Message from the CFO

The basic mission of Anritsu's financial strategy is to support sustainable growth in enterprise value in a rapidly changing market environment. Increasing profitability and efficiency, and optimizing capital cost, creates a virtuous cycle that enhances enterprise value. The centerpiece of Anritsu's financial strategy is maximizing the cash generation capacity that is the source of profitability, and applying three key measures for its most-efficient utilization—investments for growth, increasing shareholder returns, and strengthening our financial position.

Akifumi Kubota
Vice President, CFO

Anritsu has developed the Anritsu Capital-cost Evaluation (ACE) as its own specific management indicator for enterprise value. ACE is calculated as operating profit, less tax expense and capital cost. We consider that we are generating enterprise value only when ACE is greater than zero, i.e., when operating profit exceeds tax expense and capital cost. Conversely, when ACE is less than zero, enterprise value is being destroyed.

The chart on page 17 shows the ACE improvement drivers. These are divided into two main factors, "Increase in the earning capacity of our main business" and "Increase in asset efficiency." Increases in earning capacity are achieved by improving growth potential and operational efficiency. For the increase in asset efficiency, the two main factors are asset and working-capital turnover, and capital cost. We consider these factors to be the key performance indicators (KPIs), and make a concerted effort as a corporate group to improve them, and enhance enterprise value. Specifically, we set KPI targets based on the market and competitive environment for each business division, and implement measures at the department level.

The following is an overview of Anritsu's measures for principal KPIs and main factors.

■ Growth Potential

Development ROI (Return on Investment)

Anritsu has set a target for development ROI (gross profit/R&D investment) of 4.0 or higher, and works to enhance investment efficiency. When considering new products or projects, development ROI of 4.0 is our standard for determining whether to proceed with development. Our decision to invest in the development of IoT/5G and Network Reshaping, which we expect to be the main growth drivers going forward, was premised on meeting this condition. Development ROI of 4.0 is a deeply rooted part of our corporate culture, and all departments, including overseas business divisions, make R&D investments with an emphasis on global returns.

■ Operational Efficiency

CPO (Cost Per Order)

Anritsu takes proactive measures to increase efficiency in sales activities and improve operational processes in corporate divisions. For example, we carefully manage the CPO for each sales region, furthering improvements linked to reforming the cost structure in each business segment.

■ Asset and Working-Capital Turnover

Operating Cash Flow Margin & CCC (Cash Conversion Cycle)

Anritsu is working to strengthen its cash flow generating capacity, and has set a target of improving the operating cash flow margin, from 8% in FY3/15 to 13% in FY3/18. CCC is also an important cash flow improvement indicator, and we aim to shorten this by 20 days, from 140 days in FY3/15 to 120 days in FY3/18. These improvements will increase profitability by lowering costs and enhancing cost-effectiveness, while also improving asset efficiency by trimming inventories and furthering the collection of receivables. To proactively implement these efforts, we created balance sheets for each business division, and included various measures for managerial accounting, such as providing for visibility of cash and working capital.

■ Capital Cost

Anritsu adheres to the following three main financial strategies from the standpoint of capital cost.

Strengthening our financial position

When conducting business in a rapidly changing market, financial stability is the foundation that supports growth over the longer term. Proper management decisions in response to changing markets, and proactive investment decisions including M&A, are only possible with a sufficient financial foundation.

Anritsu has determined as the KPI of its financial position an equity ratio of at least 60%, and a debt/equity (D/E) ratio of no more than 30%. By adhering to financial strategies based on these KPIs as a basic financial rule, we believe we can achieve sustainable growth in rapidly changing, leading-edge markets.

Our profitability improvements and strong financial standing were recognized in May 2014, when we acquired a debt rating of A- (R&I). Greater confidence from the capital markets raises the energy level of our corporate activities. Our A- rating allows us to procure the necessary capital in a timely manner and at a reasonable cost. The steady implementation of this simple scenario is essential to achieving the GLP2017 plan.

Enhancing shareholder returns

Anritsu's basic policy for shareholder returns is to allocate profits in keeping with consolidated results, taking into account the overall return.

For dividend of surplus, our basic policy is to raise DOE in proportion to increases in consolidated earnings, with a target consolidated payout ratio of at least 30%. This increase in the target payout ratio from the previous figure of at least 25% was implemented from the current fiscal year (FY3/17). This reflects the improvement in our financial position, and is part of our effort to strengthen shareholder returns with a higher target payout ratio.

Anritsu also conducts share buybacks as part of a flexible capital strategy responsive to changes in the corporate environment, making appropriate acquisitions as necessary in consideration of financial conditions, share prices, and other factors.

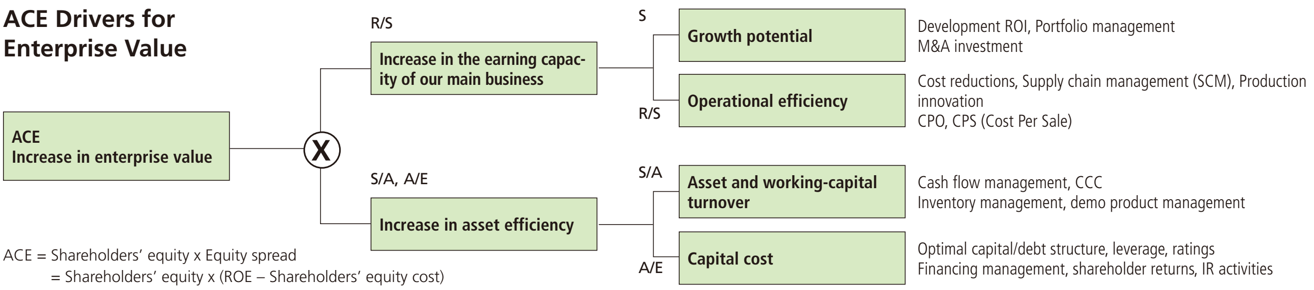
Increasing investor relations activities

Another important factor in terms of capital cost is the importance of communication with the shareholders and investors who are our principal stakeholders. We believe that communication that allows investors, our current and future shareholders, to properly understand and assess our business operations, long-term plans and outlook, as well as will lead to lower capital costs and greater enterprise value.

The specific ways in which Anritsu communicates with shareholders and investors is through informal individual meetings, as well as holding quarterly results briefings as IR events, participating in external IR conferences, and conducting overseas IR activities. We also make efforts to provide full disclosure on our corporate website, and hold regular briefings for individual investors. The opinions and information we receive as feedback from these communications are conveyed to the appropriate levels of management, with the status of IR activities regularly reported at meetings of the Board of Directors.

Anritsu utilizes careful KPI management in an effort to increase profitability and improve efficiency, optimize capital cost, and maximize enterprise value. Further, to ensure the sustainable creation of enterprise value, it is important that we proactively invest cash generated in development themes with growth potential, and make strategic investments centered on M&A. While ensuring that we make returns on investment, provide ample shareholder returns, and strengthen our financial position, it is this dynamic cycle of investment for the next stage of growth that is the royal road to enhancing enterprise value.

ACE Drivers for Enterprise Value



ACE = Shareholders' equity x Equity spread
= Shareholders' equity x (ROE – Shareholders' equity cost)
= E x ((R/S) (S/A) (A/E) – Shareholders' equity cost)

Note: R: Profit; S: Sales; E: Shareholders' equity; A: Total assets