

Toward a Lean and Muscular

Corporate Structure

— Productivity Reforms for

Optimum Response to

Market Needs —

Investment in Growth Segments Helps to Offset Poor Business Performance

In fiscal 2002, ended March 31, 2002, business results were strongly impacted by the downswing in the electronic industry following the collapse of the IT bubble, the slowing of the U.S. economy in the first half of the year, and the additional effect of the September 11 terrorist attacks in 2001. Sales were down 7.3% from the previous fiscal year, to ¥338,930 million, and operating income fell 44.5%, to ¥19,314 million.

The strong performance of Nitto Denko Corporation and its consolidated subsidiaries in the preceding fiscal year was largely due to structural reforms. However, with the dramatic changes in the market environment in fiscal 2002, we confronted the reality that such reforms were not sufficient. Further, in hindsight, the severity of the negative impact could have been avoided by launching the structural reforms from an earlier state.

With these changes in the business environment as a turning point, we decided that radical reforms enabling business segments to maintain profitability despite slight fluctuations in production was a critical issue that had to be addressed with the utmost urgency.

The downturn in performance was undeniably what led us to embark upon these initiatives. From a long-term perspective, we feel fortunate to have encountered a situation that forced us to tackle the situation early on.

On the positive side, resurging LCD-related products generated steady profits, membrane products performed well on the strength of expanding global demand, and medical-related products also turned in solid results.

The upturn in the LCD segment was largely due to the opportune timing of forward-looking investment in new plant and equipment, namely the completion of the third facility at the Onomichi Plant in time to capitalize on an upswing in demand. Focused and precise investment helped to ensure that we did not miss any business opportunities. Other major advances include the completion of the Toyohashi No. 13 Plant, SCM Center, the new Wisconsin Plant in the United States, and the new Suzhou Plant in China. In this way, our proactive push toward overall optimization produced tangible results.

Freezing of the “G-2002” Mid-term Plan and Formulation of the “Muscle Plan”

In the first half of fiscal 2002, the deteriorating business environment made it impossible to meet even monthly numerical targets. As the pace of market change accelerated to the point of making long-term projections impossible, we had no choice but to freeze our “G-2002” mid-term management plan. Faced with the need to carry out radical reforms quickly, we immediately started formulating the “Muscle Plan.”

The Muscle Plan is not an objective but a methodology for achieving productivity reforms in every aspect of our business. In short, it is aimed at thoroughly eliminating waste throughout the Nitto Denko Group. The result will be a leaner, more agile company. The Muscle Plan is a response to the reality that the traditional style of reform through streamlining and consolidation alone can no longer be expected to ensure future growth, even in sectors with the potential for growth. We must also to shift to a slimmer and more muscular corporate structure.

Cutting fixed costs is the most difficult part of improving productivity through management and structural reforms. To achieve the target ratio of operating income to sales, a reduction in fixed costs

by approximately ¥10 billion per year was determined to be essential. We therefore took steps to reduce the workforce by introducing early retirement. This initiative includes paying a fixed amount on top of benefits under an already existing retirement scheme and the opening of this option to an unrestricted number of employees. During the year, more than 10% of permanent employees in Japan opted for voluntary retirement. Personnel cutbacks are an agonizing choice, but one that cannot be avoided.

In April 2002, we spun off the Kyushu Plant. When operations were resumed, employees were re-employed using a wholly merit-based wage system revised to reflect local wage standards. This manufacturing sector restructuring plan became the first model for structural reforms required in all operating sectors.

Personnel cutbacks and spin-offs are key elements of problem-solving models that will be vigorously implemented to restructure group companies and business operations. Streamlining and consolidation of group companies will move forward in parallel.

These measures are producing a steady improvement in the cost efficiency of manufacturing operations, especially within high-cost business sectors. The initiatives under the Muscle Plan will be aggressively pursued up to March 2003, but those involving productivity reforms will be continued beyond March into the next fiscal period.

Productivity Reforms — Springboard Toward a Vigorous Growth Strategy

The Muscle Plan defines a specific growth strategy for each operating segment. In industrial products, the plan stresses “business revitalization,” while in electronic products the focus is on thorough pursuit of “low-cost production.”

“Sustainable growth” is the goal in optical products, and in functional products, the objective is “global expansion.” Each business segment has been tasked with clarifying a consistent vision for the future. This includes answering such key questions as,

“What sort of company or business division do we want to become?”

Fiscal 2003 will see the definition of the issues each sector must tackle and the formulation of concrete plans for realizing objectives. The sharing of methods with other business segments will be required to ensure the best growth plans are applied company-wide for overall optimization. A primary goal of this process is to achieve a ratio of operating income to sales of 10% in fiscal 2004.

One model developed during the year already disseminated company-wide is that mentioned earlier of cutting fixed costs by implementing an early retirement scheme. Another is the spin-off of manufacturing operations developed as a model for productivity reforms in Japan. Methods being considered for achieving low-cost production in the electronic products segment include carrying out R&D for semiconductor products in Malaysia. Overseas R&D in the tape materials segment is another option. Further, it has already been decided that a portion of production of flexible printed circuits (FPCs), currently handled by the Kameyama Plant in Mie Prefecture, will be shifted to the new Suzhou Plant in China.



*Left: Hideki Yamamoto, Chairman
Right: Masamichi Takemoto, President*

Enhancing Our Corporate DNA

Nitto Denko's motto for 2002 is, "Striving for New Growth with the Muscle Plan – Productivity Reforms, Breaking the Rules, and Expanding Our Creativity." This, taken together with such traditional Nitto Denko axioms as "Change represents opportunity," demonstrates a pattern of intrinsic positive thinking so basic to our corporate philosophy that we consider it part of the Nitto Denko DNA. The spirit of the Muscle Plan will also be ingrained into corporate thinking to the point that it also becomes a subconscious component of our genetic makeup.



Direct interviews are currently underway between the president and the 300 members comprising managerial staff throughout Japan. The aim of this initiative is to absorb opinions from the frontline of opera-

tions, while ensuring that the true intent of the Muscle Plan is communicated firsthand to every corner of the organization.

"3Es" + "O" Represent Strategic Growth Segments

Nitto Denko's potential for future growth is centered largely on the "3Es," or the electronics, ecology and energy segments, plus optical-related products in the rapidly expanding optoelectronics sector. Geographically, we plan to concentrate on the Chinese market. We are actively upgrading and expanding our manufacturing bases, and also strengthening marketing capability and streamlining distribution.

Membrane and water-related products, which are part of our global environment response technologies, are also expected to see major growth during the early years of this century. In medical-related products, we plan to move beyond our current line of transdermal drug delivery products into test agent peripherals and other new sectors. All of these represent future business strategies from a long-term perspective, and rather than Nitto Denko solely covering all of these areas, we intend to target global expansion with a

view to alliances with other companies, partner businesses, M&A and other business tie-ups.

In electronics products, rising demand is expected for not only LCD panel products but also high-performance films, including plasma display panel (PDP) and electroluminescence (EL) products.

In the tape materials sector, "desolvation" has become the keyword. In addition to forging ahead with the development of adhesives that do not use solvents, we plan to develop new applications for adhesive products outside conventional fields. Encouraged by the steady rise in tape demand for use in semiconductor manufacturing processes, we plan to develop new "fine and clean" products for other sectors as well. This could even entail flexible small-lot production. Taken as a whole, we believe that shifting to highly profitable product segments is the key to revitalization.

Product development that transcends the barriers between business segments is also essential. Nitto Denko is the only company to manufacture products ranging from FPCs to semiconductor encapsulating packaging materials, and wafer protection and fixing tapes for semiconductor manufacturing. If we can develop products that fuse Nitto Denko's advanced technologies in these fields with film materials, we will be in a position to open up vast new markets. The issue to be addressed for the time being is launching newly developed product groups quickly while performance for LCD panels remains strong.

Strengthening Adaptability to a "Market-driven Era"

To ensure that business opportunities are not missed in today's business environment, companies must become closer to customers. To achieve growth in which our products match our customers' needs and priorities, as of April 1, 2002, we broke away from an operational framework integrating all aspects of product development and marketing from design through production, sales and distribution, and drastically reorganized sales operations to sharpen their response to market realities.

In fiscal 2003, Nitto Denko will apply a market-driven approach to every aspect of operations from product development to marketing and customer service. The product-oriented development

system of the past will be replaced by one that responds to customer requirements via the shortest route, at the lowest cost, unfettered by barriers between business sectors.

We have also remapped the course to be followed in building Nitto Denko into a still more tightly integrated "technology-oriented company." A company cannot be described as being "technology-oriented" in terms of its development capability alone. Human resources appropriate for a technology-oriented company must be in place in all business sectors, especially those in charge of manufacturing, quality control and assessment, and intellectual property management. We will therefore be moving forcefully ahead with the rotation of human resources to optimize the allocation of corporate resources across a borderless company.

The effective implementation of the Muscle Plan is measured in terms of global optimization of the entire Nitto Denko Group. The standard for judging measures taken within the individual business sector is based on appropriate criteria ascertained from a Group perspective. Options include spin-off of businesses, sharing of production facilities and shifting of production to overseas locations such as China and Malaysia. The scenario also encompasses alliances with appropriate partner companies, expansion of OEM, cooperation in R&D, M&A and other moves aimed at breaking away from doing everything in-house. The rule for achieving overall optimization has therefore been defined as "Breaking the Rules."

"Global Niche Top" Business Strategy Remains Unchanged

The Nitto Denko Group has adopted "Creating New Value" as the unwavering vision of the whole Group. In addition to promoting sound growth by continuing to provide new value to customers, we are striving to become a company that is truly valuable to all stakeholders, including end users, shareholders, employees, and society as a whole.

Nitto Denko will continue to grow in the future by providing value-added products through our "Global Niche Top" business strategy for capturing the global top share in various niche fields. We have defined fiscal 2003 as a period of preparation for our next

leap forward. By implementing the Muscle Plan in line with the fundamental ideal that "Change represents opportunity," we will create a revitalized Nitto Denko with new muscle attributes that can be brought to bear globally.

The marine creatures that moved onto land millions of years ago passed through a difficult period of adaptation before diversifying into the many species of land animals we know today. Seeing ourselves in a similar situation, we at Nitto Denko Group are prepared to choose the necessary path, no matter how arduous, on the way to evolving both as a company and in the way we do business.

As we ready ourselves for the next leap forward, toward becoming a company able to achieve new and sustainable growth, we feel a strong sense of confidence in taking up the challenges we have set before us.



A handwritten signature in black ink, which appears to read "Hideki Yamamoto". The signature is written in a cursive, flowing style.

Hideki Yamamoto
Chairman

A handwritten signature in black ink, which appears to read "M. Takemoto". The signature is written in a cursive, flowing style.

Masamichi Takemoto
President