Financial Review

▼ Sales and Income

Operating Environment

The overall world economy in fiscal 2020 continued to gradually expand, with the United States economy remaining solid and the recovery continuing in Europe, despite slowing growth due to such factors as Brexit-related concerns and weakness in China and other parts of Asia.

Demand for memory chips, which had been a major factor behind slowing investment in semiconductor production equipment (SPE), gradually improved. Although investment in memory chip underwent adjustment, as memory prices bottomed out, investment began to pick up near the end of the fiscal year. In contrast, investment by logic chip manufacturers and foundries grew considerably, reflecting growth in demand for high-performance microprocessors for personal computers and data centers as well as next generation application processors for 5G smartphones in conjunction with efforts to realize a data-driven society, which are expected to ramp up from 2020. Furthermore, demand for power devices, discreet devices and other semiconductors that utilize mature technologies increased. Accordingly, although investment in memory chip was restrained, the wafer fab equipment market remained strong, at over US$50 billion for a third consecutive year.

In the display market, although investment in large generation 10.5 panels for LCD TVs remained strong, a slowdown in shipments of mobile devices led to adjustment in investment in small- and medium-sized panels for OLED display. Accordingly, the market for flat panel display (FPD) production equipment shrank approximately 25% year on year. As with semiconductors, however, demand for displays began to recover in the second half of the year. In 2020, the FPD production equipment market is expected to grow driven by the demand for OLED displays for mobile.

Sales

Net sales in fiscal 2020 came to ¥1,127.2 billion, down 11.8% year on year but surpassing the forecast despite concerns about the impact of COVID-19 in early 2020, reflecting recovery in capital investment for semiconductors and FPDs. By segment, net sales in the SPE segment fell 9.1% year on year to ¥1,060.9 billion. Net sales in the FPD production equipment segment decreased 40.6% year on year to ¥66.0 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 (encompassing sales of parts and used equipment, modifications and maintenance services) rose 5.7% year on year to ¥304.8 billion, accounting for 27.0% of consolidated net sales.

Gross Profit and Operating Income

Gross profit in fiscal 2020 was down 14.1% year on year to ¥451.9 billion, reflecting the decrease in net sales. The gross profit margin fell 1.1 percentage points to 40.1%, due to an increase in the production cost ratio as a result of the decrease in net sales. The operating margin similarly declined 3.3 percentage points to 21.0%. This was mainly due to an increase in the R&D expense ratio as a result of continued aggressive investment to maximize future growth opportunities even during this period of customer investment adjustment.

R&D Expenses

R&D expenses were up ¥6.2 billion year on year to ¥120.2 billion, a record high, due in large part to the continued reinforcement of R&D in the fields of etch, deposition and cleaning systems, in which the Company is working to expand its market share. The ratio of R&D expenses to net sales rose 1.8 percentage points to 10.7%. The Corporate Innovation Division also engaged in the development of equipment and processes in new fields in order to create markets. Furthermore, we are proactively developing new applications leveraging IoT and AI technologies to provide better customer service.

In FPD production equipment, while promotion of the PICP™ plasma etch system, which offers superior processing uniformity, has progressed as planned, Tokyo Electron is developing a new generation of the PICP™ in response to demand for higher resolution. In addition, the inkjet system is being evaluated to manufacture OLED displays, not only for large-size TVs, but also for high-resolution, rapid response gaming displays.

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

During fiscal 2020, net other expenses came to ¥0.3 billion, reflecting ¥0.5 billion in extraordinary loss due mainly to a loss on sales and disposal of property, plant and equipment, offsetting ¥0.1 billion in extraordinary income due in part to gain on change in equity. Income before income taxes came to ¥244.6 billion, down 23.9% year on year. As a result, net income attributable to owners of the parent totaled ¥185.2 billion in fiscal 2020, down 25.4% from fiscal 2019. Net income per share (basic) declined 22.7% year on year to ¥1,170.57.

Comprehensive Income

In fiscal 2020, Tokyo Electron recognized comprehensive income of ¥187.0 billion, compared with ¥242.6 billion in fiscal 2019. This was mainly due to the ¥185.2 billion in net income, ¥7.0 billion in unrealized gains on investment securities related to strategically held shares, ¥8.4 billion in loss on foreign currency translation adjustments and ¥3.2 billion in remeasurements of defined benefit plans.

Dividend Policy and Dividends

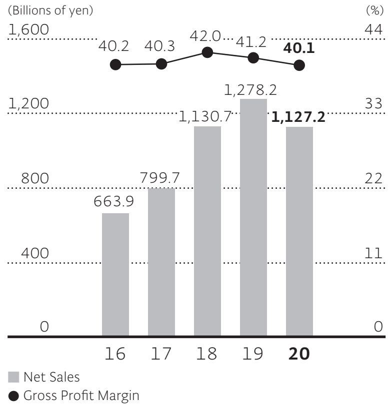
It is the policy of Tokyo Electron to pay dividends on the basis of business performance. The Company aims for a payout ratio of 50% of net income attributable to owners of the parent. Furthermore, with an eye to ensuring stable dividends, a lower limit of ¥150 per share has been set on annual dividends.[1] Accordingly, although the Company's markets were undergoing adjustment, Tokyo Electron paid annual dividends for fiscal 2020 of ¥588 per share (for a payout ratio of 50.2%), its third highest ever. Going forward, the Company will seek to build world-class profitability and reciprocate the support of shareholders by delivering profit growth.

1 This lower limit may be revised in the event that the Company does not generate net income for two consecutive fiscal years.

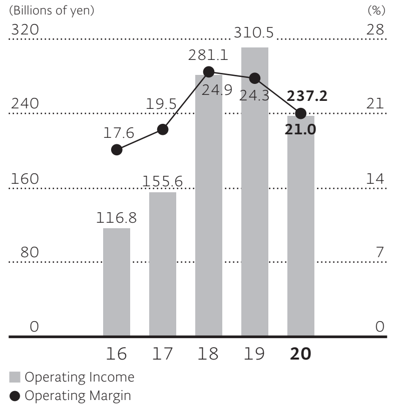
Millions of yen

Sales and Income	2016	2017	2018	2019	2020
Net sales	¥663,949	¥799,719	¥1,130,728	¥1,278,240	¥1,127,286
Gross profit	267,210	322,291	475,032	526,183	451,941
Gross profit margin	40.2%	40.3%	42.0%	41.2%	40.1%
Selling, general and administrative expenses	150,421	166,594	193,860	215,612	214,649
Operating income	116,789	155,697	281,172	310,571	237,292
Operating margin	17.6%	19.5%	24.9%	24.3%	21.0%
Income before income taxes	106,467	149,116	275,242	321,508	244,626
Net income attributable to owners of parent	77,892	115,208	204,371	248,228	185,206

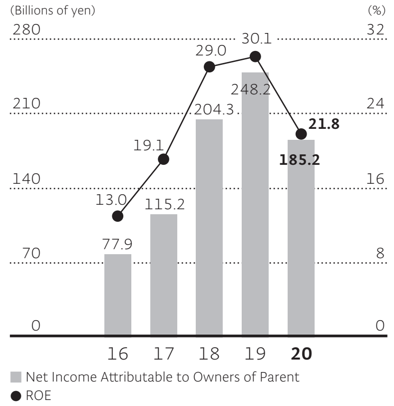
Net Sales and Gross Profit Margin



Operating Income and Operating Margin



Net Income Attributable to Owners of Parent and ROE



ROE = Net income attributable to owners of parent / Average total equity x 100

Financial Position and Cash Flows

Assets, Liabilities and Net Assets

Assets

Current assets decreased ¥20.4 billion from the end of the previous fiscal year to ¥962.4 billion, reflecting a ¥27.7 billion decrease in cash and deposits, a ¥26.5 billion decrease in short-term investments included in securities, and a ¥37.8 billion increase in inventories. The turnover period for trade notes and accounts receivable in fiscal 2020 was 49 days, compared with 42 days in fiscal 2019, and the inventory turnover period in fiscal 2020 was 127 days, compared with 101 days in fiscal 2019.

Net property, plant and equipment increased ¥25.5 billion year on year to ¥175.5 billion. This was largely due to an increase in construction in progress reflecting the new production buildings being built at the Yamanashi and Tohoku plants, and the acquisition of new evaluation tools.

Investments and other assets increased ¥13.9 billion year on year to ¥129.5 billion. Intangible assets increased ¥1.8 billion year on year to ¥10.9 billion, reflecting decreases due to depreciation and amortization (including of goodwill), as well an increase related to the core business systems to be introduced from fiscal 2022. As a result, total assets as of March 31, 2020 stood at ¥1,278.4 billion, up ¥20.8 billion year on year.

Liabilities and Net Assets

Current liabilities increased ¥77.6 billion from the end of fiscal 2019 to ¥382.5 billion at the end of fiscal 2020. This was mainly due to a ¥58.0 billion increase in customer advances and a ¥20.4 billion increase in trade notes and accounts payable.

Non-current liabilities increased ¥1.5 billion year on year to ¥66.2 billion.

Net assets came to ¥829.6 billion at the end of fiscal 2020, down ¥58.4 billion from the end of fiscal 2019. This was mainly due to ¥154.0 billion in repurchase of treasury stock and ¥95.5 billion paid in cash dividends (the fiscal 2019 year-end dividend and fiscal 2020 interim dividend), despite the recording of ¥185.2 billion in net income attributable to owners of the parent.

As a result, the equity ratio fell 5.9 percentage points year on year to 64.1% at the end of March 2020. ROE remained high at 21.8%, despite the decrease in net income attributable to owners of the parent due to market adjustment.

Capital Expenditures[1] and Depreciation and Amortization[2]

Capital expenditures totaled ¥54.6 billion in fiscal 2020, a 9.9% year on year increase. Major expenditures included the acquisition of equipment and measurement instruments for R&D in order to strengthen key areas in the SPE business as well as the construction of new production buildings at the Tohoku and Yamanashi plants to meet rising demand for deposition equipment and the seismic reinforcement of buildings at subsidiaries.

Depreciation and amortization increased 19.7% to ¥29.1 billion.

1 Capital expenditures represent only the gross increase in property, plant and equipment.
2 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 2020 stood at ¥247.9 billion, an increase of ¥15.3 billion from the end of fiscal 2019. The combined balance including ¥90.4 billion in deposits and short-term investments with original maturities of more than three months that are not included in cash and cash equivalents decreased ¥54.2 billion year on year to ¥338.4 billion at the end of March 2020. Cash flows during the fiscal year under review were as follows.

Net cash provided by operating activities came to ¥253.1 billion, up ¥63.5 billion from fiscal 2019. Major contributors were ¥244.6 billion in income before income taxes, a ¥58.6 billion increase in customer advances and ¥29.1 billion in depreciation and amortization. Major outflows included a ¥44.0 billion increase in inventories and ¥41.8 billion in income taxes paid.

Net cash provided by investing activities was ¥15.9 billion, compared with ¥84.0 billion used in the previous fiscal year. This was mainly due to an ¥80.0 billion inflow from the decrease in short-term investments, despite outflows of ¥49.3 billion used as payment for purchases of property, plant and equipment, and ¥10.4 billion due to an increase in deposits.

Net cash used in financing activities came to ¥250.3 billion, compared with ¥129.7 billion in fiscal 2019. This was mainly attributable to ¥154.0 billion in payment for purchases of treasury stock and ¥95.5 billion in dividends paid.

Millions of yen

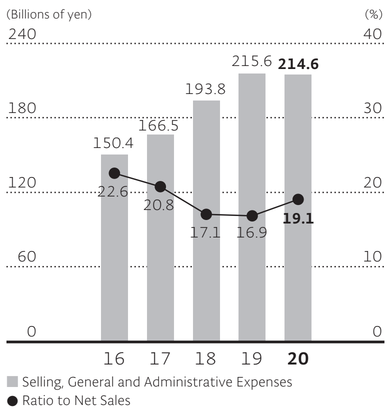
Financial Position	2016	2017	2018	2019	2020
Total current assets	¥617,416	¥775,938	¥ 946,597	¥ 982,897	¥ 962,484
Net property, plant and equipment	96,317	100,441	125,952	150,069	175,580
Total investments and other assets	79,635	81,067	130,246	124,661	140,431
Total assets	793,368	957,447	1,202,796	1,257,627	1,278,495
Total current liabilities	166,061	247,770	368,452	304,882	382,578
Total liabilities	229,129	311,447	431,287	369,510	448,802
Total net assets	564,239	645,999	771,509	888,117	829,692

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 standard.

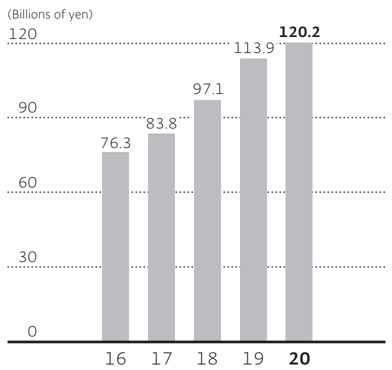
Millions of yen

Cash Flows	2016	2017	2018	2019	2020
Cash flows from operating activities	¥ 69,398	¥136,948	¥186,582	¥189,572	¥253,117
Cash flows from investing activities	(150,014)	(28,893)	(11,833)	(84,033)	15,951
Cash flows from financing activities	(138,601)	(39,380)	(82,549)	(129,761)	(250,374)
Cash and cash equivalents at end of year	95,638	164,366	257,877	232,634	247,959

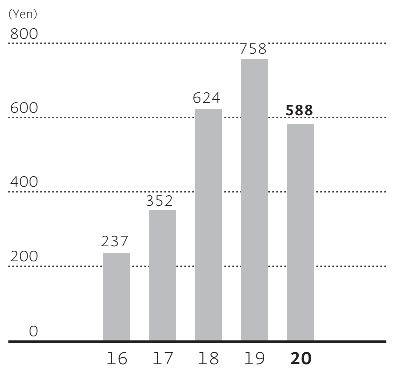
Selling, General and Administrative Expenses and Ratio to Net Sales



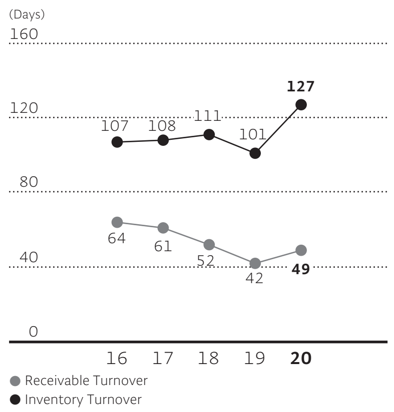
R&D Expenses



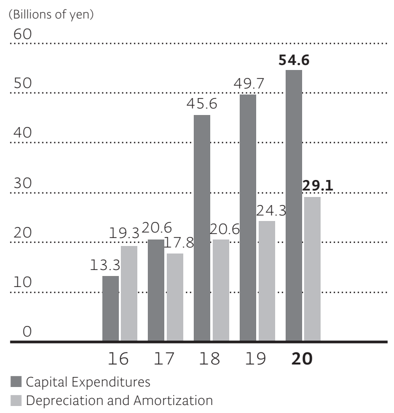
Cash Dividends per Share



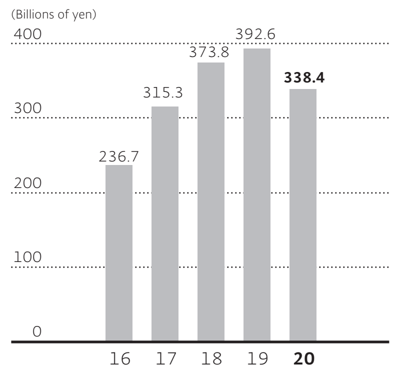
Receivable Turnover and Inventory Turnover



Capital Expenditures and Depreciation and Amortization



Cash on Hand



Cash on hand = Cash and cash equivalents at the end of the year + short-term investments with original maturities of more than three months that is not included in cash and cash equivalents

Business-Related and Other Risks

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

(1) Changes in the Semiconductor Market
The semiconductor market is influenced by a wide range of factors, including the global economy, demand for end products, trade and tariff policies, and geopolitical factors. As a result of such factors, supply and demand can become unbalanced and undergo significant short-term fluctuations. Unforeseen rapid contraction of the semiconductor market could lead to order cancellations, production capacity excess, increases in dead inventory, or losses from bad debts resulting from the worsening of a customer's financial position, or otherwise adversely affect Tokyo Electron's business performance. In addition, a rapid increase in demand that exceeds the Company's assumptions could lead to an inability to provide products to customers in a timely manner resulting in lost sales opportunities or otherwise adversely affect Tokyo Electron's business performance.

The semiconductor market is expected to expand over the medium and long terms, reflecting ongoing technological innovation in step with the adoption of IoT, next-generation (5G) telecommunications standards, AI and other technologies. Nevertheless, in order to respond to potential short-term market fluctuations, Tokyo Electron constantly works to appropriately adjust its capital investment, personnel, inventories and other aspects of its businesses based on the latest market forecasts, taking such steps as periodically reviewing market conditions and orders received at Board of Directors and other important meetings. Furthermore, Tokyo Electron's ability to respond to market fluctuations is enhanced by its wide-ranging lineup of semiconductor manufacturing products, all of which have high market shares in their respective categories and are mutually reinforcing.

(2) Concentration of Transactions on Particular Customers
A large portion of Tokyo Electron's sales are to major, leading-edge semiconductor manufacturers. As such, Tokyo Electron's performance tends to be impacted by changes in capital investment by these major customers. Reductions in their capital investment could lead to temporary decreases in sales, while postponed payment due to the worsening of a major customer's financial position could delay the collection of trade notes and accounts receivable, and these could adversely affect Tokyo Electron's business performance.

The semiconductor market is expected to expand over the medium and long terms. Tokyo Electron has established an Account Sales Division, which works in close coordination with major customers and quickly grasps trends in their capital investment outlook, as well as a Global Sales Division, which responds to a wide range of customer needs and cultivates new customers emerging in step with growth in semiconductor demand. Through such efforts, the Company strives to strengthen and expand its sales framework and customer base.

(3) Research and Development
Through ongoing R&D investment in leading-edge technologies, Tokyo Electron quickly brings to market new products incorporating such technologies, succeeding in capturing high market share in each product category and achieving a high profit margin. However, delays in the launch of new products that meet customers' technological needs, the mismatch of newly developed products with such needs, or the launch of new technologies or products by competitors before such launches by Tokyo Electron could negatively affect the competitiveness of the Company's products, impede the recovery of R&D costs and the maintenance of a high profit margin, or otherwise adversely affect Tokyo Electron's business performance.

Tokyo Electron has established a Corporate Innovation Division, which develops innovative technology and makes groundbreaking technology proposals that integrate the products and technologies of other development divisions, as part of a Groupwide development framework. In addition, the Company shares technology roadmaps spanning multiple technology generations with leading-edge customers in order to constantly provide highly competitive next-generation products that meet future needs ahead of its competitors.

(4) Production and Supply
Tokyo Electron's key production sites are located in Japan, and it supplies products to customers in and outside Japan. As such, earthquakes or other natural disasters, war, acts of terrorism, infectious disease outbreaks or other unavoidable events occurring in Japan could cause interruptions in production that, if not promptly resolvable, could delay the supply of products to customers. Furthermore, the stable supply of components provided by suppliers is indispensable to smooth production. As such, in addition to the risk of disasters, delays in component procurement due to the worsening of a supplier's management situation or similar factors could result in delays in the supply of products to customers and adversely affect Tokyo Electron's business performance.

Tokyo Electron formulates and periodically reviews business continuity plans (BCPs) and works to establish alternate production structures, develop multiple sources of important parts, seismically reinforce its plants, maintain backups of information systems and implement appropriate inventory control. Through these and other measures, the Company strives to maintain stable product supply.

(5) Safety
Damages to customers or order cancellations due to safety-related issues or other problems related to Tokyo Electron's products could result in liability for damages, decrease sales, diminish trust in the Company, or otherwise adversely affect Tokyo Electron's business performance.

Tokyo Electron's "Safety First" approach entails the constant consideration of safety and health in the execution of business activities, including development, manufacturing, sales, services and management. In accordance with this approach, Tokyo Electron works actively and continuously to improve the safety of its products and to eliminate any harmful impact on health. Measures to this end include thoroughgoing safety design at the product development phase, safety training and maintaining an accident reporting system.

(6) Quality
Tokyo Electron's products are based on the integration and optimization of numerous leading-edge technologies. The occurrence of unforeseen defects could lead to recalls or responsibility for other damages based on product or quality liability, necessitate additional costs related to implementing defect countermeasures, decrease sales, diminish trust in the Company, or otherwise adversely affect Tokyo Electron's business performance.

Based on a uniform Groupwide quality control policy, Tokyo Electron provides quality training for its employees and suppliers and strives to maintain a quality assurance system, including ISO 9001 certification, as well as a world-class service system. The Company also seeks to solve customer issues by working with customers from the early stages of product development and design. When defects occur, the Company investigates the root of the problem and takes thoroughgoing measures to prevent recurrences and similar issues. Moreover, in order to increase the quality of procured components, the Company constantly monitors supplier quality, conducting audits and providing support for suppliers in accordance with its regulations.

(7) Laws and Regulations
Tokyo Electron operates globally and is therefore subject to the various laws and regulations of the countries and regions where it does business, including those regarding imports and exports, the environment, competition, labor, the prevention of corruption and bribery, and transfer pricing taxation. Tokyo Electron strives to ensure compliance with such laws and regulations. However, violations of such laws or regulations could result in diminished public confidence in the Company, fines, damages or restrictions on business activities, or otherwise adversely affect Tokyo Electron's business performance. Furthermore, unanticipated future legal amendments or tightening of regulations could, if the Company is unable to respond appropriately, result in liability for costs related to such response or restrictions on business activities, or otherwise adversely affect Tokyo Electron's business performance.

Tokyo Electron has built a system for monitoring compliance activities at key sites in and outside Japan under the direction of a Chief Compliance Officer. The Company conducts compliance assessments, and the identified issues are reported to the CEO, Board of Directors and Audit & Supervisory Board so that they can be dealt with quickly and effectively.

(8) Intellectual Property Rights
Tokyo Electron's products are based on the integration and optimization of numerous leading-edge technologies. Obtaining and legally protecting Tokyo Electron's intellectual property rights and preventing infringements of such rights by third parties are crucial to differentiating and enhancing the competitiveness of its products. Furthermore, infringements by Tokyo Electron of the intellectual property rights of third parties could lead to restrictions on the production and sale of the Company's products or liability for damages, or otherwise adversely affect Tokyo Electron's business performance.

By advancing R&D strategy, business strategy and intellectual property strategy in an integrated manner, Tokyo Electron strives to build an appropriate intellectual property portfolio and obtain exclusive rights to numerous proprietary technologies to capture high market share and achieve high profit margins in each of its product fields.

(9) Information Security
In the course of its business activities, Tokyo Electron obtains, holds and utilizes confidential information, customer information and personal information. The unintentional leak of such information could result in diminished public confidence in the Company, liability for damages or reduced product competitiveness, or otherwise adversely affect Tokyo Electron's business performance. In addition, Tokyo Electron's businesses rely on information systems and networks. Problems with these systems and networks due to cyberattacks, unauthorized access, natural disasters, power outages, equipment malfunctions, human errors or other factors could cause interruptions to operations or a loss of trust.

Tokyo Electron has established regulations and systems for appropriate information management. In addition, the Company reinforces its information and network system by monitoring the reliability of its security though such means as security assessments.

(10) Securing Human Resources
Securing and developing human resources in and outside Japan is crucial to the continued innovation and growth of Tokyo Electron's global businesses. The inability to hire and maintain the necessary human resources on an ongoing basis or the loss of important human resources could lead to staffing shortages, resulting in diminished product development capability or customer support quality and adversely affecting Tokyo Electron's business performance.

Tokyo Electron believes that its employees are the source of ongoing value creation and that increasing employee engagement is one of the most important factors in increasing corporate value. The Company has introduced a globally unified human resources system and incentive plans linked to medium-term business performance, and is advancing ongoing measures to improve work environments as well as health and productivity management, including steps to prevent excessively long work hours and workplace harassment.

(11) Environmental Issues
Requests from Tokyo Electron's stakeholders related to reducing environmental burden are growing. Given this, difficulties in adequately conforming to environmental laws and regulations, or meeting industry standards of conduct or customer needs, could result in related costs, reduce product competitiveness, damage public confidence in the Company, or otherwise adversely affect Tokyo Electron's business performance.

Tokyo Electron strives to comply with environmental laws and regulations and industry standards of conduct, sets its own medium- to long-term environmental goals, and works to reduce greenhouse gas emissions from the use of its products as well as energy consumption at its facilities. In addition, the Company works to protect the global environment through its business activities by such means as providing technologies to reduce semiconductor power consumption, promoting used equipment and parts businesses, reducing equipment size, and increasing productivity by improving throughput.

(12) The Novel Coronavirus (COVID-19)
The spread of COVID-19 could affect Tokyo Electron's business continuity, including its manufacturing and sales activities. In addition, restrictions on the worldwide movement of people and things, the deterioration of global economic conditions, and other such impacts from the spread of COVID-19 could adversely affect Tokyo Electron's business performance.

Tokyo Electron has established an Emergency Task Force headed by the CEO and is implementing related countermeasures, including restricting travel to high infection-risk countries and regions, steps to maintain supply chains, and thoroughgoing infection prevention measures at its facilities.

(13) Other Risks
Tokyo Electron's businesses are influenced by many factors, including economic conditions worldwide and in specific regions, financial and stock markets, product and real estate markets, foreign exchange rates, the success or failure of corporate acquisitions, major lawsuits, and competition over standardization. The Company expects that such factors will sometimes adversely affect performance and takes appropriate measures to counter such risks.