

MESSAGE FROM THE CEO

A Sudden Shift in the Business Environment

Business conditions for manufacturers such as Nikon have changed significantly. The slowdown in the United States economy has led to stagnant economic growth worldwide. The war in Iraq and the ongoing tension in the Middle East underscore the instability of the international picture. Intensified price competition is producing an accelerated shift toward manufacturing in offshore locations. An extended slump in the IT sector has hit the semiconductor industry hard. These various factors have all had negative repercussions for us. In addition, greater competition around the world in the area of intellectual property, especially patents, is just one aspect of the ongoing march of globalization. The challenge for us is to find ways of responding to these new and altered forms of competition.

Our business is concentrated in three main business segments: Precision Equipment, Imaging Products, and Instruments. Although business conditions differ markedly between these three areas, they do have one thing in common—an extremely rapid pace of change. The reality is that in each of these segments we have to develop business against the background of a highly unstable environment, in which a new revolution-inducing factor could appear at any time.

The challenge facing Nikon is to construct operational systems capable of responding quickly and agilely to these kinds of change. This requires us to invest our limited resources to maximum effect in growth sectors while also ensuring that we conduct all our business at the highest levels of efficiency. Decision-making processes must obviously display similar agility. Not only must we put in place the management systems that will help us reform, we must all individually make major changes in the way we think.

Progress in Implementing Fundamental Structural Reforms

We have already implemented a number of measures designed to create fast-response reactive operational systems. We introduced an in-house company system in 1999 and, a year later, we formulated “Vision Nikon 21,” a policy document for the first decade of the 21st century that sets out our foremost business priorities. In 2001, we introduced an executive officer system. All these initiatives have collectively laid the groundwork for reform.

We undertook various structural reform measures across the Nikon Group in the year ended March 2003 in a concerted attempt to reinforce our earnings structure. We made further headcount adjustments at the consolidated level through an expanded early retirement program for employees, which helped to lower fixed costs. We pursued the liquidation and reorganization of unprofitable operations to promote the more effective distribution of resources within the Nikon Group. We worked to reduce variable costs within each business unit. All these structural reforms formed part of a major restructuring initiative.

These structural reforms are generating positive results slowly but steadily. Unfortunately, they did not make a sufficiently major impact on our financial results in the year ended March 2003. While continuing with these efforts, we will therefore put in place additional measures to boost operating efficiency and thereby implement fundamental improvements in our earnings structure.

Focus on Strengthening Core Businesses

The most important issue for us as we undertake these reforms is to strengthen the competitiveness of our core operations. Although conditions do differ between sectors, our common aim is to take measures that will establish Nikon as the top manufacturer in each industry in which we operate so that we can magnify the future potential of all our businesses.

The first aspect of this competitiveness drive is to reinforce the power of our products to lead markets. This means that we must capitalize on our strengths to launch ahead of our competitors the advanced products that will generate growth. Just as we have become the pioneering market innovator in SLR-type digital cameras, our greatest mission as a manufacturer is to supply society with products packed with the high value that only Nikon can add. Indeed, this mission is one thing that has not changed at all.

In digital camera image sensor and lens units, we plan to manufacture more components in-house so that we can add greater value to these key items. This sort of action helps to leverage the strengths of Nikon as we work to build up the competitiveness of our product range.

Next, we are working to make our businesses more cost-competitive and more profitable. When business conditions remain as harsh as they are now, our challenge as a manufacturer must be to speed up both product development and production. We are therefore improving our systems to supply our customers with products that meet the latest demands in a timely fashion, both by reforming our business processes from a value-engineering perspective and by achieving drastic cuts in manufacturing lead times. This latter initiative is of particular importance in our stepper business. Since reduction of inventory and related assets is one of the main keys to restoring profitability in this segment, we plan to intensify efforts in this area, too. Once we have taken these actions, I am confident that we will have built a value chain that can add substantial value in every part of Nikon operations, from manufacturing to sales and after-sales services.

Expansion into China

China is an important production base for us as we seek to improve cost-competitiveness. We have now established a major manufacturing plant for digital cameras in the city of Wuxi. At the same time, we also recognize that, in terms of scale and growth potential, China represents an outstanding opportunity as a market in its own right. We are establishing



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sales and customer service operations in China in each of our business segments. Our goal is to expand local sales in China and raise our market presence there.

Growth of New Businesses

Alongside structural reforms and cost-reduction initiatives, we are also proactively seeking to develop new businesses that will develop into our next generation of earnings-generators. All our business development programs draw on Nikon technology and expertise where we already lead, and they also focus on areas of high growth potential. Our greatest strength, which we have cultivated over many years, is in optics. We will apply this strength to the field of nanotechnology, an area with broad potential across many industries and one where we believe we can add fundamental value. Optics and nanotechnology will be keywords as we continue to develop our own approaches to growth areas.

Another new business with major promise is that of CMP (Chemical Mechanical Polishing) system, which is used to polish the multiple layers of conductors and dielectric layers and make them uniformly even. In the year ended March 2003, we established a division to plan and develop the full-scale launch of our CMP system business. Other potentially high-marginly profitable businesses where demand is projected to rise in the future that are currently in the planning and R&D stages include such optical component businesses as optical engines for liquid-crystal projectors, micro electro mechanical systems (MEMS) and various areas of bioscience.

Strengthening Corporate Governance

Building on the base provided by our in-house company and executive officer systems, we are seeking to improve our business management systems. We are still considering whether to shift to a system of advisory board committees, which has been designed as an alternative to the corporate auditor system under revisions to the Commercial Code of Japan. For the time being, we plan to keep the auditor system and supplement it with various reforms to improve corporate governance structures related to executive compensation issues. These moves include the creation of an Executive Compensation Committee, the adoption of stock options, and revisions to the remuneration system for directors and executive officers.

We also plan to implement reforms to our personnel systems to ensure that we remain globally competitive in the current straitened business environment. We are making fundamental changes to the system of age-based wage seniority by shifting to a performance-based remuneration system for all Nikon Group employees. We are also introducing a bonus system that is linked to the results of each business unit. This major shift toward a pay-for-performance philosophy will ensure that we make the most of limited resources, thereby contributing to enhanced performance and output.

Raising the Value Added by the Nikon Group

Modern society will simply not tolerate corporate behavior that ignores the environment. We have made consistent and significant efforts to date to ensure that Nikon products and business activities are eco-conscious. I think that individual awareness of environmental issues among Nikon Group employees is remarkably high. As an example of this, in the year ended March 2003, we achieved zero-emissions status at all Nikon's plants in Japan a full year ahead of schedule. We intend to reinforce our various efforts to be environment-friendly and to orient our business systems from an environmental management perspective.

Separately, we are also working to solidify the trust placed in us by society by ensuring that our actions meet the highest ethical standards. With the establishment of the Compliance Section, our corporate ethics committee is working to ensure that the company and all employees uphold the highest ethical standards, in terms of legal and regulatory compliance, transparency, and corporate fairness and decency.

In closing, I want to say that our challenge is to create a corporate culture that meets the challenges of a new era of business. While we need to preserve good points such as some of the more "conservative" aspects of this culture, I believe we also need to inject the company with a dose of youthful drive, intelligence and creativity. This year, we redesigned our brand symbol and redefined the value-adding elements that characterize the Nikon brand. We express these in terms of three concepts: innovative technology; the desire to accept the challenges posed by the future; and "a sense of the times." By expanding businesses in line with these notions, I sincerely believe that we can contribute to society and grow with it as a company that creates true value.