Management's Discussion and Analysis

Anritsu provides solutions in the fields of electronics, information and telecommunications and measurement to the mobile and Internet, industrial electronics, security and environment-related markets to contribute to the development of the ubiquitous network society.

Changes in the Scope of Consolidation

During the fiscal year ended March 31, 2005, Anritsu added two companies to the scope of consolidation, resulting in 30 consolidated subsidiaries. The two companies added were Anritsu Industrial Solutions USA Inc. in the United States and Anritsu Industrial Solutions Europe Ltd. in the United Kingdom. Anritsu established these two overseas subsidiaries with the aim of expanding sales in overseas industrial equipment markets.

Sales and Income

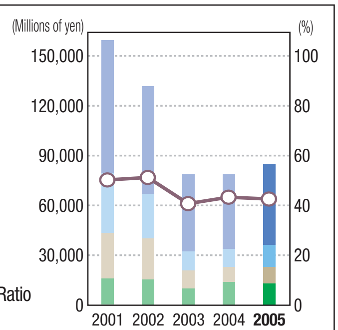
For the fiscal year ended March 31, 2005, consolidated net sales increased 7.2 percent year-on-year to ¥84,040 million. Operating income increased 168.9 percent, or ¥3,054 million, to ¥4,862 million. Income before income taxes increased 11.0 percent year-on-year, or ¥206 million, to ¥2,078 million. As a result, net income increased 16.3 percent year-on-year, or ¥179 million, to ¥1,280 million. Of note, Anritsu generated net income in the year ended March 31, 2004 by recording extraordinary gains through the sale of real estate assets including the former head office building. In contrast, for the year ended March 2005 Anritsu generated higher net income because of income growth in its primary businesses.

Net Sales

For the fiscal year ended March 31, 2005, consolidated net sales increased 7.2 percent, or ¥5,644 million, year-on-year to ¥84,040 million. A primary factor supporting the increase was a 15.9 percent year-on-year increase in sales in the Anritsu Group's core Test and Measurement segment.

By market, domestic sales increased 8.6 percent year-on-year to ¥48,644 million as a result of the increase in sales in the Test and Measurement segment. Overseas sales increased 5.3 percent to ¥35,396 million. In China, tighter government fiscal policy and delays in the issue of licenses in the third-generation (3G) mobile phone business caused telecommunications companies to restrain capital investment. These and other factors caused sales in Asian markets to decrease 6.6 percent year-on-year, but growth in sales of 15.6 percent in the Americas and 11.4 percent in Europe resulted in overall growth in overseas sales. Overseas sales decreased to 42.1 percent of net sales from 42.9 percent for the previous fiscal year.

Net Sales by Market and Overseas Sales Ratio



Japan
Americas
Europe
Asia and Others (Left scale)
Overseas Sales Ratio (Right scale)

Cost of Sales and Gross Profit

Although net sales increased, cost of sales decreased 1.1 percent, or ¥583 million, compared to the previous fiscal year to ¥53,666 million. Cost of sales was 63.9 percent of net sales, compared to 69.2 percent for the previous fiscal year. Factors in the decrease included successful efforts to further reduce cost of sales through supply chain management (SCM) and manufacturing innovations. Gross profit increased 25.8 percent compared to the previous fiscal year to ¥30,374 million. The ratio of gross profit to net sales improved 5.3 percentage points to 36.1 percent.

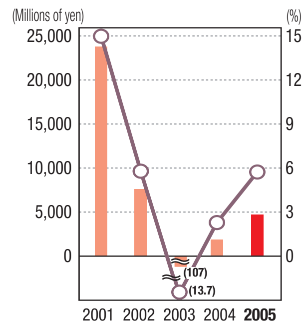
Selling, General and Administrative (SG&A) Expenses and Operating Income

SG&A expenses increased 14.2 percent compared to the previous fiscal year to ¥25,512 million as a result of the increase in net sales. Research and development expenses, which are included in general and administrative expenses and production expenses, increased 6.4 percent to ¥10,515 million, and decreased to 12.5 percent of net sales compared to 12.6 percent for the previous fiscal year. As a result, operating income increased a substantial 168.9 percent, or ¥3,054 million, year-on-year to ¥4,862 million. Operating income represented 5.8 percent of net sales, compared to 2.3 percent for the previous fiscal year.

Overview of SG&A Expenses (Millions of yen)

	2005	2004	Change (%)
Salaries and bonuses	**¥9,683**	¥8,733	10.9%
Advertising	**1,391**	1,333	4.3
Pensions	**921**	1,011	(9.0)
Travel and transportation	**1,532**	1,170	30.9
Depreciation	**516**	625	(17.4)
Research and development	**3,939**	3,859	2.0

Operating Income and Operating Income Margin



Operating Income (Loss) (Left scale)
Operating Income Margin (Right scale)

Other Income (Expenses), Income before Income Taxes, and Net Income

Other expenses, net totaled ¥2,784 million, compared to other income, net of ¥64 million for the previous fiscal year. A primary factor in the year-on-year change was the absence of the one-time gains on the sale of the head office building and the Toda plant totaling ¥4,857 million in the previous fiscal year. The gain from transfer of retirement benefits totaling ¥2,573 million in the previous fiscal year was also a one-time gain that did not recur in the year ended March 31, 2005. Offsetting the absence of these one-time gains, losses on disposal and devaluation of inventories decreased to ¥1,479 million from ¥5,509 million in the previous fiscal year because of successful efforts to reduce inventory. In addition, foreign exchange loss decreased to ¥88 million.

As a result of the above, income before income taxes increased 11.0 percent, or ¥206 million, year-on-year to ¥2,078 million. Net income increased 16.3 percent, or ¥179 million, year-on-year to ¥1,280 million. Basic net income per share increased to ¥9.31 from ¥8.38 for the previous fiscal year.

Costs, Expenses and Income as Percentages of Net Sales

	2005	2004	2003
Net sales	**100.0%**	100.0%	100.0%
Cost of sales	**63.9**	69.2	73.9
Gross profit	**36.1**	30.8	26.1
SG&A expenses	**30.3**	28.5	39.8
R&D expenses	**12.5**	12.6	16.8
Net income (loss)	**1.5**	1.4	(41.7)

Shareholder Return Policies

Dividend Policy

Distributing returns to shareholders is one of Anritsu's management priorities. Based on consolidated net income, Anritsu distributes profits taking into account various factors, including the operating environment, the outlook for the coming fiscal year and the ratio of dividends to consolidated shareholders' equity.

Cash Dividends per Share

Based on the above policy, Anritsu increased cash dividends by ¥2.50 compared to the previous fiscal year to ¥7.00 per share for the fiscal year ended March 31, 2005.

The Anritsu Group will use internal capital resources to make capital investments and conduct research and development to respond to rapid advances in technology and changes in market structure.

Share Repurchases

The General Meeting of Shareholders held on June 25, 2004 voted to change Anritsu's Articles of Incorporation to allow the Board of Directors to conduct share repurchases as per the Commercial Code Article 211-3-1, item 2.

Industry Segments

The Anritsu Group classifies operations into the segments of Information and Communications, Test and Measurement, Industrial Automation, and Services and Others. The Anritsu Group reported separate segment results for Components and Devices until March 31, 2004, but now reports these results as part of Services and Others. This change allows more accurate presentation of the status of the Anritsu Group's businesses, as the Components and Devices segment has been reorganized to supply optical devices and fundamental technologies for Anritsu Group products, and provide Groupwide basic research. Segment data for previous fiscal years has been restated to reflect the change in segment reporting and permit year-on-year comparison.

Information and Communications

The Information and Communications segment accounts for 10.4 percent of total net sales. Government entities make up a large proportion of sales in this business, which is therefore materially influenced by government and municipal budgets. Approximately 60 percent of sales in this business are concentrated in the fourth quarter, reflecting budget execution among government entities.

Consolidated net sales in this segment for the fiscal year ended March 31, 2005 decreased 29.6 percent year-on-year to ¥8,726 million. A significant proportion of government budgets were allocated to reconstruction efforts following natural disasters during the fiscal year, which reduced sales to government entities centered on video distribution systems. Operating loss expanded to ¥1,010 million from ¥215 million for the previous fiscal year.

In the future, the Anritsu Group will work to improve its earnings structure by reducing its conventional reliance on government demand in ways such as expanding in private-sector markets. Concurrently, the Anritsu Group will also aggressively shift its product mix toward video distribution solutions and other products.

Test and Measurement

Consolidated net sales in this segment for the fiscal year ended March 31, 2005 increased 15.9 percent year-on-year to ¥55,245 million. Sales of mobile phone measuring instruments increased, and income from IP network communication measuring instruments improved. In addition, the Anritsu Group worked to increase customer support overseas. Operating income increased a substantial 322.2 percent year-on-year to ¥4,236 million.

Sales in the Test and Measurement segment account for 65.7 percent of total net sales. The Test and Measurement business is structured to provide versatile measuring instruments that are broadly used throughout the field of electronics. Applications in the IP network communications field include design, manufacturing, testing, repair and maintenance for wireline network service providers and telecommunications equipment manufacturers. Applications in the mobile communications field include design, manufacturing, testing, repair and maintenance for communications companies that offer mobile phone services and manufacturers of mobile phones, components related to mobile phones such as integrated circuit (IC) chipsets, and base stations. General purpose applications include design, manufacturing and evaluation of electronic devices used in equipment related to telecommunications networks and other electronic equipment.

Measuring instruments for mobile communications is among the Anritsu Group's most important businesses. The Anritsu Group has developed highly competitive products for use in providing 3G service. However, demand in this area is influenced by technological innovation in mobile phone services including communication protocols, as well as the speed of adoption and number of subscribers. Recent trends include the ongoing convergence of wireless and wireline communication networks with the advent of the ubiquitous network society, the increasing sophistication of technology, services and handsets, and expanding need for integration. Advanced measuring instruments applications are increasing as a result.

During the fiscal year ended March 31, 2005, NTT Docomo began full-scale provision of the 3G service that it initiated in October 2001. Investment in development and mass-production among Japanese handset manufacturers was therefore very strong. In addition, demand rose for measuring instruments for the 3.5 generation (3.5G) HSDPA service scheduled to become available in the United States in 2005 and in Japan in 2006. The need for measuring instruments for application software to raise productivity also increased among customers developing handsets. However, while service providers in European countries introduced 3G service in concert, growth in subscribers remained lackluster. In addition, China is the world's largest mobile phone subscriber market and the largest producer of mobile terminals, but the matter of when 3G licenses would be issued remained unresolved. This was among factors that delayed the full-scale sale of measuring instruments for 3G mobile communications. Despite these changes in regions around the world, overall sales of measuring instruments for mobile communications expanded significantly.

Sales of general purpose measuring instruments were impacted by weakness in the digital consumer appliance market and lower demand related to electronic components. However, demand was firm for handheld compact measuring instruments for base station construction and maintenance. Sales of measuring instruments for IP networks were about the same as in the previous fiscal year. Anritsu expects this field to expand due to the shift from long-distance telecommunications lines to medium-distance telecommunications lines and subscriber-based communication networks.

Looking forward, the Anritsu Group will continue to build its core Test and Measurement business by making the investments required to offer solutions that provide outstanding customer value in overseas markets and improve customer support. The Anritsu Group's goal is to establish global market leadership.

Industrial Automation

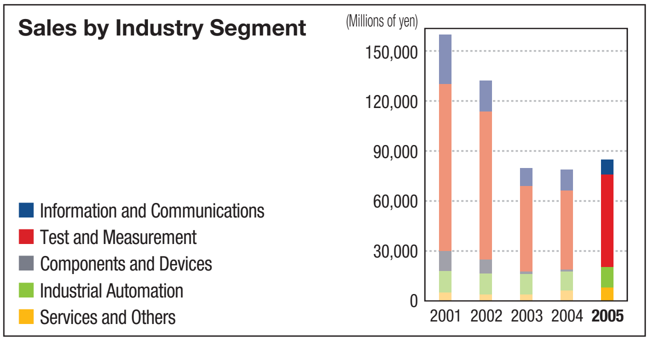
Sales in the Industrial Automation segment for the fiscal year ended March 31, 2005 increased 6.9 percent year-on-year to ¥12,234 million. Operating income increased 13.6 percent to ¥1,002 million. The Industrial Automation segment accounts for 14.6 percent of total net sales. Sales to food manufacturers account for 80 percent of total sales, and the level of economic growth and consumer spending influences food manufacturers and Anritsu results.

Demand related to food safety has increased in recent years, which has resulted in firm growth for Anritsu's highly competitive metal detectors and X-ray inspection systems used in food processing. The Anritsu Group has therefore targeted steady annual growth in this business of approximately 7 percent for net sales and 8 percent for operating income. This business generates approximately 20 percent of its sales overseas. The Anritsu Group aims to expand sales in markets outside Japan and is preparing the systems needed to further develop overseas business. The Anritsu Group is also investing to expand market share in regions worldwide by establishing sales bases that are separate from those of the Test and Measurement business. During the fiscal year ended March 31, 2005, the Anritsu Group added subsidiaries in the United States and the United Kingdom to the subsidiary established in China during the previous fiscal year, and also established a representative office in Thailand.

Services and Others

This segment includes the components and devices business, the precision measurement business, environment-related operations, logistics, welfare services, real estate leasing and other businesses. The Anritsu Group changed its segment classifications at the start of the fiscal year ended March 31, 2005 and moved the components and devices business to the Services and Others segment.

Growth in various areas, including precision measurement for quality testing of electronic packaging and liquid crystal production processes and methane gas detectors resulted in segment sales of ¥7,835 million, which was a 13.8 percent increase compared to the total of sales in the Components and Devices and Services and Others segments in the previous fiscal year. On the same basis, operating income increased 108.1 percent compared with the previous fiscal year to ¥2,023 million due to improved profitability in the device business.



Note: From the year ended March 31, 2005, "Components and Devices" is included as part of "Services and Others."

Geographical Segments

Japan

In Japan, 3G service continued to spread. In the first half of the fiscal year, demand increased substantially for measuring instruments for mass production of 3G handsets and for simple measuring instruments for service use at sales outlets. Moreover, the service area of terrestrial digital broadcasting is expanding steadily, which is increasing demand for related measuring instruments, and demand for equipment for measuring liquid crystal coating thickness in the manufacture of flat panel displays also rose. As a result, sales in Japan increased 5.6 percent year-on-year to ¥53,678 million, and operating income increased 92.9 percent year-on-year to ¥3,612 million.

Americas

The large U.S. mobile phone service provider Cingular Wireless began providing W-CDMA and HSPDA service during 2005. Moreover, global telecommunications companies began providing 3G service, which has spurred research and development of chipsets for 3G handsets and 3G and 3.5G service among manufacturers of handsets and chipsets. Demand was therefore firm for products including signaling testers and conformance test systems. In addition, sales of general purpose measuring instruments were also solid because of active investment throughout the electronics manufacturing industry. As a result, sales in the Americas increased 19.0 percent year-on-year to ¥13,651 million, and operating income increased 355.3 percent year-on-year to ¥1,407 million.

Europe

Mobile communication companies began providing 3G service, and investment in infrastructure was strong, which resulted in demand for measuring instruments for base stations. In addition, handset manufacturers conducted aggressive research and development for 3G and 3.5G services, which resulted in solid sales of the Anritsu Group's measuring instruments for development. As a result, sales in Europe increased 13.4 percent year-on-year to ¥10,104 million. Operating loss narrowed to ¥185 million from ¥455 million for the previous fiscal year.

Asia and Others

In Asia, investment among handset manufacturers remained firm in some areas, including Taiwan and Korea. Sales of measuring instruments for research and development and for manufacturing therefore remained solid. However, in China the government tightened fiscal policies and the issue of licenses for 3G service was delayed, which caused telecommunications companies to restrain capital investment. Growth in sales of measuring instruments for manufacturing 3G handsets was therefore lower than projected at the start of the fiscal year. In addition, the number of telecommunications companies offering 3G service in Europe expanded favorably, but the number of subscribers was lower than expected. The expansion in demand that Asian handset manufacturers expected therefore did not materialize, and so demand did not increase for measuring instruments for handset production. As a result, sales decreased 8.0 percent year-on-year to ¥6,607 million, and operating income decreased 7.2 percent year-on-year to ¥231 million.

Liquidity and Financial Condition

Fund Procurement and Liquidity Management

The Anritsu Group's capital requirements consist primarily of working capital for purchases of materials and other operating expenses incurred in manufacturing and selling products, and funds for capital investment and research and development expenditures. Anritsu secures sufficient capital from internal capital resources or by directly and indirectly procuring funds from external sources.

As of March 31, 2005, cash and cash equivalents totaled ¥33,744 million. This was approximately 4.8 times average monthly net sales, indicating that Anritsu has ample cash on hand to meet its liquidity requirements. Management believes that preparing against domestic and overseas financial uncertainty is important in an operating environment characterized by significant change, and seeks to maintain ready access to working capital and capital to fund business growth.

In addition, the Anritsu Group established a three-year committed ¥15,000 million line of credit, thus securing stable long-term liquidity. The Anritsu Group has also been repaying short- and long-term debt, particularly overseas, to improve its balance sheet. As a result, the net debt-to-equity ratio (see Note 11 below) improved substantially to 0.46 times as of March 31, 2005 from 0.58 times a year earlier. The Anritsu Group operates a cash management system that covers domestic companies and one that covers European companies to concentrate capital and deploy it efficiently while reducing interest-bearing debt.

As of March 31, 2005, Rating and Investment Information, Inc., a Japanese credit rating agency, rated Anritsu's short-term debt a-2 and its long-term debt BBB. The rating on Anritsu's long-term debt was lowered from A- to BBB in December 2002, but this has not had any material effect on fund procurement. Anritsu is working to restore its A-rating by improving the stability of its financial structure through means such as enhancing shareholders' equity, reducing interest-bearing debt and increasing its ability to generate cash.

For the year ended March 31, 2005, loss on devaluation of inventories and loss on disposal of inventories totaled ¥1,479 million. The Anritsu Group operates at the leading edge of telecommunications technology, and is therefore subject to the risk that technological innovation and advances in service will render inventory held for long periods obsolete. The Anritsu Group's policy for nullifying this risk is to recognize devaluation of products and work in process over set time periods. The Anritsu Group is working to manage inventory even more efficiently through manufacturing innovation and through supply chain management. Inventory turnover, defined as net sales divided by inventories at the balance sheet date, was 3.4 times for the year ended March 31, 2005, and the Anritsu Group's goal is to raise inventory turnover to 5.0 times.

Note 11. Net debt-to-equity ratio: (interest-bearing debt – cash and cash equivalents)/shareholders' equity

Cash Flow

Cash and cash equivalents as of March 31, 2005 decreased ¥1,486 million from a year earlier to ¥33,744 million. A primary factor in the decrease was that Anritsu funded reduction in interest-bearing debt using cash provided by operating activities.

Free cash flow, defined as the sum of net cash provided by operating activities and net cash provided by or used in investing activities, totaled ¥8,231 million, compared to ¥10,374 million in the previous fiscal year. However, free cash flow for the year ended March 31, 2004 would have totaled ¥4,680 million after excluding the sale of the former head office building and other assets.

Net cash provided by operating activities totaled ¥9,277 million, compared to ¥5,953 million in the previous fiscal year. Net cash provided by operating activities represented 11.0 percent of net sales. The increase in net cash provided by operating activities was the result of the increase in operating income and further improvement in income before income taxes from core operations. The Anritsu Group also continued to raise the efficiency of working capital deployment. Depreciation and amortization decreased ¥667 million compared to the previous fiscal year to ¥3,754 million.

Net cash used in investing activities totaled ¥1,046 million. In the previous fiscal year, investing activities provided net cash totaling ¥4,421 million, although this included proceeds from the sale of the former head office building and other assets totaling ¥5,694 million. The Anritsu Group continued to be selective in the acquisition of property, plant and equipment, which totaled ¥1,338 million.

Net cash used in financing activities totaled ¥9,872 million, In the previous fiscal year, financing activities provided net cash totaling ¥8,568 million, primarily because of the issue of ¥15,000 million in convertible bonds with stock acquisition rights. The year-on-year change was primarily the result of the use of ¥8,847 million to repay short- and long-term debt at a U.S. subsidiary and other Group companies. As a result, the net debt-to-equity ratio decreased to 0.46 times from 0.58 times at the previous fiscal year-end.

Assets, Liabilities and Shareholders' Equity

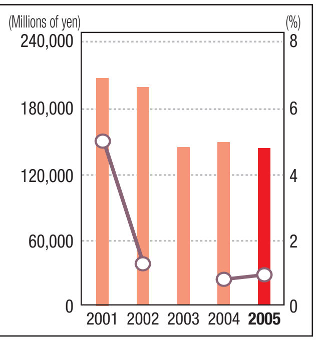
As of March 31, 2005, total assets decreased 4.2 percent, or ¥6,242 million, from a year earlier to ¥142,111 million. Current assets decreased 2.6 percent, or ¥2,441 million, from a year earlier to ¥92,121 million. Property, plant and equipment decreased 8.5 percent, or ¥2,328 million, from a year earlier to ¥25,159 million.

As of March 31, 2005, total liabilities decreased 7.4 percent, or ¥6,538 million, from a year earlier to ¥81,802 million. Current liabilities increased 7.1 percent, or ¥1,586 million, from a year earlier to ¥24,063 million, primarily because of an increase in accrued liabilities. The Anritsu Group changed its method for handling notes and accounts payable by initiating the use of factoring for a portion of notes and accounts payable beginning with the year ended March 31, 2005. Compared to the former method, the change reduced notes and accounts payable - trade by ¥2,077 million and increased other current liabilities by ¥2,077 million. Long-term liabilities decreased 12.3 percent, or ¥8,123 million, from a year earlier to ¥57,739 million.

Long-term debt decreased ¥8,532 million from a year earlier due to repayment of debt. Total interest-bearing debt decreased 12.3 percent from a year earlier to ¥61,384 million. Working capital totaled ¥68,058 million, compared to ¥72,085 million a year earlier.

Shareholders' equity increased 0.5 percent from a year earlier to ¥60,309 million. The ratio of shareholders' equity to total assets was 42.4 percent, compared to 40.5 percent a year earlier. The debt-to-equity ratio (see Note 12 below) was 1.02 times, compared to 1.17 times a year earlier.

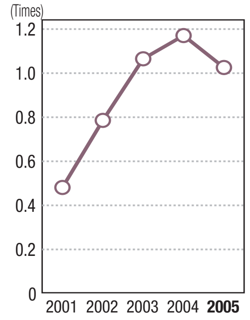
Total Assets and ROA



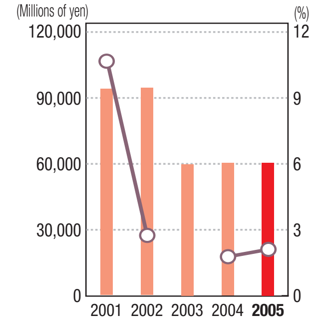
Total Assets (Left scale)
ROA (Right scale)

Note: ROA is not calculated for 2003 due to net loss.

Debt-to-Equity Ratio



Shareholders' Equity and ROE



Shareholders' Equity (Left scale)
ROE (Right scale)

Note: ROE is not calculated for 2003 due to net loss.

Note 12. Debt-to-equity ratio: Interest-bearing debt/shareholders' equity

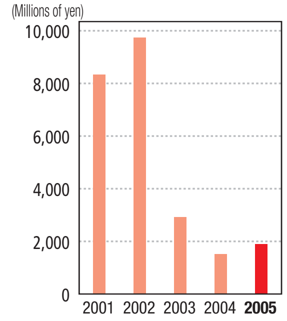
Capital Expenditures

For the fiscal year ended March 31, 2005, capital expenditures increased 22.2 percent compared to the previous fiscal year to ¥1,870 million. Anritsu is emphasizing investment of management resources in the IP network business to respond to the trends toward IP and wireless telecommunications. However, during the past fiscal year Anritsu focused on the Test and Measurement business in investing in new product development and reducing cost of sales to respond to technological innovations and sales competition.

Overview of Capital Expenditures (Millions of yen)

	2005	Change (%)
Information and Communications	¥ 188	121.2%
Test and Measurement	1,213	23.1
Industrial Automation	182	(15.3)
Services and Other	185	44.5
Sub-total	1,768	25.1
Eliminations or corporate	102	(12.8)
Total	¥1,870	22.2

Capital Expenditures



Research and Development

The Anritsu Group conducts research and development under the Group corporate philosophy of developing "Original & High Level" products that contribute to the realization of an affluent ubiquitous network society. The Anritsu Group is promoting new product research and development with a focus on leading-edge technology fields including IP networks and mobile communication systems.

An overview of research and development expenditures in the year ended March 31, 2005 follows below. Investment in research and development in the components and devices business now included in the Services and Other segment totaled ¥23 million for the year ended March 31, 2005.

(Millions of Yen)

	2005	Change (%)
Information and Communications	¥ **461**	5.3%
Test and Measurement	**7,234**	13.1
Industrial Automation	**913**	7.5
Services and Other	**368**	4.7
Basic research	**1,539**	—
Total	**10,515**	12.5

The results of research and development in each business segment are outlined below.

1. Information and Communications

Development of Fair Share PureFlow™ FS10, a Bandwidth Management Product that Optimizes Bandwidth to Solve Traffic Congestion

In recent years, Internet access channels have steadily moved to broadband, and peer-to-peer (P2P) communication in which users connect directly and exchange large files over extended periods has become increasingly common. This has caused congestion that interferes with other users' communication, which has been a problem because of the inability to allocate uniform service to each user. Previously, only high-priced bandwidth controllers that used complicated methods to identify the traffic appropriating bandwidth and detect and eliminate misappropriation were able to deal with this problem. The Anritsu Group has developed a completely new bandwidth management product that does not eliminate P2P or other applications. Instead, it constantly allocates channel bandwidth based on the number of users connected, thus contributing to the efficient use of telecommunication service providers' channels.

2. Test and Measurement

Development of the MG3700A Vector Signal Generator

The wireless communication technology that will enable the advent of the ubiquitous network society continues to advance. Examples include mobile-centric service, in which mobile phones and wireless LANs converge, and the projected start of digital broadcasting services for mobile phones in 2006. Another example is the adaptation of medium-distance wireless communications such as Bluetooth and wireless LANs for personal computers and home electronics.

These circumstances created strong demand among digital system developers for a signal generator that could output a digital modulation signal for use with a diverse array of wireless systems. Anritsu has met this demand by developing the MG3700A Vector Signal Generator, a stand-alone unit that can output digital modulation signals for a broad range of wireless systems. The MG3700A Vector Signal Generator has a built-in base-band generator and can output a signal with a RF modulation bandwidth as large as 120 MHz. As a result, it can be used for 4G mobile communication systems which use wideband digital modulation signals exceeding 100 MHz.

3. Industrial Automation

Development of the KD7337AW Large-Scale X-ray Inspection System

Concern about food safety has increased demand for even more stringent quality control in food production processes. Anritsu Industrial Solutions Co., Ltd. has responded by delivering and supplying metal detectors, which use advanced magnetic sensing technology to provide industry-leading metal contaminant detection; and X-ray alien material inspection systems, which use original X-ray technology and image processing technology.

The recently developed KD7337AW X-ray inspection system has a large portal that is 690 mm wide and 250 mm tall that enables alien material contaminant inspection of products in large packages that was formerly difficult. Conventionally, inspection of products in large packages was insufficient and initial setup and cleaning after use were problematic because they required extensive labor. The KD7337AW, however, uses newly developed image processing algorithms to enhance alien material detection sensitivity. At the same time, it offers automatic setup functions and is easier to clean, making it simple, highly sensitive alien material inspection equipment.

Change in Policy Regarding Severance and Retirement Benefits for Directors and Auditors

In June 2004, the Anritsu Group's Board of Directors and Board of Auditors resolved to abolish the internal system of severance and retirement benefits for directors and auditors and to terminate such payments in the future. The Anritsu Group therefore intends to use the reserve for severance and retirement benefits for directors and auditors as of March 31, 2005 to meet obligations to directors and auditors incurred prior to the above resolution. The effect of the abolition of the system of severance and retirement benefits for directors and auditors on the statements of income is not material. In addition, the Anritsu Group provides for bonuses for officers by funding a reserve in the amount projected to be paid at the end of the current fiscal year during each evaluation period.

Management Objectives and Indicators

Anritsu seeks to maximize its corporate value by managing its operations with a focus on consolidated cash flow. In addition, the Company emphasizes asset efficiency and uses an original metric, Anritsu Capital-cost Evaluation (ACE) to evaluate return on capital invested. Anritsu also uses ACE as an indicator to evaluate the performance of each business unit.

For the year ended March 31, 2005, consolidated ACE was negative ¥2,230 million, an improvement of ¥3,052 million compared to the previous fiscal year. Consolidated return on equity was 2.1 percent, compared to 1.8 percent for the previous fiscal year. Free cash flow totaled ¥8,231 million, compared to ¥10,374 million for the previous fiscal year. Thus Anritsu has continued the progress begun in the previous fiscal year toward improvement in each of its primary management indicators.

For the year ending March 31, 2006, Anritsu will strengthen its global business strategy to expand net sales and steadily improve its earnings structure. In addition, Anritsu will implement programs to improve its ability to generate cash while working to raise its corporate value and achieve positive ACE. Anritsu aims to achieve a consolidated operating margin of 10 percent or higher by March 31, 2007.

Risk Information

Risk Associated with the Anritsu Group's Technology and Marketing Strategy

The Anritsu Group works to deploy its well-developed technological capabilities to provide products and services that offer value to customers. However, technological change is rapid in the Anritsu Group's core information and communications markets. As a result, inability to deliver timely solutions that increase customer value or incidents that preclude sufficient support for customer needs and wants among telecommunications companies and telecommunications equipment manufacturers have the potential to impact the Anritsu Group's financial performance.

Market Fluctuation Risk

External factors including changes in economic and market conditions and technological innovation have the potential to exert a material impact on the Anritsu Group's product lines and performance.

The Test and Measurement business is subject to the impact of changes in capital investment requirements among telecommunications companies, telecommunications equipment manufacturers and electronic component manufacturers as a result of economic growth and consumption trends in countries around the world. Moreover, the number of subscribers to, speed of adoption of and technological innovation in mobile phone services, including telecommunication systems, influence demand for mobile communication measuring instruments.

Other factors that may influence earnings include changes in the mobile handset value chain such as the trend toward system on chip and intensifying price competition for measuring instruments for mass-production of mobile handsets. In the general purpose measuring instruments market, economic conditions and consumption trends in countries worldwide influence changes in capital investment among telecommunications companies, telecommunications equipment manufacturers and electronic component manufacturers. The Information and Communications business has a high proportion of sales to governmental entities, and government and municipal budgets may exert a material impact on its performance. In the Industrial Automation business, sales to food manufacturers constitute 80 percent of sales. Economic growth rates and consumer spending have the potential to impact performance, capital investment and other issues among food manufacturers and materially influence Anritsu's results.

Global Business Development Risks

The Anritsu Group markets its products globally, and aggressively conducts business in the Americas, Europe, Asia and elsewhere with the goal of enhancing its customer support capabilities. Overseas sales account for 56 percent of sales in the Test and Measurement segment, and many customers operate on a global scale. As a result, economic trends in countries worldwide, international conditions and progress in the Anritsu Group's global strategy have the potential to exert a material impact on earnings. Of particular note, the Chinese market is becoming the world's factory and is growing strongly. Capital investment trends among Chinese telecommunications carriers and telecommunications equipment manufacturers have become an important element influencing the Anritsu Group's performance.

Foreign Exchange Risk

The Anritsu Group's sales outside Japan account for a relatively high 42.1 percent of consolidated net sales. The Anritsu Group hedges the risk of foreign exchange transactions that occur upon collection of accounts receivable and other events using forward foreign exchange contracts and other instruments, and hedges risks associated with the borrowings of overseas subsidiaries using currency swaps and other instruments. However, rapid changes in foreign exchange rates have the potential to exert a material impact on the Anritsu Group's earnings and financial condition.

Long-term Inventory Obsolescence Risk

The Anritsu Group works to provide products and services that precisely meet customer needs and wants. However, particularly in the measuring instruments market, product lines are subject to rapid changes in technology, which can easily result in product obsolescence and cause inventory held for long periods to lose value. These factors have the potential to exert a material impact on the Anritsu Group's financial condition.

Financial Condition Risk

In the fiscal year ended March 31, 2003, Anritsu concluded an agreement for a syndicated loan (see Note 13 below) that was funded by several financial institutions. The outstanding balance of this loan totaled ¥9,800 million as of March 31, 2005. A financial covenant as outlined below was added to this syndicated loan agreement, under which the lenders may call the loan should any of the following occur:

① If the Anritsu Group's long-term credit rating drops to BB+ or lower, the equivalent of two ranks lower than the current BBB rating;

② If consolidated shareholders' equity falls below ¥46,100 million (shareholders' equity as of March 31, 2005 was ¥60,309 million);

③ If the Anritsu Group records an operating loss for two consecutive fiscal years.

Note 13: Syndicated loan: a method of procuring funds in which multiple financial institutions cooperate in a syndicate to meet large-scale fund procurement needs. The loan extended is structured as a single contractual obligation.

Warning from Fair Trade Commission

On April 7, 2005, the Anritsu Group received a warning from the Fair Trade Commission of Japan under Article 48, section 2 of the Act Concerning Prohibition of Private Monopolization and Maintenance of Fair Trade, in connection with an order for construction of information display panels placed by the Ministry of Land, Infrastructure and Transport. The Board of Directors took up the issue of this warning at its meeting of April 15, 2005, and acknowledged it on April 27. The Anritsu Group will prevent recurrence by implementing thorough employee education and training covering legal compliance and corporate ethics, and will also work to make business activities more fair and transparent by establishing countermeasures including a system for periodic audits. Penalties such as fines that may result from this incident have the potential to exert a material impact on the Anritsu Group's performance.

Management Issues for the Year to March 31, 2006

The global economy is expected to continue growing. The domestic economy, however, has decelerated, and factors such as trends in the foreign currency market and crude oil prices remain unclear. In the mobile communications market, which is critical to the Anritsu Group, delays in China and elsewhere in the full-scale start of 3G service, intensifying competition, and other factors indicate that the Anritsu Group's operating environment will remain unpredictable.

The Anritsu Group will respond to these conditions during the year ending March 31, 2006 by implementing its strategy of profitable growth. The current fiscal year will be key as the new Anritsu takes up the challenge of strong, sustained growth.

In the core Test and Measurement segment, the Anritsu Group's goal for the medium to long term is to take a leadership position in the telecommunication test and measurement market. To achieve this goal, the Anritsu Group will strengthen cooperation among divisions in Japan, the United States and the United Kingdom, while adding sales engineers to its sales organizations in Japan, the Americas, Europe, Asia and Oceania. The Anritsu Group will also promote the creation of an efficient management structure. Organic adjustment among development, manufacturing and sales will further strengthen global operations. In particular, the Anritsu Group will further enhance its marketing and technical support system to create even closer relationships with customers. The Anritsu Group will also promote strategies to flexibly accommodate market change. With the goal of increasing customer value, the Anritsu Group will develop its "Intelligent Solution Creator" business model.

In addition, the Anritsu Group will emphasize investment to maintain its competitive advantage in the telecommunication test and measurement business. In the Information and Communication segment, the Anritsu Group will work to improve profitability by increasing its penetration in the private-sector market for video distribution solutions. Moreover, the Anritsu Group will move forward in transforming special projects created through its in-company entrepreneurial organizations into businesses to create new sources of earnings and nurture them into core operations.

In addition, the Anritsu Group will reduce inventories, cost of sales and operating expenses in promoting management with an emphasis on cash flow. Corporate social responsibility (CSR), strengthening the business risk management system and other initiatives will also be part of efforts to renew and develop the Anritsu Group's operating foundation to increase corporate value.