From CFO

Pressing ahead with investments for growth and capital efficiency, aiming to enhance our corporate value

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The new Mid-term Business Plan GLP2020 is underpinned by initiatives designed to return our core business to growth and significantly improve our operating margin. The major financial issues to be addressed under the Plan are to improve ROE and enhance enterprise value while actively promoting growth investment to build a business portfolio that is not dependent on the cycle of mobile communications systems.

Enhancing Corporate Value

The basic policy of the financial strategy is as follows:

(1) Enhancement of Corporate Value
Work to thoroughly improve and enhance the management system to enhance enterprise value. That is to say, in addition to clarifying the enterprise value improvement index, thoroughly managing its goals, and working on continuous improvements.

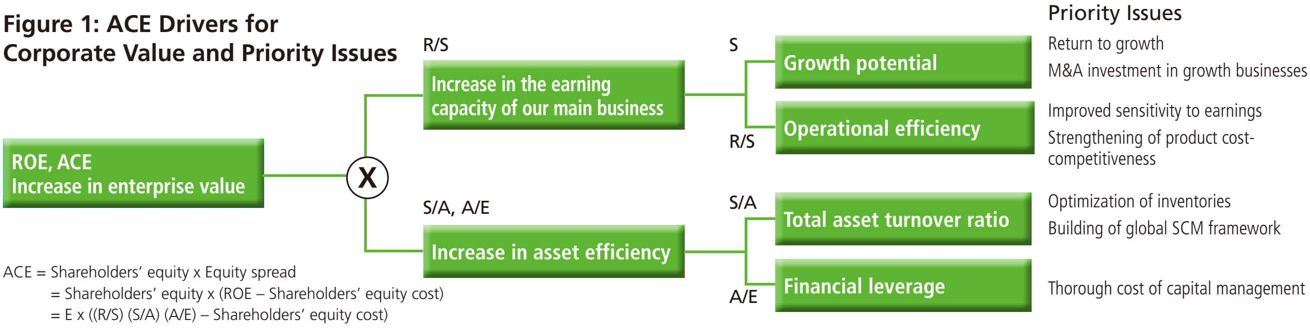
(2) Flexible Strategic Investment
In addition to establishing the financial conditions to enable the steady implementation of strategic investment to enhance enterprise value, undertaking flexible financial measures.

(3) Building Robust Earnings Structure
From an accounting perspective, establish a management system that promotes the Company policy of "continuous growth with sustainable superior profits."

From the abovementioned aspects of policy, I would like to explain the enterprise value enhancement management system.

The Company sets two KPIs as its enterprise value enhancement indices and manages the objectives. As a numerical target, we set an ROE that has comparability with other companies and, as a quantitative target, establish ACE (Anritsu Capital-cost Evaluation), our unique index, as an indicator by which to measure financial added value. ACE is expressed as operating profit, after tax, minus capital cost. Unless we ensure that the level of operating income after tax is greater than the shareholders' equity cost, the financial added value will not be positive; in other words, it can be regarded as not creating enterprise value. The elements (drivers) that will bring about the improvement and enhancement of ROE and ACE are shown in Fig. 1 on the next page. I would like to review the Mid-term Business Plan GLP2017 (fiscal 2015 to fiscal 2017) from the viewpoint of the improvements to each of these elements.

Figure 1: ACE Drivers for Corporate Value and Priority Issues



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

Review of GLP2017

The mobile test and measurement market environment of our mainstay Test and Measurement business was as follows. In addition to a leveling off in the smartphone manufacturing market and the saturation of the LTE development investment market, during the course of GLP2017, the mobile measurement market shrank sharply on account of the 4G and 5G transition period, and its situation has declined over the long term. As a result, we experienced a substantial decline in revenue in the Test and Measurement business, and its operating margin deteriorated sharply. To respond to this situation, we implemented a management restructuring plan that focused on the Test and Measurement business. The basic measure adopted for improvement of the earnings structure was to "cut our coat according to our cloth," cost management to secure profits even at the target minimum revenue scale. We have made efforts with "organizational slimming" and "thoroughly reducing costs by improving business processes" to realize the target break-even point ratio. As a result, in addition to securing the targeted profits, we promoted investment by the prioritizing of development, that is, aggressive investment towards 5G, in parallel. Looking back at our financial condition during the period of GLP2017, although we were able to sustain a certain level of operating cash flow-generating ability, capital efficiency deteriorated significantly, and this resulted in ROE of less than 5% and ongoing negative ACE. Management structure reform yielded results for both enhanced durability at the time of profit deterioration and for measures to improve profit structure. Despite this, a number of challenges in terms of capital efficiency remain. Based on a review of GLP2017, the priority issues arranged from the viewpoint of corporate value improvement are as shown in Fig. 1.

GLP2020 Financial Strategy

Toward ROE Improvement

Under GLP2020, we will focus on returning to double-digit ROE and address positive ACE as a top priority theme. The top priority measures to improve ROE are to improve the profitability and operating margin of each business. I will now set out the measures designed to improve the profitability of each business.

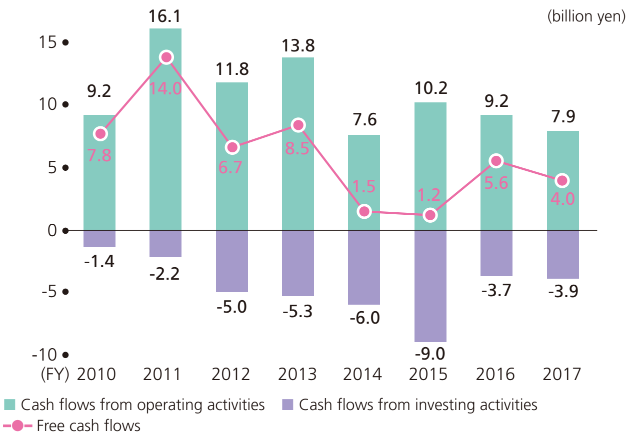
■ Test and Measurement Business

The operating margin of the Test and Measurement business for fiscal 2017 was 3.4%. We will bring about a recovery to 14% in fiscal 2020. To that end, we will steadily capture growth drivers for the GLP2020 growth strategy and restore revenue to the ¥70 billion level. In particular, what will support the growth scenario for the coming three years is to reliably capture the start of 5G business. We will seek to dramatically improve the operating margin by restoring the growth rate of Anritsu's strong point mobile test and measurement business and recovering development investment in 5G at a high return. As a measure for managing development investment efficiency, we are thoroughly managing development ROI (Return on Investment = gross profit/development costs). The immediate goal for development ROI is 4 or higher.

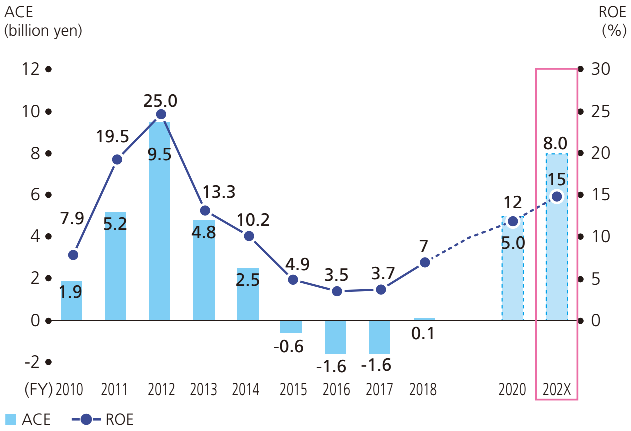
■ PQA Business

The operating margin of the PQA business for fiscal 2017 was 8.7%. On a quarterly financial settlement basis, we have improved its earnings structure to the point at which PQA is generating 10% of earnings. The most-important task in improving the operating margin of the PQA business is to improve its price competitiveness, meaning to improve its gross profit. The initiatives adopted under GLP2020 are as follows:

Graph 1: Cash Flow Trends



Graph 2: ACE, ROE Trends, and Targets



(1) Differentiation of X-ray inspection system business
(2) Provision of new solutions by means of quality data analysis
(3) Business expansion in European markets
(4) Full-scale entry into pharmaceutical product market
(5) Adding of value to operations throughout entire value chain

By steadily implementing these initiatives, we will transform the profit structure to constantly generate an operating margin of 12% or more.

Aiming for ROE of 15%

Focusing on the core component of achieving the operating margin targets for each business, we will first aim for ROE of 12% in fiscal 2020. Thereafter centering on thorough capital efficiency management and facing the challenges of increasing the operating profit margin of the Testing and Measurement business to 20%, we will aim to achieve the ROE of 15% upheld in the medium- to long-term guidelines under GLP2023, the mid-term business plan that will follow GLP2020.

Promotion of Capital Efficiency Management

With regard to the Company's capital costs, shareholders' equity costs are measured at 7%, and the weighted average cost of capital (WACC), used for our unique ACE indicator, is measured as 5%. From the capital cost viewpoint, the "measures to improve corporate value in medium- to long-term financial strategies" are investment for growth (including M&A), which will generate returns in excess of 7% of shareholders' equity cost, and capital efficiency improvements.

The total capital cost and total corporate value of the Anritsu Group are the sum totals of its Testing and Measurement business, PQA business and Others business. It is also the sum totals by business unit broken down by each business. To thoroughly pursue "management with awareness of capital costs," we are planning to manage capital efficiency on a business unit level basis. As a specific KPI, we will set ROBA (return on business assets: the return of operating income against the operating assets of each division) as a target and monitor improvements.

Shareholder Returns

Based on raising the dividend on equity (DOE) in line with rises in consolidated net income earnings for the fiscal period, Anritsu's basic policy is to flexibly provide shareholder returns in keeping with consolidated results, with a target consolidated payout ratio of at least 30%, taking into account the overall return.

Regarding surplus, the plan provides for the demand for capital from business expansion into industrial areas utilizing 5G/IoT and from strategic investment (including M&A) for business development in, for example, the cloud services market. We will continue to respond to the expectations of our shareholders by further improving corporate value, including investment in such new businesses.

Graph 3: Dividend Trends