line operations. Previously,



there was a tendency for TDK management to send researchers directly to research facilities without first giving them the opportunity to gain a firsthand understanding of our businesses and the issues that determine whether value can be created. Nurturing researchers with both technical skills and a business mindset is an important element of our personnel strategy.

#### An even tighter focus on research themes

Standards for selecting research themes are fluid. They change to mirror changes in the competitive landscape and market needs. Building a storehouse of patents is incomparably far more important now than ever before. In the digital era, the development timeframe is also a very important parameter for selecting research themes. Our task is to improve R&D efficiency by sufficiently considering the importance of ever-changing parameters and using this analysis to concentrate resources in a more tightly focused manner.

#### 3. Professionals trusted by customers and society

Maximizing enterprise value is the single greatest mission of management. And there is no question that the people working at TDK are the foundation for this. It is people that make the products that satisfy customers and generate earnings. That's why we are creating an environment that motivates and inspires employees to create the products that create the value that creates an Exciting Company—an exciting electronic components company.

#### Controlling Inventory Levels

The life cycles of electronic components are growing shorter year by year, meaning that prices can quickly drop if one isn't careful. In this environment, the decision to raise output cannot be based solely on projections of strong sales of a particular product. Because inventory soon becomes obsolete, the return on assets and lead times are more important than the capacity utilization rate. Misreading trends in demand can be fatal for any electronic components company. That's why, we tightly manage inventory by setting basic stock levels based on lead times.

Looking at the medium- to long-term picture, I believe that the electronics industry is entering a new cycle of growth. The industry has a major role to play in creating a ubiquitous information society as progress is made in building Internet- and broadband-based networks. It is my view that, while demand is likely to ebb and flow in the short term due to inventory cycles, there will be strong growth over the long term.

But make no mistake, not everyone will be successful in the digital era just because they are part of the electronics industry. Companies that have the technologies to provide products imbuing value will thrive. Others won't.

Leveraging materials, process and evaluation & simulation technologies, TDK's core technologies, we will deliver products of value to the market, in the process contributing to the development of the electronics industry. Making this possible will be the support of shareholders, customers and business partners, and the commitment of employees.


As we pursue the goal of being an Exciting Company, we aim to maximize enterprise value through a tight focus on electronic materials and components, an area that is key to our future growth. We still have much unfinished business in this regard—but the growth prospects are there.

June 2004



Hajime Sawabe  
President and CEO





**Why? Because  
we still have much  
unfinished business  
to be an Exciting  
Company.**

**We have yet to achieve the strong growth and high profit margins that we expect in our core business. Only when we do, which means addressing various issues, and have created a company that is the leader in the electronic components field will we earn high marks from stakeholders.**