

The Nikon Group posted a solid recovery in performance in the year ended March 2005. This turnaround was not achieved by means of short-term solutions or one-off gains. It was the product of real structural reforms undertaken over the past few years — reforms that constitute a first step toward sustained earnings growth over the medium and long term. In this sense, we finished laying the foundations for future profits. Here, we review the results achieved and explain the ongoing systemic improvements that promise to drive the ongoing growth of the Nikon Group.

#### **Record high sales and net income**

Three key achievements led to the significantly improved results for the Nikon Group. First, we boosted our sales in expanding markets by developing competitive new products and conducting aggressive marketing campaigns. The results were particularly good in digital cameras and LCD exposure systems. Second, we focused on improving our financial position by cutting inventory levels and squeezing trade receivables, which allowed us to reduce debt levels. Third, we reformed our business processes and systems to make our operations capable of swifter and more-effective responses to rapidly changing market conditions.

The effects of these changes are manifested in our top and bottom lines. On a consolidated basis, net sales advanced 26.1% year-on-year to ¥638,468 million. Operating income was ¥30,545 million, which represented more than a sevenfold gain compared with the previous year. Special gains included a US\$145 million (¥15,879 million) legal settlement related to a patent dispute with ASML Holding N.V. and others. Net income rose by a factor of ten to ¥24,141 million. The net sales and net income figures both marked new record highs.

The key operating results in our core businesses are summarized below. Please refer to the separate sections in the Review of Operations for further details.

- Precision equipment: Sales rose 35.6% to ¥214,326 million due to growth in sales of IC and LCD steppers. Operating income improved substantially, recovering to ¥11,387 million

from a prior-year loss of ¥20,806 million.

- Imaging products: Strong sales of the Nikon D70 digital SLR camera lifted total sales, which increased 24.9% to ¥355,489 million, but savage price erosion in the digital compact sector squeezed overall margins, resulting in a 33.2% year-on-year fall in operating income to ¥16,841 million.
- Instruments: Although sales of biological microscopes were flat, growth in industrial microscopes, measuring instruments and semiconductor inspection equipment pushed overall sales up to ¥52,184 million, a gain of 8.7% compared with the previous year. Operating income rose 5.3% to ¥2,826 million.
- Other businesses: Sales gained 11.6% to ¥44,253 million; operating loss shrank significantly to ¥647 million, an improvement of ¥2,585 million compared with the previous year.

The business segment analysis confirms that there remain a significant number of issues that we must address – despite the fact that profitability improved dramatically at the consolidated level. To put it another way, we see considerable scope for further gains in earnings.

#### **Engineering gains in profitability along with stable growth**

Nikon Group profits are currently supported on two main pillars: the precision equipment business and the imaging products business. To use a

transport analogy, we are driving a two-wheeler. Over the medium and long term, our aim is to make growth more stable by converting this vehicle to three and, ultimately, to four wheels. We see this task as the prime strategic directive of our new senior management team.

#### ***Stepper roadmap clarified with the advent of immersion technology***

Our first objective is to make the current two-wheeler run better. In the precision equipment business, the key to long-term growth is to establish Nikon as the clear technological leader. During the year we conducted on-site tests of our new immersion scanner technology with the help of customers. These confirmed Nikon's superiority in the industry in bringing to market the next generation of technology. Immersion techniques extend the limits of ArF excimer scanners, raising lens resolution to unprecedented levels (with N.A. values above 1.0). Moreover, we also have a clear roadmap as we develop EUVL, which will take us into yet another generation. In LCD exposure systems, our proprietary multi-lens scanning technology has a huge technical advantage because it comes into its own as LCD panels increase in size. Our latest LCD exposure systems are designed for 7th and 8th generation LCD manufacturing processes, and we expect sales of these models to expand rapidly. We expect to be profitable in this fiscal year, which ends in March 2006, despite the fact that it will likely mark the bottom of the current silicon cycle. From 2006-7 onward we expect to generate significant growth from stepper operations.



From left:  
Michio Kariya,  
Ichiro Terato

to our  
shareholders  
and investors

### ***Urgent focus on raising profits in the digital compact camera sector***

In the imaging products business, the main issue is how to increase profits from the digital camera market, notably in the compact segment. Nikon is the leader in the expanding digital SLR camera segment, where our strengths in traditional photography have proved critical. We aim to build on our strong position by expanding this market further, focusing on interchangeable lenses, digital camera accessories and related services. We are confident we can grow profits in this segment of the market. In the compact sector, our urgent need is to compress development and production lead times to cope with shrinking product cycles. To raise our speed of response while maintaining quality, we are pursuing structural business reforms in conjunction with efforts to transform our development mindset. By implementing these reforms quickly and by launching attractive products incorporating Nikon's unique technology amassed with traditional film and digital SLR cameras, we believe we can make these operations substantially more profitable.

### ***Instruments business evolving into a new pillar of consolidated growth***

The instruments business clearly has the potential to be the Nikon Group's third wheel. We are undertaking root-and-branch reforms in order to transform our growth prospects. These reforms aim to transform the structure of our operations and to alter internal mindsets. Both tasks are necessary if we are to develop new, competitive products that can sustain high growth going forward. In particular, we are concentrating on the bioscience field, which has enormous potential. Leveraging our strengths in precision optics, we believe that we can implement the necessary changes to raise profits in the instruments sector.

### ***Aggressive development of new business areas***

We see new businesses as the main candidate for the Nikon Group's fourth wheel. The critical factors for developing businesses in new areas are ideas and creativity. But these are not enough. To turn ideas into commercial successes, we also need to have a broad-based, ongoing research program to develop the supporting technical expertise, plus internal systems capable of seeing trends and responding to market developments swiftly. In short, we need dynamic ideas, skills and systems. These elements are all within our

grasp. We also plan to invest more resources in areas where we have already been able to apply Nikon technology to create fledgling businesses, such as glass materials.

### **Acceleration of Nikon Group reforms**

Our basic plan is therefore to continue to reform our existing operations while investing aggressively in the development of new businesses. In our reform programs, the recurring themes boil down to three core objectives. First, we must continue to provide innovative products that can be highly competitive. Second, we need to proactively bring about change and not simply react quickly to market changes. Third, we must create a free and open-minded corporate culture that breeds motivation in everyone.

To continue providing innovative products that can be highly competitive, we must reaffirm the basics of Nikon's business philosophy, which is summed up in the phrase "Trustworthiness and Creativity." "Trustworthiness" symbolizes the high quality and performance of Nikon products, and "creativity" expresses their essential originality. The essence of Nikon lies in a combination of product, solutions and services that satisfy the unspoken needs of customers. This level of originality is what our customers have come to expect from us; it forms the core of the Nikon brand value.

We are taking measures to expand our output of innovative items to supply the market with the right product at the right time. These initiatives include changing our business style, reforming internal processes, implementing comprehensive cost-reduction programs, and taking in new ideas from outside. But most of all, we are taking measures that aim to invigorate the whole of Nikon, creating a more dynamic workplace where employees are free to express opinions and be creative. We hope to create conditions favorable to fostering the talent that is the future of the Nikon Group. Ultimately, we aim to create a Nikon that leads change rather than one that follows fashion.

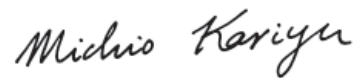
### **Promotion of CSR-oriented management**

Corporate social responsibility (CSR) is now regarded as an important yardstick of the value created by companies. We plan to raise the priority accorded to CSR issues in management going forward, affecting such areas as the environment, employment policies, human rights, compliance and social contribution.

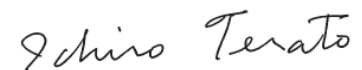
At the same time, we are acutely conscious of the risks Nikon faces in a business environment characterized by rapid change. We are upgrading our risk management systems to ensure we are fully prepared for any natural disasters or large-scale problems in overseas markets. Since Nikon precision equipment supports critical industries that demand continuous, smooth operations, it is important that our own risk management systems function well.

Nikon is at the beginning of a major transformation. Our goal is to react speedily to changes in business conditions while staying one step ahead of the market. At the same time, it is equally vital that we do not discard the heart of Nikon in our eagerness to change with the times. The Nikon name is identified around the world with SLR cameras, and we intend to make sure that this remains so. In October 2004, we launched the Nikon F6 in the face of a rapidly shrinking market for traditional film cameras. Many applauded this move – not just the diehard fans of silver-halide photography. Even though we aim to undergo reform, we will always listen carefully to the needs of our customers.

We sincerely ask all shareholders and investors for their continued support and understanding as we move forward.



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