Management's Discussion and Analysis

Anritsu deploys its "Original & High Level" communications, information, test and measurement, optical, sensor and other technologies and products cultivated over more than 110 years to expand and achieve progress in the business fields of Test and Measurement, Information and Communications, and Industrial Automation as an "Intelligent Solution Creator" that provides optimal solutions with high customer value, and thereby contributes to the realization of a safe, secure and comfortable society.

Changes in the Scope of Consolidation

During the fiscal year ended March 31, 2006, Anritsu added 15 companies to the scope of consolidation, resulting in 45 consolidated subsidiaries. The 15 companies added were Anritsu A/S, a test and measurement equipment manufacturer in Denmark, and its subsidiaries. The Anritsu Group acquired the shares of Anritsu A/S at the end of the first half of the fiscal year, and changed its fiscal year end to March 31 from December 31. Six months of Anritsu A/S's operations are therefore included in the Anritsu Group's consolidated statements of income for the year ended March 31, 2006.

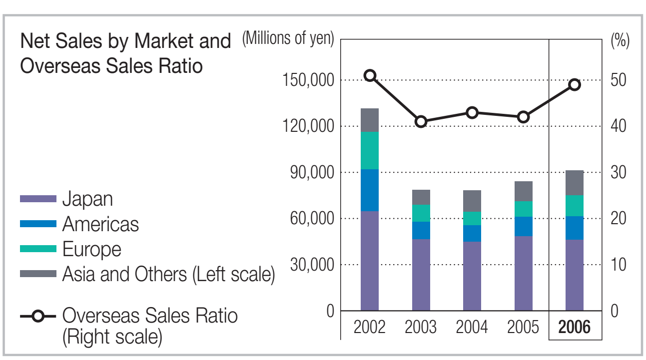
Sales and Income

For the fiscal year ended March 31, 2006, consolidated net sales increased 8.6 percent year-on-year to ¥91,262 million. Although sales in the Information and Communications segment decreased a substantial 17.0 percent compared with the previous fiscal year, overall Group net sales increased due to factors including the acquisition of NetTest A/S and a 17.9 percent year-on-year increase in sales in the core Test and Measurement segment. Operating income decreased 6.4 percent, or ¥313 million, year-on-year to ¥4,549 million. Operating income increased in the Test and Measurement segment because improvement in the cost of sales compensated for expenses associated with infrastructure improvements to bring the Anritsu Group closer to customers and the cost of acquiring and integrating NetTest A/S. The Information and Communication segment's operating loss increased, which caused operating income, income before income taxes and net income to decrease compared to the previous fiscal year.

Net Sales

For the fiscal year ended March 31, 2006, net sales increased 8.6 percent, or ¥7,222 million, year-on-year to ¥91,262 million. Primary factors supporting the increase included the acquisition of NetTest A/S, and year-on-year increases in both orders and sales in the Anritsu Group's core Test and Measurement segment.

By market, domestic sales decreased 5.1 percent year-on-year to ¥46,155 million, mainly as a result of the decrease in sales in the Information and Communications segment. Overseas sales increased 27.4 percent year-on-year to ¥45,107 million as a result of sales growth in each of the regions of the Americas, Europe and Asia. Overseas sales increased to 49.4 percent of net sales, up 7.3 percentage points from 42.1 percent for the previous fiscal year.



Cost of Sales and Gross Profit

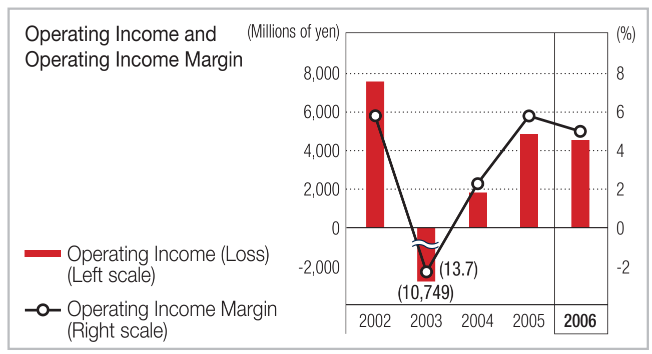
Cost of sales increased 2.9 percent, or ¥1,539 million, compared with the previous fiscal year to ¥55,205 million. Cost of sales decreased to 60.5 percent of net sales from 63.9 percent in the previous fiscal year. The decrease was the result of successful efforts to further reduce cost of sales through supply chain management (SCM) and manufacturing innovations that continued from the previous fiscal year. Gross profit increased 18.7 percent compared to the previous fiscal year to ¥36,057 million. The ratio of gross profit to net sales improved 3.4 percentage points to 39.5 percent.

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

SG&A expenses increased 23.5 percent compared with the previous fiscal year to ¥31,508 million as a result of higher testing research expenses and other factors due to the increase in net sales. Research and development expenses, which are included in general and administrative expenses and production expenses, increased 19.0 percent year-on-year to ¥12,509 million, and increased to 13.7 percent of net sales compared to 12.5 percent for the previous fiscal year. While results in the core Test and Measurement segment drove overall Group performance, the Information and Communications segment's operating loss increased. As a result, operating income decreased 6.4 percent, or ¥313 million, year-on-year to ¥4,549 million. Operating income represented 5.0 percent of net sales, compared to 5.8 percent for the previous fiscal year.

SG&A Expenses (Millions of yen)

	2006	2005	Change (%)
Salaries and bonuses	11,441	9,682	18.2
Advertising	1,844	1,390	32.6
Pensions	782	920	(15.0)
Travel and transportation	1,752	1,531	14.4
Depreciation	626	516	21.3
Testing research	5,603	3,938	42.3



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

Other expenses, net totaled ¥2,521 million, compared to ¥2,784 million for the previous fiscal year. Foreign exchange gain totaled ¥551 million, compared to a foreign exchange loss of ¥88 million for the previous fiscal year. The Anritsu Group also generated gain on sales of investment securities totaling ¥1,648 million. However, loss on devaluation of inventories increased ¥382 million over the previous fiscal year to ¥1,566 million. The Anritsu Group also incurred expenses totaling ¥1,023 million in connection with the restructuring of the Information and Communications segment.

As a result of the above, income before income taxes decreased 2.4 percent, or ¥50 million, year-on-year to ¥2,028 million. Net income decreased 56.0 percent, or ¥717 million, year-on-year to ¥563 million. Basic net income per share decreased to ¥3.76 from ¥9.31 for the previous fiscal year.

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 maintained cash dividends at ¥7.00 per share for the fiscal year ended March 31, 2006, unchanged from the previous fiscal year despite continued challenging conditions.

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.

Industry Segments

The Anritsu Group classifies operations into the segments of Test and Measurement, Information and Communications, Industrial Automation, and Services and Others.

Test and Measurement

During the year ended March 31, 2006, demand remained firm for measuring instruments for use in third-generation mobile communications (3G) services and 3.5G service development by mobile phone handset manufacturers in Japan and overseas. In addition, demand for handheld measuring instruments for use in installation and maintenance of base stations was favorable in the Americas and other markets worldwide. In Asian markets, demand for measuring equipment for mobile phone handset manufacturing showed signs of recovery toward the end of the period. As a result, sales and profits increased substantially, centered on measuring instruments for the mobile communications market. However, the integration process following the consolidation of Anritsu A/S starting in October 2005 and investment in further strengthening its business resulted in an operating loss for this subsidiary. Consequently, overall segment sales increased 17.9 percent compared with the previous fiscal year to ¥65,113 million. Operating income increased 24.9 percent compared with the previous fiscal year to ¥5,290 million.

This segment accounts for 71.3 percent of the Anritsu Group's consolidated net sales. It consists primarily of: (1) the field of mobile communications measuring instruments for design, production, inspection, adjustment, and maintenance of telecommunications carriers that provide mobile communications services and manufacturers of mobile phones, chip sets and other related electronic components and base stations; (2) the field of IP network communications measuring instruments for design, production, inspection, adjustment and maintenance and service quality assurance of network service providers of fixed telecommunication networks and communications equipment manufacturers; (3) the field of general purpose measuring instruments widely used in the electronics industry, particularly for design, production and evaluation of electronic devices used in telecommunication network-related communications equipment and other electronic equipment; and (4) the service assurance business, which the Anritsu Group entered through the purchase of NetTest A/S (now Anritsu A/S). Based on a core of protocol analysis technologies for VoIP* and mobile communications, the service assurance business is building a solid position in the field of wireless network monitoring. The service assurance business provides its customers, which are major telecommunications operators in Europe and North America, with solutions that improve network performance and service and enhance management and operating cost performance.

Wireline and wireless communication networks are converging because of the progress of the ubiquitous network society, which is driving demand for more sophisticated and integrated technology, services and mobile phones. As a result, the wide range of high-level applications in the test and measurement field is also expanding.

In the core mobile communications measuring instrument field, Anritsu's products for 3G and 3.5G services are strongly competitive. However, demand in this field tends to be influenced by technological innovations and the prevalence rate of mobile communications service, as well as by the number of new subscribers, the number of new mobile phone models and the number of mobile phones shipped. During the year ended March 31, 2006, investment for development and commercial production by Japanese mobile phone manufacturers leveled out with the approach of full-scale diffusion of 3G services originally inaugurated by NTT DoCoMo, Inc. in October 2001. However, demand continued to increase for measuring instruments used to develop 3.5G services, which commenced in the United States in 2005 and are planned to be introduced in Japan in 2006, and for measuring instruments used to develop application software for mobile phones. In Europe, all major operators have introduced 3G services at the same time, so the pace of diffusion among subscribers continues to be subdued, but demand for the conformance testing required to certify the ability of interconnection expanded. In China, which has the largest number of subscribers in the world and is the largest global production source for mobile phones, granting of licenses for 3G services is behind schedule. Consequently, demand for measuring instruments for 3G services has been significantly delayed. Despite these various regional developments, global demand grew for compact and handheld measuring instruments for mobile base station maintenance, a strong product area for Anritsu. Overall, mobile communications measuring equipment continues to strongly support earnings.

In the field of IP network communications equipment, where the shift to broadband is spreading from long-distance networks to mid-range and subscriber networks, the Anritsu Group secured the leading global position in measuring equipment for installation and maintenance of optical digital networks with the addition of the existing product line of the former NetTest A/S. Anritsu will work to improve earnings by moving forward with integration plans that generate synergies in all processes, including marketing, development, manufacturing and sales.

In the general purpose measuring instruments field, sales were strong as investment related to digital terrestrial broadcasting in Japan neared its peak and capital investment by electronic component manufacturers increased due to the recovery of the digital home appliance market. Anritsu A/S, which handles the service assurance business, recorded a loss due to expenses arising from factors including investments to integrate its functions and resources with those of the Anritsu Group after its acquisition and to expand its solutions function.

As a result, the Anritsu Group’s sales and income for the year ended March 31, 2006 increased overall due to an increase in sales of measuring equipment for the mobile communications market and the result of efforts to get closer to customers in overseas markets. Of note, the consolidation of Anritsu A/S had the effect of increasing sales and decreasing income. The Anritsu Group aims to be a global market leader in its core business of measuring instruments by continuing to make necessary investments in world markets to enhance its ability to respond to customers and provide solutions that create value for them.

Information and Communications

The Information and Communications segment accounts for 7.9 percent of the Anritsu Group's consolidated net sales. It is easily influenced by the budgets of the national and local governments because a high proportion of segment sales result from delivery to the government market. In addition, nearly 55 percent of sales tend to be concentrated in the fourth quarter, reflecting the influence of budget execution among government entities. During the year ended March 31, 2006, competition intensified for public works projects, which lowered the level of contract prices. As a result, sales in the government market decreased. In addition, private-sector sales did not grow due to factors such as the weakness of the Anritsu brand in bandwidth control equipment for IP networks. Consequently, operating loss in this segment widened significantly from the previous fiscal year. Segment sales decreased 17.0 percent to ¥7,239 million. Segment operating loss totaled ¥1,972 million compared to ¥1,010 million for the previous fiscal year.

Anritsu has been working to reform the management structure of this underperforming business. Fundamental reforms include (1) review of business and market structures, including reorganization of unprofitable businesses; (2) reform of the employment structure to reduce the number of employees in line with the scale of business; and (3) establishing the business as a separate company to promote its independent viability. During the year ending March 31, 2007, Anritsu is implementing aggressive measures to create the base for this segment to return to profitability, and is further reforming its revenue structure. Based on fundamental reforms that establish an organization with resources optimized in line with the scale of business, the Information and Communications business will move away from dependence on the government market by expanding demand in the private sector as a measure to improve its earnings structure. Moreover, this business will work to increase sales by changing its product mix, including expansion of sales of video distribution solutions, and expanding sales channels.

Industrial Automation

During the year ended March 31, 2006, capital investment in the food industry was flat because of higher packaging and distribution costs resulting from the rise in crude oil prices. Segment sales decreased 0.3 percent compared to the previous fiscal year to ¥12,198 million. Operating income decreased 21.4 percent year-on-year to

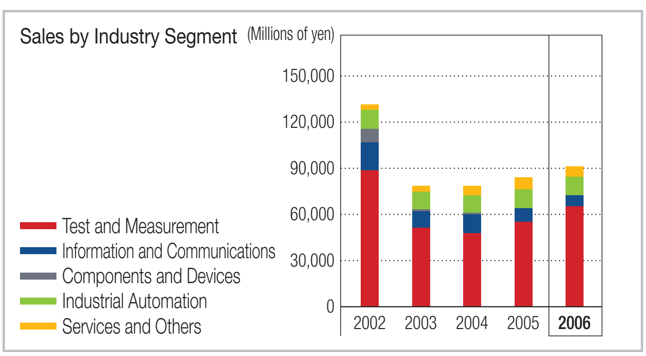
¥787 million, primarily because of development investments to enhance the functions of X-ray inspection systems and investments for expansion in overseas markets.

The Industrial Automation segment accounts for 13.4 percent of the Anritsu Group's consolidated net sales. Sales to food manufacturers account for 80 percent or more of segment sales. This business segment is therefore influenced by the effect of economic growth and consumer spending levels on food manufacturers. The Anritsu Group's highly competitive metal detectors and X-ray inspection systems have achieved leading market share due to their high speed and high precision in detecting metal fragments and other alien materials in food processing. Strong concern about the bovine spongiform encephalopathy (BSE) problem is representative of rising demand for food safety in recent years. While segment sales were essentially unchanged compared with the previous fiscal year, the operating profit margin remained stable in the 6 percent range. Overseas sales account for 20 percent of segment sales, and Anritsu is working aggressively to increase overseas sales by leveraging its strengths in the field of inspection systems and enhancing its overseas business development organization. Anritsu will continue to invest in overseas expansion with the aim of using its subsidiary in China, its subsidiaries established in the previous fiscal year in the United States and the United Kingdom, and its representative office in Thailand as bases to increase market share in each region. These new sales bases function independently of the Test and Measurement business.

Services and Others

This segment comprises devices, precision measurement, environmental, logistics, welfare services, real estate leasing and other businesses.

During the year ended March 31, 2006, segment sales decreased 14.3 percent compared to the previous fiscal year to ¥6,712 million, primarily because the precision measurement business, which carries out quality inspections in the electronic component mounting process and liquid crystal display manufacturing process, was weaker compared to the previous fiscal year. Segment operating income decreased 11.6 percent compared to the previous fiscal year to ¥1,788 million.



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

Geographical Segments

Japan

In the Test and Measurement segment, demand increased for measuring instruments for 3G mobile phone application software development and measuring instruments for 3.5G development. Demand was also firm for measuring instruments for terrestrial digital broadcasting and general purpose measuring instruments for manufacturers of electronic components. However, demand decreased for measuring instruments for use in mass-production of mobile phone handsets. In the Information and Communications segment, intensified competition in the market for public information systems for the government market resulted in a significant decrease in sales, and sales of video distribution solutions to Internet service providers in the private sector did not increase. Consequently, the operating loss in this segment increased substantially. In the other segments, sales decreased year-on-year in the precision measurement business, which carries out quality inspections in the electronic component mounting process and liquid crystal display manufacturing process. As a result, sales in Japan decreased 6.2 percent year-on-year to ¥50,371 million, and operating income increased 2.5 percent year-on-year to ¥3,702 million.

Americas

In North America and elsewhere in the Americas, demand increased substantially for handheld measuring instruments for wireless infrastructure (base station) installation and maintenance and for specific communication standards. In addition, demand was also pronounced for general purpose measuring instruments in the electronics manufacturing industry and among government-related customers. As a result, sales in the Americas increased 26.6 percent year-on-year to ¥17,288 million, and operating income increased 55.4 percent year-on-year to ¥2,187 million.

Europe

In Europe, demand was firm for measuring instruments used in the installation of infrastructure for 3G mobile phones. In addition, demand increased for measuring instruments used for conformance test systems for 3G handsets and for 3.5G development. However, higher expenses for developing 3G and 3.5G measuring instruments caused operating losses to increase. Results for the year ended March 31, 2006 include six months of the results of Anritsu A/S, which recorded a net loss because of expenses in connection with its integration into the Anritsu Group and investment to further strengthen its business base in businesses including service assurance. As a result, sales in Europe increased 39.3 percent year-on-year to ¥14,077 million. Operating loss increased substantially to ¥2,001 million from ¥185 million for the previous fiscal year.

Asia and Others

In Asia, continued moderate growth in the number of subscribers for 3G service in Europe and delay of the issue of 3G licenses in China delayed growth in demand for measuring instruments for mass-production of 3G handsets. However, demand recovered for measuring instruments used in mass-production of 2G (Second generation: GSM) handsets. In addition, demand was firm for handheld measuring instruments used in the installation and maintenance of wireless infrastructure (base stations). As a result, sales increased 44.2 percent year-on-year to ¥9,526 million, and operating income increased 87.9 percent year-on-year to ¥434 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. The Anritsu Group required significant capital during the year ended March 31, 2006 to acquire and make additional investments in NetTest A/S. However, net cash provided by operations represented 6.5 percent of net sales, and as a result of this ability to generate cash, cash and cash equivalents as of March 31, 2006 totaled ¥30,870 million. This was approximately 4.1 times average monthly net sales. In addition, in March 2005 the Anritsu Group established a committed ¥15,000 million line of credit effective until March 2008, thus securing stable long-term liquidity. 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, flexible access to working capital and capital to fund business growth and repay debt consistently over the three years beginning with 2006.

During the year ended March 31, 2006, the Anritsu Group committed to long-term loans overseas to fund the capital requirements of its sales subsidiary in Europe and Anritsu A/S, and also assumed the debt of NetTest A/S. As a result, the net debt-to-equity ratio (see Note 18 below) increased substantially to 0.57 times as of March 31, 2006 from 0.46 times a year earlier. Looking forward, the Anritsu Group will work to strengthen its financial structure by increasing ACE (net operating income after tax less a charge for the cost of capital), improving asset turnover and implementing other strategies to generate cash while enhancing capital efficiency through means such as its internal cash management system to reduce interest-bearing debt and improve the net debt-to-equity ratio.

As of March 31, 2006, 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, 2006, loss on devaluation of inventories and loss on disposal of inventories totaled ¥1,621 million, and the Anritsu Group incurred expenses of ¥621 million in reforming the management structure of the Information and Communications business. 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 mitigates this risk by recognizing 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 3.7 times for the year ended March 31, 2006, and the Anritsu Group's goal is to raise inventory turnover to 5.0 times.

The acquisition of NetTest A/S incurred goodwill totaling ¥5,848 million in the six months ended September 30, 2005. Anritsu intends to amortize this amount using the straight-line method over nine years. Goodwill resulting from the acquisition of NetTest A/S as of March 31, 2006 totaled ¥5,445 million.

Note 18. Net debt-to-equity ratio: (interest-bearing debt – cash and cash equivalents)/shareholders' equity

Cash Flow

Cash and cash equivalents as of March 31, 2006 decreased ¥2,874 million from a year earlier to ¥30,870 million. The main factor in this change was Anritsu's acquisition of NetTest A/S (now Anritsu A/S).

Free cash flow, the sum of net cash provided by operating activities and net cash used in or provided by investing activities, was negative ¥5,016 million, compared with positive ¥8,231 million in the previous fiscal year.

Net cash provided by operating activities totaled ¥5,929 million, compared to ¥9,277 million for the previous fiscal year. The main factors for the year-on-year decrease were an increase in working capital at Anritsu A/S, and increased expenditures for items including corporate taxes at U.S. and other subsidiaries. Depreciation and amortization totaled ¥3,630 million, a decrease of ¥124 million compared with the previous fiscal year.

Net cash used in investing activities totaled ¥10,945 million compared to ¥1,046 million for the previous fiscal year. The year-on-year increase was mainly the result of the use of cash totaling ¥7,948 million to acquire and make additional investments in Anritsu A/S. Acquisition of property, plant and equipment totaled ¥2,448 million, an increase of ¥1,110 million compared with the previous fiscal year.

Net cash provided by financing activities totaled ¥1,761 million. In the previous fiscal year, financing activities used net cash totaling ¥9,872 million. The year-on-year change resulted mainly because the Anritsu Group borrowed long-term funds overseas. Payment of cash dividends offset the cash provided by debt financing.

Assets, Liabilities and Shareholders' Equity

As of March 31, 2006, total assets increased 7.2 percent, or ¥10,279 million, from a year earlier to ¥152,390 million. Current assets increased 4.3 percent, or ¥3,942 million, from a year earlier to ¥96,063 million. While cash decreased ¥7,673 million, notes and accounts receivable — trade increased ¥5,434 million as a result of the increase in net sales, and marketable securities increased ¥5,703 million. Inventory turnover improved to 3.7 times from 3.4 times for the previous fiscal year.

Property, plant and equipment decreased 2.8 percent, or ¥692 million, from a year earlier to ¥24,467 million.

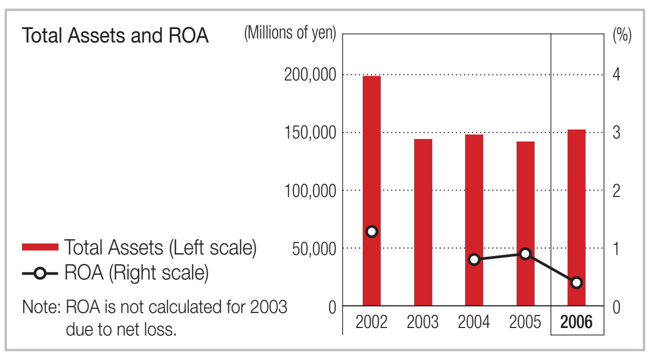
Investments and other assets increased 28.3 percent from a year earlier, or ¥7,029 million, to ¥31,860 million. The primary factor in this year-on-year increase was an increase of ¥6,292 million in goodwill, net of amortization, which consisted mainly of goodwill totaling ¥5,445 million resulting from the acquisition of NetTest A/S.

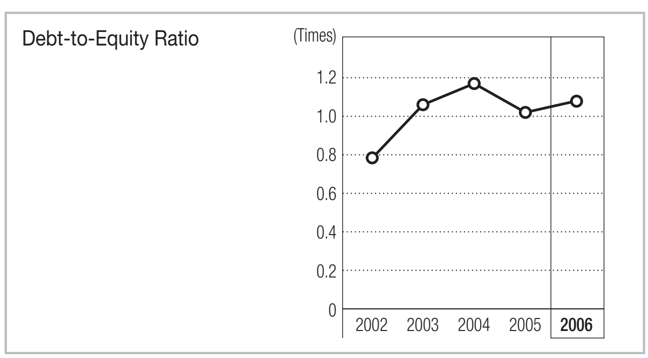
As of March 31, 2006, total liabilities increased 11.8 percent, or ¥9,617 million, from a year earlier to ¥91,419 million. Current liabilities increased 99.4 percent, or ¥23,913 million, from a year earlier to ¥47,976 million, primarily because of the shift of ¥14,793 million in convertible bonds from long-term debt to long-term debt due within one year, and an increase of ¥4,149 million in short-term borrowings to fund capital requirements. In addition, notes and accounts payable — trade increased ¥2,036 million to ¥9,341 million as a result of the increase in net sales. The current ratio was 200.2 percent, compared to 382.8 percent a year earlier.

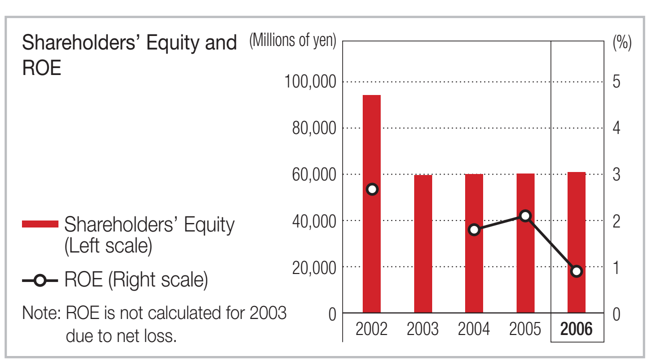
Long-term debt decreased ¥14,736 million from a year earlier to ¥40,207 million due to the pending repayment of convertible bonds discussed above. Total interest-bearing debt increased ¥4,206 million from a year earlier to ¥65,590 million. Working capital totaled ¥48,087 million as of March 31, 2006, compared to ¥68,058 million a year earlier.

Shareholders' equity increased ¥662 million from a year earlier to ¥60,971 million. The ratio of shareholders' equity to total assets was 40.0 percent, compared to 42.4 percent a year earlier. The debt-to equity ratio (see Note 19 below) was 1.08 times, compared to 1.02 times a year earlier.

Note 19: Debt-to-equity ratio: Interest-bearing debt/shareholders' equity







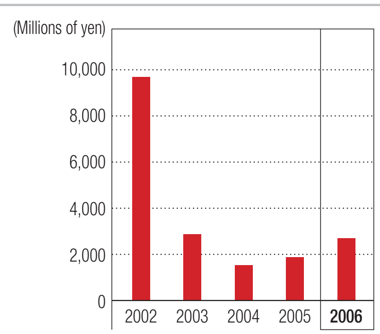
Capital Expenditures

For the fiscal year ended March 31, 2006, capital expenditures increased 44.3 percent compared with the previous fiscal year to ¥2,699 million. The Anritsu Group is emphasizing investment of management resources in fields related to the ongoing evolution of communication network quality and high performance, including expansion of triple play services, the integration of wireline and wireless communication networks, and development of next generation networks. During the year ended March 31, 2006, the Anritsu Group concentrated capital expenditures in the core test and measurement business with the primary objectives of enhancing its research and development environment and improving its business processes to support its strategies for profitable growth.

Overview of Capital Expenditures (Millions of yen)

	2006	Change (%)
Test and Measurement	¥1,889	55.7%
Information and Communications	241	28.3
Industrial Automation	144	(21.2)
Services and Others	388	109.4
Sub-total	2,662	50.5
Eliminations or corporate	37	(63.4)
Total	¥2,699	44.3%

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, 2006 follows below.

(Millions of yen)

	2006	Ratio to Segment Sales (%)
Test and Measurement	¥ 9,214	14.2%
Information and Communications	489	6.7
Industrial Automation	1,017	8.3
Services and Others	341	5.1
Basic research	1,448	—
Total	¥12,509	13.7%

Note: The total is compared to net sales.

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

1. Test and Measurement
Enhanced Application Testing Functions for the MD8470A Signalling Tester

3G service is in a global growth phase, and its increasing use is expanding a diverse array of services such as the delivery of various types of content. Moreover, competition to acquire subscribers is intensifying in countries where mobile communications are more advanced, which is increasing the importance of differentiation through attractive services and handsets. Amid these conditions, the number of applications available in mobile phones continues to proliferate, which has made greater development and testing efficiency a key issue among mobile phone manufacturers. Anritsu therefore worked to increase development efficiency for the growing number of mobile phone applications by enhancing the testing functions of the MD8470A Signalling Tester. Use of the MD8470A enables easy setting and operation of required network performance simulations for application testing. Contents download, video calling and multimedia messaging service (MMS) are becoming common worldwide, and the MD8470A enables functional testing of these applications with a single unit. In the future, Anritsu will strengthen the functions of the MD8470A by expanding the communication systems with which it is compatible to contribute to further efficiency gains in the development of applications for mobile phones.

2. Information and Communications
Development of a Mobile Video Distribution System that Uses FOMA (3G Service by NTT DoCoMo) Video Calling Functions

Anritsu has developed a mobile video distribution system that enables collection of video information at locations where cameras are not installed and on-site video viewing. It distributes video and sound shot with a mobile phone camera via a disaster prevention videoconferencing system, and allows mobile phone users to freely select and view MPEG2 video distributed via IP networks. The collection of information at disaster sites using this system supports rapid recovery efforts.

3. Industrial Automation
Development of X-ray Inspection Systems

Concern about food safety has increased, and quality control is becoming even more stringent in food production processes. Assuring the quality of food has become a major issue not only among large food processing companies, but also among medium-sized regional food processing companies. Anritsu Industrial Solutions Co., Ltd. has been responding to these social trends and contributing to its customers’ quality control programs by delivering and supplying metal detectors that use advanced magnetic sensing technology to provide industry-leading metal contaminant detection, and by developing X-ray inspection systems that use original X-ray technology and image processing technology.

The recently developed KD7400 X-ray inspection system is based on a preceding series that earned customer praise. It raises contaminant sensing to a higher level, detects cracked and defective processed foods and features enhanced network connectivity, thus offering multiple functions for handling an array of sensing conditions. It also offers significantly improved cost performance compared to conventional models, and can be used for line quality monitoring by a greater number of customers.

Management Objectives and Indicators

Anritsu aims to maximize corporate value by managing its operations with a focus on consolidated cash flow. In addition, to focus on capital efficiency and evaluate return on capital, Anritsu uses an original metric, ACE (Anritsu Capital-cost Evaluation) for evaluating the results of each business.

For the year ended March 31, 2006, consolidated ACE was negative ¥3,121 million, compared to negative ¥2,230 million in the previous fiscal year due to factors including an increase in capital invested in the acquisition of NetTest A/S (now Anritsu A/S). ROE was 0.9 percent, compared to 2.1 percent in the previous fiscal year, and free cash flow was negative ¥5,016 million, compared to ¥8,231 million in the previous fiscal year.

For the year ending March 31, 2007, Anritsu will strengthen its global business strategy to expand 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 be a highly profitable company with a consolidated operating margin of 10 percent or higher by March 31, 2009.

Outlook and Management Issues for the Year to March 31, 2007

In the fiscal year ending March 31, 2007, economic recovery is expected to continue in Japan. Overseas, favorable economic conditions are projected for the United States and Europe as well as China and other Asian countries. However, the Anritsu Group’s operating environment is expected to remain unpredictable due to the adverse impact of high crude oil prices on the global economy and other concerns including: (1) trends in exchange and market interest rates; (2) a possible slowdown in consumer spending and capital investment in the United States, which has been the growth engine of the global economy; and (3) delays in issuing 3G licenses in China and price declines caused by intensifying competition in the Anritsu Group's businesses.

Anritsu will deal with this environment by implementing measures that enhance the execution of its strategies for profitable growth.

In the core Test and Measurement business, Anritsu will work to achieve the Company's medium- to long-term objective of becoming the global market leader in telecommunications measuring solutions. To do so, Anritsu plans to strengthen core businesses and promote a business organization that anticipates the integration of wireline and wireless networks while making further progress with integration measures that generate synergy with newly added Anritsu A/S and improve profitability. On April 1, 2006, Anritsu established a central sales company in the United Kingdom that will cover Europe, the Middle East and Africa (the EMEA region), with the aim of reinforcing its sales structure and improving organizational efficiency. Through this company, Anritsu will establish a structure to expand sales in the EMEA region by undertaking measures such as restructuring European sales subsidiaries and implementing task-sharing of back-office functions. In addition, by reinforcing and strengthening the marketing and technical support organization, Anritsu will become closer to its customers and implement its "Intelligent Solution Creator" business model aimed at flexibly adapting to market changes and increasing customer value.

In the Information and Communications business, Anritsu will boost its competitiveness in video distribution solutions and implement business structure reforms such as strengthening business in the IP access market. In addition, Anritsu will work to significantly improve profitability by following through with fundamental reforms that include establishing this business as a separate company to unify resources and streamlining the employment structure.

Furthermore, Anritsu will promote cash flow-oriented management in ways such as reducing inventories and cutting costs and expenses. Anritsu will also work to strengthen its management foundation and enhance corporate value by further developing corporate social responsibility activities and strengthening its business risk management structure and internal control systems.

Based on the above, for the year ending March 31, 2007 as of April 26, 2006, Anritsu projects that net sales will increase 7.4 percent year-on-year to ¥98,000 million, operating income will increase 42.9 percent year-on-year to ¥6,500 million, and net income will increase 344.1 percent year-on-year to ¥2,500 million.

Risk Information

The following are among the operational and management issues presented in this annual report that have the potential to materially affect investor decisions. Forward-looking statements reflect the Anritsu Group's judgement as of March 31, 2006.

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, the rapid pace of technological innovation in the Anritsu Group's core information and communication markets and the Anritsu Group's ability to deliver products and services in a timely manner to meet the needs and wants of customers are factors that have the potential to exert a material impact on the Anritsu Group's results.

Amid advances in mobile phone and internet protocol (IP) technologies, an especially important point is the ability to provide customers with timely solutions based on an accurate understanding of trends in service and research and development investment for triple play services incorporating voice, video and Internet, as well as Fixed Mobile Convergence (FMC) and NGN.

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 operating results of the Anritsu Group.

In the Test and Measurement business, economic conditions and consumption trends in countries worldwide influence changes in capital investment among telecommunications companies, telecommunications equipment manufacturers and electronic component manufacturers. In addition, the increasing sophistication and complexity of telecommunications services represented by triple play services, FMC and NGN are accelerating integration and reorganization in the telecommunications industry, which is adding uncertainty to investment trends. Moreover, demand for mobile communications measuring instruments, the cornerstone of earnings for the Anritsu Group, is affected by such factors as the number of subscribers, rate of adoption of and technological innovation in mobile phone services, and earnings are also affected by the Company's response to factors such as changes in the value chain, as seen in areas such as System on Chip for mobile phones, and intensified price competition for measuring instruments for commercial scale production of mobile phones. The Information and Communications business has a high proportion of sales to government 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, consumer spending and raw material price trends 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 conducts intensive business with the objective of improving its ability to be close to its customers in the Americas, Europe, Asia and elsewhere. In particular, the overseas sales ratio for the Test and Measurement business is 63 percent, and many customers likewise 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 importance are trends in capital investment by carriers and telecommunications equipment manufacturers in the Chinese market, which is growing markedly as a global production source. In addition, timing of business authorization and diffusion trends of third-generation mobile communications services in China, where there are already nearly 400 million subscribers, have the potential to materially influence the operating results of the Anritsu Group, which is deploying its strengths in this field.

Foreign Exchange Risk

The Anritsu Group's sales outside Japan account for 49 percent of consolidated net sales. The Anritsu Group hedges foreign exchange risk using instruments including forward foreign exchange contracts for foreign exchange transactions that occur upon collection of accounts receivable and other events, and currency swaps for loans to overseas subsidiaries. However, rapid changes in foreign exchange rates have the potential to exert a material impact on the Anritsu Group's performance.

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 change 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 March 2003, Anritsu concluded an agreement for a syndicated loan (loan amount as of March 31, 2006 was ¥8.4 billion; see note 20 below) that was funded by several financial institutions. A financial covenant as outlined below was added to this syndicated loan agreement in the past fiscal year, 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 ¥46.1 billion (shareholders' equity as of March 31, 2006 was ¥60.9 billion);
3. If the Anritsu Group records an operating loss for two consecutive fiscal years.

Note 20: 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.