2003 Annual Report

Solutions for Your Changing World

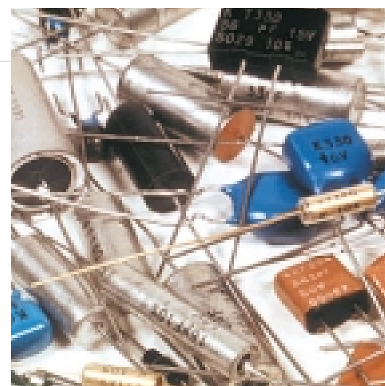
PROFILE

KEMET Corporation is the world's leading manufacturer of solid tantalum capacitors and a world leader in the manufacturing of multilayer ceramic capacitors and solid aluminum capacitors. Our vision is to be the market leader in the global capacitor industry by being the preferred supplier to the world's most successful electronics manufacturers and distributors.

KEMET'S LEGACY OF SUCCESS

After beginning in 1919, KEMET's early products were vacuum tube components. In the 1950s, KEMET transitioned to electronic capacitors to support newly invented transistors. In the 1960s, operations moved to low cost areas in the United States and Mexico. Today, KEMET has the best reputation in the capacitor industry for quality, delivery and service among the world's most successful electronics manufacturers and distributors.

Union Carbide Electronics Division (KEMET), 1965

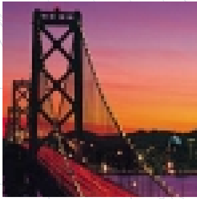


KEMET Leaded Capacitors

HIGHLIGHTS

Years ended March 31, (Dollars in thousands except per share data)	2001	2002	2003
Net sales	$1,406,147	$508,555	$447,332
Net earnings (loss)	$ 352,346	$ (27,289)	$ (55,988)
Net earnings/Net sales	25.1%	—	—
Net earnings (loss) per share, diluted(1)	$ 4.00	$ (0.32)	$ (0.65)
Selling, general and administrative expenses	$ 62,319	$ 54,420	$ 54,390
Research and development expenses	$ 27,145	$ 26,334	$ 25,268
Fixed asset expenditures	$ 210,559	$ 78,546	$ 22,197
Percent debt to capital	10.1%	10.5%	11.2%
Year-end number of employees	13,900	6,900	6,300

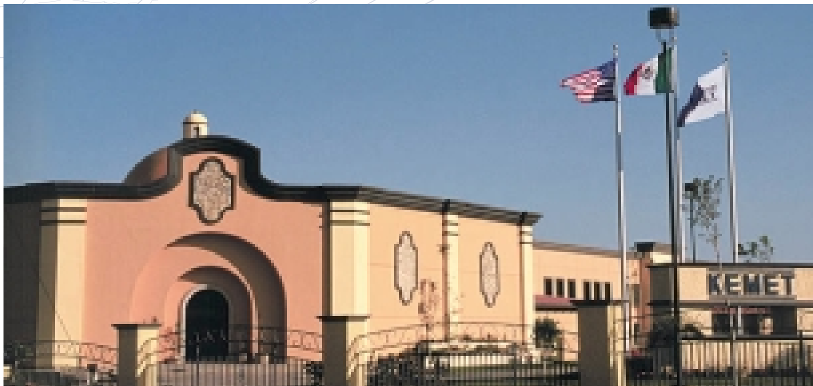
(1) Reflects the impact of 2-for-1 stock split effective June 1, 2000.



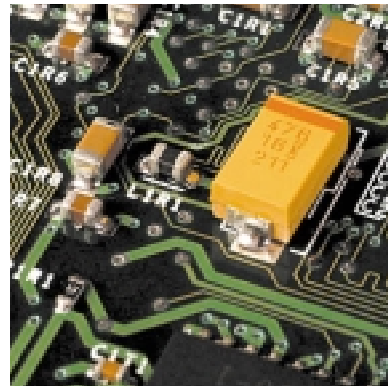
opportunity

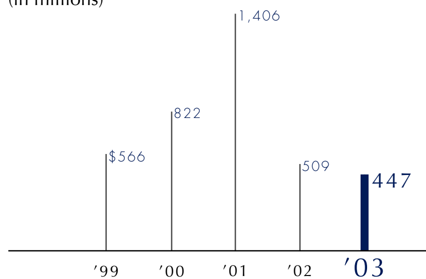
KEMET'S PATH TO PROSPERITY

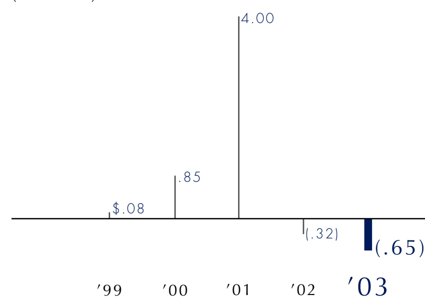
To enhance our market leadership position, KEMET will continue to excel at execution to enhance our leadership in quality, delivery and service. We will have a global mindset, with consistent core values around the world, while meeting local customer preferences. And we will accelerate the pace of innovations, anticipating our customers' future needs and developing components to support their applications.

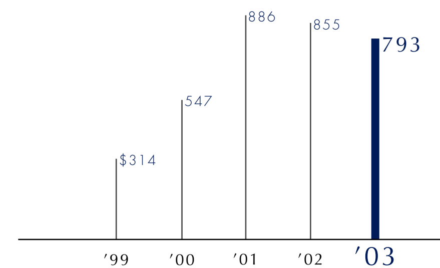


KEMET Tantalum Plant in Ciudad Victoria, Mexico, 2003


KEMET Tantalum and Ceramic Surface Mount Capacitors







strategy

There is a significant market opportunity for the first truly global supplier of passive component technology solutions.

DEAR FELLOW SHAREHOLDERS:

Fiscal 2003 was a year of reflection and transition at KEMET. We spent much of the year listening intently to customers about how their needs are evolving and how they see their business developing in the future.

As a result of the prolonged slump in the electronics industry, total sales for fiscal 2003 were $447.3 million with a net loss of $(56.0) million, or $(0.65) per diluted share, which includes $52.3 million, or $0.61 per share in special after-tax charges. Given industry conditions, the KEMET team did an outstanding job of reducing costs and adjusting to the realities of the market.

Late last year after over four decades of service, Dave Maguire announced his intention to retire as Chief Executive Officer of KEMET. After a national search for a successor, the Board of Directors appointed Dr. Jeffrey Graves President and Chief Executive Officer in March 2003. Since that time, Jeff has led the management team in the development of a strategic plan that builds on KEMET's legacy of success while positioning the company to enhance its market leadership in the evolving electronics industry. KEMET has a clear vision of what we will become and a highly experienced, talented and motivated team to execute the plan.

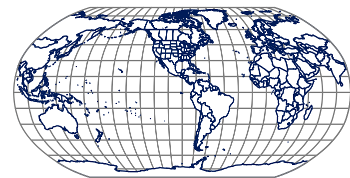
KEMET's vision remains being the market leader in the global capacitor industry as the preferred supplier to the world's most successful electronic manufacturers and distributors. We will achieve this leadership by providing comprehensive, high-performance solutions in an easy-to-buy-from environment encompassing technology, quality, delivery, and service at competitive prices.

KEMET's business model continues to include servicing our key accounts though a direct, salaried sales force with supporting, proprietary information technologies. We consider this a long-term investment in our customer relationships, so our selling, general and administrative (SG&A) costs do not vary much from year to year. Likewise we currently invest in research and development (R&D) to create innovative capacitor solutions and achieve world class costs, therefore our R&D costs are relatively stable year to year. This business model gives us considerable upside leverage as the capacitor industry recovers and ensures continuity in our development programs.

While the supporting costs of our business process are fairly consistent from year to year, our model is dynamic in meeting the needs of our global customers. For example, without increasing overall SG&A, the KEMET sales force has increased significantly in Asia, reflecting the shift of much of the electronics industry from Europe and North America to Asia. In another example, customers give KEMET's web site high marks as an important, easy-to-buy-from resource for electronic designers, and this year we began providing web

content in Mandarin to be easy-to-buy-from for our Chinese customers. We also announced the beginning of production in China during calendar 2003, primarily to demonstrate to our Asian customers our commitment to supporting their operations in Asia.

During the past year, we have been successful at accelerating the pace of innovation, launching over twice the number of new products in 2003 than we did in 2002 without increasing the overall investment in R&D. We continue to make advances in tantalum capacitors in which we are the world leader. During the year, KEMET launched the world's largest, fastest tantalum capacitor, the KO-MAT, targeted at power management of high frequency electronics, such as notebooks, advanced video games, and high-end servers. Revenues from the AO-CAP line, KEMET's entry into the solid aluminum organic polymer capacitor market, continue to increase. Additionally, AO-CAPs represent a significant growth opportunity for the company. KEMET has recently made significant progress in the development of high capacitance ceramic capacitors, which is a high-growth market sector.



As we look to the future, we see critical activities for KEMET around the world. The United States will remain our corporate headquarters, and we will evolve our significant research and development activities here into one of the premier innovation centers in the world. Our Mexican production facilities are among the most cost efficient in the world, and will serve primarily the electronics industry in North America and Europe. We have a major sales and distribution presence in North America, Europe and Asia today. We are supplementing that with a low-cost, Asian-based manufacturing presence, with the objective of growing our business in Asia faster than the Asian market as a whole. KEMET strives to exceed the local preferences of customers around the world, while maintaining globally our consistent core values that are the basis for KEMET's success.

leadership

BEING EASY-TO-BUY-FROM

Being easy-to-buy-from by providing outstanding on-time delivery and quality with excellent customer service is the foundation of KEMET's legacy of success. It is what we are most known for in the marketplace. We will continue to excel in the execution of our easy-to-buy-from technology, quality, delivery, and service processes to enhance our position as the leader in the capacitor industry. Every KEMET employee understands that each day he is responsible for identifying ways to make it easier for customers to buy more from us.

Our customers do not design new electronic products because of advances in capacitors, but capacitors are essential passive electronic components supporting all of our customers' products. No customer wants a production line to shut down because capacitors are not available, and they do not want a quality problem with their products because a capacitor fails. As a result, customers value high quality and on-time delivery when buying passive components.

An important part of being easy-to-buy-from is being price competitive, so KEMET maintains a constant focus on producing our products at globally competitive costs, especially in a challenging competitive environment like we are in today. By offering products at competitive world prices, and differentiating ourselves with quality, delivery and service, KEMET intends to grow our share of the capacitor industry over the next several years.

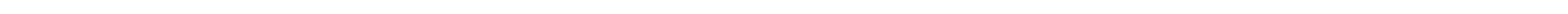
San Francisco, California, USA

Hong Kong, China

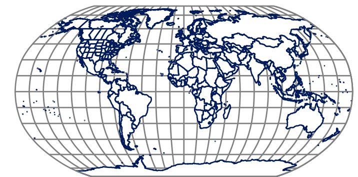
SPEED

The pace of change in the electronics industry today is as fast as it has ever been. While the industry has been in an economic slump, the rate of innovation remains unabated and permeates our entire industry. Microprocessors operate at higher frequencies, portable devices operate at lower voltages, and automotive electronics operate at higher temperatures and higher voltages, all of which put stress on electronic components and create opportunities for innovation.

To continue our success, the KEMET team will focus on quickly assessing the opportunities available to us in the marketplace, developing innovative technology or service solutions to address those needs, and introducing those innovations to customers as quickly as possible to maximize the benefit we receive. KEMET must continue to be responsive to the shift of much of the electronics industry from high-cost to low-cost parts of the world and to continued outsourcing of production from original equipment manufacturers to electronic manufacturing services companies.



Shanghai, China



EMPOWERMENT AND ACCOUNTABILITY

KEMET's senior leadership team has been very clear about the path to success for KEMET. We will ensure we have the best trained and motivated people in our industry. We will give them the resources necessary for them to excel. We will remain focused on our goals and move into new opportunities from positions of knowledge and strength. Empowered KEMET employees will be able to execute to achieve the company's objectives, rapidly enabling KEMET to be more effective as an organization.

Along with empowerment comes accountability. KEMET employees are accountable to our customers for quality, delivery and service and to our shareholders for financial results.

growth

A GLOBAL MINDSET

Traditionally, most component suppliers have been North American companies, or Asian or European companies, doing business around the world much as they did business at home. The electronics industry has rapidly migrated around the world in recent years, and the industry's shift to new places will continue as companies constantly seek new markets and lower costs. There is an enormous opportunity for companies that are truly global, combining a consistent, worldwide focus with the flexibility to meet local preferences wherever customers choose to operate.

KEMET has historically been successful in Asia, the world's highest growth region for electronics which today accounts for over a quarter of our revenue. We have a major initiative underway currently to further enhance our presence in Asia, including the beginning of production in China, to take advantage of growing opportunities by being closer to customers in this important part of the world.

Regardless of where customers locate facilities in the world, KEMET's core values ensure that we will provide outstanding quality, delivery and service while meeting their local needs.

Prague, Czech Republic

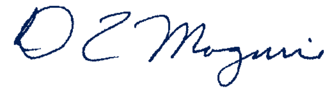
strength

INTEGRITY

Integrity is an essential value which permeates our strategies and actions. KEMET has built its reputation on credibility and integrity, and we are determined to maintain this reputation going forward.

While continuing to manage through the current challenges, we are focused on enhancing KEMET's global leadership in the marketplace. We recognize that the past several years have been a very challenging time for everyone on the KEMET team, including our shareholders. Thanks to each of you for continuing to share our enthusiasm about KEMET's future.

Sincerely,



Mr. David E. Maguire
Chairman of the Board of Directors

Dr. Jeffrey A. Graves
President and Chief Executive Officer

The Downtown Campus of Greenville, South Carolina, USA

Selected Financial Data

Dollars in thousands except per share data	**2003**	2002	2001	2000	1999
	Years ended March 31,				
Income Statement Data:					
Net sales	**$ 447,332**	$ 508,555	$1,406,147	$822,095	$565,569
Operating income (loss)	**(97,002)**	(40,365)	566,986	124,315	22,604
Interest income	**(3,818)**	(9,809)	(16,713)	(2,079)	—
Interest expense	**4,599**	6,736	7,507	9,135	9,287
Net earnings (loss)	**(55,988)**	(27,289)	352,346	70,119	6,150
Per Share Data:					
Net earnings (loss) per share—basic	**$ (0.65)**	$ (0.32)	$ 4.05	$ 0.87	$ 0.08
Net earnings (loss) per share—diluted	**$ (0.65)**	$ (0.32)	$ 4.00	$ 0.85	$ 0.08
Weighted-average shares outstanding					
—basic	**86,167,563**	85,773,763	86,930,965	80,650,376	78,441,440
—diluted	**86,167,563**	85,773,763	88,181,118	82,411,634	79,027,860
Balance Sheet Data:					
Total assets	**$1,101,010**	$1,171,714	$1,366,530	$927,256	$663,690
Working capital	**463,535**	454,776	460,055	260,154	90,371
Long-term debt	**100,000**	100,000	100,000	100,000	144,000
Stockholders' equity	**793,275**	855,045	886,176	547,456	313,674
Other Data:					
Cash flow from (used in) operating activities	**$ 43,710**	$ (34,219)	$ 392,440	$183,052	$ 20,817
Capital expenditures	**22,197**	78,546	210,559	82,009	59,047
Research and development	**25,268**	26,334	27,145	24,910	22,133

Management's Discussion and Analysis of Results of Operations and Financial Condition

The following discussion and analysis provides information that the Company believes is useful in understanding KEMET's operating results, cash flows, and financial condition for the three years ended March 31, 2003. The discussion should be read in conjunction with, and is qualified in its entirety by reference to, the Consolidated Financial Statements and related notes appearing elsewhere in this report. Except for the historical information contained here, the discussions in this document contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and involve risks and uncertainties. The Company's actual results could differ materially from those discussed here. Factors that could cause or contribute to such differences include, but are not limited to, those discussed under "The Safe Harbor Statement" and, from time to time, in the Company's other filings with the Securities and Exchange Commission.

Critical Accounting Policies

The Company's significant accounting policies are summarized in Note 1 to the Consolidated Financial Statements. The following identifies a number of policies which require significant judgments or estimates.

The Company's estimates and assumptions are based on historical data and other assumptions that KEMET believes are reasonable in the circumstances. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period.

The judgments are based on management's assessment as to the effect certain estimates, assumptions, or future trends or events may have on the financial condition and results of operations reported in the Consolidated Financial Statements. It is important that a reader of the financial statements understand that actual results could differ from these estimates, assumptions, and judgments.

KEMET's management believes the following critical accounting policies contain the most significant judgments and estimates used in the preparation of the Consolidated Financial Statements.

INVENTORIES. Inventories are valued at the lower of cost or market, with cost determined under the first-in, first-out method and market based upon net realizable value. The valuation of inventories requires management to make estimates. For instance, units shipped decreased substantially after fiscal 2001 and reduced the turnover of finished goods inventories. The Company computes an obsolescence reserve by gauging the current demand for a specific product, comparing it with historical trends, and taking into account general economic conditions. The Company also must assess the prices at which it believes the finished goods inventory can be sold compared to its cost. A sharp decrease in unit demand could adversely impact earnings as the reserve estimates may increase. Conversely, a sharp increase in unit demand could favorably impact earnings as the reserve estimates may decrease.

RAW MATERIAL WRITE-DOWNS. In the year ended March 31, 2003, the Company recorded charges of $40.8 million related to tantalum raw material. The Company wrote down approximately $16.4 million in on-hand inventory of tantalum powder and wire and approximately $24.4 million related to contractual commitments to purchase tantalum powder and wire through calendar year 2006. This was done because the current market prices of tantalum were substantially below the prices at which the Company committed to purchase tantalum in the future under a long-term contract and the prices carried in tantalum raw materials inventory. These actions involved significant judgments on the part of the Company, including determining the amount of charges and write-downs, their timing, and their amount.

The determination was made after management concluded that the substantial fall-off in the demand for tantalum capacitors was likely to continue for the foreseeable future. Combining this assessment with the worldwide overcapacity in tantalum production, KEMET could not foresee when tantalum prices might recover from their currently depressed levels. This determination was made in the quarter ended December 31, 2002, after it was apparent that customers' inventory levels had dropped without any effect on the demand or pricing for tantalum capacitors and after the settlement of tantalum pricing litigation. (See Form 10-K, Item 3, Legal Proceedings—Cabot Corporation for the period ended March 31, 2003.) Although the Company believes that the charges and the write-downs as well as their timing were appropriate under the circumstances, visibility for future demand and pricing is limited and the judgments made by management necessarily involved subjective assessments.

The write-down of current tantalum inventory and the charges with respect to future tantalum commitments were calculated based on current market prices for tantalum. There is no established market on which tantalum raw materials are regularly traded and quoted. The Company based its determination of current market price on quotations from two suppliers of these materials. KEMET cannot say that the prices at which we could currently enter into contracts for the purchase of tantalum would be the same as these quoted prices. In quantifying the charges that were taken against future purchase commitments, the Company assumed, for lack of another benchmark, that current market prices would continue through 2006, when KEMET'S purchase commitments end. Had other assumptions on current and future prices for tantalum been made, the amount of the inventory write-downs and the charges against purchase commitments would have been different.

If tantalum prices were to recover in the future, the Company would not reverse the write-downs taken on raw materials inventory or the charges that were recorded against the purchase commitments, so that the cost of materials will continue to reflect these write-downs and charges regardless of future price increases in tantalum. This could have the effect of increasing the earnings in future periods from what they would have been had KEMET not taken these actions until future raw material prices were known with certainty. If tantalum prices experience further declines, the Company could also be required to take further write-downs and charges.

GOODWILL. KEMET adopted SFAS No. 142, "Goodwill and Other Intangible Assets," on April 1, 2002. Under SFAS No. 142, goodwill, which represents the excess of purchase price over fair value of net assets acquired, and intangible assets with

indefinite useful lives are no longer amortized but are to be tested for impairment at least on an annual basis in accordance with the provisions of SFAS No. 142.

The Company's goodwill is tested for impairment at least on an annual basis. The impairment test involves a comparison of the fair value of each of the reporting units as defined under SFAS No. 142, with its carrying amount. For purposes of determining potential impairment of goodwill, the Company aggregated its reporting units as its segments are aggregated to a single reporting segment under SFAS No. 131. If the reporting unit's aggregated carrying amount exceeds its fair value, then an indication exists that the reporting unit's goodwill may be impaired. The impairment to be recognized is measured by the amount by which the carrying value of the reporting unit being measured exceeds its fair value, up to the total amount of its assets. The Company determined fair value based on a market approach which incorporates quoted market prices of the Company's common stock and the premiums offered to obtain controlling interest for companies in the electronics industry. Downward movement in either stock prices or premiums paid for controlling interest in the electronics industry could have a material effect on the fair value of goodwill in future measurement periods. On an ongoing basis, KEMET expects to perform its impairment tests during the first quarter of each year. In accordance with SFAS No. 142, KEMET completed the transitional goodwill impairment test upon adoption on April 1, 2002, and completed its annual goodwill impairment test in the first quarter of fiscal 2003, neither of which indicated impairment.

As of March 31, 2003, KEMET had unamortized goodwill in the amount of $28.4 million.

REVENUE RECOGNITION. Revenue is recognized from sales when a product is shipped. A portion of sales is made to distributor customers which, under certain conditions, allows for returns of overstocked inventory and provides protection against price reductions initiated by the Company. At the time sales to distributors are recorded, allowances are also recognized against net sales for estimated product returns and price protection. Historical distributor returns and price adjustments on both a consolidated level and on an individual distributor level as well as the economic climate are considered in determining the allowances. These procedures require the exercise of significant judgments, but the Company believes they reasonably estimate future credits for returns and price adjustments. Variations in these assumptions could have a significant effect on the amounts reported through the Consolidated Statement of Operations.

PENSION AND OTHER NONPENSION POST-RETIREMENT BENEFITS. KEMET engages an independent actuarial firm to perform an actuarial valuation of the fair values of its post-retirement plans' assets and benefit obligations. Management provides the actuarial firm with certain assumptions that have a significant effect on the fair value of the assets and obligations such as the:

—Weighted-average discount rate—used to arrive at the net present value of the obligation;

—Return on assets—used to estimate the growth in invested asset values available to satisfy certain obligations;

—Salary increases—used to calculate the impact future pay increases will have on post-retirement obligations; and

—Medical cost inflation—used to calculate the impact future medical costs will have on post-retirement obligations.

Management understands that these assumptions directly impact the actuarial valuation of the assets and obligations recorded on the balance sheet and the income or expense that flows through the Consolidated Statement of Operations.

Management bases its assumptions on either historical or market data that it considers reasonable in the circumstances. Variations in these assumptions could have a significant effect on the amounts reported through the Consolidated Statement of Operations.

The Company announced that it would freeze benefits of its non-contributory pension plan effective July 1, 2003.

TAXES. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Management evaluates its tax assets and liabilities on a periodic basis and adjusts these balances on a timely basis as appropriate. Management believes that it has adequately provided for its future tax consequences based upon current facts and circumstances and current tax law. However, should management's tax positions be challenged and not prevail, different outcomes could result and have a significant impact on the amounts reported through the Consolidated Statement of Operations.

The carrying value of the Company's net deferred tax assets (tax benefits expected to be realized in the future) assumes that KEMET will be able to generate, based on certain estimates and assumptions, sufficient future taxable income in certain tax jurisdictions to utilize these deferred tax benefits. If these estimates and related assumptions change in the future, the Company may be required to reduce the value of the deferred tax assets resulting in additional income tax expense.

Management believes that it is more likely than not that the deferred tax assets will be realized, based on the scheduled reversal of deferred tax liabilities and projected future taxable income. However, there can be no assurance that KEMET will meet its expectations of future income. Management evaluates the deferred tax assets on a periodic basis and assesses the need for additional valuation allowances.

Results of Operations

Overview

KEMET estimates that the compounded annual growth rate for capacitors was approximately 20% during the 1990s. Underlying the strong demand for capacitors is the cyclical nature of the electronics industry. The Company believes that the industry entered into another correction phase of a long-term growth trend during calendar 2001. The Company considers that the rapidity with which this inventory/capacity correction occurred was unprecedented compared to previous cycles. After achieving record revenues and profits in fiscal 2001, demand for capacitors fell considerably in fiscal 2002 and 2003.

Comparison of Fiscal Year 2003 to Fiscal Year 2002

Net sales for fiscal year 2003 were $447.3 million, which represented a 12% decrease from fiscal year 2002 net sales of $508.6 million. The decrease in net sales was primarily attributable to a decline in both tantalum and ceramic capacitor average selling prices. Unit volumes increased 36% to approximately 17.6 billion units from approximately 12.9 billion units in fiscal 2002. Sales of surface-mount capacitors for fiscal 2003 were $362.3 million, a decrease of 9% from the prior year. Export and domestic sales decreased 9% and 15% to $251.0 and $196.3 million, respectively.

Cost of goods sold for the year ended March 31, 2003, was $388.8 million as compared to $412.5 million for the year ended March 31, 2002. As a percentage of net sales, cost of sales was 87% for the year ended March 31, 2003, as compared to 81% for the prior year. Decreased average selling prices more than offset increased volume and accounted for the increase in the percentage of cost of goods sold in fiscal 2003 versus fiscal 2002.

Selling, general, and administrative expenses for the year ended March 31, 2003, were $54.4 million, or 12% of net sales, as compared to $54.4 million, or 11% of net sales, for the year ended March 31, 2002. Selling, general and administrative expenses increased as a percent of sales largely as a result of lower sales in the current year.

Research and development expenses were $25.3 million for fiscal year 2003, compared to $26.3 million for fiscal year 2002. These costs reflect the Company's continuing commitment to the development and introduction of new products, such as aluminum capacitors, along with the improvement of product performance and production efficiencies.

Restructuring and impairment charges for the year ended March 31, 2003, were $75.9 million as compared to $55.7 million for the prior period. The following table reflects the charges in both fiscal periods (in millions):

	Year ended March 31		
	2003	2002	Change
Inventory charges	**$44.2**	$ 6.3	$ 37.9
Impaired long-lived assets	**4.6**	32.9	(28.3)
Personnel reductions	**27.1**	12.8	14.3
Joint venture termination	**—**	3.7	(3.7)
Total	**$75.9**	$55.7	$ 20.2

The charges are explained in detail by quarter for both fiscal 2003 and 2002 later in this section.

The operating loss for the year ended March 31, 2003, was $97.0 million compared to $40.4 in the prior year. The increase in operating loss from the prior year was principally from a combination of the aforementioned lower sales levels, corresponding reduction in manufacturing margins, and increased restructuring and impairment charges.

Income tax benefit for fiscal year 2003 increased to $31.9 million as compared to $13.4 million for fiscal year 2002 due to the higher pre-tax loss in the current year versus the pre-tax loss in the prior year.

Fiscal 2003 Restructuring and Impairment Charges

The Company incurred restructuring and impairment charges in the quarters ended September 30, 2002; December 31, 2002; and March 31, 2003. A summary of the charges incurred in fiscal year 2003 are as follows (in millions):

	Quarter ended			
	Sep 30	Dec 31	Mar 31	Total
Inventory and related supply agreement charges	$ —	$42.6	$ 1.6	$44.2
Impaired assets	4.6	—	—	4.6
Personnel reductions	9.1	—	18.0	27.1
Total	$13.7	$42.6	$19.6	$75.9

Restructuring and Impairment Charges in the Quarter Ended September 30, 2002

Restructuring and impairment charges represent the closing of one manufacturing facility in Greenwood, South Carolina, and one of four manufacturing facilities in Matamoros, Mexico, which was announced in July 2002. These actions were part of KEMET's cost saving initiatives over the past two fiscal years in response to the prolonged downturn in the electronics industry. A description of the charges expensed in the quarter ended September 30, 2002, follows:

Impaired assets—The impaired assets consisted of certain long-lived assets associated with the closing of a manufacturing facility in Greenwood, South Carolina.

Personnel reductions—The Company made manufacturing and support personnel reductions of approximately 185 and 240 employees in the U.S. and Mexico, respectively.

Restructuring and Impairment Charges in the Quarter Ended December 31, 2002

On December 10, 2002, the Company announced that it agreed to an extension of the term of its tantalum supply agreement with Cabot Corporation ("Cabot").

Inventory and Related Supply Agreement—The Company records inventory at the lower of cost or market and estimated losses associated with inventory received under the extended supply agreement were approximately $16.4 million. In addition, the Company's estimated future losses for the commitment to purchase tantalum at above-market prices were approximately $24.4 million. In addition, this caption contains excess palladium sold at a loss of $1.8 million. Accordingly, a $42.6 million charge was recorded.

Restructuring and Impairment Charges in the Quarter Ended March 31, 2003

On January 6, 2003, the Company announced a cost saving initiative in response to the prolonged downturn in the electronics industry.

Personnel reductions—Workforce reductions, primarily from U.S. facilities, totaled approximately 280 employees, with approximately 170 being from voluntary early retirements and the remainder being from a reduction-in-force. In addition

to normal retirement benefits, the early retirement program included a special retirement bonus based on length of service to encourage participation. Severance benefits based on years of service were provided to other employees affected by the reduction-in-force.

Inventory and Related Supply Agreement—The Company terminated palladium forward contracts at a loss of $1.6 million.

Comparison of Fiscal Year 2002 to Fiscal Year 2001

Net sales for fiscal year 2002 were $508.6 million, which represented a 64% decrease from fiscal year 2001 net sales of $1,406.1 million. There was a substantial decrease in demand across market segments during the year ended March 31, 2002. The Company regards the decline as the most pronounced in its history, and it resulted from two factors. First, customers' capacitor consumption fell off as demand turned down. Second, customers were purchasing capacitors significantly below their level of consumption as they used up inventory.

The decrease in net sales was attributable to a decline in both tantalum and ceramic capacitor unit volume and lower average selling prices. Unit volumes decreased 64% to approximately 12.9 billion units in fiscal 2002 from approximately 36.1 billion units in fiscal 2001. After increasing throughout fiscal 2001, average selling prices decreased each quarter during fiscal 2002. Sales of surface-mount capacitors for fiscal 2002 were $399.6 million, a decrease of 72% from the prior year. Both export and domestic sales decreased 64% to $277.0 million and $231.6 million, respectively.

Cost of sales for the year ended March 31, 2002, was $412.5 million as compared to $749.7 million for the year ended March 31, 2001. As a percentage of net sales, cost of sales was 81% for the year ended March 31, 2002, as compared to 53% for the prior year. Manufacturing throughput was down in response to the decrease in demand, which resulted in the absorption of fixed costs over fewer units than in the same period in the prior year. Combined with decreasing average selling prices, this resulted in an increase in the cost of sales as a percentage of sales in the current year as compared to the prior year.

Selling, general, and administrative expenses for the year ended March 31, 2002, were $54.4 million, or 11% of net sales, as compared to $62.3 million, or 4% of net sales, for the year ended March 31, 2001. Selling, general, and administrative expenses decreased compared to the prior year primarily due to the Company's efforts to control overhead expenses in anticipation of declining capacitor demand. Selling, general, and administrative expenses increased as a percent of sales largely as the result of lower sales in the current year.

Research and development expenses were $26.3 million for fiscal year 2002, compared to $27.1 million for fiscal year 2001. These costs reflect the Company's continuing commitment to the development and introduction of new products, such as aluminum capacitors, along with the improvement of product performance and production efficiencies.

Restructuring and impairment charges for the year ended March 31, 2002, were $55.7 million as compared to none in the prior period. The primary reason for the increase is $36.6 million of asset impairment charges, approximately $12.8 million of charges related to layoffs in operations both in the U.S. and Mexico, and $6.3 million of losses related to the settlement of precious metals contractual obligations.

The operating loss for the year ended March 31, 2002, was $40.4 million compared to $567.0 million of operating income in the prior year. The change from operating income in the prior year to operating loss in the current year resulted primarily from a combination of the aforementioned lower sales levels and the corresponding reduction in manufacturing margins, and restructuring and impairment charges.

The income tax benefit for fiscal year 2002 was $13.4 million as compared to income tax expense of $216.0 million in the prior year. The benefit in the current year versus the expense in the prior year was the result of a current year pre-tax loss compared to a pre-tax profit in the prior year.

Fiscal 2002 Restructuring and Impairment Charges

The Company incurred restructuring and impairment charges in the quarters ended December 31, 2001, and March 31, 2002. A summary of the charges incurred follows (in millions):

	Quarter ended		
	Dec 31	Mar 31	Total
Inventory charges	$ 6.3	$ —	$ 6.3
Impaired long-lived assets	11.4	21.5	32.9
Personnel reductions	9.9	2.9	12.8
Joint venture termination	3.7	—	3.7
Total	$31.3	$24.4	$55.7

Restructuring and Impairment Charges in the Quarter Ended December 31, 2001

Following two years of tremendous growth in product shipments during calendar years 1999 and 2000, the electronics industry experienced a severe inventory correction. The Company anticipated that lower production levels would continue well into calendar 2002. The Company acted by streamlining manufacturing facilities, accelerating productivity improvement programs, and reducing manufacturing and support personnel in the Company's U.S. and Mexican facilities. The charges related to the aforementioned activities in the quarter ended December 31, 2001, were as follows:

Inventory charges—Inventory charges consisted of the loss on sale of excess precious metal inventory, primarily palladium, sold during the quarter.

Impaired long-lived assets—This represents certain long-lived assets used in production, as well as costs related to the disposal of those assets. These assets were retired as part of the effort to streamline manufacturing facilities and in response to a lack of anticipated product demand associated with the productive assets.

Personnel reductions—The Company made manufacturing and support personnel reductions of approximately 600 and 1,000 employees in the U.S. and Mexico, respectively.

Termination of joint venture—Through its wholly-owned subsidiary, the Company agreed with Australasian Gold Mines NL (AGM) to sell KEMET's interest in Tantalum Australia, a joint venture in Australia. The investment was written down to its net realizable value. In conjunction with this transaction, the agreement for the Company to purchase product from Tantalum Australia was also canceled. The Company continues to hold a 10% equity interest in AGM.

Restructuring and Impairment Charges in the Quarter Ended March 31, 2002

The Company announced enhancements to its high-frequency products organization. High-frequency electronics include products such as notebook computers and high-end servers using microprocessors operating at frequencies greater than 1 GHz. Two product lines are targeted at these applications: KEMET organic capacitors (KO-CAP) and solid aluminum organic capacitors (AO-CAP). The restructuring and impairment charges incurred in the quarter ended March 31, 2002, were as follows:

Impaired long-lived assets—This represents certain long-lived assets used in production, as well as costs related to the disposal of those assets. These assets were the first-generation of high-frequency solid aluminum production equipment.

Personnel reductions—Consolidation of certain manufacturing and support personnel resulted in a reduction of approximately 350 manufacturing personnel in the U.S. and Mexico in March 2002.

Quarterly Results of Operations

The following table sets forth certain quarterly information for the years ended March 31, 2003 and 2002. This information is unaudited but, in the opinion of the Company's management, reflects all adjustments (consisting only of normal recurring adjustments) necessary to present fairly this information when read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere herein.

Dollars in thousands except per share data	**Fiscal year ended March 31, 2003**				
	First Quarter	**Second Quarter**	**Third Quarter**	**Fourth Quarter**	**Total**
Net sales	**$ 124,045**	**$ 113,055**	**$ 103,727**	**$ 106,505**	**$ 447,332**
Operating income (loss)[1]	**$ 2,456**	**$ (20,848)**	**$ (50,511)**	**$ (28,099)**	**$ (97,002)**
Net earnings (loss)	**$ 3,422**	**$ (11,149)**	**$ (31,725)**	**$ (16,536)**	**$ (55,988)**
Net earnings (loss) per share (basic)	**$ 0.04**	**$ (0.13)**	**$ (0.37)**	**$ (0.19)**	**$ (0.65)**
Net earnings (loss) per share (diluted)	**$ 0.04**	**$ (0.13)**	**$ (0.37)**	**$ (0.19)**	**$ (0.65)**
Weighted-average shares outstanding (basic)	**86,078,012**	**86,163,766**	**86,099,656**	**86,230,198**	**86,167,563**
Weighted-average shares outstanding (diluted)	**86,956,317**	**86,163,766**	**86,099,656**	**86,230,198**	**86,167,563**

Dollars in thousands except per share data	Fiscal year ended March 31, 2002				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Net sales	$152,721	$120,636	$117,296	$117,902	$508,555
Operating income (loss)[1]	$ 20,438	$ 2,163	$ (36,838)	$ (26,128)	$ (40,365)
Net earnings (loss)	$ 13,051	$ 990	$ (26,919)	$ (14,411)	$ (27,289)
Net earnings (loss) per share (basic)	$ 0.15	$ 0.01	$ (0.31)	$ (0.17)	$ (0.32)
Net earnings (loss) per share (diluted)	$ 0.15	$ 0.01	$ (0.31)	$ (0.17)	$ (0.32)
Weighted-average shares outstanding (basic)	85,815,664	85,653,867	85,916,721	85,873,025	85,773,763
Weighted-average shares outstanding (diluted)	86,737,292	86,399,931	85,916,721	85,873,025	85,773,763

(1) Operating income (loss) as a percentage of net sales fluctuates from quarter to quarter due to a number of factors, including net sales fluctuations, restructuring and impairment charges, product mix, the timing and expense of moving product lines to lower cost locations, and the relative mix of sales between distributors, original equipment manufacturers, and electronics manufacturing services providers.

Liquidity and Capital Resources

The Company's liquidity needs arise from working capital requirements, capital expenditures, and principal and interest payments on its indebtedness. The Company intends to satisfy its liquidity requirements primarily with funds provided by operations, the sale of short-term investments, and borrowings under its Loan Agreement.

Cash and cash equivalents increased $29.0 million, from $234.6 million at March 31, 2002 to $263.6 million at March 31, 2003. KEMET generated $43.7 million and $0.3 million from operating and financing activities, respectively, and used $15.0 million from investing activities.

CASH FROM OPERATING ACTIVITIES

Cash flows from operating activities for the year ended March 31, 2003, generated $43.7 million compared to using $34.2 million in the prior year. The increase in cash flow was

primarily a result of a $75.3 million reduction in inventory and net income tax refunds of $32.8 million partially offset by the net loss and working capital accounts such as accounts receivable, accounts payable, and accrued expenses.

CASH FROM INVESTING ACTIVITIES

Cash flows from investing activities for the year ended March 31, 2003, used $15.0 million compared to $85.6 million in the prior year. Capital expenditures accounted for most of the change as they decreased to $22.2 million in the year ended March 31, 2003, compared to $78.5 million for the prior year. Capital expenditures in the prior year principally reflect completion of projects initiated during and prior to fiscal 2001, a period in which demand was substantially higher. The capital expenditures in the current year represent the Company's commitment to improve product quality, expand into new products, and improve manufacturing efficiencies. The Company estimates its capital expenditures for fiscal 2004 to be approximately $30 million.

CASH FROM FINANCING ACTIVITIES

Cash flows from financing activities for the year ended March 31, 2003, generated $0.3 million compared to $6.3 million used in the prior year. The Company paid $3.7 million for a put option settlement in the fiscal year ended March 31, 2003, which almost entirely offset financing activities that generated cash. In the prior fiscal year, the Company purchased $10.8 million of its common stock, which resulted in a net use of cash by investing activities.

The Board of Directors authorized programs to purchase up to 8.0 million shares of its common stock on the open market. Through March 31, 2003, the Company made purchases of 2.1 million shares for $38.7 million. Approximately 469,000 shares were subsequently reissued for the exercise of employee stock options, and at March 31, 2003, the Company had the maximum potential obligation to purchase approximately 300,000 shares of its common stock at a weighted average purchase price of $9.50 ($8.75 net of put premiums received) for an aggregate of $2.8 million under the program. The put options are exercisable only at maturity and expire in July of 2003. The amount and timing of future purchases will depend on market conditions and other factors and will be funded from existing cash.

The Company is subject to restrictive covenants which, among others, restrict its ability to make loans or advances or to make investments, and require it to meet financial tests related principally to funded debt and net worth. At March 31, 2003, the Company was in compliance with such covenants. Borrowings are secured by guarantees of certain of the Company's wholly-owned subsidiaries.

On January 20, 2000, the Company sold 6,500,000 shares of its common stock in a public offering for $142.6 million in net cash proceeds after deducting underwriting fees and offering expenses. Included in the offering were 2,193,220 shares sold by a stockholder of the Company which were shares of non-voting common stock that were converted into common stock on a share-for-share basis. The net proceeds to the Company were used to repay outstanding debt under the Company's short-term credit facility and to fund capital expenditures.

In May 1998, the Company sold $100.0 million of its Senior Notes pursuant to the terms of a Note Purchase Agreement dated as of May 1, 1998, between the Company and the eleven purchasers of the Senior Notes named therein. These Senior Notes have a final maturity date of May 4, 2010, with required principal repayments beginning on May 4, 2006. The Senior Notes bear interest at a fixed rate of 6.66%, with interest payable semiannually beginning November 4, 1998. The terms of the Note Purchase Agreement include various restrictive covenants typical of transactions of this type, and require the Company to meet certain financial tests including a minimum net worth test and a maximum ratio of debt to total capitalization. The net proceeds from the sale of the Senior Notes were used to repay existing indebtedness and for general corporate purposes. The Company was in compliance with its covenants at March 31, 2003, and at the time of this filing.

The agreement whereby a subsidiary of the Company sells certain non-U.S. accounts receivable expired in April 2002 and was not replaced. Approximately $40.1 million in proceeds to the Company related to the sale of these non-U.S. accounts receivable at March 31, 2002.

In April 2002, the Company entered into the Loan Agreement with a bank. The Loan Agreement is an uncommitted credit facility which allows borrowings by the Company in an aggregate principal amount not to exceed $50.0 million for a term not to exceed 180 days for any single borrowing. The interest rate charged on any borrowing under the Loan Agreement is mutually agreed upon by the Bank and the Company at the time of such borrowing.

As discussed in Note 12 to the Consolidated Financial Statements, the Company or its subsidiaries are at any one time parties to a number of lawsuits arising out of their respective operations, including workers' compensation or work place safety cases and environmental issues, some of which involve claims of substantial damages. Although there can be no assurance, based upon information known to the Company, the Company does not believe that any liability which might result from an adverse determination of such lawsuits would have a material adverse effect on the Company.

The Company believes its strong financial position will permit the financing of its business needs and opportunities.

President and Chief Executive Officer Appointed

Dr. Jeffrey A. Graves was named President and Chief Executive Officer in March 2003 and was previously appointed President and Chief Operating Officer in October 2002. Dr. Graves joined KEMET in July 2001 as Vice President of Technology. Prior to joining KEMET, Dr. Graves held a number of key leadership positions with General Electric's ("GE") Corporate Research and Development Center and with their Power Systems Division. While at GE, Dr. Graves led global teams spanning the U.S., Eastern Europe, India, and Japan to deliver advanced power generation products and services to customers worldwide. Dr. Graves holds a Ph.D. in Metallurgical Engineering and was also among the first Master Black Belts certified in GE's Six Sigma program.

Long-term Supply Agreement

On December 10, 2002, the Company announced that it agreed to an extension of the term of its tantalum supply agreement with Cabot Corporation ("Cabot"). The extended agreement relates to both tantalum powder and tantalum wire products and calls for reduced prices, higher volumes, and a term through 2006. The Company received approximately $38.1 million of material in the year ended March 31, 2003. The additional commitment totals $83.3 million, an average of $22.2 million each fiscal year through 2006 and $16.7 million in fiscal 2007. If the Company's demand for tantalum exceeds the amount supplied under the contract, Cabot has the option to sell additional product to the Company at prices approximating market throughout the term. In connection with this extension, the Company and Cabot settled all claims in the litigation regarding the original supply agreement.

The Company records inventory at the lower of cost or market and estimated losses associated with inventory received under the extended supply agreement were approximately $16.4 million. In addition, the Company's estimated future losses for the commitment to purchase tantalum at above-market prices were approximately $24.4 million. Accordingly, a $40.8 million charge was recorded to cost of goods sold in the quarter ended December 31, 2002.

Manufacturing in China

The Company announced on January 2, 2003 that it plans to begin manufacturing operations in the People's Republic of China during calendar 2003. Approximately a quarter of KEMET's revenue is generated in Asia, and a long-term trend of many of the Company's European and North American customers is the migration of manufacturing operations to Asia, particularly China. In addition, KEMET is building strong relationships with emerging global leaders in electronics manufacturing companies based in Asia. The announcement is a continuation of the Company's easy-to-buy-from philosophy, which will help maintain and enhance KEMET'S leadership position in the capacitor industry.

Business Outlook

The Company believes that major cost-saving initiatives that occurred throughout fiscal years 2003 and 2002 positioned KEMET to maintain a strong financial position and further enhance earnings capability.

From a peak of 16,000 employees in the summer of 2000, the number of employees at May 31, 2003, was reduced to approximately 6,200. This was achieved through a variety of programs, such as attrition, leaves of absence, early retirement programs, and reductions-in-force. The Company also established other cost-reduction or cost-containment programs, resulting in the aforementioned restructuring and impairment charges, in response to the business downturn. The Company believes these actions will result in significant annualized cash savings.

The strategic plan that the KEMET team developed in early calendar 2003 has three foundations necessary to realize the Company's vision to be the market leader in the global capacitor industry:

- First, KEMET must continue to excel in the execution of its easy-to-buy-from technology, quality, delivery, and service processes to enhance the Company's position as the leader in the capacitor industry.
- Second, KEMET must accelerate the pace of innovations to broaden the product portfolio and increase the mix of innovative components that meet the needs of customers' leading-edge products.
- Finally, KEMET must intensify its global mindset, holding firm to core KEMET values worldwide, while having local KEMET employees meet local customer preferences, as evidenced by the current expansion in Asia.

For fiscal 2004, the Company anticipates maintaining its investments in key customer relationships through its direct sales and customer service professionals, as well as through research and development, to maintain its position at the leading edge of technology in the capacitor industry.

Capital expenditures for fiscal 2004 are anticipated to be approximately $30 million, compared to $22 million in fiscal 2003. The Company plans to continue to transfer production to low-cost manufacturing facilities in Mexico and to manufacturing operations in China that are expected to commence in fall 2003.

Commitments

As of March 31, 2003, the Company had contractual obligations in the form of non-cancelable operating leases (see Note 10 to the Consolidated Financial Statements), long-term contracts for the purchase of tantalum powder and wire (see Note 10 to the Consolidated Financial Statements), and debt (see Note 3 to the Consolidated Financial Statements) as follows (dollars in thousands):

	Fiscal years ended March 31						
Description	2004	2005	2006	2007	2008	Thereafter	Total
Operating leases	$ 2,729	$ 1,707	$ 914	$ 731	$ 552	$ —	$ 6,633
Tantalum	22,200	22,200	22,200	16,650	—	—	83,250
Debt	—	—	—	20,000	20,000	60,000	100,000
Total	$24,929	$23,907	$23,114	$37,381	$20,552	$60,000	$189,883

Adoption of Accounting Standards

In May 2003, the FASB issued Statement of Financial Accounting Standards No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equities" (SFAS No. 150). SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) three classes of freestanding financial instruments that embody obligations for the issuer. Generally, SFAS No. 150 is effective for financial instruments entered or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period beginning after June 15, 2003. The Company is currently assessing the impact of the adoption of SFAS No. 150.

In April 2003, the FASB issued Statement of Financial Accounting Standards No. 149, "Amendment of SFAS No. 133 on Derivative Instruments and Hedging Activities" (SFAS No. 149). SFAS No. 149 amends SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 149 amends SFAS No. 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, (2) in connection with other Board projects dealing with financial instruments, and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative, in particular, the meaning of *an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors,* the meaning of *underlying,* and the characteristics of a derivative that contains financing components. SFAS No. 149 is effective for all contracts entered into or modified after June 30, 2003 with certain exceptions. The Company is currently assessing the impact of the adoption of SFAS No. 149.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure—an amendment of FASB Statement No. 123" (SFAS No. 148). SFAS No. 148 amends FASB Statement No. 123, "Accounting for Stock-Based Compensation." SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 is effective for fiscal years beginning after December 15, 2002, and has been adopted by the Company effective April 1, 2003 with disclosure requirements effective March 31, 2003.

In November 2002, the FASB issued Interpretation No. 45 (FIN 45), "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN 45 requires a guarantor to include disclosure of certain obligations, and if applicable, at the inception of the guarantee, recognize a liability for the fair value of other certain obligations undertaken in issuing a guarantee. The recognition requirement is effective for guarantees issued or modified after December 31, 2002. The Company will follow FIN 45 guidance for guarantees issued or modified after December 31, 2002. The Company has no material guarantees falling within the scope of this interpretation.

In June 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" (SFAS No. 146). SFAS No. 146 addresses financial accounting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3 (Issue No. 94-3), "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability, as defined in FASB Concepts Statement No. 6, *Elements of Financial Statements,* is met. Under Issue No. 94-3, a liability for an exit cost was recognized at the date of a commitment to an exit plan. SFAS No. 146 is effective for exit or disposal activities that are initiated after December 31, 2002, and was adopted by the Company effective January 1, 2003.

In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 requires entities to test a long-lived asset, excluding goodwill and other intangible assets that are not amortized, for recoverability whenever events or changes in circumstances indicate that the entity may not be able to recover the carrying value of the asset. An impairment loss would be recognized for an asset that is assessed as being impaired. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001, and was adopted by the Company effective April 1, 2002.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" (SFAS No. 141), and Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet to be recognized and reported apart from goodwill. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment. Any unamortized negative goodwill must be written off at the date of adoption. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001, and has been adopted by the Company effective April 1, 2002. Footnote 2 summarizes the impact of SFAS Nos. 141 and 142 to the financial statements.

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143). SFAS No. 143 requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the Company is required to capitalize a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period,

and the capitalized cost is depreciated over the useful life of the related asset. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002, and has been adopted by the Company effective April 1, 2003. The Company believes the adoption of SFAS No. 143 will not significantly impact its financial results.

Safe Harbor Statement

From time to time, information provided by the Company, including but not limited to statements in this Report or other statements made by or on behalf of the Company, may contain "forward-looking" information within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. Such statements involve a number of risks and uncertainties. The Company's actual results could differ materially from those discussed in the forward-looking statements. The cautionary statements set forth in the Company's 2003 Annual Report under the heading Safe Harbor Statement identify important factors that could cause actual results to differ materially from those in any forward-looking statements made by or on behalf of the Company.

This Annual Report contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. The Company intends that these forward-looking statements be subject to the safe harbor created by that provision. These forward-looking statements involve risks and uncertainties beyond the Company's control. The inclusion of this forward-looking information should not be regarded as a representation by the Company that the future events, plans, or expectations contemplated by the Company will be achieved. Furthermore, past performance in operations and share price is not necessarily predictive of future performance. Finally, the Company cannot assume responsibility for certain information that is based upon market estimates.

The Company wishes to caution readers that the following important factors, among others, in some cases have affected, and in the future could affect, KEMET's actual results and could cause KEMET's actual consolidated results for the first quarter of fiscal year 2004 and beyond to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company whether contained herein, in other documents subsequently filed by the Company with the SEC, or in oral statements:

A moderating growth rate in end-use products which incorporate the Company's products and the effects of a downturn in the general economy or in general business conditions;

Underutilization of KEMET's plants and factories, or of any plant expansion or new plant, including, but not limited to, those in Mexico and China, resulting in production inefficiencies and higher costs; start-up expenses, inefficiencies, delays, and increased depreciation costs in connection with the start of production in new plants and expansions; capacity constraints that could limit the ability to continue to meet rising demand for surface-mount capacitors;

Occurrences affecting the slope or speed of decline of the pricing curve for the Company's products, or affecting KEMET's ability to reduce product and other costs, and to increase productivity; the effect of changes in the mix of products sold and the resulting effects on gross margins;

Difficulties in obtaining raw materials, supplies, power, natural resources, and any other items needed for the production of capacitors; the effects of quality deviations in raw materials, particularly tantalum powder and ceramic dielectric materials; the effects of significant price increases for tantalum, palladium, or silver or an inability to obtain adequate supplies of tantalum from the limited number of suppliers;

The amount and rate of growth in the Company's selling, general, and administrative expenses and the impact of unusual items resulting from KEMET's ongoing evaluation of its business strategies, asset valuations, and organizational structure;

The acquisition of fixed assets and other assets, including inventories and receivables; the making or incurring of any expenditures and expenses, including, but not limited to, depreciation and research and development expenses; any revaluation of assets or related expenses; and the amount of and any changes to tax rates;

The effect of any changes in trade, monetary, and fiscal policies, laws, and regulations; other activities of governments, agencies, and similar organizations; social and economic conditions, such as trade restrictions or prohibitions, inflation, and monetary fluctuations; import and other charges or taxes; the ability or inability of KEMET to obtain, or hedge against, foreign currency; foreign exchange rates and fluctuations in those rates, particularly a strengthening of the U.S. dollar; nationalization; unstable governments and legal systems; intergovernmental disputes; the costs and other effects of legal and administrative cases and proceedings (whether civil, such as environmental and product-related, or criminal); settlements, investigations, claims, and changes in those items; developments or assertions by or against the Company relating to intellectual property rights and intellectual property licenses; adoption of new or changes in accounting policies and practices and the application of such policies and practices; the effects of changes within KEMET's organization, particularly at the executive officer level, or in compensation and benefit plans; the amount, type, and cost of the financing which the Company has and any changes to that financing; the effects of severe weather on KEMET's operations, including disruptions at manufacturing facilities; the effects of a disruption in KEMET's computerized ordering systems; and the effects of a disruption in KEMET's communications systems.

Effect of Inflation

Inflation generally affects the Company by increasing the cost of labor, equipment, and raw materials. The Company does not believe that inflation has had any material effect on the Company's business over the past three years except for the following discussion in Commodity Price Risk.

Quantitative and Qualitative Disclosure About Market Risk

Interest Rate Risk

The Company's exposure to market risk for changes in interest rates relates primarily to the Company's long-term debt obligations and interest rate swaps. The Company also has an uncommitted debt financing alternative in the form of an Offering Basis Loan Agreement for $50 million which is priced on a mutually agreed upon rate by the bank and the Company at the time of such borrowing. The Company had not historically used interest rate swaps, interest rate caps, or other derivative financial instruments for the purpose of hedging fluctuations in interest rates, but entered into interest rate swap agreements during the year ended March 31, 2003. The Company uses interest rate swap agreements to effectively convert its fixed rate debt to a floating rate basis. The interest rate differential to be received or paid on the swaps is recognized over the lives of the swaps as an adjustment to interest expense. Any gain or loss on the termination of interest rate swap contracts prior to maturity is recorded as other income or expense. All interest rate swaps initiated during fiscal 2003 were terminated by March 31, 2003. During the year ended March 31, 2003, the Company recorded pre-tax gains of $6.3 million and interest expense reduction of $1.6 million related to interest rate swaps.

Foreign Currency Exchange Rate Risk

A portion of the Company's sales to its customers and operating costs in Europe are denominated in the Euro, thereby creating an exposure to foreign currency exchange rates. Also, a portion of the Company's costs are in its Mexican operations and are denominated in Mexican pesos, creating an exposure to exchange rates. In order to minimize its exposure, the Company will periodically enter into forward foreign exchange contracts in which the future cash flows in the Euro or Mexican peso are hedged against the U.S. dollar.

The impact of changes in the relationship of other currencies to the U.S. dollar has historically not been significant, and such changes in the future are not expected to have a material impact on the Company's results of operations or cash flows. The Company does not use derivative financial instruments for speculative purposes or if there is no underlying business transaction supporting or related to the derivative financial instrument.

Commodity Price Risk

The Company purchases various precious metals used in the manufacture of capacitors and is therefore exposed to certain commodity price risks. These precious metals consist primarily of palladium and tantalum.

Palladium is a precious metal used in the manufacture of multilayer ceramic capacitors and is mined primarily in Russia and South Africa. Currently, the Company uses forward contracts and spot buys to secure the acquisition of palladium and manage the price volatility in the market. The Company is also aggressively pursuing ways to reduce palladium usage in ceramic capacitors and minimize the price risk.

Tantalum powder is a metal used in the manufacture of tantalum capacitors. Management believes the tantalum needed has generally been available in sufficient quantities to meet manufacturing requirements. However, the increase in demand for tantalum capacitors during fiscal year 2001, along with the limited number of tantalum powder suppliers, led to increases in tantalum prices and impacted availability. Tight supplies of tantalum raw material and some tantalum powders caused the price to increase from under $50 per pound early in calendar 2000 to over $300 per pound in calendar 2001. During the year ended March 31, 2003, the Company recorded $40.8 million of charges related to a tantalum inventory purchase commitment that exceeded market prices. (See *Critical Accounting Policies* and *Long-term Supply Agreement.*)

Independent Auditors' Report

The Board of Directors
KEMET Corporation:

We have audited the accompanying consolidated balance sheets of KEMET Corporation and subsidiaries as of March 31, 2003 and 2002, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended March 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of KEMET Corporation and subsidiaries as of March 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, effective April 1, 2002, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets," and SFAS No. 144, "Accounting for the Impairment of Long-Lived Assets."

KPMG LLP

Greenville, South Carolina
April 25, 2003

KEMET CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

Dollars in thousands except per share data	March 31, 2003	March 31, 2002
Assets		
Current assets:		
Cash and cash equivalents	**$ 263,585**	$ 234,622
Accounts receivable (Notes 10 and 11)	**45,418**	22,101
Inventories:		
Raw materials and supplies	**91,333**	118,527
Work in process	**43,404**	68,318
Finished goods	**49,337**	72,547
Total inventories	**184,074**	259,392
Income taxes receivable	**24,640**	—
Prepaid expenses and other current assets (Note 15)	**6,120**	10,791
Deferred income taxes (Note 7)	**23,947**	40,255
Total current assets	**547,784**	567,161
Property and equipment, net (Notes 9 and 11)	**485,166**	539,785
Intangible assets, net (Note 2)	**41,560**	41,856
Other assets (Note 5)	**26,500**	22,912
Total assets	**$1,101,010**	$1,171,714
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable, trade (Notes 10)	**$ 49,171**	$ 73,057
Accrued expenses (Notes 11 and 15)	**35,078**	32,252
Income taxes payable	**—**	7,076
Total current liabilities	**84,249**	112,385
Long-term debt (Note 3)	**100,000**	100,000
Other non-current obligations (Note 4)	**57,617**	48,926
Deferred income taxes (Note 7)	**65,869**	55,358
Total liabilities	**307,735**	316,669
Stockholders' equity (Notes 8, 10, 14 and 16):		
Common stock, par value $.01, authorized 300,000,000 shares, issued 87,870,731 and 87,783,060 shares at March 31, 2003 and 2002, respectively)	**879**	878
Additional paid-in capital	**318,545**	321,734
Retained earnings	**506,915**	562,903
Accumulated other comprehensive income (loss)	**(2,996)**	3,808
Treasury stock, at cost (1,631,265 and 1,859,695 shares at March 31, 2003 and 2002, respectively)	**(30,068)**	(34,278)
Total stockholders' equity	**793,275**	855,045
Commitments and contingencies (Notes 10 and 12)		
Total liabilities and stockholders' equity	**$1,101,010**	$1,171,714

See accompanying notes to consolidated financial statements.

KEMET CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations

	Years ended March 31,		
Dollars in thousands except per share data	**2003**	2002	2001
Net sales (Note 9)	**$447,332**	$508,555	$1,406,147
Operating costs and expenses:			
Cost of goods sold	**388,778**	412,510	749,697
Selling, general, and administrative expenses	**54,390**	54,420	62,319
Research and development	**25,268**	26,334	27,145
Restructuring and impairment charges (Note 13)	**75,898**	55,656	—
Total operating costs and expenses	**544,334**	548,920	839,161
Operating income (loss)	**(97,002)**	(40,365)	566,986
Other (income) and expense:			
Interest income	**(3,818)**	(9,809)	(16,713)
Interest expense	**4,599**	6,736	7,507
Other expense (income) (Note 11)	**(9,889)**	3,438	7,892
Earnings (loss) before income taxes	**(87,894)**	(40,730)	568,300
Income tax expense (benefit) (Note 7)	**(31,906)**	(13,441)	215,954
Net earnings (loss)	**$ (55,988)**	$ (27,289)	$ 352,346
Net earnings (loss) per share (Note 14):			
Basic	**$ (0.65)**	$ (0.32)	$ 4.05
Diluted	**$ (0.65)**	$ (0.32)	$ 4.00
Weighted-average shares outstanding:			
Basic	**86,167,563**	85,773,763	86,930,965
Diluted	**86,167,563**	85,773,763	88,181,118

See accompanying notes to consolidated financial statements.

KEMET CORPORATION AND SUBSIDIARIES

Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)

Dollars in thousands except share amounts	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
Balance at March 31, 2000	87,025,908	$870	$308,724	$237,846	$ 16	$ —	$547,456
Comprehensive income (loss):							
Net earnings	—	—	—	352,346	—	—	352,346
Unrealized gain on foreign exchange contracts, net of $1,398 tax	—	—	—	—	2,594	—	2,594
Foreign currency translation loss	—	—	—	—	(255)	—	(255)
Total comprehensive income	—	—	—	—	—	—	354,685
Exercise of stock options (Note 8)	549,720	5	3,204	—	—	—	3,209
Tax benefit on exercise of stock options	—	—	4,325	—	—	—	4,325
Purchases of stock by Employee Savings Plan	43,889	1	1,094	—	—	—	1,095
Put options proceeds (Note 10)	—	—	4,721	—	—	—	4,721
Treasury stock purchases (Note 16)	(1,600,040)	—	—	—	—	(29,315)	(29,315)
Balance at March 31, 2001	86,019,477	876	322,068	590,192	2,355	(29,315)	886,176
Comprehensive income (loss):							
Net loss	—	—	—	(27,289)	—	—	(27,289)
Unrealized gain on foreign exchange contracts, net of $1,267 tax	—	—	—	—	2,143	—	2,143
Unrealized securities loss, net of $425 tax	—	—	—	—	(756)	—	(756)
Foreign currency translation gain	—	—	—	—	66	—	66
Total comprehensive loss	—	—	—	—	—	—	(25,836)
Exercise of stock options (Note 8)	299,315	1	(1,893)	—	—	4,430	2,538
Tax benefit on exercise of stock options	—	—	1,048	—	—	—	1,048
Purchases of stock by Employee Savings Plan	104,573	1	1,319	—	—	—	1,320
Put options proceeds (Note 10)	—	—	599	—	—	—	599
Treasury stock purchases (Note 16)	(500,000)	—	(1,407)	—	—	(9,393)	(10,800)
Balance at March 31, 2002	85,923,365	878	321,734	562,903	3,808	(34,278)	855,045
Comprehensive income (loss):							
Net loss	—	—	—	(55,988)	—	—	(55,988)
Unrealized loss on foreign exchange contracts, net of $3,547 tax	—	—	—	—	(6,451)	—	(6,451)
Unrealized securities loss, net of $283 tax	—	—	—	—	(620)	—	(620)
Foreign currency translation gain	—	—	—	—	267	—	267
Total comprehensive loss	—	—	—	—	—	—	(62,792)
Exercise of stock options (Note 8)	228,430	—	(1,486)	—	—	4,210	2,724
Tax benefit on exercise of stock options	—	—	728	—	—	—	728
Purchases of stock by Employee Savings Plan	87,671	1	1,070	—	—	—	1,071
Put options proceeds (Note 10)	—	—	225	—	—	—	225
Put option settlement	—	—	(3,726)	—	—	—	(3,726)
Balance at March 31, 2003	**86,239,466**	**$879**	**$ 318,545**	**$ 506,915**	**$ (2,996)**	**$ (30,068)**	**$ 793,275**

See accompanying notes to consolidated financial statements.

KEMET CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Dollars in thousands	Years ended March 31, 2003	2002	2001
Sources (uses) of cash and cash equivalents			
Operating activities:			
Net earnings (loss)	**$ (55,988)**	$ (27,289)	$ 352,346
Adjustments to reconcile net earnings (loss) to net cash from operating activities:			
Depreciation, amortization, and impairment charges	**75,391**	109,660	63,601
Other non-current obligations	**8,691**	(2,158)	(3,662)
Gain on termination of interest rate swaps	**(6,317)**	—	—
Loss on sale and disposal of equipment	**1,162**	1,043	5,266
Deferred income taxes	**30,648**	5,084	(8,023)
Changes in other non-current assets and liabilities	**(14,500)**	(5,987)	2,233
Changes in assets and liabilities:			
Accounts receivable	**(23,317)**	74,482	(2,456)
Inventories	**75,318**	(57,115)	(71,318)
Prepaid expenses and other current assets	**4,670**	39,702	(45,805)
Accounts payable, trade	**(23,886)**	(128,710)	78,059
Accrued expenses and income taxes	**(28,890)**	(43,979)	17,874
Tax benefit of stock options exercised	**728**	1,048	4,325
Net cash provided (used) by operating activities	**43,710**	(34,219)	392,440
Investing activities:			
Purchases of short-term investments	**(14,959)**	(57,819)	(202,354)
Proceeds from maturity of short-term investments	**14,959**	57,819	326,041
Additions to property and equipment	**(22,197)**	(78,546)	(210,559)
Investment in affiliates	**(113)**	(7,207)	—
Proceeds from termination of interest rate swaps	**6,317**	—	—
Other	**952**	179	(255)
Net cash used by investing activities	**(15,041)**	(85,574)	(87,127)
Financing activities:			
Proceeds from sale of common stock to Employee Savings Plan	**1,071**	1,320	1,095
Proceeds from exercise of stock options	**2,724**	2,538	3,209
Put option settlement	**(3,726)**	—	—
Proceeds from put options	**225**	599	4,721
Purchases of treasury stock	**—**	(10,800)	(29,315)
Net cash provided (used) by financing activities	**294**	(6,343)	(20,290)
Net increase (decrease) in cash and cash equivalents	**28,963**	(126,136)	285,023
Cash and cash equivalents at beginning of period	**234,622**	360,758	75,735
Cash and cash equivalents at end of period	**$263,585**	$ 234,622	$ 360,758
Supplemental Cash Flow Statement Information:			
Interest paid, including capitalized interest of $360, $232 and $116	**$ 6,660**	$ 7,671	$ 7,361
Income taxes (received) paid	**$ (32,785)**	$ 20,047	$ 209,186

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1: Organization and Significant Accounting Policies

Nature of Business and Organization

KEMET Corporation and subsidiaries ("KEMET" or the "Company") is the world's largest manufacturer of solid tantalum capacitors, the fifth largest manufacturer of multilayer ceramic capacitors, and a leader in the development of solid aluminum capacitors. The Company is headquartered in Simpsonville, South Carolina, and has twelve manufacturing plants located in South Carolina, North Carolina, and Mexico with two new plants under construction in China. Additionally, the Company has wholly-owned foreign subsidiaries which primarily sell KEMET's products in foreign markets.

Principles of Consolidation

The accompanying consolidated financial statements of the Company include the accounts of its wholly-owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Cash Equivalents

Cash equivalents consist of direct obligations of U.S. government agencies and investment-grade commercial paper with an initial term of less than three months. For purposes of the Consolidated Statements of Cash Flows, the Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

Derivative Financial Instruments

Derivative financial instruments are utilized by the Company to reduce exposures to volatility of foreign currencies and commodities impacting the cost of its products. The Company does not enter into financial instruments for trading or speculative purposes.

Effective October 1, 2000, the Company adopted Statement of Accounting Standards No. 133 ("SFAS No. 133"), "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138. SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts and hedging activities. It requires the recognition of all derivative instruments as either assets or liabilities in the consolidated balance sheet and measurement of those instruments at fair value. The accounting treatment of changes in fair value is dependent upon whether or not a derivative instrument is designated as a hedge and, if so, the type of hedge. For derivatives designated as cash flow hedges, to the extent effective, changes in fair value are recognized in Accumulated Other Comprehensive Income (Loss) until the hedged item is recognized in earnings. Ineffectiveness is recognized immediately in earnings. For derivatives designated as fair value hedges, changes in fair value are recognized in earnings.

Prior to adoption of SFAS No. 133, the Company recorded gains and losses related to the hedges of forecasted foreign currency transactions directly to earnings ("Other income and expense"), and gains and losses related to hedges of firm commitments were deferred and recognized in earnings as adjustments of carrying amounts when the transactions occurred.

The adoption of SFAS No. 133 did not result in a significant transition adjustment and is therefore not separately captioned in the Consolidated Statements of Operations as a cumulative effect of a change in an accounting principle. The transition adjustment as of October 1, 2000, was a gain of approximately $0.9 million net of tax, and is included in cost of goods sold for the period.

Inventories

Inventories are stated at the lower of cost or market. The cost of inventories is determined by the "first-in, first-out" (FIFO) method.

At March 31, 2002, approximately 6% of inventory costs of certain raw materials had been determined on the "last-in, first-out" (LIFO) basis. It is estimated that if all inventories had been costed using the FIFO method, they would have been approximately $0.8 million higher than reported at March 31, 2002. In the quarter ended June 30, 2002, the Company converted the cost of its remaining inventory determined by the LIFO basis to the FIFO method. The after-tax impact was approximately $544,000 and was not considered material to the consolidated financial statements. Therefore, prior period amounts have not been restated for this change in an accounting principle. LIFO was the basis for approximately 6% of inventory costs of certain raw materials at March 31, 2002. After the conversion, 100% of the Company's inventory costs are determined by the FIFO method.

When KEMET Electronics Corporation was formed as a separate entity in 1987, it continued the Union Carbide practice of expensing depreciation and amortization costs in the current period, rather than including such costs as a component of inventory and expensing them through cost of goods sold over time, as required by generally accepted accounting principles. Beginning with the June 2002 quarter, KEMET included depreciation and amortization as a component of its cost of inventory. The impact of this change on year ended March 31, 2003 amounted to additional after-tax income of approximately $658,000 or $0.008 per share. KEMET has also reviewed the financial statements contained in its previously filed 2002 Annual Report and Form 10-K and confirmed that this change would not have resulted in any material changes to those financial statements. In addition, the presentation of the Consolidated Statements of Operations has been reclassified to include depreciation and amortization expenses of $62.8 million, $63.9 million, and $56.0 million in cost of goods sold; depreciation of $8.1 million, $7.8 million, and $6.6 million in selling, general, and administrative expenses; and depreciation of $1.6 million, $1.2 million, and $1.0 million in research and development expenses in the fiscal years ended March 31, 2003, 2002, and 2001, respectively. This change makes KEMET's financial statement presentation more comparable to those of other capacitor manufacturers.

Property and Equipment

Property and equipment are carried at cost. Depreciation is calculated principally using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized using the straight-line method over the lesser of the estimated useful lives of the assets or the terms of the respective leases. Maintenance costs are expensed; expenditures for renewals and improvements are generally capitalized. Upon sale or retirement of property and equipment, the related cost and accumulated

depreciation are removed and any gain or loss is recognized. In October 2001, the FASB issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" (SFAS No. 144). SFAS No. 144 requires entities to test a long-lived asset, excluding goodwill and other intangible assets that are not amortized, for recoverability whenever events or changes in circumstances indicate that the entity may not be able to recover the carrying value of the asset. An impairment loss would be recognized for an asset that is assessed as being impaired. SFAS No. 144 was adopted by the Company effective April 1, 2002. Reviews are regularly performed to determine whether facts and circumstances exist which indicate that the carrying amount of assets may not be recoverable. The Company assesses the recoverability of its assets by comparing the projected undiscounted net cash flows associated with the related asset or group of assets over their remaining lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

Goodwill and Intangible Assets

The Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," on April 1, 2002. Under SFAS No. 142, goodwill, which represents the excess of purchase price over fair value of net assets acquired, and intangible assets with indefinite useful lives are no longer amortized but will be tested for impairment at least on an annual basis in accordance with the provisions of SFAS No. 142. See Note 2, "Goodwill and Intangible Assets" for a discussion of the adoption of SFAS No. 142 and the transitional and annual goodwill and other identifiable intangible assets impairment tests.

The Company's goodwill is tested for impairment at least on an annual basis. The impairment test involves a comparison of the fair value of each of the reporting units as defined under SFAS No. 142, with its carrying amount. For purposes of determining potential impairment of goodwill, the Company aggregated its reporting units as its segments are aggregated to a single reporting segment under SFAS No. 131. If the reporting unit's aggregated carrying amount exceeds its fair value, then an indication exists that the reporting unit's goodwill may be impaired. The impairment to be recognized is measured by the amount by which the carrying value of the reporting unit being measured exceeds its fair value, up to the total amount of its assets. The Company determined fair value based on a market approach which incorporates quoted market prices of the Company's common stock and the premiums offered to obtain controlling interest for companies in the electronics industry. On an ongoing basis, KEMET expects to perform its impairment tests during the first quarter of each year and when otherwise warranted.

The Company also tests impairment of other identifiable intangible assets including indefinite-lived trademarks, as well as patents and technology that have definite lives and will continue to be amortized. For purposes of determining the fair value of its trademarks, the Company uses a discounted cash flow model which considers the costs of royalties in the absence of trademarks owned by the Company.

Prior to April 1, 2002, goodwill was amortized on a straight-line basis over the expected period to be benefited and did not exceed 40 years. KEMET assessed the recoverability of this intangible asset by determining whether the amortization of the goodwill balance over its remaining life could be recovered through undiscounted future net cash flows of the acquired operation. The amount of goodwill impairment, if any, was measured based on projected discounted future operating cash flows using a discount rate reflecting the Company's average cost of funds.

Prior to April 1, 2002, patents and technology were amortized using the straight-line method over twenty-five years, and trademarks were amortized using the straight-line method over a forty-year period. The Company assessed the recoverability of its intangible assets by determining whether the amortization of the intangible asset's balance over its remaining life could be recovered through undiscounted future operating cash flows of the acquired assets. The amount of intangible impairment, if any, was measured based on projected discounted future operating cash flows. The assessment of the recoverability of intangibles would have been impacted if the estimated future operating cash flows were not achieved.

Other Assets

Other assets consist principally of the cash surrender value of life insurance policies, prepaid pension benefits, and marketable equitable securities designated as available-for-sale.

Deferred Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Stock-Based Compensation

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and its related interpretations in accounting for stock options. As such, compensation expense would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. The Company has elected the "disclosure only" provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," which provide pro forma disclosure of earnings as if stock compensation were recognized on the fair value basis.

Had compensation costs for the Company's two stock option plans been determined based on the fair value at the grant date for awards in fiscal years 2003, 2002, and 2001, consistent with the provisions of SFAS No. 123, the Company's net earnings and earnings per share would have been reduced to the pro

forma amounts indicated below (dollars in thousands except per share data):

		Years ended March 31		
		2003	2002	2001
Net earnings (loss)				
As reported		**$(55,988)**	$(27,289)	$352,346
Less stock-based compensation expense determined under fair value based methods, net of related tax effects		**(3,601)**	(4,896)	(3,718)
Pro forma		**$(59,589)**	$(32,185)	$348,628
Earnings per share:				
Basic	As reported	**$ (0.65)**	$ (0.32)	$ 4.05
	Pro forma	**$ (0.69)**	$ (0.38)	$ 4.01
Diluted	As reported	**$ (0.65)**	$ (0.32)	$ 4.00
	Pro forma	**$ (0.69)**	$ (0.38)	$ 3.95

The pro forma amounts indicated above recognize compensation expense on a straight-line basis over the vesting period of the grant. The pro forma effect on net income for fiscal year 2003 is not representative of the pro forma effects on net income in future years because it does not take into consideration pro forma compensation expense related to grants made prior to 1996.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: expected life of 5 years for 2003, 2002, and 2001; a risk-free interest rate of 2.8% for 2003, 4.9% for 2002, and 5.1% for 2001; expected volatility of 54.8% for 2003, 57.8% for 2002, and 58.0% for 2001; and a dividend yield of 0.0% for all three years.

Concentrations of Credit Risk

The Company sells to customers located throughout the United States and the world. Credit evaluations of its customers' financial conditions are performed periodically, and the Company generally does not require collateral from its customers.

Foreign Operations

Financial statements of the Company's Mexican operations are prepared using the U.S. dollar as its functional currency. Translation of the Mexican operations, as well as gains and losses from non-U.S. dollar foreign currency transactions, such as those resulting from the settlement of foreign receivables or payables, are reported in the Consolidated Statements of Operations.

Translation of other foreign operations to U.S. dollars occurs using the current exchange rate for balance sheet accounts and an average exchange rate for results of operations. Such translation gains or losses are recognized as a component of equity in Accumulated Other Comprehensive Income (Loss).

Comprehensive Income (Loss)

Comprehensive income (loss) consists of net earnings, foreign currency translation gains or losses, unrealized gains or losses from available-for-sale securities, and unrealized gains and losses from cash flow hedges and is presented in the Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss).

Accumulated Other Comprehensive Income contained in the stockholders' equity section of the Consolidated Balance Sheets consisted of the following (dollars in thousands):

	March 31,	
	2003	2002
Currency forward contract gains (losses), net	**$(1,714)**	$4,737
Currency translation gains (losses)	**95**	(173)
Unrealized securities loss, net	**(1,377)**	(756)
Total accumulated other comprehensive income (loss)	**$(2,996)**	$3,808

The currency forward contract gain (loss) was net of tax expense (benefit) of $(882,000) and $2,665,000 at March 31, 2003 and 2002, respectively. The unrealized securities loss was net of tax expense of $708,000 and $425,000 at March 31, 2003 and 2002, respectively.

Revenue Recognition

Revenue is recognized from sales when a product is shipped. A portion of sales is made to distributors under agreements allowing certain rights of return and price protection on unsold merchandise held by distributors (see Note 10). The Company adopted the Securities and Exchange Commission's Staff Accounting Bulletin No. 101 (the "SAB") effective January 1, 2001. The SAB requires that a company recognize revenue only when all of the following criteria are met: (1) Persuasive evidence of an arrangement exists; (2) Delivery has occurred or services have been rendered; (3) The seller's price to the buyer is fixed or determinable; and (4) Collectibility is reasonably assured. Upon adoption of the SAB, there was no impact on the Company's results of operations or financial condition.

Exit Costs

The Company adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" on January 1, 2003. SFAS No. 146 addresses financial accounting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3 (Issue No. 94-3), "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability, as defined in FASB Concepts Statement No. 6, *Elements of Financial Statements,* is incurred. Under Issue No. 94-3, a liability for an exit cost was recognized at the date of a commitment to an exit plan. SFAS No. 146 was effective for exit or disposal activities that were initiated after December 31, 2002.

Earnings per Share

The Company calculates earnings per share in accordance with SFAS No. 128, "Earnings per Share." Basic earnings per share is computed using the weighted-average number of shares outstanding. Diluted earnings per share is computed using the weighted-average number of shares outstanding adjusted for the incremental shares attributed to outstanding options to purchase common stock and for put options issued by the Company.

Environmental Cost

The Company recognizes liabilities for environmental remediation when it is probable that a liability has been incurred and can be reasonably estimated. The Company determines its liability on a site-by-site basis, and it is not discounted or reduced for possible recoveries from insurance carriers. Expenditures that extend the life of the related property or mitigate or prevent future environmental contamination are capitalized.

Business Segments

The Company has determined, using the criteria in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," that it operates in a single reporting segment. The Company's products may be categorized generally based upon primary raw material (tantalum, palladium, or aluminum) or method of attachment (surface-mount or leaded), and are sold to original equipment manufacturers, electronics manufacturing services providers, and electronics distributors. Two customers each accounted for more than 10% of net sales in the fiscal year ended March 31, 2003. No customer accounted for more than 10% of net sales in fiscal 2002. Two customers each accounted for more than 10% of net sales in the fiscal year ended March 31, 2001. Geographic information is included in Note 9.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. In addition, they affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions.

Reclassification

Certain prior-year amounts have been reclassified to conform to 2003 presentation.

Other

All dollar amounts are presented in thousands unless otherwise noted.

Note 2: Goodwill and Intangible Assets

In July 2001, the FASB issued Statement of Financial Accounting Standards No. 141, "Business Combinations" (SFAS No. 141), and SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS No. 142). SFAS No. 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. SFAS No. 141 also specifies criteria that intangible assets acquired in a purchase method business combination must meet in order to be recognized and reported apart from goodwill. SFAS No. 142 requires that goodwill and intangible assets with indefinite useful lives no longer be amortized, but instead be tested for impairment. In addition, any unamortized negative goodwill must be written off at the date of adoption. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001, and was adopted by the Company effective April 1, 2002.

In connection with the adoption of SFAS No. 142, the Company completed impairment tests of its goodwill and other identifiable intangible assets including indefinite-lived trademarks, as well as patents and technology that have definite lives and will continue to be amortized. No impairment of assets was noted.

For purposes of determining the fair value of its trademarks, the Company utilizes a discounted cash flow model which considers the costs of royalties in the absence of trademarks owned by the Company.

The Company's goodwill is tested for impairment at least on an annual basis. The impairment test involves a comparison of the fair value of each of the reporting units as defined under SFAS No. 142, with its carrying amount. For purposes of determining potential impairment of goodwill, the Company aggregated its reporting units as its segments are aggregated to a single reporting segment under SFAS No. 131. If the reporting unit's aggregated carrying amount exceeds its fair value, then an indication exists that the reporting unit's goodwill may be impaired. The impairment to be recognized is measured by the amount by which the carrying value of the reporting unit being measured exceeds its fair value, up to the total amount of its assets. The Company determined fair value based on a market approach which incorporates quoted market prices of the Company's common stock and the premiums offered to obtain controlling interest for companies in the electronics industry. On an ongoing basis, KEMET expects to perform its impairment tests during the first quarter of each year and when otherwise warranted. Negative goodwill of approximately $661,000 was written off upon adoption of the new standard and was included in "Other income" in the Consolidated Statements of Operations for the quarter ended June 30, 2002 because it was not material.

The carrying amounts, accumulated amortization, and amortization expense for each of the periods presented are noted below by intangible asset class (in thousands):

	March 31, 2003		March 31, 2002	
	Carrying Amount	**Accumulated Amortization**	Carrying Amount	Accumulated Amortization
Goodwill	**$41,630**	**$13,278**	$41,630	$13,278
Negative goodwill	**—**	**—**	(920)	(259)
Trademarks	**10,000**	**2,819**	10,000	2,819
Patents and technology	**12,000**	**6,411**	12,000	5,611
Other	**1,143**	**705**	1,143	548
	$64,773	**$23,213**	$63,853	$21,997

Amortization Expense	Year ended March 31, 2003	2002	2001
Goodwill	**$ —**	$ 987	$ 987
Negative goodwill	**—**	(23)	(23)
Trademarks	**—**	250	250
Patents and technology	**800**	800	800
Other	**157**	157	160
	$957	$2,171	$2,174

The expected amortization expense for the fiscal years ending March 31, 2004, 2005, 2006, 2007, and 2008 is $908, $604, $504, $473, and $442, respectively.

The reconciliation of net income (loss) and income (loss) per share, adjusted to exclude goodwill, trademark, and negative goodwill amortization expense, net of tax, for the years ended March 31, 2003, 2002, and 2001 is as follows (in thousands, except per share amounts):

	Year ended March 31 2003	2002	2001
Net income (loss):			
Reported net income (loss)	**$(55,988)**	$(27,289)	$352,346
Goodwill amortization, net of tax	**—**	443	410
Negative goodwill amortization, net of tax	**—**	(15)	(15)
Trademark amortization, net of tax	**—**	168	168
Adjusted net income (loss)	**$(55,988)**	$(26,693)	$352,909
Basic income (loss) per common share:			
Reported basic income (loss) per common share	**$ (0.65)**	$ (0.32)	$ 4.05
Goodwill amortization, net of tax	**—**	0.01	0.01
Negative goodwill amortization, net of tax	**—**	—	—
Trademark amortization, net of tax	**—**	—	—
Adjusted basic income (loss) per common share	**$ (0.65)**	$ (0.31)	$ 4.06
Diluted income (loss) per common share:			
Reported diluted income (loss) per common share	**$ (0.65)**	$ (0.32)	$ 4.00
Goodwill amortization, net of tax	**—**	0.01	0.01
Negative goodwill amortization, net of tax	**—**	—	—
Trademark amortization, net of tax	**—**	—	—
Adjusted diluted income (loss) per common share	**$ (0.65)**	$ (0.31)	$ 4.01

Note 3: Debt

In May 1998, the Company sold $100,000 of its Senior Notes pursuant to the terms of a Note Purchase Agreement dated May 1, 1998, between the Company and the eleven purchasers of the Senior Notes named therein. The Senior Notes have a final maturity date of May 4, 2010, and begin amortizing on May 4, 2006. The Senior Notes bear interest at a fixed rate of 6.66%, with interest payable semiannually beginning November 4, 1998. The aggregate maturities of the debt subsequent to March 31, 2003 follow: 2007, $20,000; 2008, $20,000; 2009, $20,000; 2010, $20,000; and 2011, $20,000.

In April 2002, the Company entered into an Offering Basis Loan Agreement (the "Loan Agreement") with a bank. The Loan Agreement is an uncommitted credit facility which allows borrowings by the Company in an aggregate principal amount not to exceed $50.0 million for a term not to exceed 180 days for any single borrowing. The interest rate charged on any borrowing under the Loan Agreement is mutually agreed upon by the Bank and the Company at the time of such borrowing.

The Company is subject to restrictive covenants under its loan agreements which, among others, restrict its ability to make loans or advances or to make investments and require it to meet financial tests related principally to funded debt and net worth. At March 31, 2003, the Company was in compliance with such covenants. Borrowings are secured by guarantees of certain of the Company's wholly-owned subsidiaries.

Note 4: Other Non-Current Obligations

Non-current obligations are summarized as follows (dollars in thousands):

	March 31, 2003	2002
Deferred compensation (Note 5)	**$ 1,370**	$10,336
Accrued post-retirement medical plan liability (Note 6)	**37,856**	36,448
Inventory supply agreement (Note 10)	**17,640**	—
Other	**751**	2,142
Other non-current obligations	**$57,617**	$48,926

Included as a part of other non-current obligations is the Company's accrual for environmental liabilities.

Note 5: Employee Pension and Savings Plans

The Company has a non-contributory pension plan ("Plan") which covers substantially all employees in the United States who meet age and service requirements. The Plan provides defined benefits that are based on years of credited service, average compensation (as defined), and the primary social security benefit. The effective date of the Plan is April 1, 1987. The Company announced that it would freeze benefits of the Plan effective July 1, 2003.

The cost of pension benefits under the Plan is determined by an independent actuarial firm using the "projected unit credit" actuarial cost method.

Components of net periodic pension cost include the following (dollars in thousands):

	Years ended March 31, 2003	2002	2001
Service cost	**$ 3,681**	$ 4,891	$ 4,246
Interest cost	**8,877**	9,201	8,462
Expected return on assets	**(7,448)**	(9,612)	(8,862)
Amortization of:			
Transition asset	**—**	(1)	(6)
Prior service cost	**(23)**	(76)	(84)
Actuarial loss	**1,054**	1,199	—
Curtailment	**1,668**	(121)	—
Special termination benefits	**3,638**	1,518	—
Total net periodic pension cost	**$11,447**	$ 6,999	$ 3,756

The special termination benefits and curtailment were the result of personnel reductions occurring within fiscal 2003 and 2002.

The weighted-average rates used in determining pension cost for the Plan are as follows (dollars in thousands):

	Years ended March 31,		
	2003	2002	2001
Discount rate	**6.50%**	7.00%	7.00%
Rate of compensation increase	**4.00%**	5.00%	5.00%
Expected return on plan assets	**7.00%**	9.00%	9.00%

A reconciliation of the Plan's projected benefit obligation, fair value of the Plan assets, and funding status is as follows (dollars in thousands):

	March 31,	
	2003	2002
Accumulated benefit obligation	**$118,735**	$ 94,242
Projected benefit obligation:		
Net obligation at beginning of year	**133,646**	128,658
Service cost	**3,681**	4,891
Interest cost	**8,877**	9,201
Actuarial gain	**990**	205
Gross benefits paid	**(7,829)**	(6,198)
Curtailment	**1,668**	(4,629)
Special termination benefits	**3,638**	1,518
Net benefit obligation at end of year	**$144,671**	$133,646
Fair value of Plan assets:		
Fair value of Plan assets at beginning of year	**$110,950**	$ 93,898
Actual return (loss) on Plan assets	**(7,432)**	2,050
Employer contributions	**23,846**	21,200
Gross benefits paid	**(7,829)**	(6,198)
Fair value of Plan assets at end of year	**$119,535**	$110,950
Funding status:		
Funded status at end of year	**(25,136)**	(22,696)
Unrecognized net actuarial loss	**48,083**	33,620
Unrecognized prior service cost	**181**	(195)
Net prepaid asset	**$ 23,128**	$ 10,729

The Company sponsors an unfunded Deferred Compensation Plan for key managers. This plan is non-qualified and provides certain key employees defined pension benefits which would equal those provided by the Company's non-contributory pension plan if the plan were not limited by the Employee Retirement Security Act of 1974 and the Internal Revenue Code. Expenses related to the deferred compensation plan totaled $529 in fiscal 2003, $1,710 in fiscal 2002, and $1,504 in fiscal 2001. Total benefits accrued under this plan were $1,370 at March 31, 2003, and $10,336 at March 31, 2002. The Company announced that it would freeze benefits of the deferred compensation plan effective July 1, 2003.

In addition, the Company has a defined contribution plan (the "Savings Plan") in which all U.S. employees who meet certain eligibility requirements may participate. A participant may direct the Company to contribute amounts, based on a percentage of the participant's compensation, to the Savings Plan through the execution of salary reduction agreements. In addition, the participants may elect to make after-tax contributions. The Company will make annual matching contributions to the Savings Plan of 30% to 50%. The Company contributed $1,685 in fiscal 2003, $1,914 in fiscal 2002, and $2,061 in fiscal 2001.

Note 6: Post-Retirement Medical and Life Insurance Plans

The Company provides health care and life insurance benefits for certain retired employees who reach retirement age while working for the Company. The components of the expense for post-retirement medical and life insurance benefits are as follows (dollars in thousands):

	Years ended March 31,		
	2003	2002	2001
Service cost	**$1,128**	$1,375	$1,268
Interest cost	**3,148**	2,688	2,985
Amortization of actuarial loss	**119**	—	111
Expected return on assets	**(172)**	(140)	—
Curtailment	**1,926**	251	—
Special termination benefits	**1,033**	306	—
Total net periodic benefits cost	**$7,182**	$4,480	$4,364

The special termination benefits and curtailment were the result of personnel reductions occurring within fiscal 2003 and 2002.

A reconciliation of the post-retirement medical and life insurance plans' projected benefit obligation, fair value of plan assets, and funding status is as follows (dollars in thousands):

	March 31,	
	2003	2002
Projected benefit obligation:		
Net obligation at beginning of year	**$ 40,423**	$ 43,210
Service cost	**1,128**	1,375
Interest cost	**3,148**	2,688
Actuarial (gain) loss	**6,413**	(4,813)
Curtailment	**1,926**	109
Special termination benefits	**1,033**	306
Gross benefits paid	**(4,021)**	(2,452)
Net benefit obligation at end of year	**$ 50,050**	$ 40,423
Fair value of plan assets:		
Fair value of plan assets at beginning of year	**$ 2,425**	$ —
Employer contributions	**5,774**	4,852
Actual return (loss) on plan assets	**(197)**	25
Gross benefits paid	**(4,021)**	(2,452)
Fair value of plan assets at end of year	**$ 3,981**	$ 2,425
Funding status:		
Funded status at end of year	**$(46,069)**	$(37,998)
Unrecognized net actuarial loss	**8,213**	1,550
Net accrued benefit liability	**$(37,856)**	$(36,448)

The weighted-average rates used in determining post-retirement medical and life insurance costs are as follows (dollars in thousands):

	Years ended March 31,		
	2003	2002	2001
Discount rate	**6.50%**	7.00%	7.00%
Rate of compensation increase	**4.00%**	5.00%	5.00%
Expected return on plan assets	**7.00%**	9.00%	9.00%
Health care cost trend on covered charges	**10.5% decreasing to ultimate trend of of 5.0% in 2013**	7.5% decreasing to ultimate trend of 6.0% in 2005	7.5% decreasing to ultimate trend of 6.0% in 2008
Sensitivity of retiree welfare results			
Effect of a one percentage point increase in assumed health care cost trend:			
—On total service and interest cost components	**$ 295**	$ 129	$ 143
—On post-retirement benefit obligation	**$ 2,627**	$ 737	$ 933
Effect of a one percentage point decrease in assumed health care cost trend:			
—On total service and interest cost components	**$ (257)**	$(118)	$(131)
—On post-retirement benefit obligation	**$(2,338)**	$(698)	$(885)

Note 7: Income Taxes

The components of earnings (loss) before income taxes consist of (dollars in thousands):

	Years ended March 31		
	2003	2002	2001
Domestic	**$(98,182)**	$(50,111)	$530,128
Foreign	**10,288**	9,381	38,172
	$(87,894)	$(40,730)	$568,300

The provision for income tax expense (benefit) is as follows (dollars in thousands):

	Years ended March 31		
	2003	2002	2001
Current			
Federal	**$(64,239)**	$(22,376)	$197,522
State and local	**(1,627)**	(469)	16,384
Foreign	**3,312**	4,321	10,071
	$(62,554)	(18,524)	223,977
Deferred			
Federal	**$ 29,035**	4,629	(7,859)
State and local	**1,865**	512	(499)
Foreign	**(252)**	(58)	335
	$ 30,648	5,083	(8,023)
Provision for income taxes	**$(31,906)**	$(13,441)	$215,954

A reconciliation of the statutory federal income tax rate to the effective income tax rate is as follows:

	Years ended March 31,		
	2003	2002	2001
Statutory federal income tax rate	**(35.0)%**	(35.0)%	35.0%
State income taxes, net of federal taxes	**0.2**	(0.3)	1.9
Foreign sales corporation	**(0.0)**	(2.1)	(1.8)
Goodwill amortization	**—**	0.9	0.1
Other	**(1.5)**	3.5	2.8
Effective income tax rate	**(36.3)%**	(33.0)%	38.0%

The components of deferred tax assets and liabilities are as follows (dollars in thousands):

	March 31,	
	2003	2002
Deferred tax assets:		
Tax effect of hedging	**$ 882**	$ —
Medical benefits	**14,383**	14,565
Sales and inventory allowances	**21,512**	41,638
Other	**3,031**	4,363
	39,808	60,566
Deferred tax liabilities:		
Depreciation and differences in basis	**(68,246)**	(67,003)
Amortization of intangibles	**(4,141)**	(4,515)
Tax effect of hedging	**—**	(2,665)
Pension benefits	**(7,790)**	—
Other	**(1,553)**	(1,486)
	(81,730)	(75,669)
Net deferred income tax liability	**$(41,922)**	$(15,103)

Deferred tax expense (benefit) of ($3,830), $842, and $1,398 was attributed to other comprehensive income (loss) for the years ended March 31, 2003, 2002, and 2001, respectively.

The net deferred income tax liability is reflected in the accompanying 2003 and 2002 balance sheets as a $23,947 and $40,255 current asset and a $65,869 and $55,358 non-current liability, respectively.

Based on the scheduled reversal of deferred tax liabilities and projected future taxable income, the Company believes that the deferred tax assets will ultimately be realized. Accordingly, no valuation allowance has been provided for in 2003 or 2002.

At March 31, 2003, unremitted earnings of the subsidiaries outside the United States were deemed to be permanently invested. No deferred tax liability was recognized with regard to such earnings. It is not practicable to estimate the income tax liability that might be incurred if such earnings were remitted to the United States.

Note 8: Stock Option Plans

The Company has two option plans that reserve shares of common stock for issuance to executives and key employees. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). On July 1, 2000, the Company adopted the provisions of FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation," which requires variable accounting treatment on certain re-priced options. This requires that any increase in the stock price above the July 1, 2000 adoption date stock price be recognized immediately as compensation expense. For fiscal years 2003, 2002, and 2001, no compensation cost has been recognized for the stock option plans.

Under the 1992 Executive Stock Option Plan approved by the Company in April 1992, 1,905,120 options were granted to certain executives. In May 1992, the Company also approved the 1992 Key Employee Stock Option Plan, which authorizes the granting of options to purchase 2,310,000 shares of common stock. The Key Employee Stock Option Plan was amended in October 2000 to provide for the issuance of options to purchase an additional 2,000,000 shares of common stock. In addition, stockholders approved the 1995 Executive Stock Option Plan at the 1996 Annual Meeting. This plan provides for the issuance of options to purchase 3,800,000 shares of common stock to certain executives.

These plans provide that shares granted come from the Company's authorized but unissued common stock or treasury stock. The prices of the options granted thus far pursuant to these plans are no less than 100% of the value of the shares on the date of grant. Also, the options may not be exercised within two years from the date of grant and no options will be exercisable after ten years from the date of grant.

A summary of the status of the Company's three stock option plans as of March 31, 2003, 2002, and 2001, and changes during the years ended on those dates is presented below:

	March 31,					
	2003		2002		2001	
Fixed Options	**Shares**	**Weighted-Average Exercisable Price**	Shares	Weighted-Average Exercisable Price	Shares	Weighted-Average Exercisable Price
Options outstanding at beginning of year	**3,358,455**	**$14.39**	2,841,020	$13.12	2,632,020	$10.09
Options granted	**839,500**	**9.11**	824,250	16.59	828,000	17.51
Options exercised	**(228,430)**	**11.92**	(299,315)	8.35	(549,720)	5.62
Options cancelled	**(116,000)**	**13.90**	(7,500)	16.50	(69,280)	11.10
Options outstanding at end of year	**3,853,525**	**$13.42**	3,358,455	$14.39	2,841,020	$13.12
Option price range at end of year	**$5.00 to $19.80**		$2.50 to $19.80		$2.50 to $19.38	
Option price range for exercised shares	**$2.50 to $14.50**		$2.50 to $18.19		$2.50 to $16.07	
Options available for grant at end of year	**1,100,120**		1,823,620		2,647,870	
Options exercisable at end of year	**2,290,525**		1,717,205		723,020	
Weighted-average fair value of options granted during the year	**$4.51**		$9.01		$9.61	

The following table summarizes information about stock options outstanding at March 31, 2003:

Options Outstanding				Options Exercisable	
Range of Exercisable Prices	Number Outstanding at 3/31/03	Weighted-Average Remaining Contractual Life	Weighted-Average Exercisable Price	Number Exercisable at 3/31/03	Weighted-Average Exercisable Price
$ 5.00 to $ 5.73	369,875	3.5 years	$ 5.44	369,875	$ 5.44
$ 6.00 to $ 6.75	78,600	2.4 years	$ 6.02	78,600	$ 6.02
$ 9.03	781,250	9.3 years	$ 9.03	—	—
$14.50	1,024,800	5.1 years	$14.50	1,024,800	$14.50
$16.31 to $17.50	1,558,000	6.8 years	$17.03	799,250	$17.50
$18.19 to $19.80	41,000	7.9 years	$19.10	18,000	$18.58
	3,853,525	6.5 years	$13.42	2,290,525	$13.82

Note 9: Geographic Information (dollars in thousands):

	Years ended March 31[1]		
	2003	2002	2001
United States	**$196,268**	$231,605	$ 642,406
China[2]	**44,125**	—	—
Asia Pacific[3]	**40,132**	94,133	273,853
Mexico	**39,045**	45,312	86,779
Singapore[2]	**34,540**	—	—
Germany	**29,254**	35,980	124,980
Other countries[4]	**63,968**	101,525	278,129
	$447,332	$508,555	$1,406,147

(1) Revenues are attributed to countries or regions based on the location of the customer. The Company sold $48,677 and $45,024 to two customers and each accounted for more than 10% of net sales in the fiscal year ended March 31, 2003. No customer accounted for more than 10% of net sales in the fiscal year ended March 31, 2002. The Company sold $231,801 and $148,158 to two customers and each accounted for more than 10% of net sales in the fiscal year ended March 31, 2001.

(2) Did not exceed 5% of sales in 2002 and 2001 and are included with "Other countries."

(3) 2003 excludes countries that exceeded 5% of consolidated sales. No country in this group exceeded 5% of consolidated net sales in 2002 and 2001.

(4) No country in this group exceeded 5% of consolidated net sales.

The following geographic information includes long-lived assets based on physical location (dollars in thousands):

	March 31,	
	2003	2002
United States	**$256,712**	$290,705
Mexico	**227,644**	248,222
Other	**810**	858
	$485,166	$539,785

Note 10: Commitments

(a) The Company has agreements with distributor customers which, under certain conditions, allow for returns of overstocked inventory and provide protection against price reductions initiated by the Company. Allowances for these commitments are included in the Consolidated Balance Sheets as reductions in trade accounts receivable (Note 11). The Company adjusts sales to distributors for anticipated returns and price protection changes based on historical experience. Charges against sales in fiscal 2003, fiscal 2002, and fiscal 2001 were $52,375, $33,509, and $72,575, respectively. Actual applications against the allowances in fiscal 2003, fiscal 2002, and fiscal 2001 were $60,865, $63,692, and $35,603, respectively.

(b) A subsidiary of the Company sold certain receivables discounted at .60% above LIBOR for the number of days the receivables are outstanding, with a recourse provision not to exceed 5% of the face amount of the factored receivables. The Company issued a joint and several guarantee in an aggregate amount up to but not to exceed $4,000 to guarantee the recourse provision. The facility expired in April 2002 and was not replaced. The Company transferred receivables and incurred factoring costs of $0 and $32 in fiscal 2003, $306,693 and $2,399 in fiscal 2002, and $529,946 and $5,236 in fiscal 2001, respectively.

Included in accounts payable, trade, is $0 and $19,974 at March 31, 2003 and 2002, respectively, which represents factored receivables collected but not remitted.

(c) The Company sold put options to institutional parties as part of a program to purchase up to 8.0 million shares of its common stock. Net premiums generated from the sale of outstanding put options were $0.2 million, $0.6 million and $4.7 million in fiscal 2003, 2002, and 2001, respectively, and were accounted for as Additional Paid-In Capital. During the year ended March 31, 2003, the Company paid approximately $3.7 million to settle put options. During the year ended March 31, 2002, the Company purchased 500,000 shares of treasury stock in connection with the exercise of put options. At March 31, 2003, the Company had the maximum potential obligation to purchase approximately 300,000 shares of its common stock at a weighted-average purchase price of $9.50 ($8.75 net of put premiums received) for an aggregate of $2.8 million. The put options are exercisable only at maturity and expire in July 2003. The fair value of the put options at March 31, 2003 was not material. The Company has the right to settle the put options through physical settlement or net share settlement using shares of the Company's common stock.

(d) On December 10, 2002, the Company announced that it agreed to an extension of the term of its tantalum supply agreement with Cabot Corporation ("Cabot"). The extended agreement relates to both tantalum powder and tantalum wire products and calls for reduced prices, higher volumes, and a term through 2006. The Company received approximately $38.1 million of material in the year ended March 31, 2003. The commitment to purchase tantalum totals $83.3 million or $22.2 million each fiscal year through 2006 and $16.7 million in fiscal 2007. If the Company's demand for tantalum exceeds the amount supplied under the contract, Cabot has the option to sell additional product to the Company at prices approximating market throughout the term. In connection with this extension, the Company and Cabot settled all claims in the litigation regarding the original supply agreement.

The Company records inventory at the lower of cost or market and estimated losses associated with inventory received under the extended supply agreement are approximately $16.4 million. In addition, the Company's estimated future losses for the commitment to purchase tantalum at above-market prices were approximately $24.4 million. Accordingly, a $40.8 million charge was recorded to restructuring and impairment charges in the year ended March 31, 2003.

(e) The Company's leases consist primarily of equipment and expire principally between 2004 and 2008. A number of leases require that the Company pay certain executory costs (taxes, insurance, and maintenance) and contain certain renewal and purchase options. Annual rental expenses for operating leases were included in results of operations and were approximately $2,796 in fiscal 2003, $6,011 in fiscal 2002, and $7,346 in fiscal 2001. Future minimum lease payments over the next five fiscal years under non-cancelable operating leases at March 31, 2003 are as follows (dollars in thousands):

	2004	2005	2006	2007	2008	Total
Minimum lease payments	$2,729	$1,707	$914	$731	$552	$6,633

Note 11: Supplementary Balance Sheet and Income Statement Detail (dollars in thousands):

	Useful Life	March 31, 2003	2002
Accounts Receivable			
Trade		**$ 56,270**	$ 42,360
Other		**3,614**	2,708
		59,884	45,068
Less:			
Allowance for doubtful accounts		**650**	661
Allowance for price protection and customer returns (Note 10)		**13,816**	22,306
Net accounts receivable		**$ 45,418**	$ 22,101
Property and Equipment, at Cost:	Useful Life		
Land and land improvements	20 years	**$ 12,790**	$ 12,834
Buildings	20–40 years	**114,915**	112,426
Machinery and equipment	10 years	**735,001**	746,928
Furniture and fixtures	4–10 years	**47,197**	44,424
Construction in progress	—	**16,935**	31,145
Total property and equipment		**926,838**	947,757
Accumulated depreciation		**(441,672)**	(407,972)
Net property and equipment		**$ 485,166**	$ 539,785
Accrued Expenses:			
Salaries, wages, and related employee costs		**$ 9,413**	$ 13,361
Vacation		**6,912**	8,848
Inventory supply agreement (Note 10)		**6,670**	—
Property taxes		**2,770**	3,444
Other		**9,313**	6,599
Total accrued expenses		**$ 35,078**	$ 32,252

	Years ended March 31, 2003	2002	2001
Other (Income) Expense:			
Gain on swap contract termination	**$(6,317)**	$ —	$ —
Loss on retirement of assets	**(448)**	931	3,380
Accounts receivable discounting	**32**	2,399	5,236
Unrealized foreign currency exchange gains	**(1,415)**	—	(941)
Other	**(1,741)**	108	217
	$(9,889)	$3,438	$7,892

Note 12: Legal Proceedings

Cabot Corporation

On April 10, 2002, the Company was sued by Cabot Corporation ("Cabot") in the Superior Court of the Commonwealth of Massachusetts (Suffolk Co. Civil Action No. 02-1585-BLS) with respect to its existing supply agreement with Cabot for tantalum powder, ore, and wire. This lawsuit was settled in December 2002.

Other

The Company has periodically incurred, and may continue to incur, liability under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, as amended ("CERCLA") and analogous state laws with respect to sites used for off-site management or disposal of Company-derived wastes. The Company has been named as a potentially responsible party ("PRP") at the Seaboard Chemical Site in Jamestown, North Carolina. The Company is participating in the clean-up as a "de minimis" party and does not expect its total exposure to be material. In addition, Union Carbide Corporation (Union Carbide), the former owner of the Company, is a PRP at certain sites relating to the off-site disposal of wastes from properties presently owned by the Company. The Company is participating in coordination with Union Carbide in certain PRP-initiated activities related to these sites. The Company expects that it will bear some portion of the liability with respect to these sites; however, any such share is not presently expected to be material to the Company's financial condition. In connection with the acquisition in 1990, Union Carbide agreed, subject to certain limitations, to indemnify the Company with respect to the foregoing sites.

The Company or its subsidiaries are at any one time parties to a number of lawsuits arising out of their respective operations, including workers' compensation or workplace safety cases, some of which involve claims of substantial damages. Although there can be no assurance, based upon information known to the

Company, the Company does not believe that any liability which might result from an adverse determination of such lawsuits would have a material adverse effect on the Company's financial condition or results of operations.

Note 13: Restructuring and Impairment Charges

Year Ended March 31, 2003

Restructuring and impairment charges were incurred during the quarters ended September 30, 2002, December 31, 2002,and March 31, 2003. The pre-tax charges totaled $75.9 million of which $40.8 million, $27.1 million, $4.6 million, and $3.4 million were charges for an inventory supply agreement, personnel reductions, asset impairment, and palladium transactions, respectively, in fiscal 2003. These charges were part of an ongoing effort by the Company to reduce costs after demand substantially decreased in fiscal 2002 and are included in the Consolidated Statements of Operations as Restructuring and Impairment Charges.

During the quarter ended September 30, 2002, these actions resulted in (1) charges of $9.1 million associated with personnel reductions of approximately 185 and 240 employees in the U.S. and Mexico, respectively, and (2) asset impairment charges of $4.6 million of certain long-lived assets associated with the closing of the facility in Greenwood, South Carolina. At March 31, 2003, approximately $0.8 million, related to the reduction in the labor force during the period ended September 30, 2002, was included in accrued expenses and is expected to be paid within one year.

During the quarter ended December 31, 2002, the Company incurred $42.6 million in charges related to inventory. The Company records inventory at the lower of cost or market and estimated losses associated with an extended supply agreement to be $40.8 million. In addition, the Company sold excess palladium at a loss of $1.8 million.

During the quarter ended March 31, 2003, the Company (1) announced a cost-saving initiative that resulted in charges of $18.0 million associated with personnel reductions of approximately 255 and 183 in the U.S. and Mexico, respectively, and (2) the Company terminated palladium forward contracts at a loss of $1.6 million. All charges related to these personnel reductions were paid during the quarter ended March 31, 2003, and the Company expected that there would be no additional charges or payments.

Year Ended March 31, 2002

Restructuring and impairment charges were incurred during the quarters ended December 31, 2001 and March 31, 2002. The pre-tax charges totaled $55.7 million in fiscal 2002. Demand for the Company's products decreased substantially during the first nine months of fiscal 2002, requiring a reevaluation of the Company's cost structure resulting in (1) charges of $9.9 million associated with personnel reductions of approximately 600 and 1,000 employees in the U.S. and Mexico, respectively, (2) charges of $6.3 million in connection with loss on sale of excess precious metals inventory, primarily palladium, and (3) asset impairment charges of $15.1 million including $11.4 million of machinery and equipment and a $3.7 million loss associated with the termination of the Company's Australian joint venture, all of which were recorded in the quarter ended December 31, 2001.

The Company announced enhancements to its high-frequency products organization that resulted in the following charges in the quarter ended March 31, 2002: (1) charges of $2.9 million associated with personnel reductions of approximately 350 employees in the U.S. and Mexico, and (2) asset impairment charges of $21.5 million, primarily machinery and equipment.

A reconciliation of the beginning and ending liability balances for restructuring and impairment charges included in accrued expenses and other non-current obligations of the Consolidated Balance Sheets were as follows (dollars in thousands):

	Personnel Reductions		Inventory Supply Agreement	
	Years ended March 31,		Years ended March 31,	
	2003	2002	**2003**	2002
Beginning of year	**$ 2,500**	$ —	**$ —**	$ —
Costs charged to expense	**27,100**	12,800	**40,800**	—
Costs paid or settled	**(28,800)**	(10,300)	**(16,490)**	—
End of year	**$ 800**	$ 2,500	**$ 24,310**	$ —

Note 14: Earnings (Loss) Per Share

Basic and diluted earnings (loss) per share are calculated as follows (dollars in thousands except per share data):

	Years ended March 31,		
	2003	2002	2001
Net earnings (loss)	**$(55,988)**	$(27,289)	$352,346
Weighted-average shares outstanding (basic)	**86,167,563**	85,773,763	86,930,965
Stock Options	**—**	—	1,250,153
Weighted-average shares outstanding (diluted)	**86,167,563**	85,773,763	88,181,118
Basic earnings (loss) per share	**$ (0.65)**	$ (0.32)	$ 4.05
Diluted earnings (loss) per share	**$ (0.65)**	$ (0.32)	$ 4.00

The years ended March 31, 2003 and 2002 excluded potentially dilutive securities of 3,442,000 and 3,031,000, respectively, in the computation of diluted earnings per share because the effect would have been anti-dilutive.

Note 15: Derivatives, Hedging, and Other Financial Instruments

The Company uses certain derivative instruments (e.g., forward currency contracts) to reduce exposures to volatility of foreign currencies and commodities impacting revenues and the cost of its products. Unrealized gains and losses associated with the change in value of these financial instruments are recorded in Accumulated Other Comprehensive Income (Loss). The after-tax impact on

AOCI related to the change in value of these financial instruments is as follows (in millions):

	2003	2002
Balance ended March 31,	**$ 4.7**	$ 2.6
Current year unrealized gains (losses) related to the change in value of the financial instruments	**(6.0)**	13.2
Less prior year unrealized gains in AOCI that were recognized in the current year and reclassified to earnings	**0.4**	11.1
Net change in AOCI related to financial instruments	**(6.4)**	2.1
Balance ended March 31,	**$(1.7)**	$ 4.7

The $1.7 million loss remaining in AOCI at March 31, 2003 (see Note 1: Comprehensive Income (Loss) table) is expected to be reclassified to earnings during the next twelve months as the hedged items affect earnings.

Hedging Foreign Currencies

Certain operating expenses at the Company's Mexican facilities are paid in Mexican pesos. In order to hedge these forecasted cash flows, management purchases forward contracts to buy Mexican pesos for periods and amounts consistent with the related underlying cash flow exposures. These contracts are designated as hedges at inception and monitored for effectiveness on a routine basis. At March 31, 2003 and 2002, the Company had outstanding forward exchange contracts that mature within approximately one year to purchase Mexican pesos with notional amounts of $62.1 million and $93.0 million, respectively. The fair values of these contracts at March 31, 2003 and 2002, totaled $2.6 million and $7.4 million, respectively, and were recorded as a derivative liability and asset, respectively, on the Company's balance sheet as accrued expenses and other current assets, respectively. Changes in the derivatives' fair values are deferred and recorded as a component of AOCI, until the underlying transaction is recorded in earnings. When the hedged item affects earnings, gains or losses are reclassified from AOCI to the consolidated statement of operations as cost of goods sold. Any ineffectiveness in the Company's hedging relationships is recognized immediately in earnings.

Prior to adoption of SFAS No. 133 (as amended by SFAS No. 138), the Company recorded gains from foreign currency contracts of $0.9 million in 2001, as a component of other income and expense in its statement of operations. Subsequent to adoption of the new standard, the Company recorded $0.6 million, $16.5 million, and $2.8 million of gains from foreign currency contracts as a component of cost of goods sold in 2003, 2002, and 2001, respectively.

The Company formally documents all relationships between hedging instruments and hedged items, as well as risk management objectives and strategies for undertaking various hedge transactions.

Hedging Commodity Prices

The Company occasionally enters into contracts for the purchase of its raw materials, primarily palladium, which are considered to be derivatives or embedded derivatives with underlyings not clearly and closely related to the host contract. As such, the fair values of these embedded derivatives are recorded on the balance sheet as derivative assets or liabilities and the change in fair values is recorded as a component of cost of goods sold. At March 31, 2003 and 2002, the Company had no derivative assets from these embedded derivatives. The change in fair values of such derivatives since adoption of the new standard in fiscal 2001 was $0 in 2003, a loss of $3.7 million and a gain of $2.1 million in 2002 and 2001, respectively.

All other contracts to purchase raw materials qualify for the normal purchases exclusion and are not accounted for as derivatives.

Interest Rate Swaps

In the quarter ended March 31, 2003, the Company terminated two interest rate swap contracts it initiated in November 2002. The contracts effectively converted its $100 million aggregate principal amount of 6.66% senior notes to floating-rate debt. These derivative instruments reduced interest expense by approximately $0.3 million for the year ended March 31, 2003, and resulted in other income of $0.7 million for the year ended March 31, 2003.

In the quarter ended December 31, 2002, the Company terminated two interest rate swap contracts it initiated in April 2002. The contracts effectively converted its $100 million aggregate principal amount of 6.66% senior notes to floating-rate debt. These derivative instruments reduced interest expense by approximately $1.3 million for the year ended March 31, 2003, and resulted in other income of $5.6 million for the year ended March 31, 2003.

The Company entered into two interest rate swap contracts in April 2003 that effectively converted its $100 million aggregate principal amount of 6.66% senior notes to floating-rate debt, both of which were terminated for a gain in May 2003.

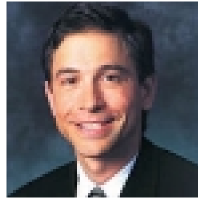
Other Financial Instruments

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable approximate their fair values. The fair value of the Company's debt outstanding at March 31, 2003 and 2002, was $100.5 million and $96.5 million, respectively, which was determined based on indications from a lending institution.

Note 16: Common Stock

The Board of Directors has authorized programs to purchase up to 8.0 million shares of its common stock in the open market. Through March 31, 2003, the Company made purchases of 2.1 million shares for $38.7 million. Approximately 469,000 shares were subsequently reissued in connection with employee stock option exercises. At March 31, 2003 and 2002, the Company held 1,631,265 and 1,859,695 treasury shares at a cost of $30.1 and $34.3 million, respectively. The amount and timing of future purchases will depend on market conditions and other factors. The program will be funded from existing cash and a combination of direct purchases and/or put options may be used to execute the program.

On May 15, 2000, the Company's Board of Directors declared a two-for-one stock split. The record date for the split was May 24, 2000, with distribution of the additional shares on June 1, 2000.



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