

## TO OUR STAKEHOLDERS



Hajime Sawabe President and CEO

### TOP AND BOTTOM LINES DROP

In fiscal 2002, ended March 31, 2002, consolidated net sales decreased 16.7 percent to ¥575,029 million. And fiscal 2001's net income of ¥43,983 million was followed by a net loss of ¥25,771 million.

Lower sales can be linked to several factors. First was a large decline in both sales and earnings in the electronic materials and components segment. This was the result of a sudden drop-off in IT demand, particularly for mobile phones and PCs. It also reflected the protracted nature of inventory corrections by customers; overly optimistic forecasts for mobile phone and PC demand left them holding large quantities of stock. The U.S. economic slowdown in the second half of fiscal 2002 also took its toll.

The recording devices sector, which is part of the electronic materials and components segment, recorded a year-on-year decline in sales. But it was a year of two halves. In the first half, sales of mainstay HDD heads dropped, as TDK 30 gigabyte/disk heads lost market share, and HDD makers cut production to counter soft PC demand. We gained momentum in the second half, however. TDK regained market share on increasing sales of 40 gigabyte/disk heads, bringing a halt to sliding sales. Sales of HDD heads have also fallen due to continuous and fundamental factors, including a reduction in the number of heads used per HDD, stemming from a rapid rise in areal recording density.

Sales increased slightly in the recording media & systems segment. The sales of audiotapes and videotapes further declined as demand shifted to optical discs. However, CD-Rs, which account for the majority of our optical disc sales, posted sales growth, with higher volumes outweighing falling sales prices. Recording equipment sales, which started in Europe during fiscal 2002, also

contributed to the increase in segment sales. Sales of these products started in the U.S. in the autumn of fiscal 2001. At the start of the fiscal year, we had expected the recording media & systems segment to move into the black. Unfortunately, the segment remained in the red as we could not overcome the downward pressure on earnings of falling CD-R prices and other factors.

The deterioration in our operating results is due in part to a host of external factors, including the U.S. economic downturn, the post-IT bubble correction, and stiff competition from China and Taiwan. But internal issues hampered us, too. In particular, we were slow to identify and react to market shifts. Recognizing this, I set into motion a series of countermeasures. To quickly lower our break-even point in the future, we reduced both fixed and variable expenses and raised efficiency by integrating domestic and overseas production subsidiaries. As we pursued what were essentially restructuring measures, we didn't lose sight of the necessity to meet market needs. We realigned our organization to make it run faster and we undertook a thorough review of how we develop new products. We took restructuring charges of ¥25,872 million to implement all of the above restructuring measures during the year under review.

### **BASIC POLICY FOR FISCAL 2003**

While economic indicators point to an upturn in the U.S., the recovery is expected to be tenuous and gradual. We are seeing orders start to slowly pick up both in Japan and overseas. That said, there don't appear to be any products to stimulate new demand and sustain a full-scale recovery in electronic components and semiconductors. The speed and intensity of competition in today's networked society, the growing presence of China, the presence of EMS, the implications for the industry of ICs, and a supply glut are adding to the difficulties faced in the electronic components industry. The area of greatest uncertainty surrounds the direction of prices and foreign exchange rates.

I feel that fiscal 2003 marks a critical juncture for TDK. We must lower our break-even point as far as we can to restore profitability. And we must move faster to develop products that can hold their own against our competitors. Moreover, we must wisely invest the money that is entrusted to us by shareholders. I am determined to carry out these imperatives in tandem and with the utmost speed.

There are two overriding goals. First, create a structure that remains profitable even when sales are not growing. Second, swiftly shift resources from unprofitable, low-growth fields to more-profitable, high-growth fields through a process of selection and concentration.

## IMPROVING OUR EARNINGS STRUCTURE

- Reducing Fixed and Variable Expenses, and Improving ROA

In the year to March 2002, we reduced the workforce by 3,257 in Japan and 4,511 overseas to lower our break-even point. We expect this move to save us some ¥23.0 billion in labor costs on a consolidated basis in fiscal 2003. We also hope to pare fixed expenses by ¥14.5 billion this year. And to raise our ROA, we have integrated 4 plants in Japan and 3 plants overseas. As I mentioned before, we have responded to markets by speeding up product development under a new organizational structure. In addition, we have taken steps to improve variable expenses by reviewing terms of supply and requesting discounts from purchased materials vendors.

- Selection and Concentration—Clarifying Withdrawal Rules

I expect sales prices of our products to continue to drift downward in fiscal 2003, given the excess supply capacity of electronic components and the ongoing actions by customers to cut costs. We must make up for these declines to maintain sales and generate earnings. That calls for shortening development lead-times, using development expenses more efficiently and expanding sales of new products. It also calls for greater selection and concentration of business units and products.

In fiscal 2003, we will advance structural reforms through this selection and concentration, something we haven't made much progress with heretofore. Key to this process will be how we deal with critical business units, which we have defined as units that have produced negative TDK Value Added (TVA) for the past two years. We will conduct thorough, multidimensional reviews of their business plans using Net Present Value (NPV). Based on this analysis, we will withdraw from critical business units that we don't expect to return to positive NPV within three years. Where we expect a turnaround within three years to positive NPV, we will conduct semi-annual reviews.

- Improving Cash Flows

TDK has been using various performance indicators such as TVA, but these have not been enough to sufficiently improve our ROA. Moving forward, we will work to improve cash flows by setting clearer goals that can be easily understood, even by workers on the factory floor.

## EXECUTING A GROWTH STRATEGY

To deliver value to employees, shareholders and other stakeholders, we must continue to grow in both quantitative and qualitative terms. We must grow sales by reshaping our product mix; increasing the proportion of distinctive, competitive products. The way forward, I believe, still lies in our "e-material solution provider" concept. We must continue to draw on our core strengths to offer unrivaled products imbued with TDK value (the fragrance of TDK) that can

meet market and customer needs as they emerge. We have pinpointed certain areas we will focus our energies on.

- Bolster Capabilities in High Functional Materials and Ultra-Fine Process Technologies

TDK was the first company in the world to commercialize ferrite. We leveraged our technology for producing magnetic materials to add ceramic dielectric materials to our lineup. Indeed, our greatest strengths lie in materials technology, particularly magnetic and dielectric ceramic materials. We also pride ourselves on our high level of process technology. TDK is extremely skilled in forming layers, controlling powdered materials, sintering, coating and developing micro-process technologies used in the manufacture of electronic components, recording tapes and magnetic recording heads. The best way to cope with present market conditions is to turn to our cornerstones of strength in materials and process technologies. Our focus moving forward will be on high functional materials and ultra-fine process technologies. In respect of process technologies, TDK will take the following measures: make existing materials finer, improve micro-processes at the nano-scale level, and improve film-forming technologies. This is to address increasing circuit density driven by progress in making finished products smaller and more lightweight.

- Strengthen Product Planning

Ultimately, the mission of a company is to develop and offer products that match customer needs. This requires plotting product strategy on a matrix comprised of three dimensions—product specifications, market needs and time. Improving how we plan products in this way will facilitate optimal resource allocation that better targets products and businesses.

- Improve Simulation Technologies and Build a Central Database

As I mentioned earlier, it is imperative that we shorten the development lead-time. One way this can be achieved is by improving how we use simulation and evaluation technologies. This will enable us to reduce time spent producing and trying out prototypes, making the development process considerably more efficient. Properly managing the wealth of technological knowledge that each division acquires, through the development of functional blocks and other technologies, is another way to speed up R&D. Such an important intangible asset should be managed at the corporate level. To this end, we intend to build a central database. A database of this type will facilitate the sharing of knowledge among those connected with product development, across divisional boundaries. It should also stimulate the use of our technology throughout the TDK Group.

- Improving Semiconductor and Circuit Technologies

One consideration is paramount when planning products and using TDK's core technologies to bring plans to reality: taking the perspective of our customers, the manufacturers of finished products.

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Put another way, we must constantly ask ourselves, "What functions do their products require?" The next step is looking at ICs and anticipating circuit designs, which form the basis for functional blocks.

It is crucial that we produce functional blocks that address customers' problems and are easy to use. This requires a flexible approach. In some situations, modules will be the answer. In other situations, a multilayer chip capacitor will hold the solution. And there will be times when the best answer will be a one-of-a-kind combination of inductors, power supplies and other components. In short, TDK must use its products and technologies to create best-fit functional blocks for customers' products, while taking into consideration quality, delivery timeframes, cost and other relevant issues.

Developing customized functional blocks requires sophisticated semiconductor and circuit technologies. TDK is determined to improve its skills in both these areas. Four themes are important:

1. Becoming fully versed in technical trends in ICs,
2. Anticipating circuit designs that stay in step with technological progress,
3. Developing functional blocks for those circuits, and
4. Selecting and developing the best materials, components and processes for creating functional blocks.

We must persevere in the face of the present difficult operating environment in which a full-scale market recovery is still some time away. But medium- to long-term prospects are brighter. I feel optimistic about the future with a broadband-centric network society—the second stage of the IT revolution—just around the corner. We hope to benefit from the flourishing demand for home appliances and other products that connect with this network.

We will continue to ready ourselves for this by pushing through further reforms to our earnings structure in fiscal 2003 that we set into motion last year. We will also steadily unfold a growth strategy over the medium term to improve profitability. As we do so, I ask for your continued support and encouragement.



Hajime Sawabe  
President and CEO

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