

# MESSAGE FROM THE PRESIDENT

In the fiscal year ended March 31, 1999, Tokyo Electron's consolidated net sales decreased 31.1 percent year-on-year to ¥313,820 million as unfavorable economic conditions in Asia and oversupply in the DRAM market depressed investment in equipment among semiconductor manufacturers worldwide. These changes in our operating environment, which began appearing during the second half of 1997, were far more severe than we had anticipated and directly impacted our business. However, we remained committed to our corporate mission of consistently generating earnings, and made every effort to do so. As a result, although



consolidated earnings decreased sharply year-on-year — operating income fell 89.9 percent to ¥6,383 million and net income dropped 93.8 percent to ¥1,866 million, or ¥10.70 per share — Tokyo Electron was able to remain profitable.

Significantly, our success in overcoming these challenges was made possible by the combination of two factors: the quick decision making brought about by the reform of our management structure last spring and the effective operations of each business unit. Furthermore, in responding to the changes in our business environment, we have become more keenly aware than ever of what kind of company we must be, and to that end we have already begun implementing a concrete action plan.

## Divisional Performance and Measures to Improve Earnings

Sales of Tokyo Electron's mainstay Semiconductor Production Equipment division decreased 36.3 percent to ¥242,240 million in the past fiscal year. The primary reason for the decrease was the small number of new fabs constructed worldwide as semiconductor manufacturers scaled back production and cut capital spending in response to oversupply in the

memory market. The bulk of investment was not for new capacity expansion but for shrink technology that allows more chips to be created on a single wafer. This limited both the type of equipment and the amount of investment needed.

Sales of the Electronic Components division decreased 4.0 percent to ¥57,734 million and sales of the Computer Systems division decreased 15.6 percent to ¥12,878 million. Concerted efforts to expand sales of our business partners' world-class products did not fully offset weakening demand in the domestic market. In July 1998, we completed the transfer of all electronic components operations to

wholly owned subsidiary Tokyo Electron Device Limited, creating the optimal structure for advancing this business. The benefits of this move were apparent in the relatively small decrease in sales despite the weakness of the domestic semiconductor business environment.

We viewed the drastic changes in our business environment as an opportunity to strengthen our operating structure and took steps to improve profitability throughout the Tokyo Electron Group. In response to the slowdown in the semiconductor market and the decrease in sales volume, we cut back the subcontracted workforce at domestic production facilities by half and implemented a hiring freeze. We also reduced capital expenditures sharply from the prior fiscal year and minimized depreciation expenses. In addition, we consolidated the resources of certain development functions and downsized some production operations. In light of these cuts, we remain well prepared for the next industry upturn.

These cost cutting measures improved profitability, but our main goal was to establish an operating structure that can generate sufficient profits even if the operating environment remains challenging. We believe this cost effectiveness, coupled with the measures outlined here, will contribute even more strongly to profits beginning in the current fiscal year.

## Building a Leaner, More Profitable Earnings Structure

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New changes are sweeping the industry. In addition to personal computers, digital consumer products have emerged as new market drivers, particularly in the areas of information and communications. As a result, demand for high-speed, large-capacity semiconductors will further expand, and applications that use ICs will continue to broaden. On the other hand, cost competition among chip manufacturers will intensify as many applications move eventually toward commoditization. Moreover, as the semiconductor industry becomes increasingly diverse, it will feel the effects of the global economy more rapidly.

All of these changes will exert a powerful influence on equipment manufacturers. Therefore, we must quickly create an operating structure that engenders both strong product development and potent earnings capabilities to satisfy customers completely under any conditions.

We have already begun taking the necessary steps by eliminating indirect operations and establishing a framework to stem the tendency for costs to rise. We are also executing a project to raise productivity and reduce manufacturing costs even further. In addition, we have established Tokyo Electron EE Limited, which focuses on refurbishing and upgrading previously sold equipment for semiconductor manufacturers as they diversify capital investment in step with their needs. By establishing a separate, specialized organization in this field, we expect new value to be created.

We believe that our efforts will begin yielding benefits incrementally in the current fiscal year, and will further solidify our position as a leading supplier with the ability to provide true customer satisfaction.

## Delivering Leading-Edge Technologies and Optimal Solutions

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The pace of advances in process technology for semiconductor production, which until now has occurred in roughly

three-year cycles, grew more rapid during the past year, driven by accelerated shrinkage in die size. Today, equipment makers must have the ability to provide semiconductor manufacturers with superior production equipment without delays in the chip evolution timetable. We specialize in solutions in the critical areas of the fabrication process and continue to introduce high-end equipment and technology on a timely basis.

In 1998, we introduced the *CLEAN TRACK ACT™8 SOD*, an advanced spin-on deposition system that forms low-k dielectric films required for multilayer interconnects. Initial orders have been favorable, and we expect that this product will capture the leading share in its market. Moreover, in response to new architecture such as chip scale packaging (CSP) and system-on-chip (SOC), in the near future we intend to introduce a wafer-level burn-in system that will greatly contribute to reducing the total cost of testing.

We will continue supplying products that provide higher value to customers by closely monitoring trends in next-generation technologies. To accomplish this, we will further strengthen alliances with the world's leading chip manufacturers and remain firmly in the mainstream of technology. Continuing to conduct sufficient investment in research and development will also be crucial. In the past fiscal year, even though the equipment market contracted, we continued to focus investment on select themes and actually maintained development at its strongest level ever. This policy will remain unchanged as long as we continue pursuing the leading edge of technology.

Our first priority is providing customers with high-value-added technologies that they can use with confidence to differentiate their products. This philosophy has earned Tokyo Electron the support and trust of customers worldwide. The 300mm New Process Technology Center completed last year is the most advanced of its kind in the industry, and was prepared for the purpose of working with customers. The seeds of new products lie in knowing what each customer's unique needs are and working with them on solutions.

## Toward Truly Global Management

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Already we have developed a global infrastructure for sales, service and production that few equipment suppliers can match. Now, we are turning our attention toward globalizing management to maximize the value of the Company and ensure its continual success and development. In the past fiscal year, we reformed the function of the Board of Directors, appointed Corporate Senior Staff, established a performance-based compensation program including a stock option plan, created a Compensation Committee and began disclosing corporate officers' compensation — reforms which prepare us for global competition. In view of the growing importance of overseas markets in our overall corporate performance, we will continue to consider which management systems and functions we need to introduce to be a truly global company. This management philosophy is crucial for staffing our operating bases worldwide with the most talented personnel.

In addition, as we build our business on a global scale, careful consideration of environmental issues must also be a top management priority. We have been putting great efforts into the acquisition of ISO 14001 and the development of equipment that minimizes environmental impact. Furthermore, we codified a code of ethics entitled "Code of Ethics in the Business of TEL" to be observed by everyone who works for the Tokyo Electron Group, and established an Ethics Committee as a concrete organization. It is our hope that by all employees respecting and honoring these international rules, Tokyo Electron will be recognized and accepted by people around the world.

## Outlook

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In the short term, orders for semiconductor production equipment began to recover at the end of 1998, and the future appears bright. For the time being, semiconductor makers will continue to invest in shrinkage (technology investment) in existing fabs, but expectations for capacity

investment following this gradual recovery have grown steadily. We are prepared for this upturn in terms of new technology and production capacity, and as a result will not need extensive investment to keep pace with market conditions. Moreover, in response to predictions of a global shortage in the supply of TFT-LCD panels in 1999, new production lines are being built in Taiwan, Korea and Japan. Tokyo Electron holds the leading market share for LCD coater/developers and etcher/ashers, so we stand to benefit greatly from this trend.

The medium- to long-term outlook for expansion in the semiconductor market remains unchanged. Personal computers and Internet-related products are becoming advanced and widespread, while information- and communications-related digital consumer products are moving to the forefront of the market. These developments are giving rise to demand for high-speed processors and large-capacity memories, as well as for high-value-added system-on-chip technologies. The production equipment we supply is indispensable for making these advanced semiconductors.

We realize, however, that this industry expansion will pose many challenges. Change is causing intense competition for both us and our customers, along with an ever-changing landscape of mergers and spin-offs. Only companies that can provide outstanding value will thrive, and we intend to be one of them.

Tokyo Electron faces the future with many assets: world-leading technologies, outstanding people, a flexible and entrepreneurial corporate culture and a global base of customers. We have the right ingredients in place to further build the value of the Company, and will work to strengthen our ability to withstand changes in our environment and consistently generate profits in order to fully meet the expectations of our shareholders.



Tetsuro Higashi  
C.E.O., President  
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