



Kiyoshi Sato
President & CEO

The past fiscal year was an exciting year for us at Tokyo Electron, as we witnessed the semiconductor industry emerge from its long recession and enter a recovery phase. Full-blown market penetration of digital consumer electronics, such as digital cameras, DVD recorders, and FPD television sets, in addition to replacement demand for next-generation personal computers and mobile phones, boosted demand for semiconductor devices. Amid the notable growth of economies in Asia, which now strongly influence the overall global economy, Japanese semiconductor manufacturers focused their business resources on their areas of strength, building momentum. Reflecting this strategy, capital investment sentiment began to build and shifted more to Asia.

Under these circumstances, the Company's performance also rebounded strongly in the second half, resulting in annual consolidated net sales rising 15%, to ¥529.7 billion. Profitability jumped as well. Operating income climbed to ¥22.3 billion from ¥1.1 billion and net income surged to ¥8.3 billion from a loss of ¥41.6 billion in the prior fiscal year. As a result, net income per share amounted to ¥46.37, and annual cash dividends were ¥10.0 per share.

Strengthening our Leading Position in the Industry

Along with broadening applications of semiconductors in digital consumer electronics and mobile devices, the demand for higher integration, faster speed, and lower energy consumption is steadily increasing. At our customers' semiconductor plants, full-scale, volume IC production based on 90 nanometer design rules is beginning. Based on technology capabilities that rank at the very pinnacle of our industry, we are contributing to the manufacture of our customers' leading-edge devices by developing highly differentiated products backed by our high-quality support services. Semiconductor manufacturers are now investing in equipment for 300mm wafer facilities. Anticipating that this trend would further strengthen, we developed 300mm wafer equipment and have been promoting it for the past several years.

Moreover, centered on our Process Technology Center in Nirasaki, Yamanashi Prefecture, we have been proceeding with joint development projects with leading semiconductor manufacturers from around the world, with the goal of supplying our customers with the most appropriate solutions for emerging and leading-edge processes. Consequently, 300mm wafer equipment now accounts for more than 50% of our semiconductor production equipment sales. According to our surveys, in the fiscal year under review, our semiconductor production equipment held top share of the market in many of our product categories.

Also in the past fiscal year, the Company established TEL Technology Center, America, LLC (TTCA), in Albany, New York, as its center for research and development in North America. TTCA will handle a variety of research and development projects for both next generation processes and the semiconductor manufacturing equipment needed by leading chip manufacturers worldwide. This development effort will involve a number of partners ranging from chip manufacturers to equipment suppliers and academia.

Strengthening our Leading Position in the Industry

In the future, we will continue to demonstrate technological leadership as a multi-product supplier of semiconductor production equipment and strengthen our ability to unify and incorporate leading-edge technologies by aggressively launching new products in the global market.

Among digital electronics products, growth expectations are particularly high for the LCD television market. This is good news for TEL, as our FPD production equipment is essential for the production of the TFT-LCDs used in these televisions. FPD manufacturers are currently increasing their capital investments in facilities that can process large glass substrates, causing orders for our related equipment to continue at record levels. Since further innovations are expected in advanced display technologies, we are also looking forward to business expansion in this field.

In our Electronic Components Division, which is operated by our subsidiary Tokyo Electron Device Ltd., we market high-value-added products of world's device manufacturers that have application in digital electronic and mobile phone devices, along with our technology support services. In this area, we are also working to expand sales of semi-custom design services and develop our own original products, along with tremendous efforts in application engineering.

Following the collapse of the IT bubble, our Computer Network Division achieved sales growth despite stagnation in the communications and network-related industries. The key to this success was customer recognition of the superiority of technical support, system design, and other technology capabilities behind the leading-edge products we distribute. In fact, it could be said that these adverse business conditions resulted in a strengthening of our position in the industry. In the computer network field, we expect to expand sales and improve profitability of our business, including higher service revenues along with the Japanese macro economy recovery and overall CAPEX increase.

Business Structural Reforms

Commencing with the fiscal year under review, TEL has moved ahead with a companywide structural reform plan aimed at preparing the Company, over the next one-to-two years, for its next growth stage. Among our top priorities are eliminating the excessive inventories built-up during the IT bubble and downsizing personnel appropriately for current conditions. In addition, we are seeking further cost reductions and shortening of production lead times to meet the requirements of end-use applications targeting the consumer market.

Building Higher Profitability

During the last fiscal year, we took thorough measures to reduce inventories, disposing unnecessary items in Japan and overseas, and refurbishing or converting products that could be sold. As a result, despite an increase in work in process during the second half due to higher production rates, we cut our inventory assets and improved our inventory turnover to 72 days from 89 days as a result of the first year of structural reforms. In our personnel program, we initiated measures to decrease the number of employees worldwide by around 1,000, decreasing our fixed costs.

To reduce costs and shorten production lead times, we set goals for each Business Unit. Guided by these targets, we made fundamental revisions of our procurement, design, manufacturing, and logistics. We are also implementing a system for shortening production lead times at all plants. As we are facing substantial growth in production volume this fiscal year, we are convinced that reducing production lead times at our plants will be an especially important factor in achieving higher production volumes without increasing fixed costs.

Although our restructuring efforts have progressed favorably during the past fiscal year, we are still merely at the halfway point. In the current fiscal year, we are redoubling our efforts in the second phase of the program, aiming to achieve agile management capabilities, as well as a low-cost structure to deal with the sudden fluctuations in our business cycles.

Building Higher Profitability

In addition to our business structural reforms, we recognize further improvement of profitability as a top priority management issue at Tokyo Electron.

Over the past few years, we have invested approximately 10% of our semiconductor production equipment sales in research and development, targeting high-value-added products. This focus is now steadily producing results. Our new thermal processing system, TELFORMULA™, which customers started using for volume production about two years ago, combines the advantages of a hot-wall thermal furnace with quick turnaround time. The model has earned a strong reputation among customers for high-end thermal processing applications.

The new coater/developer, CLEAN TRACK™ LITHIUS™, which we began manufacturing in volume during the past fiscal year, has also been a success. Fitted with embedded measurement devices and software technology, this model incorporates functions that enable improved process stability. As such, the model is compatible with the processes of 90 nanometer and beyond design rule, which are

now beginning in earnest in the semiconductor industry. CLEAN TRACK LITHIUS is already winning high praise from many customers, and shipments in the current fiscal year are anticipated to equal those of the Company's best-selling model CLEAN TRACK ACT® series. Both of these new products are contributing to greater profitability based on the high-value-added content they offer customers in comparison with previous models. Clearly, the demands of the market have spread beyond shrinking device sizes, diversifying to the application of new structures and materials. We believe that this field holds many opportunities to introduce new equipment, and are determined to successively launch new products.

To buffer ourselves from the silicon cycles, establishment of a business style ensuring stable earnings is in progress, and as part of that process, we are expanding our services and refurbishing business. As capital investment in 300mm equipment grows, there have been many requests from customers using 200mm and lower equipment for relocation and refurbishing services. We will focus more on this refurbishing business under our subsidiary Tokyo Electron FE Ltd., which is responsible for field engineering services. We are currently creating a plan to expand the sales of this business by 50% over the next few years.

Accelerate Innovations in Semiconductor Technology and Target a Truly High-Quality Company

Present applications for semiconductors go beyond personal computers and mobile phones, extending to storage-related devices, such as flash memory, and to sensors and microcontrollers used in automobiles. Along with higher communication speeds, the growing popularity of advanced mobile device functions, and the full-fledged start to digital terrestrial television broadcasting, there will be explosive growth in the volume of information being processed and accumulated globally. Naturally, this is expected to stimulate further expansion in the semiconductor market. Current semiconductor technology has only taken the first few steps toward its potential goal. Although facing various technological and economic hurdles, I have no doubt that technological innovations will enable semiconductor technology to continue to evolve. Determined to be one of the drivers of the technological innovations, the Company will continue to pursue and supply the highest quality in the industry in both our technology and support services. As a result, we hope to fulfill and exceed the expectations of our shareholders, customers, employees, regional communities, and all other stakeholders. In meeting these challenges, we look forward to the continued support of our shareholders. I would like to thank our shareholders for the support you have given us, and invite you to share in the benefits as we make our vision for the future reality.

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