Message from the Director of Corporate Unit

Strengthening organizational capital and maximizing enterprise value by enhancing business management

Member of the Board of Directors and Executive Vice President
Director of Corporate Unit
Director of Corporate Management Group

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New responsibilities and roles as Director of Corporate Unit

In July 2022, I assumed the position of Director of the Corporate Unit, adding responsibilities in the areas of human resources, IT, sustainability, governance, corporate communications, and legal affairs/intellectual property to those I was already handling in my previous role, such as accounting/finance, and management strategy. The Corporate Unit is tasked with optimizing functions, supporting business operations, and promoting synergies among businesses within Murata's distinctive three-dimensional matrix organization.

Recently, the viewpoints that need to be kept in mind in corporate management have expanded from financial to non-financial, and the long-term goals of the company and its stakeholders are becoming more aligned. In this regard also, I feel the weight of responsibility in my new role to lead the corporate function as a whole and contribute to the co-creation of value with stakeholders from multiple perspectives.

Anticipating a drop in sales and profits, but seeing signs of medium- to long-term growth

Although our product sales steadily expanded during the COVID-19 pandemic, demand for components for laptop PCs and tablets declined sharply from the middle of fiscal 2022 on. There has also been a large-scale inventory adjustment in the smartphone space, weakening demand for components. As for profits, we could not counteract the decline in the operating rate for key products and the rise in manufacturing costs (including raw materials and energy expenses) by benefitting from the depreciation of the yen, streamlining, and passing on higher costs to customers. As a result, fiscal 2022 saw a 6.9% decrease in net sales and a 29.8% drop in operating income compared to the previous year.

For fiscal 2023, we expect demand for components to recover in the second half gradually. However, we are working on the assumption that sales and profits will decline for a second consecutive fiscal year because of lower product prices, a significant drop in the operating rate due to production cutbacks at plants, and rising costs such as personnel and energy expenses.

Despite these circumstances, we are beginning to see results from efforts to drive medium- to long-term growth in the mobility market, one of our focus markets. We expect sales to increase with vehicle electrification and are taking steps to regain market share for some of our related second-layer products.

Steadily addressing medium-term management issues despite the challenging business environment

Despite our poor operating performance, in fiscal 2022 we achieved some degree of success in building a foundation for long-term value creation. Specifically, we proceeded with the four medium-term management issues articulated in Medium-term Direction 2024, specifically the first phase of Vision 2030, which includes management transformation, higher-level portfolio management, formation of a lean management base, and preparation for 2030.

Regarding management transformation, to firmly establish hypothesis-based thinking in the business management process, we integrated our single-year budget with our medium-term plan and added the data to the numerical targets as monitoring indicators. We clearly defined the hypotheses on which these targets are based and verified them every quarter, laying a foundation for promptly responding to changes in our environment. In addition to joining the Responsible Business Alliance (RBA) (see page 29) and establishing a Human Rights Committee within the CSR Management Committee, we introduced a sustainability investment promotion system to achieve sustainable growth. This system consists of two measures. The first is a mechanism for encouraging investment that involves the relaxation of rules on determining investment recoup periods and establishing special quotas. The second is the application of an Internal Carbon Pricing (ICP) system, characterized by the recognition of amounts of GHG emissions as expenses in management accounting.

For higher-level portfolio management, we strive to create value by practicing 3-layer portfolio management and positioning four business markets as key business opportunities. Regarding the former, we moved forward with integrating Resonant and Eta Wireless, which we acquired in fiscal 2021, to strengthen differentiated technologies in the second-layer businesses. Regarding the latter, in the mobility area, one of our core fields, we worked to build our presence by aggressively increasing capacitor production capacity and launching products such as new inductors. In our challenge fields, we pressed ahead with the deployment of proprietary energy management systems at our own factories. Also, we invested in an environmental fund to create essential new businesses for the next generation.

Concerning the formation of a lean management base, we endeavored to strengthen our human capital and upgrade our risk management process. In terms of human capital, in addition to developing the next generation of corporate executives, we also launched "Make2030," a program designed to nurture the next generation of leaders who are our path forward. In this way, we are putting together a structure whereby talent in a wide range of age groups can work with the current executives to address long-term management issues. In addition, we have focused on risk management in recent years, leveraging the insights of our Outside Directors to develop a risk management structure that contributes to our value-creation process. For example, in April 2023, we put the Risk Management Committee, which had previously been under the jurisdiction of the CSR Management Committee, under the direct control of the Representative Director, to emphasize that risk management is our highest priority. Under the new structure, we expanded the scope of risk management to encompass business opportunities. We will also aim to enhance the sophistication of our risk management further while linking it with the change-responsive management theme based on hypothetical thinking.

Preparation for 2030 refers to activities that assess business management-related risks and opportunities and translate the necessary preparations into concrete actions. In addition to discovering and nurturing technologies that can be a source of future competitiveness and formulating and implementing intellectual property strategies to support these, we are connecting our global network to address possible future threats and moving forward with scenario planning to manage risks.

Flexible financial strategies and execution of a stock split to broaden our investor base

Our financial strategy remains unchanged from Medium-term Direction 2024. We will meet shareholders' expectations over the long term through a fundamental policy of stable dividend increases with a dividend on equity (DOE) of 4% and a dividend payout ratio of 30% or more as targets. We will hold cash reserves equivalent to 2.5 to 3.5 months of net sales to cope with unexpected risks and promptly execute strategic investments when speed is required. In fiscal 2022, we conducted a treasury stock acquisition for the first time in 11 years, purchasing shares worth 80 billion yen. Going forward, we will continue to pursue flexible financial strategies while monitoring business opportunities from a medium- to long-term perspective, the corresponding investment plans, and the level of liquidity we have on hand.

In May 2023, under applicable disclosure rules, we announced a three-for-one stock split effective October 1, 2023. The purpose of the stock split is to enlarge our investor base and make our shares more liquid by reducing the monetary amount of each share trading unit, thus making it easier for individual investors to buy and sell our shares. Although BtoB business models like ours may be difficult for individual investors to understand, we will further evolve our IR activities to emphasize the appeal of Murata's value creation story.

Practicing and further advancing the consistent management philosophy founded on the Murata Philosophy

We incorporated a management philosophy centered on the Murata Philosophy, our guiding principle, into our vertically integrated business model and the business management system that supports it. Its understanding is well understood by our people and organizations in the form of values and codes of conduct. In other words, we have consistency because management is always based on our philosophy. We collectively define this as "organizational capital" in the value creation process and are continually refining it.

For example, the Murata Philosophy includes the phrase "applying scientific approach," which is reflected in our upstream management-centered manufacturing and quality control systems, global marketing processes, and management accounting systems. One concept we have had in place since our founder employed it is our management accounting system, which recognizes "internal interest" as a cost. This internal interest is calculated by applying a predetermined interest rate to accounts receivable, inventories, and production facilities. Since the internal interest rate is determined after considering our cost of capital, each business division and factory naturally becomes conscious of the cost of capital as they operate their business. At the same time, the concept of ROIC has become ingrained within the company. We have positioned it as the most important KPI for business evaluation for many years.

Of course, my mission also encompasses upgrading our business management system to keep pace with the changing times and enhancing effectiveness. As a system, hypothesis-based thinking is also taking root as a business management tool to support autonomous decentralized management, but issues remain with portfolio management, such as our dependence on first-layer businesses for earnings and the need to rebuild our second-layer business and develop new business models for our third-layer business. I believe that we will demonstrate results in these areas within the period of Medium-term Direction 2024. In addition, the inclusion of ICP in profit and loss for each business and product category, which I mentioned earlier, is intended to clarify that responsibility for formulating strategies to reduce GHG emissions also lies with business managers and to translate these strategies into deploying policies to the frontlines. In the future, we will continue to evolve our business management processes to reflect social demands and the business models we develop as a result.

Strengthening the "earning power" required for sustainable growth

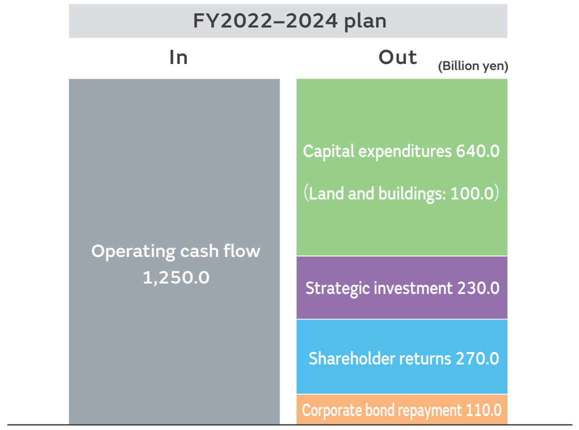
Our ROIC (pre-tax basis) for fiscal 2022 dropped significantly from 22.6% in the previous year to 14.6% as a result of a decline in the ratio of operating income to net sales, as well as a deterioration in asset efficiency due to a sharp fall in the equipment operation rate and inventories increase. The rise in inventories was intentional, designed to stand us in good stead when demand recovers. However, since the pace of the component demand rebound is proving to be slower than expected in fiscal 2023, we are making additional production cutbacks and adjusting operations to lower the age of inventories to appropriate levels before the end of fiscal 2023.

While our operations will remain subdued in the short term, business opportunities will expand given the evolution of communications systems from 5G to 6G, the construction of network infrastructure, the proliferation of electrification and autonomous driving technologies, further advances in the mobility space, and the expansion of the electronics industry into the environmental and wellness markets. To ensure we are prepared, we need to make investments to maintain and expand our competitive advantage. Given the lackluster demand for components, now is precisely the right time to prepare ourselves for future growth opportunities. Therefore, during fiscal 2023, we intend to steadily execute the capital expenditures and strategic investments (including environmental investments, investment for growth such as M&A, and IT infrastructure reinforcement) called for in the capital allocations section of Medium-term Direction 2024.

To achieve our management target ROIC (pre-tax basis) of 20% or more after making investments for growth, we need to improve our ratio of operating income to net sales and asset efficiency. In my view, if we make our partner companies or employees bear the burden of our drive to boost ROIC, this would conflict with the "together with all our stakeholders" part of the Murata Philosophy, and would actually have the effect of pushing up our capital cost and eroding our operational capital in the medium to long term.

Considering that, measures to improve ROIC must encompass not only smart factories and digital-driven productivity improvements but also the sound management of our portfolio by utilizing a system for assessing the viability of businesses. In addition to directing the revamp of our businesses and technologies, we will position the resolution of issues such as improving capital efficiency and which businesses to select and focus on, as well as translating the solutions into tangible financial results as our highest priority management challenge. We will accelerate our pivot to portfolio management through in-depth Board of Directors and the Management Committee discussions.

Medium-term Direction 2024 capital allocations



Sustainable value creation through stakeholder discussions

In Vision 2030, we declare that having led the sector with our products and technologies, from now on, we will strive to "become the leading choice for customers and society by creating a continuous cycle of social and economic values." To kickstart this continuous cycle of social and economic values and sustainably create growth through co-creation with our stakeholders, we must define the scenarios, milestones, and management strategies we will employ. We will then need to link them with our human resource, DX, and sustainability strategies and support them with an appropriate risk management framework and governance structure.

As Director of the Corporate Unit, I will be pressing ahead with formulating specific value-creation scenarios and making them more viable propositions through dialogue with our stakeholders. I would therefore ask for your continued guidance and support.