Financial Review

Sales and Income

Operating Environment

The overall-world economy in fiscal 2019 held firm, with the United States economy remaining solid, despite signs of stagnation in the economies of China, Asia and Europe.

In the electronics industry, investment in mobile devices and data centers remained brisk. Demand for semiconductors, especially memory, increased. As a result, the wafer fab equipment market grew a further 16% year on year from the previous year’s record-breaking US$50 billion, reaching approximately US$59 billion. At the same time, the display industry saw full-scale investment in large generation 10.5 panels, despite adjustments in investment in small- and medium-sized panels due to slower growth in shipments of mobile devices. Accordingly, the market for flat panel display (FPD) production equipment maintained the brisk level from the previous year, staying at around US$20 billion.

Sales

Net sales in fiscal 2019 rose 13.0% year on year to ¥1,278.2 billion. This reflected the favorable market environment for semiconductors and FPD as well as the increase in the Company’s share of each market. By segment, net sales in the semiconductor production equipment (SPE) segment grew 10.6% year on year to ¥1,167.8 billion. Net sales in the FPD production equipment segment grew 48.2% year on year to ¥112.3 billion. For details on performance by segment, please refer to Review of Operations and Business Outlook on page 7. Furthermore, net sales in the field solutions business (comprising sales of parts and used equipment modifications and maintenance services) rose 14.8% year on year to ¥288.2 billion, accounting for 22.6% of consolidated net sales.

Gross Profit, SG&A Expenses and Operating Income

Gross profit in fiscal 2019 was up 10.8% year on year to ¥261.1 billion, reflecting the growth in net sales. The gross profit margin fell 0.8 percentage points to 41.2%, due to an increase in the production cost ratio following an expansion of the production and service systems. SG&A expenses rose 11.2% year on year to ¥235.6 billion, but the ratio of SG&A expenses to net sales dropped 0.2 percentage points from the previous fiscal year to 16.9% in the fiscal year under review. The Group actively advanced R&D with the aim of out-performing the SPE market, where growth is expected Consequently, operating income increased 10.5% year on year to ¥310.5 billion, and the operating margin decreased 0.6 percentage points to 24.3%. This was due to increases in the R&D expense ratio and the production cost ratio.

R&D Expenses

R&D expenses were up 17.4% year on year to ¥13.9 billion. The increase was focused consistently with the previous year: the reinforcement of R&D in the fields of etch, deposition and cleaning systems, in which the Company is working to expand its market share under the medium-term management plan. Tokyo Electron also focused on R&D aimed at achieving the competitiveness of future products. This included not only enhancing the performance of individual products, but developing innovative technologies to optimize entire processes, as well as making products more intelligent. Tokyo Electron regards advanced technological prowess as the source of its growth. Accordingly, the Company actively invests in growth to produce next-generation products, mainly focusing on fields in which market growth is forecast. In the fiscal year under review, Tokyo Electron increased its market share in key fields related to cutting-edge DRAM and 3D NAND flash memory production, making progress toward the goals of the medium-term management plan.

In FPD production equipment, Tokyo Electron developed a new version of the PICP™ plasma etch system for generation 10.5 panels, which are expected to see rapid market growth. This system excels in uniformity and was originally released for small- and medium-sized panels. In addition, the Company released a high-resolution inkjet printing system for small- and medium-sized panels amid growing demand for higher definition OLED displays.

Other Income (Expenses) and Net Income Attributable to Owners of Parent

During fiscal 2019, net other expenses came to ¥0.1 billion (digits below ¥1 billion are truncated), reflecting ¥0.1 billion in extraordinary loss due to a gain on sales of investment securities and property, plant and equipment. Income before income taxes came to ¥321.5 billion, up 16.6% year on year. As a result, net income attributable to owners of the parent totaled ¥248.2 billion in fiscal 2019, up 21.5% from fiscal 2018. Net income per share (basic) rose 21.5% year on year to ¥1,513.58.

Comprehensive Income

In Fiscal 2019, Tokyo Electron recognized comprehensive income of ¥243.6 billion, up from ¥201.1 billion in fiscal 2018. This was mainly due to the ¥243.6 billion in net income. ¥4.1 billion in unrealized loss on investment securities related to strategically held shares, ¥0.2 billion in net deferred loss on hedging instruments, and ¥11 billion in loss on foreign currency translation adjustments.

Dividend Policy and Dividends

It is the policy of Tokyo Electron to pay dividends on the basis of business performance. The Company aims for a payout ratio of 50% of net income attributable to owners of the parent. Furthermore, with an eye to ensuring stable dividends, a lower limit of ¥500 per share has been set on annual dividends.1 Reflecting the Company’s strong sales and profit growth, Tokyo Electron paid annual dividends for fiscal 2019 of ¥758 per share (for a payout ratio of 50.1%), its highest ever. Going forward, the Company will seek to build world-class profitability and reciprocate the support of shareholders through delivering profit growth.

Financial Position and Cash Flows

Assets, Liabilities and Net Assets

Current assets increased ¥36.2 billion from the end of the previous fiscal year to ¥982.8 billion, reflecting a ¥25.2 billion decrease in cash and cash equivalents and ¥44.0 billion increase in short-term investments. The turnover period for trade notes and accounts receivable in fiscal 2019 was 42 days, compared with 52 days in fiscal 2018, and the inventory turnover period in fiscal 2019 was 101 days, compared with 111 days in fiscal 2018.

1 This lower limit may be revised in the event that the Company does not generate net income for two consecutive fiscal years.
Net property, plant and equipment increased ¥24.1 billion year on year to ¥500.9 billion. This was largely due to finishing construction of new development buildings at the Yamanashi and Tohoku plants, and acquiring new evaluation tools. Investments and other assets decreased ¥5.5 billion year on year to ¥24.6 billion. This reflected a ¥6.8 billion year-on-year decrease in intangible assets to ¥9.0 billion, due primarily to depreciation and amortization, as well as the removal of TEL NEXX, Inc. from the scope of consolidation due primarily to depreciation and amortization, as well as the completion of construction of a new development building at the Miyagi Plant and start of construction of new production buildings at the Tohoku and Yamanashi plants to meet rising demand for etch and deposition equipment.

As a result, the equity ratio rose 6.2 percentage points year on year to 70.0% at the end of March 2019 ROE climbed to 30.1% from 29.0% in fiscal 2018. In addition, Tokyo Electron adopted Partial Amendments to Accounting Standard for Tax Effect Accounting (ASBJ Statement No. 28, revised on February 16, 2018) from April 1, 2018. Prior year comparisons retroactively apply these standards to the abovementioned figures for assets, liabilities and net assets as of March 31, 2018.

**Financial Position**

<table>
<thead>
<tr>
<th>Millions of yen</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total current assets</td>
<td>¥670,883</td>
<td>¥671,416</td>
<td>¥775,938</td>
<td>¥546,597</td>
<td>¥922,897</td>
</tr>
<tr>
<td>Net property, plant and equipment</td>
<td>106,896</td>
<td>96,317</td>
<td>100,441</td>
<td>125,952</td>
<td>150,069</td>
</tr>
<tr>
<td>Total investments and other assets</td>
<td>98,375</td>
<td>79,635</td>
<td>81,067</td>
<td>130,246</td>
<td>124,661</td>
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<tr>
<td>Total assets</td>
<td>876,154</td>
<td>793,368</td>
<td>957,447</td>
<td>1,202,796</td>
<td>1,202,796</td>
</tr>
<tr>
<td>Total current liabilities</td>
<td>172,812</td>
<td>166,061</td>
<td>247,770</td>
<td>368,452</td>
<td>304,882</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>254,991</td>
<td>220,129</td>
<td>311,447</td>
<td>431,287</td>
<td>369,510</td>
</tr>
<tr>
<td>Total net assets</td>
<td>621,163</td>
<td>573,239</td>
<td>646,000</td>
<td>968,509</td>
<td>933,286</td>
</tr>
</tbody>
</table>

Note: From fiscal 2019, the Company applied the Accounting Standards Board of Japan's "Partial Amendments to Accounting Standard for Tax Effect Accounting" (ASBJ Statement No. 28, revised on February 16, 2018). Total current assets, total investments and other assets, total assets and total liabilities for fiscal 2018 have been restated in accordance with the revised accounting standards.

**Capital Expenditures and Depreciation and Amortization**

Capital expenditures totaled ¥49.7 billion in fiscal 2019, a 9.1% year-on-year increase. Major expenditures included the acquisition of evaluation tools in order to strengthen key areas in the SPE business as well as the completion of construction of a new development building at the Miyagi Plant and start of construction of new production buildings at the Tohoku and Yamanashi plants to meet rising demand for etch and deposition equipment. Depreciation and amortization increased 18.0% to ¥24.3 billion.

Capital expenditures are subject to the gross increase in property, plant and equipment. Depreciation and amortization does not include amortization of goodwill or losses on impairment.

**Cash Flows**

The balance of cash and cash equivalents at the end of March 2019 stood at ¥232.6 billion, a decrease of ¥2.9 billion from the end of fiscal 2018. This was mainly attributable to ¥24.7 billion in dividends paid.

In addition, cash in investing activities was ¥84.0 billion, compared with ¥18.8 billion used in the previous fiscal year. This was mainly due to the investment of ¥45.5 billion used as payment for purchases of property, plant and equipment and a net outflow of ¥44.0 billion due to an increase in short-term investments. Net cash used in financing activities came to ¥192.7 billion, compared with ¥82.5 billion in fiscal 2018. This was mainly attributable to ¥204.7 billion in dividends paid.

**Cash on Hand**

Cash on hand, cash and cash equivalents were ¥282.6 billion as of March 31, 2019, which includes investments with original maturities of less than one year not included in cash and cash equivalents, increased ¥18.7 billion year on year to ¥392.6 billion at the end of March 2019. Cash flows during the fiscal year under review were as follows.

Net cash provided by operating activities came to ¥189.5 billion, up ¥2.9 billion from fiscal 2018. Major contributors were ¥321.5 billion in income before income taxes, ¥243.4 billion in depreciation and amortization, and a ¥10.0 billion decrease in trade notes and accounts receivable. Major outflows included ¥102.9 billion in income taxes paid, a ¥31.7 billion decrease in trade notes and accounts payable, a ¥22.0 billion decrease in customer advances, and a ¥14.7 billion increase in inventories.

Net cash used in investing activities was ¥84.0 billion, compared with ¥18.8 billion used in the previous fiscal year. This was mainly due to the investment of ¥45.5 billion used as payment for purchases of property, plant and equipment and a net outflow of ¥44.0 billion due to an increase in short-term investments. Net cash used in financing activities came to ¥192.7 billion, compared with ¥82.5 billion in fiscal 2018. This was mainly attributable to ¥204.7 billion in dividends paid.
Business-Related and Other Risks

The following risks may have a material impact on Tokyo Electron's business performance, stock price, or financial position.

(1) Impact from Changes in the Semiconductor Market
Tokyo Electron has achieved a high profit margin by concentrating resources in high-tech fields, including semiconductor production equipment, where technological innovation is rapid but Tokyo Electron can effectively use its strengths. Although technological change is responsible for the semiconductor market's rapid growth, Tokyo Electron has actively undertaken structural reforms to be able to generate profits under any circumstances, including when the market contracts temporarily due to imbalance of supply and demand. However, order cancellations, excess capacity, and increased inventories resulting from an unexpectedly large market contraction, losses from bad debts resulting from the worsening of a customer's financial position, and supply shortages resulting from the worsening of a supplier's management situation, could adversely affect Tokyo Electron's business performance considerably.

(2) Impact from Concentration of Transactions on Particular Customers
Tokyo Electron has been successful at increasing transactions with the leading semiconductor manufacturers worldwide, including those in Japan, through the provision of products featuring outstanding, cutting-edge technology and of services offering a high level of customer satisfaction. However, Tokyo Electron's sales may from time to time be temporarily concentrated on particular customers due to the timing of large capital investments of major semiconductor manufacturers. The resulting escalation in sales competition could adversely affect Tokyo Electron's business performance.

(3) Impact from Research and Development
Through ongoing and proactive R&D investment and activities in cutting-edge technologies—miniaturization, vacuum, plasma, thermal processing, coating/developing, cleaning, wafer-transfer and clean technologies—Tokyo Electron has created advanced technologies. At the same time, by quickly bringing to market new products incorporating these technologies, Tokyo Electron has successfully captured a high market share in each of the product fields it has entered and generated a high profit margin. However, delays in the launch of new products and other factors could adversely affect Tokyo Electron's business performance.

(4) Safety-Related Impact
Tokyo Electron's basic philosophy is to always bear in mind safety and health in the execution of business activities, including development, manufacturing, sales, services, and management. In accordance with this philosophy, Tokyo Electron works actively and continuously to improve the safety of its products and to eliminate any harmful impact on health. However, harm to customers, order cancellations or other circumstances resulting from safety or other problems related to Tokyo Electron's products could adversely affect Tokyo Electron's business performance.

(5) Impact from Quality Issues
Tokyo Electron actively develops outstanding, cutting-edge technologies for incorporation in new products that are brought quickly to market. At the same time, Tokyo Electron has promoted its R&D strategy for the early development of cutting-edge technologies together with its business and intellectual property strategies. This approach has enabled Tokyo Electron to obtain sole possession of many proprietary technologies that have been instrumental to the Company's ability to capture a high market share and generate high profit margins in each of its product fields. Tokyo Electron's products incorporate and optimize many of these proprietary cutting-edge technologies. There may be cases in which, by avoiding the use of third-party technologies and intellectual property rights, Tokyo Electron's business performance could be adversely affected.

(6) Impact of Intellectual Property Rights
In order to distinguish its products and make them more competitive, Tokyo Electron has promoted its R&D strategy for the early development of cutting-edge technologies together with its business and intellectual property strategies. This approach has enabled Tokyo Electron to obtain sole possession of many proprietary technologies that have been instrumental to the Company's ability to capture a high market share and generate high profit margins in each of its product fields. Tokyo Electron's products incorporate and optimize many of these proprietary cutting-edge technologies. There may be cases in which, by avoiding the use of third-party technologies and intellectual property rights, Tokyo Electron's business performance could be adversely affected.

(7) Impact of Fluctuating Foreign Exchange Rates
Success in the development of overseas operations has increased the share of sales generated overseas. As a rule, Tokyo Electron conducts export transactions on a yen basis to avert exposure to foreign currency risks. However, some exports are denominated in foreign currencies. In these cases, Tokyo Electron hedges foreign currency risk by using a forward foreign exchange contract when an order is received or by other means. However, foreign exchange rate risks can arise from fluctuations in prices due to sudden foreign exchange movements, which could have an indirect adverse effect on Tokyo Electron's business performance.

(8) Influence of Corporate Acquisitions
As part of its business strategy, Tokyo Electron conducts corporate acquisitions in order to expand into new business areas, secure new technologies and business platforms, and strengthen the competitiveness of existing businesses. The Company conducts due diligence and carefully deliberates each specific acquisition. However, in the event that the results following an acquisition do not meet expectations, Tokyo Electron's business performance could be adversely affected.

(9) Impact from Major Lawsuits or Legal Actions
Tokyo Electron is not currently involved in any lawsuits or other legal actions that are likely to significantly influence its business results. However, in the event that the Company's business or other activities become the subject of a major lawsuit or other legal action, depending on the outcome of such action, Tokyo Electron's business results could be adversely affected.

(10) Impact of Laws and Regulations
Tokyo Electron operates globally and is therefore subject to many other factors. These include the world and regional economic environments, natural disasters, war, terrorism, infectious diseases and other unavoidable occurrences, financial or stock markets, government or other regulations, supply chains, market conditions for products and real estate, the ability to recruiting personnel in Japan and overseas, competition over standardization, and loss of key personnel. Any of these factors could adversely affect Tokyo Electron's business performance.