

Message from the CFO



I was named senior general manager of the Global Strategy HQ in March 2014. In April 2017, I assumed the post of chief financial officer of the OMRON Group. At present, I hold both CFO and senior general manager titles, responsible for both group finance and management strategy. I joined OMRON as a freshly graduated engineering student. Over the next ten years, I worked on development for automatic control technics. Later, I went on to hold positions in business and headquarters management strategy, group resource management (including human resources and administration), and a variety of other posts. A CFO with both technical and business backgrounds might be an exception to the norm today; however, I believe my experience is a strength for a company like OMRON that has declared itself a leading technology company since the beginning. Technological innovation has changed so much in our world. I believe any financial strategy now must integrate management, business, and technology strategies. I will continue to rely on my experience, offering a high-level perspective to the OMRON decision-making process.

A handwritten signature in black ink that reads "Koji Nitto".

Koji Nitto

Director, Senior Managing Executive Officer
CFO and Senior General Manager, Global Strategy HQ

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Fiscal 2017: A Positive Cycle of Growth

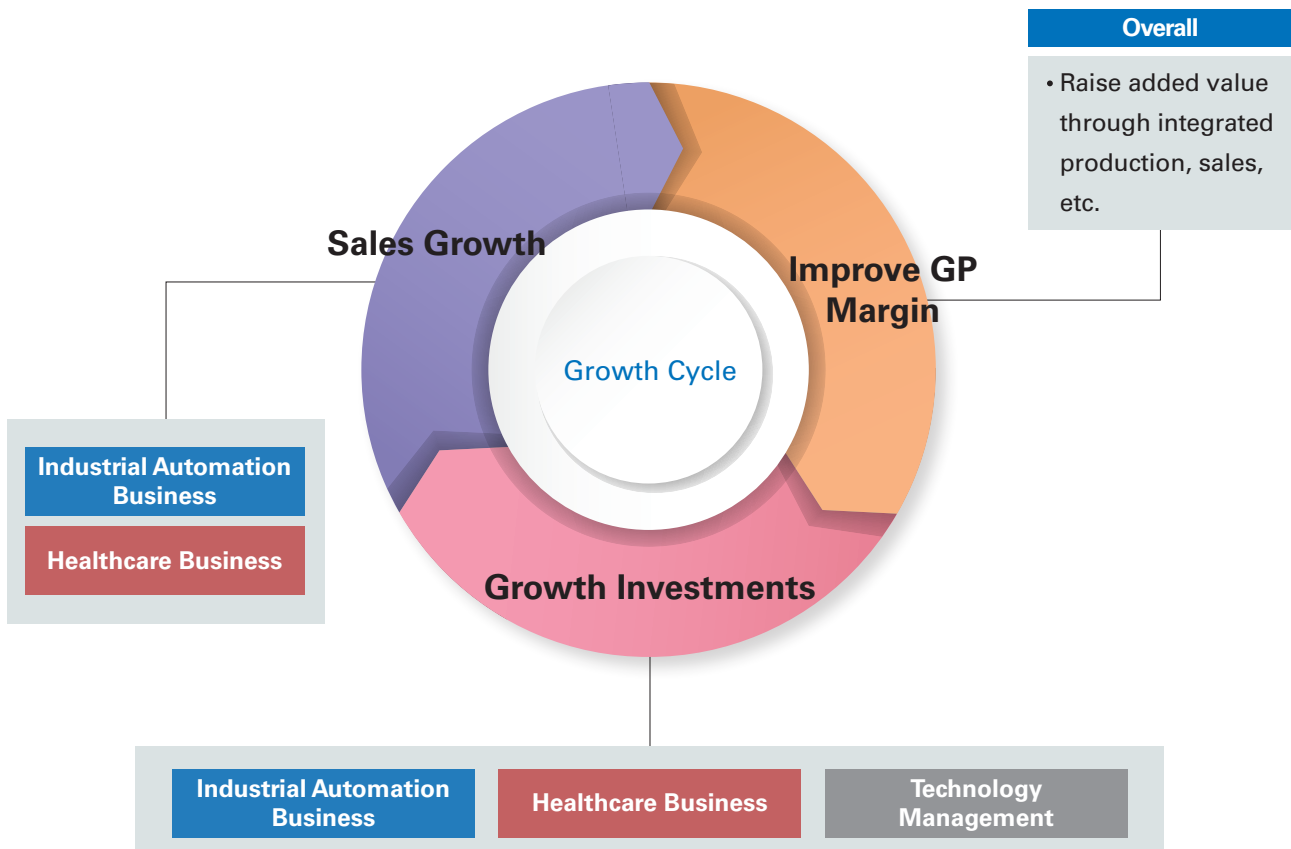
I view fiscal 2017, our first year under the VG2.0 plan, as a year in which we created a positive cycle of growth.

First, I will address measures we took to strengthen corporate earning power through improved gross profit margin. For fiscal 2017, we recorded a gross profit margin of 41.6%, a sharp 2.3-point jump compared to the prior year. What drove this improvement? Our practice of ROIC management, two specific factors that I wish to mention here. The first factor was improved value added ratio. This growth in value added ratio stems from coordinating production, development, sales, and planning functions. This coordination leads to a better mix of high-value-added products, as well as cost savings through standardized components. The second factor was lower fixed manufacturing costs, achieved through gains in productivity generated by industrial engineering (research into manufacturing processes). Consistent, intentional efforts in three

areas shifted our product mix and led to gross profit margin gains: (1) Constant attention to improving value added and reducing fixed costs (just mentioned); (2) Concentration of management resources for growth in our high-margin Industrial Automation Business; and (3) Ongoing company-wide structural reform. I am confident that our corporate earnings power has reached a new stage.

We are using our profits as a resource to accelerate growth investments in technology management in our organization as a whole, and in our mainstay Industrial Automation Business and Healthcare Business in particular. These two businesses were the workhorses driving us to record-high OMRON Group sales.

We will reach new levels of corporate value as we continue to repeat this growth cycle, building our earnings power, investing for market dominance, and growing our revenue base.



ROIC Management Builds True Earnings Power

OMRON has selected ROIC as a key management indicator to measure the profitability of our invested capital. We believe ROIC correctly assesses the profitability across multiple businesses having different characteristics. This, in turn, allows us to invest our resources wisely. ROIC management has become familiar throughout our business, an accepted company-wide measure we use to encourage ongoing improvement. Our activities to improve gross profit margin, mentioned earlier, stem from our focus on ROIC. ROIC management consists of two components: Down-top management and portfolio management. Down-top ROIC management is a more detailed key performance indicator tied to activities in the local workplace. Portfolio management assesses our more than 90 business units using a combination of sales growth and market growth. We ensure ROIC management is the tool by which management and local workplaces view our business. This is how we strengthen our ability to generate value and earnings power, as well as establish a persistent growth cycle. For fiscal 2017, we generated an extremely high ROIC of 12.7%.

Under VG2.0, we consider ROIC of between

10% and 15% to be appropriate. Accordingly, we require business divisions to deliver a minimum 10% ROIC. Where a business cannot reach 10% ROIC, we assess the business's future and market value, taking action as necessary. For example, during fiscal 2017 we introduced structural reforms in our Micro Devices Business, which has struggled with profitability. More specifically, we closed the smartphone microphone business, while we integrated the competitive MEMS business into our Electronic and Mechanical Components Business. At the same time, we moved the important technologies and expertise of the R&D and manufacturing departments under the management of headquarters. We also sold the shares of OMRON Laserfront Inc. and continued with structural reform measures at our Backlights Business, downsizing the scope operations.

Practicing ROIC management in this way, we generate value (profits), which is used to create even greater value through correct cash allocation and investment management.

Balancing Discipline and Risk in Investment Management

We will focus the resources we generate through improved earnings power to invest in promising growth areas, speeding initiatives for *innovation driven by social needs*.

The first half of VG2.0, fiscal years 2017 and 2018, is a time for us to solidify our growth structure, bolstering sales and other front office functions. We will also increase investments in research and development, facilities, and M&A. Speaking of M&A, we made two acquisitions during 2017 in our Industrial Automation Business. When we consider an acquisition, we give priority to the type of synergies and innovation we expect from combining the resources of the target with our own. Simple addition is not acceptable. We must be confident of multiplicative effects gained through synergies. As an objective standard, we

set a minimum 10% ROIC as the hurdle for recovering our investment. Obviously, we require a higher rate of return for projects that demand higher returns from a standpoint of strategic value. Acquisitions are subject to annual performance reviews to determine whether results are in line with plans. If progress is not satisfactory, we monitor the project to understand what measures are being taken. I am proud to say that each of the five M&A transactions over the past four years have outperformed our expectations, offering dramatic synergies with our existing businesses.

M&A Transactions Since Fiscal 2014

Acquisition (FY)	Company Name	Company Overview
2014	NS Indústria de Aparelhos Médicos Ltda.	Nebulizer manufacturer with the number one share of the nebulizer market in Brazil
2015	Delta Tau Data Systems, Inc.	U.S.-based manufacturer of world-class motion controllers
2015	Adept Technologies, Inc.	U.S.-based manufacturer of a wide range of industrial robot models
2017	Sentech Co., Ltd.	Japan-based manufacturer of ultra-compact high-definition industrial cameras
2017	Microscan Systems, Inc.	U.S.-based manufacturer of industrial code readers incorporating industry-leading reading technologies

Research and development expense is an important long-term investment for the OMRON Group. We have set a standard for R&D expense at 7% of sales, and we intend to raise this level to 7.5% by fiscal 2020. Our target for investments in core technologies, including AI and robotics, is about 1% of sales. Dedicating capital to the progress of technology represents up-front investments that will bear fruit for corporate growth 10 and 20 years down the line. This is the

type of investment we must undertake as a manufacturing company if we are to develop innovations that improve lives and contribute to a better society. Accordingly, we will continue to make bold investment decisions that challenge the frontiers of science, balancing discipline and risk to deliver to the world innovation driven by social needs.

Appropriate Cash Management and Profit Distribution

OMRON distributes profits according to principles of appropriate cash management and our own profit distribution policy. Our profit distribution policy prioritizes growth investment, stable dividends, and stock buybacks, in that order. We engage actively in growth investments, including M&A activities. At present, we hold cash reserves at a level of between one and two months' sales, a policy we intend to continue. We used internal reserves for the past five corporate acquisitions. However, we would consider borrowing funds from outside sources—after considering the impact on our credit rating—if a promising growth investment demanded more cash than we held in reserve.

Once we have allocated profits to growth investment, we next look to shareholder return. Under the fiscal years covered by VG2.0, our

target for dividend payout ratio and dividend on equity is approximately 30% and 3%, respectively. Why did we add a dividend on equity target of 3% to a dividend payout ratio? We did this to avoid wide swings in dividend payments, even in the event we change earnings forecasts during the fiscal year. Share buybacks will be performed as opportunities present themselves, balanced by growth investment plans and cash on hand. In July 2017, we set a one-year scope of ¥20 billion for share repurchases, securing the entire amount as of May 2018.

Speaking on behalf of OMRON management, we will redouble our efforts to build corporate value as we implement the growth cycle.

Thank you for your support of the OMRON Group.