

# Message from the President

Tokyo Electron's primary objectives are customer and shareholder satisfaction. Strong earnings that allow us to satisfy our shareholders demonstrate that our products and services provide the value necessary to satisfy customers. We are striving to use our technology and management skills to contribute meaningfully to the global dissemination of the information revolution to all sectors of society in the twenty-first century.

In the past fiscal year, factors such as the continuing slowdown in the DRAM market and economic downturns in Japan, Korea and Southeast Asia during the second half kept the semiconductor industry from meeting its expectations for growth. For Tokyo Electron, however, it was a year of excellent progress toward our mid- and long-term objectives.

In the first half, Tokyo Electron generated solid growth in orders. In the second half, orders were adversely affected as memory manufacturers revised their capital spending plans downward. However, orders from non-memory manufacturers in the United States and Taiwan posted solid gains.

Tokyo Electron achieved record consolidated net sales of ¥455,585 million for the fiscal year ended March 1998, generating a year-on-year gain of 5.3 percent through a focus on global sales of original equipment for producing semiconductors and LCDs. Notably, sales in the United States and Taiwan increased 146.6 percent and 41.1 percent, respectively, over the previous fiscal year. Sales outside Japan accounted for 62 percent of original product sales, compared to 35 percent five years ago. Operating income increased 4.8 percent to ¥63,296 million, and net income increased 0.1 percent to ¥30,009 million. Cash dividends per share were ¥30.00, up from ¥28.00 for the previous fiscal year.

While the semiconductor and semiconductor production equipment markets tend to be cyclical, we expect them to grow strongly over the mid- to long-term. Capital expenditures totaling ¥33,302 million during the past fiscal year reflected our aggressive outlook. We invested in new production facilities in Japan and the United States to ensure we will be able to smoothly meet future demand. In addition, Tokyo Electron completed construction of a new Process Technology Center in Yamanashi prefecture, Japan to support next-generation 300mm equipment development and process integration capabilities.



To further boost our competitiveness and maintain market leadership in the next generation of technology, we increased R&D expenses 27.7 percent to ¥26,813 million. Primary areas of emphasis were developing the equipment and process technologies that will be required to meet the trend toward more precise design rules, and developing 300mm equipment in each of our broad product lines.

## Share Gains in Non-Memory Applications

Tokyo Electron's customers are the world's leading chip makers. In every market we serve, our mission is to provide leading-edge products and outstanding support that helps our customers achieve their goals. Looking forward, semiconductors will require technologies that support more precise design rules, increased layering and higher integration. The global information revolution is already fueling demand for these technologies, and we expect strong growth in the equipment market for memory devices, logic devices and system LSIs, in which both memory and logic functions are embedded. Tokyo Electron is broadly targeting all of these markets to achieve consistent and steady growth.

Our globalization strategy over the past several years and passionate pursuit of customer satisfaction guided us in establishing a solid presence in Asia and Europe. We are now

focusing our efforts on the United States, where many major logic and memory manufacturers are based. First we established local sales and marketing capabilities, and in 1996 we started in-market development and manufacturing. We recognize that success in the U.S. market means steadily strengthening our long-term commitment to customers there. In particular, success in the technologically advanced U.S. logic market requires that we be able to develop and manufacture advanced products and processes closer to leading customers so that we can respond quickly to their needs.

We have achieved steady growth as a result. In the past fiscal year, our sales in the U.S. more than doubled over the previous fiscal year, demonstrating that the value of our products and quality of service is recognized.

The U.S. wafer fabrication equipment market, the largest in the world, totaled about US\$7 billion in 1997. Our emphasis on close communication has earned us trust in this market, and we expect rapid earnings growth over the next few years. Naturally, we will also continue to further expand our sales and service capabilities in Europe, Asia and Japan.

## Making Management Global

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Tokyo Electron's globalization has now entered its third stage. The first stage was the globalization of sales and marketing bases, and the second stage was the globalization of development and manufacturing bases. Now we are advancing the globalization of management structures. To continue earning the respect of shareholders and investors in global financial markets, we have initiated a number of programs to maximize shareholder returns and improve management transparency.

In June 1997, we began a unique incentive plan in which we set numerical management goals every year for three years into the future. As we achieve these goals, senior-level managers receive special bonuses for the purchase of Tokyo Electron stock. This program will encourage sound management by making participants shareholders with a direct stake in our success. We believe that our greatest asset is qualified people, and the initiation of this incentive program will help us secure and retain superior personnel from around the

world. In addition, Japanese regulations prohibiting stock options were lifted in 1997, and we plan to introduce a stock option program this year.

With the start of the new fiscal year on April 1, 1998 we also reorganized our system of corporate governance. The new structure clarifies management missions and responsibilities by dividing top managers into the Board of Directors and the Corporate Senior Staff (CSS). The Board of Directors represents shareholders and is responsible for establishing fundamental corporate goals for maximizing the value of the company and supervising execution of them by the CSS. The CSS is charged with developing and implementing the strategies to achieve these goals and generating favorable results. Clearer allocation of management responsibility has reduced the need for daily involvement of directors on an operational level, and we have adjusted the size of the Board accordingly.

In addition, we established a Compensation Committee within the Board of Directors to determine the compensation of the C.E.O., President. To make disclosure more timely, we plan to introduce quarterly reporting beginning in the fiscal year ending March 2000. Our top management team will continue to respond flexibly to current needs and work to ensure that management reflects global standards.

Speedy decision-making is key to business success. This is one of the reasons why Tokyo Electron has succeeded in the rapidly changing semiconductor industry. To make the Company even more decisive, in April 1998 we launched a business unit system on a global basis, which unites marketing, sales, field engineering, development and manufacturing by product. This system allows us to make decisions quickly at the operating level and clarify the responsibilities of management in each product line. Moreover, in July 1998 we will transfer our electronic components operations to wholly owned subsidiary Tokyo Electron Device Ltd. (TED). This will allow Tokyo Electron to focus on its core semiconductor production equipment business, including distributed products, and will strengthen TED's presence in the electronic components business. We are confident this will help increase earnings for both businesses, which in the long run will maximize the satisfaction of our business partners as well.

## Progress Through Customer Commitment

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Semiconductor manufacturers are now moving from 0.25 to 0.18 micron design rule and below in an effort to shrink chip size and raise capabilities, and 300mm technology is positioned to become mainstream in a few years. Only a few of the world's equipment makers have the ability to comprehensively support the increasingly high technological levels of the semiconductor production process. Tokyo Electron has built the world-class technology development and capital investment capabilities required to help customers successfully make the shift to new technologies. In February 1998, we opened a new Process Technology Center in Japan. Featuring the latest equipment for 300mm process evaluation and process integration, it is the most advanced facility of its kind in the industry. We delivered our first 300mm equipment to a customer during 1997, thus taking the first step toward demonstrating the excellence of our products for the 300mm era.

One of our strengths is the ability to provide process integration for managing the complex interrelationships between semiconductor production processes. Our position as a supplier of a wide range of products is an important source of this expertise. In addition, we are adept at helping customers remove bottlenecks from critical areas, and our equipment has consistently demonstrated high reliability on our customers' mass production lines.

Tokyo Electron is firmly committed to helping each customer differentiate its products. By providing solutions that contribute to this effort, we work toward our goal of true customer satisfaction. We believe this commitment is one reason why Tokyo Electron has earned the support and trust of many of the world's leading chip manufacturers.

## Outlook

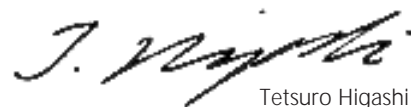
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Tokyo Electron is a growth company in a growth industry. Society is becoming increasingly reliant on information technology, which will lead to continuing expansion of demand for more sophisticated semiconductors. Our equipment is critical to the production of advanced semiconductors, meaning we are well positioned to grow. By 2002, we expect global semi-

conductor demand to almost double from current levels, and the market for wafer fabrication equipment to double to nearly US\$40 billion. The market for LCD production equipment, in which Tokyo Electron has a dominant share for two key types of equipment, should also expand rapidly. Given this outlook, we have the potential to more than double sales over the next five years, and are working to make the most of this opportunity and use our position as a major player to further expand our share. With a solid financial base, well-established engineering capabilities and worldwide support network, Tokyo Electron's future over the mid- to long-term is bright.

Short-term, however, we are faced with a slowdown in growth in the semiconductor industry, which has been caused by the financial problems in Asia and the global oversupply of DRAMs. These trends will temporarily discourage semiconductor manufacturers from making capital investments, so we will take this opportunity to thoroughly review our business model, including our overall cost structure, in order to strengthen our competitiveness. One example is our effort to evaluate the entire Tokyo Electron Group structure to determine ways in which business units can share resources productively and maximize earnings. Moreover, we are focusing on high-potential areas in developing the next generation of equipment. We believe this is a good chance to strengthen our technological capabilities and production efficiency, so that when the semiconductor cycle turns upward again in the near future, we will be better prepared than ever to satisfy customer needs.

Tokyo Electron's entrepreneurial corporate culture emphasizes responsiveness to change, creativity and aggressive goals. This emphasis has been the basis of our growth, and we have worked hard to ensure that all employees worldwide share it as we have expanded globally. In addition, we are dedicated to continuously raising the quality of every aspect of our business, from products and service to management. Tokyo Electron is therefore well positioned to benefit from the many opportunities before us, and provide outstanding value to our customers and shareholders.



Tetsuro Higashi  
C.E.O., President  
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