TO OUR CUSTOMERS, EMPLOYEES AND STOCKHOLDERS

A NEW GROWTH STRATEGY

Fiscal 2002, ended March 31, 2002 was a good year for JVC in Europe and Asia. Double-digit growth in these markets helped lift consolidated net sales 2.1% year on year, to ¥954.2 billion (US$7,174 million). However, this impressive performance was overshadowed by the effects of the persistent slump and declining selling prices in the Japanese market. Mainly because of weakness in Japan, we recorded an operating loss of ¥12.1 billion (US$91 million). After several one-time charges, we had a net loss of ¥44.6 billion (US$335 million).

Masahiko Terada, President

After being appointed president of Victor Company of Japan, Limited (JVC) in June 2001, my first priority was to bolster the company's financial footing by correcting our over-reliance on using inventories to generate profit. I also concluded that realigning our growth strategy to effectively allocate resources to businesses that highlight JVC's core competence would be vital in turning round the company. JVC's management team was therefore entrusted to focus on our wealth of high-quality audio and visual technologies while rebuilding the financial structure, growth strategy and organizational framework of the company from scratch. During the year, we took a number of bold steps to establish a sound base for our long-term development. We reduced the company's total assets by ¥73.3 billion. This improvement was primarily achieved by reducing inventories ¥29.3 billion, cutting interest-bearing debt ¥30.0 billion, achieved by using Group funds more effectively, and reducing fixed assets ¥12.0 billion. Inventories fell from ¥155.3 billion at the end of the previous fiscal year, to ¥126.1 billion at the end of fiscal 2002. Inventory turnover also showed a marked improvement, falling from 60 days to 48 days. Meanwhile, reserves for the cost of business restructuring to be carried out during fiscal 2003 were set aside, laying the foundation for a V-shaped recovery in the company's results.

The numerous reforms we implemented during the past year were painful, but crucial for the revival of JVC. They are already breathing new life into our company. I am confident that last year's reforms will ultimately draw out the unlimited potential inherent in our technologies and people.

BUILDING A CORPORATE STRUCTURE RESILIENT TO MARKET CHANGE

Despite progress in strengthening our balance sheet during the year, the company still has to address a number of fundamental issues. On an operating level we were still in the red. Furthermore, our three-year plan, which we rolled out in April 2001, "Value Creation 21," faces some hard realities that we must tackle.

AN INNOVATIVE SPIRIT

Our powerful lineup of proprietary technology lies at the heart of our competitiveness. This technology is supporting our efforts to develop market-leading products as we strive to realize an earnings recovery in our Consumer electronics business.

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The major factor behind our operating loss was the continued decline in selling prices. In response, we are taking initiatives to significantly lower the company's breakeven point. The aim is to create a resilient corporate structure capable of absorbing further declines in selling prices while generating profits. We have already taken a number of steps toward achieving a non-consolidated breakeven point of ¥500 billion in sales by fiscal 2003. These steps included realigning our manufacturing facilities in conjunction with a review of unprofitable businesses, including withdrawal from the magnetic head business. We have also reduced the number of our facilities, from 37 at the end of fiscal 2001 to 30 by the end of fiscal 2002, and our domestic workforce from 9,969 to 9,399 during the same time frame. These initiatives helped the company to generate operating income in the second half of the year. In the current year there will be more of the same, as we strive to create a highly cost-competitive corporate structure. The workforce will be pared back further to 8,200 through an early retirement program, and we will target a 20% reduction in procurement costs by focusing on Value Engineering (VE) at the design stage.

CHANGING CORPORATE CULTURE: CHANGING JVC

At JVC we face another critical issue: how to create a corporate culture that binds together our entire organization so we can effectively implement our growth strategy. Past JVC growth strategies have not stood the test of being applied in core business processes, such as product development, manufacturing or in the sales frontline. The result was a lack of focus on factors that really mattered to the big picture—keeping a tight reign on inventory levels, developing products that consumers really want and maximizing earnings. Put simply, organizations within the company weren't strong enough to support strategy implementation. This resulted in a negative mindset. Our people were convinced that there was no panacea for the company's problems, no matter how hard they worked. Motivating our people is therefore vital, by convincing them that their actions directly affect the profitability of JVC.

MARKET PRESENCE

Over the years, we have built a formidable presence in the global market. Based on this foundation, we are aiming to establish a new position in the market as a company known for consistently creating market-leading products.

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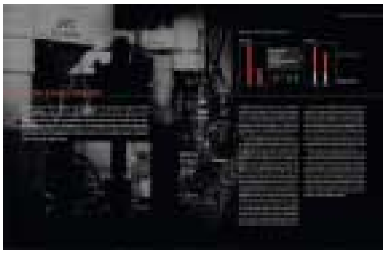
Organizations aren't changed by management alone. This process can begin only after the entire workforce is made aware of the issues so that everyone can work together to bring about change. The first step at JVC was to ascertain employee thinking. With this in mind, I established a taskforce in November 2001 to identify and discuss with our employees the main cross-functional issues facing JVC: redefining our corporate culture; restructuring our business portfolio; originating new products; creating new businesses; implementing marketing reforms; and modifying procurement processes. This taskforce is helping to bring about a sea change at JVC, transforming mere words into real commitment among our workforce to enact change. The clearest benefit of this approach is that both the management team and the employees are now working together to establish a new JVC corporate culture.

SHIFTS IN RETAILING: A NEW OPPORTUNITY FOR JVC

The onus is now on JVC to formulate a clear growth strategy to drive a recovery in earnings. A change of tack is needed. We are discarding our existing approach of attempting to compete across all product categories. Instead, we are aiming to capture a greater share of the high-end market with value-added products that are more resilient to price competition, thereby improving our margins and generating stronger earnings. I believe the paradigm shift currently underway in the Japanese retailing industry provides the perfect opportunity for our new approach.

In Japan, one of the main reasons for JVC's declining earnings is the intense competition driving down prices. This trend is also affecting the performance of large-scale domestic retailers. Many of these retailers are facing difficulties as weak consumer demand and falling prices have prevented chain store expansion programs from meeting sales targets. To avoid insolvency, they are now being forced to merge with rivals and shift from products that generate low returns to selling high-value-added products.

At JVC, we are seeking to take advantage of this shift by paring back our product lines and channeling our resources into key products that fully leverage the value of the JVC brand. In fact, we are forging



NEW CHALLENGES

To achieve the goals in our three-year plan, we are striving to lower our breakeven point in sales and generate stronger cash flows by strengthening our operating structure and working to launch products more rapidly.

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alliances with retailers to effectively tie in our new strategy with their new retailing stance. One example of this collaboration is a deal with a leading electronics retailer to hold Digital Advisor Seminars at their stores. At these seminars, experienced JVC engineers are on hand to provide technical assistance to customers who are increasingly confused by the growing complexity of digital products. The thinking behind this approach is simple: the success of the seminars allows us to select the best in-store position for our products, enhances the visibility of the JVC brand and gives us access to customer feedback that can be used to develop future products.

REVIVING THE JVC BRAND THROUGH KEY PRODUCTS

I've already commented above about the new role for JVC's key products. But what do I mean when I talk about key products that better demonstrate JVC brand value? In short, products that incorporate our market-leading audio and visual technology. Hardware, software, systems and service businesses are merging into one, as society becomes increasingly wired into networks. JVC's growth strategy is designed to take advantage of this trend by transforming our audio and video hardware, renowned for their quality, into value-added components that empower the user by enhancing network connectivity. Connecting our devices to networks will also open the door to other elements of the JVC value chain, allowing us to fully maximize our software and media property. Consumers are constantly looking for the next superior level of sound and picture quality; they have an insatiable desire to experience new forms of audio and visual entertainment. I am convinced that responding to these needs by offering innovative and exciting entertainment will translate into increasing demand for our key products. Enhancing connectivity will also lend added value to JVC products in our three priority business areas—high-definition displays, networkable AV systems and digital high-density storage. This approach will be reinforced in other areas of JVC—strengthening our core components business and augmenting the value chain in the software and media business—to ultimately generate new corporate value.

JVC has great potential: high market visibility and a global market presence; outstanding development capabilities in digital audio and visual technology; and a team of engineers able to develop products that offer consumers unrivaled entertainment value. Drawing out these strengths is up to us—management and employees—and is vital to reviving JVC as a company capable of taking on the competition and winning. In fiscal 2003, a crucial year for the transformation of JVC, this theme will be foremost in our minds as we work together to put the company on the path to recovery.

August 2002

M. Terada

Masahiko Terada
President