To Our Stakeholders

Hajime Sawabe *President and CEO*

Our Operating Environment

Macroeconomic conditions remained severe in fiscal 2003, ended March 31, 2003. The bellwether U.S. economy, the driving force of the world economy, appeared to gradually move back onto a recovery footing after taking a step backwards at the start of 2002. However, in the closing months of 2002 consumer and corporate sentiment nosedived due to stagnant demand and tumbling share prices. The Japanese and European economies, which are highly reliant on external demand, felt the effects of the US slowdown. Asia, including China, fared relatively well, but this region is nowhere near becoming a leading force in the world economy just yet.

Fiscal 2003 Results

■ Sales and Earnings

TDK shook off this difficult operating environment to post a 6.7% increase in consolidated net sales, to ¥608,880 million, in fiscal 2003. Growth was paced by the electronics materials and components segment, with recording devices, in particular, posting higher sales on the back of a recovery in TDK's share of the HDD-head market. Consolidated net income also bounced back. TDK recorded a sharp increase to ¥12,019 million, reversing a net loss in fiscal 2002 of ¥25,771 million. The turnaround stems from structural reforms implemented during the past two years.

Sales by Segment

Sales increased in the electronic materials and components segment. This reflected higher sales in recording devices, where growth was spurred by a recovery in the market share of TDK's HDD heads, and higher demand for capacitors and inductive devices, which is being fueled by the digitalization of audio and visual equipment and the increasing use of electronics in automotive applications.

Sales in the recording media & systems segment edged down slightly. In optical media, demand for CD-Rs and DVDs was buoyant, but this was negated by falling MD demand and lower sales prices of CD-Rs, resulting in largely flat sales overall. Audiotape sales fell as demand waned, and higher sales of tape-based data storage media for computers and software were insufficient to offset this decline. Although sales dipped, this segment moved back into the black in the year ended March 31, 2003 as the results of major structural reforms began to show through. Looking ahead, we will build on this momentum by gaining certification for new tape-based data storage media standards and working on the commercialization of Blu-ray Discs, which are widely expected to be the next generation in optical discs.

Improving Cash Flows and Return on Assets

TDK focused on improving its inventory turnover, fixed asset turnover and trade receivables turnover in fiscal 2003 in an effort to improve cash flows and the return on assets. Due to improvements in data processing systems and mindset of everyone at TDK, we are making progress as planned. The numbers bear this out. As of March 31, 2003, the inventory turnover was 1.5 months, which contrasts with 1.9 months a year earlier. Likewise, fixed asset turnover has improved from 2.1 times to 2.5 times and trade receivables turnover improved from 3.1 months to 2.8 months over the same time frame. We are confident that we can raise our cash flows even more by enhancing our supply chain management system and making other improvements.

Continuation of Structural Reforms

Given the challenges we faced in fiscal 2003, we worked to generate profits with the presumption that our top line wouldn't grow. Our accomplishments of the past year were a major step toward building a base that can once again generate sustained earnings growth. We lowered our break-even point by reining in fixed costs. We overhauled our profit structure by concentrating resources on selected businesses. And we raised production efficiency. These measures allowed us to hit our initial operating income target of ¥20 billion. There is still work to be done though. While fixed costs have been trimmed as planned, we haven't seen the improvements we had hoped for in respect of the variable expense ratio. This is because languishing demand and a supply glut caused sales prices to drop sharply.

Another noteworthy development in fiscal 2003 was the progress we made in corporate governance, an area that is attracting increasing attention. By introducing the post of Corporate Officer, we have clearly separated the roles of determining policies and strategies and overseeing the day-to-day operations of TDK in accordance with these guidelines. We are committed to making further improvements as we go forward.

But with challenging external conditions in mind we are determined to make further refinements to our profit structure by tackling a number of ongoing themes. These include achieving greater rationalization of our existing product lineup; making TDK more competitive in terms of cost by raising productivity; ceasing to produce products that we can't count on to contribute to earnings; and increasing sales of highly profitable products.

Fiscal 2004 Basic Policy

■ Difficult Operating Environment

As we turn our focus to the year ahead, one factor is almost certain to remain constant—macroeconomic conditions will continue to stagnate. Heretofore, much of the money in the world has been channeled into the U.S., which has set the tone for the world economy. But now this flow of money has changed. Two causes are falling share prices in the U.S. and increasing euro-denominated foreign currency reserves held by many countries. Net capital inflows prevented the U.S. economy from contracting, but now that these inflows are declining, the U.S. economy has lost some of its momentum. That said, for the time being, it is difficult to see another country replacing the U.S. as the key growth driver in the world economy. One other external factor is casting a pall over our operating environment—the protracted stagnation in demand and fall in prices in the electronics industry.

The stagnation in demand is the result of three main forces. One is that the markets for PCs and mobile phones are now being shaped by replacement demand. These markets will likely tread water until applications for harnessing the potential of broadband emerge. Secondly, we are still in a period of correction following the excessive capital expenditures by companies during the IT bubble. In short, companies continue to curb their capital expenditures. The third reason is structural economic reforms brought about by the Internet. Given this situation, no major expansion in demand in the electronics industry can be expected for the time being.

Regarding falling sales prices, two main factors suggest that the downward trend will persist. One is excess supply resulting from an increase in the supply capabilities of companies in Asia, including China, and excess capacity that is a remnant of the IT bubble. A second reason is that Internet-based sales are exerting downward pressure on prices of products of all kinds.

It is with these difficult macroeconomic conditions in mind that we will advance our businesses in the current fiscal year.

The Second Stage of Structural Reforms

Despite the ever-present economic difficulties, we see the year ahead as a period in which we can lay the groundwork for a new stage of growth. As I said earlier, we must generate earnings without counting on top-line growth. But we must also raise sales even without market growth. These are two main goals of ours for fiscal 2004. We must reform our physical constitution to one that is not at the whim of sudden market shifts, and we must change our way of thinking so as to respond to an era of uncertainty and rapid change. This will make us more profitable and drive growth.

Reforms for Earnings Growth

1. Timely Provision of New Products Customers Really Want

Taking a medium- to long-term point of view, the electronics industry can be expected to expand. But, as I said before, it is unlikely that we can count on any major upturn in demand in the next few years. A company must, however, strive to grow no matter what conditions it faces. That leads to an important question: what will it take to increase sales in a market that itself is not growing? The answer is simple: inventive, new products that the market wants. But that also demands the highly specialized capabilities required to make products that generate profits.

TDK has these skills. We develop our own materials, an underlying source of our strength since our inception. And we have the ability to refine process technologies that transform these materials into products. By combining these unique strengths, accurately identifying what customers want and putting it all together, I believe we can deliver distinctive products in a timely manner. Put another way, we aim to reinforce our core ability as an "e-material solution provider" and generate a greater proportion of sales from highly profitable new products. We have already set into motion several strategies that are building the platform for delivering on this promise.

Narrowing Down Development Themes and More Reviews—TDK is narrowing the focus of existing R&D themes to three key fields where growth is expected in the coming years—IT Home Electronics Appliances, High-Speed, Large-Capacity Networks and Car Electronics. All are fields where we have a competitive edge. And by monitoring R&D progress and conducting reviews more regularly, we can speed up the review cycle so as to be in step with market changes.

Sales Force Reforms and Establishment of the Application Center—To respond to dizzying changes in markets and customer needs and effectively apply our strengths, we are realigning our sales force, placing emphasis on the three fields I have just mentioned. This focus should enable us to quickly identify customer needs. And to provide the best new products matched to those needs in a timely fashion, we have established the Application Center to support product development. The center's primary role is ensuring that TDK's collective strengths are effectively brought together and applied.

Establishment of Intellectual Properties Center—The importance of patents and other forms of intellectual property is growing constantly. We have established the Intellectual Properties Center as a specialist body to promote business development by integrating intellectual property considerations with our operations and R&D.

2. Improving the Variable Expense Ratio

In fiscal 2003, we failed to sufficiently improve the ratio of variable expenses to net sales due mainly to large sales price discounts. Given that calls for discounts will likely continue, we must strengthen our constitution and overcome this challenge. What is called for are measures to eliminate unprofitable products and boost productivity.

■ A Mindset Change

Development, manufacturing and sales lead times are all becoming shorter. But TDK has more work to do if we are to adapt to this rapidly changing pace of business. One area we must target in particular is changing our mindset. We must alter our corporate mindset and culture in areas where they aren't in sync with our operating environment and markets. I want our people to be aware of the need to understand the true nature of the challenges we face and the status of front-lines operations like manufacturing and sales. I want everyone to recognize the importance of acting with speed. And I want us to have a sense our urgency about everything we do.

As in fiscal 2003, the macroeconomic environment in fiscal 2004 will no doubt be characterized by uncertainty. But I am confident that in the long term the electronics industry will experience further growth. Broadband is expected to come of age in 2005 and 2006, propelling us toward a ubiquitous information society and the electronics industry toward more growth. But for now the industry is in a transitional stage. Our actions in fiscal 2004 reflect this as well as current economic conditions—we will push through the second stage of structural reforms that target an increase in profits. With the stronger operating base that results, we will be better positioned for creating corporate value over the medium term.

Fiscal 2004 marks the end of Exciting 108, our current medium-term management plan. Unfortunately, it will be very difficult for us to achieve our goals in the wake of the bursting of the IT bubble and the miscalculation of capital expenditures that the IT bubble brought about. Nevertheless, we are intent on completing our program of structural reforms and achieving our targets even if we are a little late in doing so. I ask for your continued support and guidance as we work to put TDK firmly back on a growth path.

June 2003

Hajime Sawabe
President and CEO