CFO Interview

Constantly Evolving ROIC Management Enabling OMRON's Self-driven Growth

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Earning Capacity Further Enhanced despite an Unprecedented Contingency

——You have led OMRON's COVID-19 countermeasures requiring difficult decisions amid the challenging situations found all over the world. What are your thoughts looking back on the previous fiscal year?

After launching the COVID-19 Emergency Headquarters in January 2020, as deputy general manager I oversaw the implementation of countermeasures while working closely with each business unit and our overseas sites. During the pandemic, I focused on our responsibilities as a member of local communities and our responsibility to supply products to customers, with employees' safety and health a top priority. The number of infections varied by country and region, so our basic policy was to disseminate information from the headquarters in Japan while setting up emergency headquarters in each region; thereby, ensuring an independent and agile response, including in terms of working styles.

Furthermore, we reduced fixed costs by more than ¥20 billion per year and actively worked on solution proposal-based sales and business process reforms utilizing remote work, in order to survive this crisis when a substantial drop in sales was expected. As a result, in fiscal 2020 we posted a 14.1% year-on-year increase in profits, despite a downturn in revenue, and gross profit margin, an indicator of profitability, rose by 0.7 points to 45.5%, marking the highest level on record.

Our reduction in fixed costs in fiscal 2020 went beyond just cutting or stopping fixed costs. We recognized this as an opportunity to transform our conventional approaches to work, such as face-to-face communication. Therefore, we were able to lower fixed costs by ¥22.2 billion, well above the target of ¥20 billion. At the same time, investments in IT systems along with the future growth drivers of the Industrial Automation Business (IAB) and Healthcare Business (HCB) were carried out after careful consideration during the COVID-19 pandemic. We were able to progress according to plan because we worked with the shared recognition that reducing fixed costs and making growth investments are actions paving the way to the future.

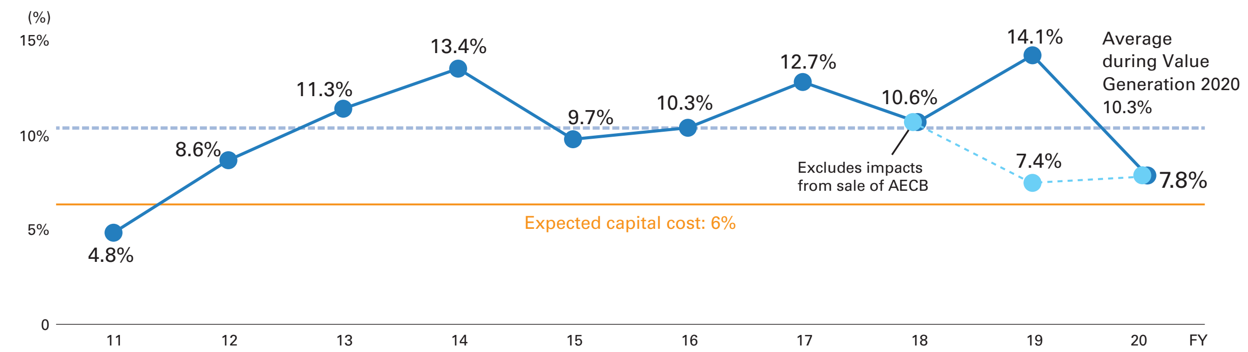
ROIC Management Underpinned by Portfolio Management and Down-Top ROIC Tree

—— Fiscal 2020 marked the final year of OMRON's 10-year long-term vision Value Generation 2020. During this period, the Company promoted management based on the OMRON Principles using both ROIC Management and Technology Management. How do you evaluate the results over this 10-year period?

Our corporate Principles form the foundation of ROIC Management. Based on this recognition, we are focusing first and foremost on rebuilding our business portfolio. Our aim is to contribute to the development of society through our business, going beyond increasing sales and profits. If we can supply the world with essential products, this will naturally lead to higher sales and profits and as a result we will be in a position to invest in the next stage of growth. As such, we will explore ways to enhance the value we offer by accelerating growth investments in businesses that generate profits. At the same time, since businesses that do not generate profits do not contribute to the world, we will search for the best partner outside OMRON to take over these businesses or consider exiting them altogether. In making these decisions, we will not rely simply on the numbers, but rather deliberate over the technologies of these businesses and future potential of the market.

ROIC was 4.8% in fiscal 2011 at the start of Value Generation 2020. Since fiscal 2012, though, ROIC has trended above expected capital cost of 6%, with the 10-year average sitting at 10.3%. In fiscal 2020, ROIC fell back to 7.8%, but this was impacted by the transfer of the Automotive Electronic Components Business in fiscal 2019 and because cash on hand is at 4.6 months of sales, which greatly exceeds the target range of one to two months during normal times. Going forward, in order to further enhance corporate value, the cash stockpiled until now and the cash generated from businesses in the future will be used to strengthen existing businesses and invest in new opportunities to accelerate our growth. We will continue to increase capital efficiency and our ability to generate future cash flow by allocating management capital in the best way possible.

Trends in Return on Invested Capital (ROIC)



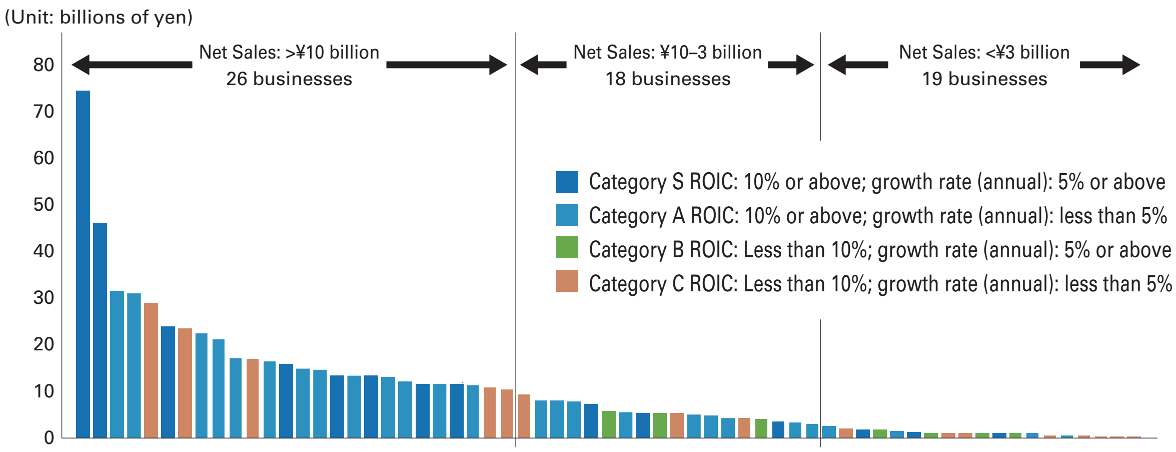
—— Business Portfolio Management is important in promoting ROIC Management.

OMRON had a total of 63 business units as of the end of fiscal 2020. When evaluating business units using ROIC, we have established the level of 6% of expected capital cost for each business to measure where corporate value is being undermined or not. From this, the hurdle rate is set at 10%, exceeding the cost of salespeople and administrative departments. However, first discussions are held based on present numbers while considering differences in the business life cycle and stage, without making a judgement based solely on this hurdle rate, to determine problem areas and how to make improvements. Next, an action plan is formulated and explained which contains the milestones and measures needed to clear the hurdle rate. At that time, I take ownership as the person responsible for ROIC Management and need to reach a consensus with the heads of business units.

Business units probably feel a constant sense of pressure, but amid our discussions using the common language of ROIC repeated every year, composed and realistic opinions naturally emerge. This includes recognition that a business unit's problems can be fully resolved organically, determination of who to partner with, or whether it is wise to transfer the business. Furthermore, from the perspective of the company's entire business portfolio, we are now able to examine business repositioning or organizational restructuring. For example, we determined that IAB and HCB should be focus areas as our core business, that the Social Systems, Solutions and Service Business (SSB) should develop the solutions business together

with the environmental business, and that the Electronic and Mechanical Components Business (EMC) should consolidate its production sites to enhance its earnings structure.
In fiscal 2020, we added three business units to investment domains (Category S) compared to fiscal 2019 and removed four business units from the profitability restructuring domains (Category C), which greatly improved the evaluations of business units compared to fiscal 2019. Going forward, we will continue to deepen discussions with business units using the common language of ROIC to build a more powerful and pliable business portfolio.
Furthermore, we have changed our expected capital cost from 6% to 5.5% starting from fiscal 2021. The hurdle rate for the businesses, though, remains the same at 10%. We will continue aiming to enhance corporate value by improving ROIC and lowering capital cost.

Business Units Subject to Portfolio Management (FY2020)

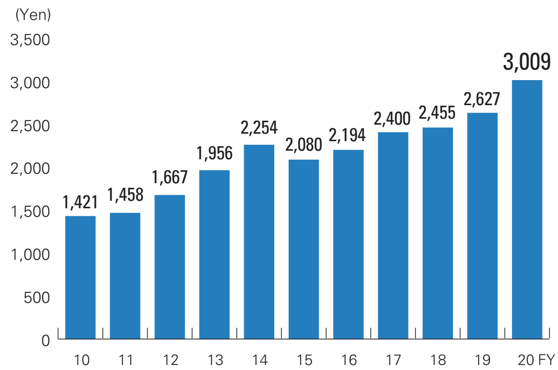


Evolving ROIC Management toward Self-Propelled Growth

—— Could you provide a general overview of OMRON's improved financial resiliency, which can be considered as an outcome from a decade of ROIC Management? Could you also share the company's cash allocation policy?

Looking at cash allocation, we have greatly improved our earnings power compared to 10 years prior and we have built up capital. Furthermore, we integrated cash management operations globally and established as system where cash can be allocated by the Head Office.
Operating cash flow during Value Generation 2.0 (fiscal 2017 to fiscal 2020) has steadily risen owing to our enhanced earnings power and efficient use of working capital. Furthermore, we saw a major inflow of cash together with these operating cash flows following the transfer of AEC. Meanwhile, we are funding capital investment aimed at future growth and executing strategic investments such as M&A focused on our core IAB and HCB segments. As for shareholder returns, we continued to pay out a stable dividend and initiated stock buybacks in an agile manner considering capital efficiency.
As a result of these initiatives, book value per share (BVPS) at the end of fiscal 2020 totaled ¥3,009, which is roughly double the level of fiscal 2010. In addition, total shareholder returns including stock price increased by 397.5% as of the end of fiscal 2020 when using the closing price as of the end of fiscal 2010, roughly quadrupling.
As for our cash allocation policy including shareholder returns, we will continuously increase operating cash flow generated from existing businesses and prioritize investments needed for future growth, aiming to sustainably enhance corporate value. After securing internal reserves

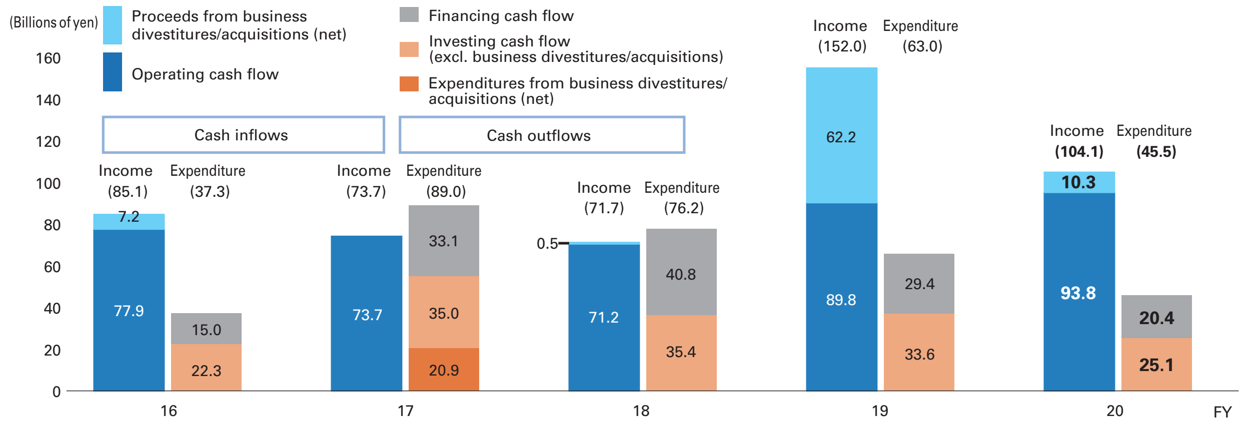
Book Value Per Share (BVPS)



*Figures as of the end of each fiscal year in the case of purchasing at the closing price as of the end of fiscal 2010.

needed to fund future investments, we will pay out a stable and continuous dividend to our shareholders. To efficiently administer surplus funds accumulated over many years, we will work toward management conscious of capital efficiency and execute stock buybacks in an agile manner.

Trends in Cash Flow



Note 1: Figures presented exclude impacts of foreign exchange rates.
Note 2: Figures for cash flow from investing activities are presented separate from impacts due to business divestitures/acquisitions. Proceeds and expenditures from business divestitures/acquisitions include "Acquisition of business, net of cash acquired (net with cash outflow amount)," "Proceeds from sale of business, net of cash paid (net with cash outflow amount)" and "Decrease in investments in affiliates (increase)" appearing in the consolidated statements of cash flows.

—— How will ROIC Management evolve in OMRON's future growth?

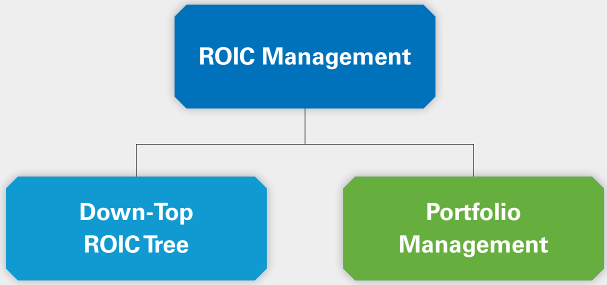
There are new ways of generating earnings through the service business and recurring business amid the worldwide trend of combining products and user experience. This change has not been fully reflected in our Down-Top ROIC Tree previously; thus, we will need to ascertain initiatives underway while reviewing KPI as necessary. At the same time, we will have to establish a new indicator going forward, since ROIC indicates the present value calculated as financial information but cannot measure the value of intangible assets linked to future growth. As such, aimed at the next long-term vision, we are holding discussions on indicators and visualization of future growth including ESG (Environmental, Social, Governance) issues and non-financial value.

—— Fiscal 2021 has been positioned as the starting line for the Company's efforts toward self-driven growth. As CFO, how will you work to achieve this growth?

In addition to a recovering global economy, there are growing demands in society to address sustainability including reducing CO_2 emissions. In fiscal 2021, we will boost revenue across all business segments by steadily capturing these business opportunities. In addition, we will work on structural reforms and on increasing added value by strengthening the marketability of our products, while prioritizing investments needed for future growth along with continuously increasing operating cash flow generated from existing businesses aimed at continuing new working styles implemented during the COVID-19 pandemic. After securing internal reserves needed to fund future investments, we will pay out a stable and continuous dividend to shareholders. Additionally, surplus funds accumulated over the years will be used toward management conscious of capital efficiency by executing stock buybacks in an agile manner. We will minimize any uptick in fixed costs to further boost earning capacity going forward. Currently, our core IAB and HCB segments are expected to see substantial growth in the future and for this reason we will work to achieve robust sales growth here. The cash generated from this sales growth and strong earnings power will be deployed to fund M&A, business alliances, and investments in venture companies, unlocking new growth opportunities, which will pave the way for the next stage of our growth. To actualize this growth, we will invest in human capital and further accelerate digital transformation (DX) including the evolution of our core IT systems currently underway. Since both require a long-term perspective, we will work toward each with an eye toward future cash flows.
Today the world is experiencing profound changes characterized by Volatility, Uncertainty, Complexity and Ambiguity (VUCA). We will be left behind if we simply maintain the status quo. In such an era, OMRON will further strengthen its existing businesses while also creating value based on new growth opportunities. Under our next long-term vision, we will evolve our business model by not only providing value through products, but also combining them with services and user experience and co-creating with partners. Toward this end, in fiscal 2021 we will speed up our business model reforms and concepts for our next management system to actualize growth during the next long-term vision.

ROIC Management

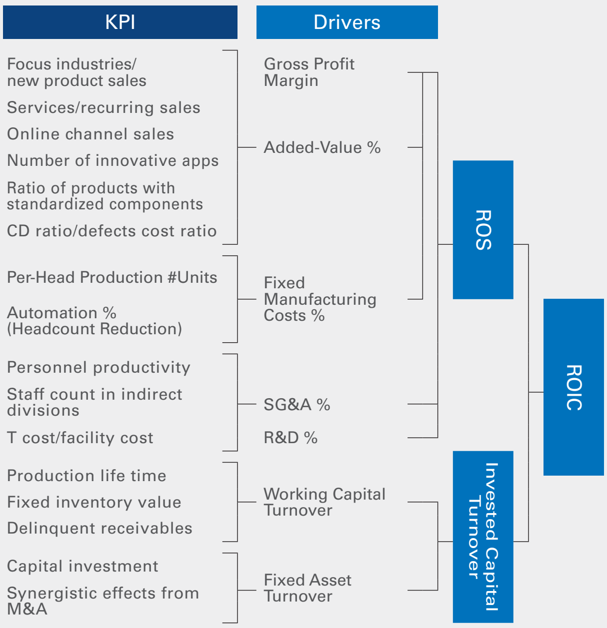
ROIC management consists of Down-Top ROIC Tree and Portfolio Management.
OMRON encompasses a number of business divisions with varied characteristics. We believe ROIC is an excellent measure for assessing business performance fairly for each business. Using operating income or operating income margin as an indicator doesn't account for variances due to the nature or scope of a business. ROIC, on the other hand, measures return on invested capital, providing a fair assessment.



Down-Top ROIC Tree

Down-Top ROIC Tree breaks ROIC into key performance indicators for each department, allowing us to improve ROIC at the most basic operating level. Using simple ROS or invested capital turnover as ROIC indicators are ineffective, since they do not relate directly to front-line operations. On-site managers would have trouble thinking of ways to improve ROIC using these indicators. However, we can break ROIC down into automation/head count reduction or facilities turnover as KPIs of manufacturing departments. With these indicators, managers can finally see how their goals tie directly to ROIC improvement initiatives. At OMRON, one of our greatest strengths is our unified approach to improving ROIC from the ground level up.

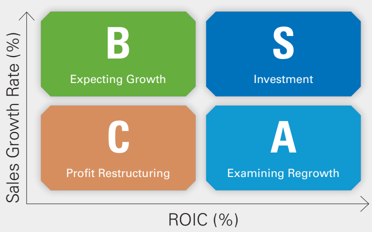
Down-Top ROIC Tree



Portfolio Management

OMRON consists of approximately 60 business units, each subject to a portfolio management system that assesses the economic value of the unit according to (1) ROIC and (2) sales growth rate. In this way, OMRON management can make proper and timely decisions related to new business entry, growth acceleration, restructuring, or divestiture to drive improvements in OMRON Group value.
We consider both the economic value and the market competitiveness of a business to allocate limited resources in an optimal manner. This assessment system allows us to identify the growth potential of each business unit, making an optimal allocation of our resources.

Assessing Economic Value



Assessing Competitiveness