



**DISCO**

Kiru · Kezuru · Migaku Technologies

# DISCO IS INDISPENSABLE



**DISCO CORPORATION**

Annual Report 2014 For the year ended March 31, 2014

# 3/400 PROCESSES

## Specializing in Just Three of 400 Semiconductor Fabrication Processes

Semiconductor fabrication is divided into 400 different processes, of which DISCO handles just three—*Kiru* (cutting), *Kezuru* (grinding) and *Migaku* (polishing). DISCO will continue to contribute to society by specializing in just these three areas, and by developing the most advanced technologies for each of these processes.

DISCO's *Kiru* (cutting) technology allows materials to be cut into tiny pieces with a margin of error of one micrometer ( $\mu\text{m}$ ), or one-thousandth of a millimeter. With this level of precision, the cross-section of a single strand of hair can be divided into 35 pieces.

With our *Kezuru* (grinding) technology, we can achieve thicknesses that are accurate to within  $5\ \mu\text{m}$  compared to the  $100\ \mu\text{m}$  thickness of a piece of copy paper.

Our *Migaku* (polishing) technology allows us to polish materials to mirror-like perfection, thereby enhancing their resistance to cracking.

## SINGULAR BUSINESS DOMAIN





# STACKING UP RELIABILITY

## 70% Average Share of the World Market for Semiconductor Cutting and Grinding Equipment

DISCO aims not simply to sell products, but to be a total solutions provider capable of providing customers with the processing results that they need. Our unmatched success in turning this concept into reality has allowed us to maintain our share of the markets in which DISCO products are sold at an average of 70%.

# 70%

DISCO values customer feedback. Feedback is shared within the company, and the relevant departments, including marketing, technical and service staff, work together to take any actions that may be required. Our efforts to offer optimized solutions begin with in-depth analyses of each customer's needs. We believe that genuine customer satisfaction is achieved through constant efforts to create win-win situations as the basis for continuing relationships based on trust.

## Maintaining Competitiveness through R&D

We actively invest in research and development, which we regard as essential to future growth. The speed of the development cycle is a particular priority because of its importance to our ability to respond quickly and flexibly to customer needs. In fiscal 2013, the ratio of R&D expenses to net sales was 11%. Our future business development will continue to be guided by our commitment to leadership in research and development.

# 11%

## EXPANDING OUR LEADERSHIP



Our R&D Center is located at DISCO's corporate headquarters. Within the R&D Center, research and testing facilities have placed alongside offices, to allow the results of tests conducted by engineers to be shared quickly with those responsible for the next stage of development. Particular importance is placed on inspiration and experimentation.

## KEY STRATEGIC INITIATIVE



# 3,700 test cuts

### 3,700 Test Cuts in Fiscal 2013

DISCO's test cut system is an experimentation service that allows customers to submit wafers that they wish to process and work together with DISCO's engineers through a process of trial and error until the desired results are achieved. Although the test cutting service is provided entirely free of charge, it has become an important part of our business strategy because of the potential to create new technologies and products through this process of finding solutions.

Test cuts are carried out in the Application Lab, a dedicated facility located within the R&D center at DISCO's corporate headquarters. Staffed by almost 50 specialized engineers, this facility has over 70 smaller labs with various types of equipment.

DISCO engineers use their accumulated expertise to suggest optimal combinations from among 50 models of precision processing equipment and tens of thousands of precision processing blades and wheels. They also help customers to find "processing recipes" based on the best possible combinations of parameters.



## PREPARING FOR DISASTER

A new building completed at the Kure Plant in January 2012 is equipped with seismic base isolation systems to minimize damage from earthquakes. In addition, we have installed solar power and cogeneration systems to provide power during emergency situations.

These initiatives reflect our determination to ensure that DISCO can reliably supply the precision processing equipment used by customers with the blades and wheels used in their day-to-day operations.

# ALL Facilities

## Seismic Base Isolation Structures Installed at the Head Office and All Plants

We are determined to ensure that DISCO products can be supplied reliably to our customers in the semiconductor fabrication industry. We installed seismic base isolation systems in Building A of the R&D Center at our corporate headquarters, which was completed in 2004. We have since installed these systems in all of our facilities, including Building B of the R&D Center, the Kuwabata Plant, where precision processing equipment is manufactured, and the Kure Plant, where we produce precision processing blades and wheels. We have also established systems to ensure an early resumption of operations in the event of emergencies.





**Mission:**

Bringing science to comfortable  
living through advanced  
*Kiru, Kezuru, Migaku* technologies.

cutting

grinding

polishing

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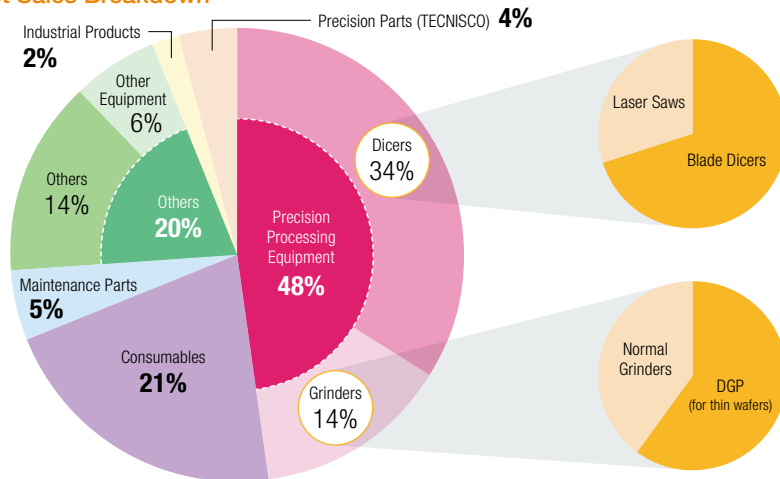
# TOWARD THE REALIZATION OF THE MISSION

Since its founding, DISCO has specialized in the technologies of Kiru (cutting), Kezuru (grinding) and Migaku (polishing). We have achieved growth by continually exploring the ultimate potential of these processes. DISCO uniquely provides both means and results, as a solutions provider, responding to customers' needs with an extensive range of application technologies and products.

## Sales Mix

DISCO uniquely supplies both precision processing blades and wheels and precision processing equipment. We strongly believe that what our customers need is not the product itself, but the processing results that can be achieved with those products. DISCO has built its reputation as an international provider of Kiru (cutting), Kezuru (grinding) and Migaku (polishing) technologies using achieved processing results as a stepping stone to gather advanced expertise and to fulfill ever-more advanced needs.

### Product Sales Breakdown

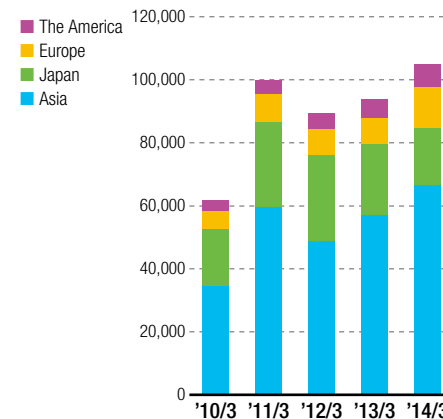


## Overseas Sales

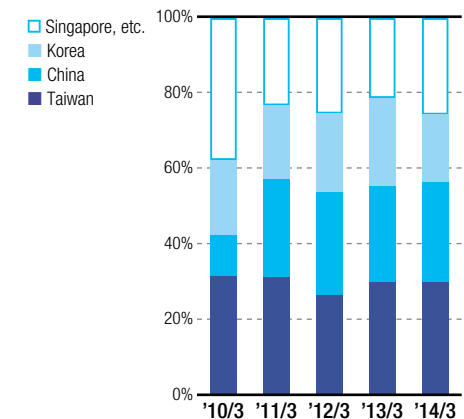
The task of our Application Laboratories is to carry out test cuts to verify whether or not the results sought by our customers can actually be achieved. We have established Application Laboratories not only in Japan but also in the United States, Germany, Singapore and Shanghai, China as part of our continuing efforts to bring the best application technology to our customers. We have dynamically expanded our service network in Asia to be able to adapt flexibly to the on-going expansion of the Asian semiconductor market.

### Sales Breakdown by Region

(Millions of yen)



### Asian Sales Share by Country

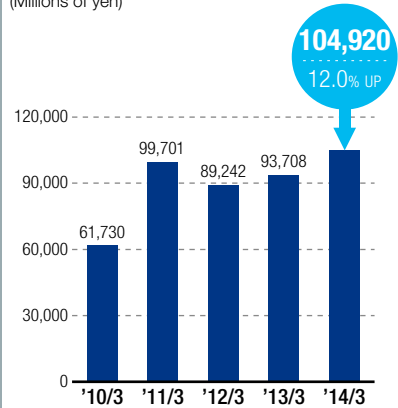




# Financial Highlights

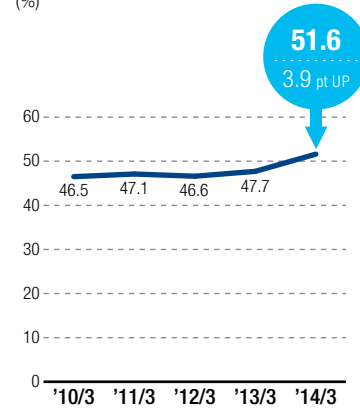
## Net Sales

(Millions of yen)



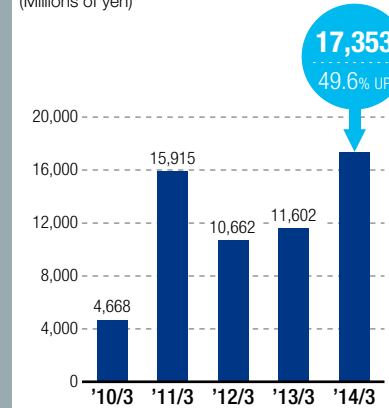
## Gross Profit Margin

(%)



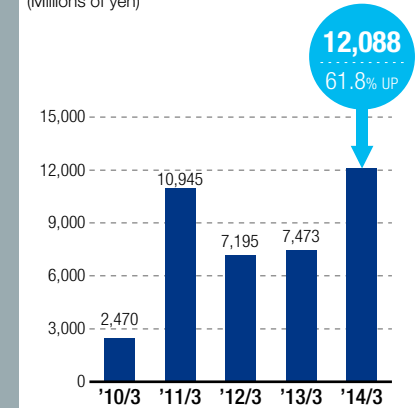
## Operating Income

(Millions of yen)



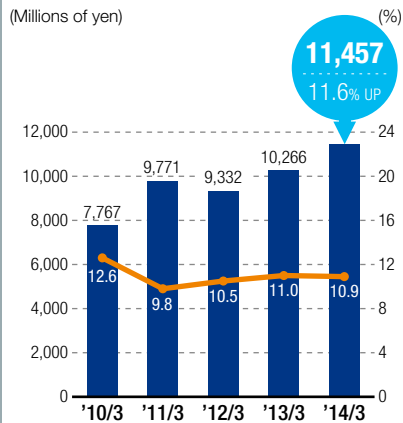
## Net Income

(Millions of yen)



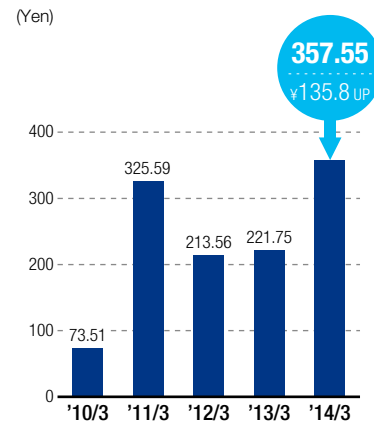
## R&D Expenses R&D Expense to Net Sales Ratio

(Millions of yen)



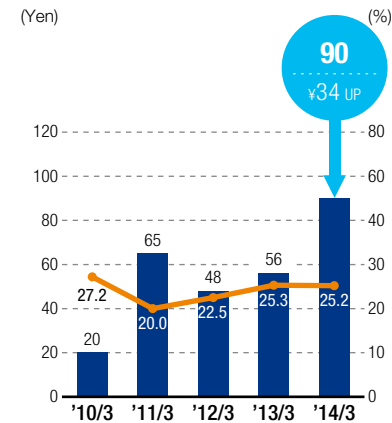
## Basic Net Income per Share

(Yen)



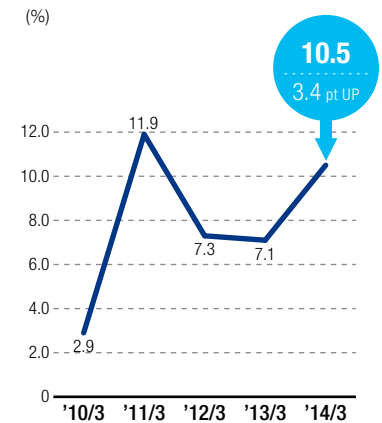
## Cash Dividends per Share Dividend Payout Ratio

(Yen)



## ROE

(%)



Demand for semiconductors has increased in step with the growing demand for smartphones and tablets. We will continue to expand our market presence by improving our cost control and enhancing our organizational strengths.

**Q How would you sum up the elements that go into your continued success and growth?**

**A** Our business activities center on three key processes—Kiru (cutting), Kezuru (grinding) and Migaku (polishing). Because these processes are used in an extremely wide range of situations, the scope of our activities extends all the way across the semiconductor and electronic component fields. Whenever a manufacturer needs to develop a new process, it becomes a business opportunity for DISCO. For example, processes that previously required users to create molds can now be performed by means of programmable processing on our systems. Every time a customer consults us about cutting, grinding and polishing technologies required for a new application, our engineers can further hone their skills and accumulate new knowledge. In this way, we have been able to continually strengthen the competitiveness of our products.

**Q What are the challenges that you need to overcome in order to achieve growth in the prevailing business environment?**

**A** Demand is strong at present, especially in the area of products for use in mobile equipment. However, the future outlook is extremely difficult to




**Kazuma Sekiya,**  
President and COO

predict because of the rapid change in our markets.

One of the technology trends that we anticipate is the accelerating evolution of packaging technology for semiconductors used in mobile devices. We are determined to keep pace with this evolution and continue to supply high-added-value products that our competitors cannot match.


Because the expansion of our sales also leads to growth in the size of our organization, one of our priorities from the perspective of organizational management is to counter the risk of succumbing to the condition known as “big company disease.” We will take steps to avoid organizational rigidity while also working to minimize costs. At the same time, we aim to build an organization capable of responding flexibly to urgent requests from customers.

## What is your thinking on mergers and acquisitions?

 Our goal is not to expand the size of our company. We aim instead to focus management on qualitative growth. Our business domain is defined by the three key processes of Kiru (cutting), Kezuru (grinding) and Migaku (polishing), and we do not intend to expand into other business areas.

For this reason, while we see mergers and acquisitions as one way to acquire promising technologies, we do not acquire competitors as a means to enhance price competitiveness. In addition, the acquisition of other companies can bring problems resulting from differences in corporate culture. We believe that quantitative growth ultimately occurs as the result of qualitative growth achieved by continuing to provide the best possible solutions to customers' needs.

## What is the future for DISCO?

 We believe that people will continue to enjoy better living standards and living environments through the progress of science and technology, and that the range of uses for semiconductors will continue to expand. Engineers working for manufacturers throughout the world are helping to make our lives ever

more convenient by creating innovative and increasingly sophisticated end products. The potential of this process appears to be extraordinarily great. The expanding range of uses for semiconductors will eventually lead to lower prices made possible by mass-production, as well as increasing miniaturization. As a result, the range of applications for semiconductors will expand to include fields and end products in which semiconductors previously could not be used. Examples include medical equipment and wearable devices. We expect this environment to bring accelerating growth in the range of uses for semiconductors.

As semiconductor manufacturers approach the limits of miniaturization, the level of technology required for semiconductor assembly and testing processes has become increasingly sophisticated. Manufacturers are responding to this trend by striving to differentiate their products using DISCO products to develop highly complex and original processes. We see this approach as a way of building high barriers against market entry by competitors.

We are determined to maximize our earnings performance by continuing commitment to R&D so as not to lose out on future possibilities.

# Basic Policy on Income Distribution

## Linkage of Income Distribution to Financial Results

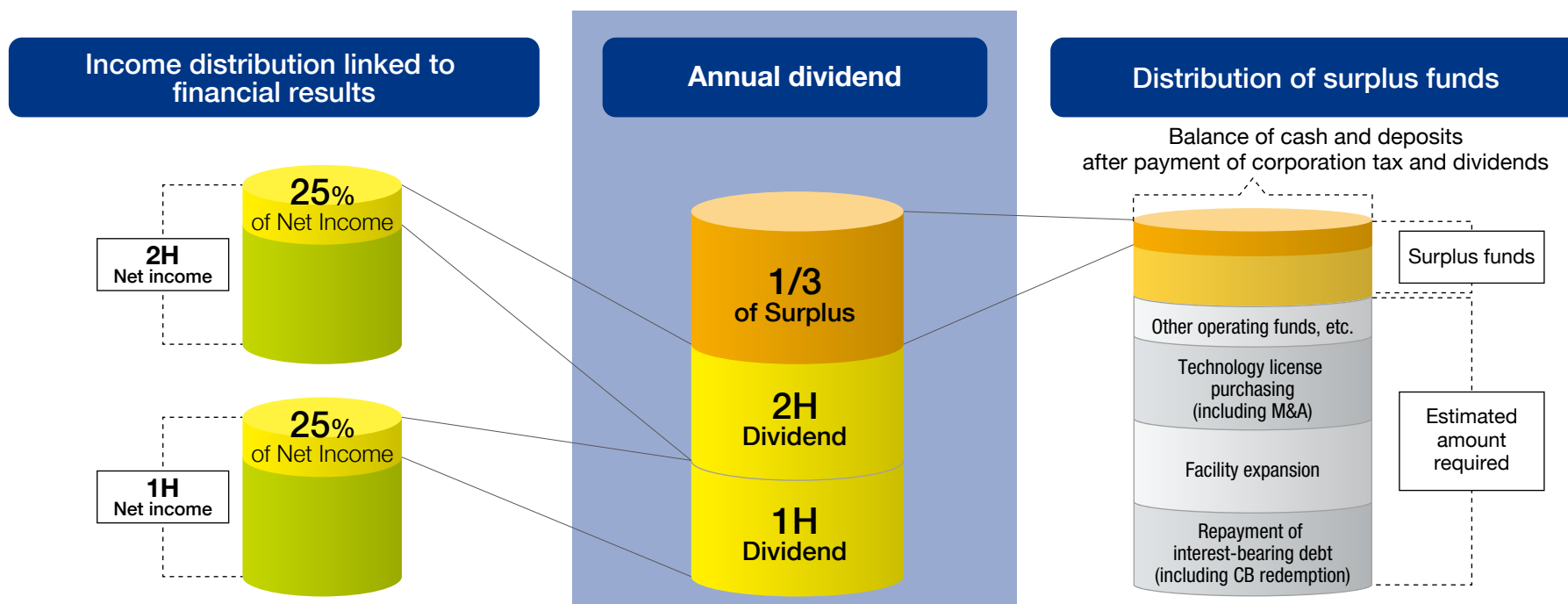
Under our dividend policy, dividends are linked to financial results on the basis of 25% of consolidated net income. In recent years, the semiconductor and electronic component industry has gone through boom-and-bust cycles within single years. For this reason, income distribution is based on financial results for the first

and second halves of the year. However, regardless of the level of income, our policy is to provide a reliable dividend consisting of half-yearly dividends of ¥10 (¥20 per annum)<sup>1</sup>.

Notes

1. The aforementioned reliable dividend policy may be reviewed if there is a consolidated net loss in three successive fiscal years.

## Income Distribution



## Distribution of Surplus

If the amount of cash and deposits<sup>2</sup> at the end of the fiscal year is in excess of the estimated amount required, our policy is to add approximately one-third of this surplus to the dividend, except when the Company has made a loss. The estimated amount required includes funds for technology license purchases or investment in ventures, funds for the expansion of facilities, funds for repayment of interest-bearing debt, and other operating funds.

In recent years, the Company has needed substantial amounts of funds to support a growing number of R&D themes and other purposes, such as business continuity management (BCM). From a long-term perspective, however, if conditions

become more conducive to the generation of cash flows, we will distribute income more aggressively.

As outlined above, our approach to income distribution is based on a combination of payments linked to financial results and surplus funds.

Notes

2. This is the amount remaining after payment of corporation tax and dividends.

# Ten-Year Summary

	Millions of yen										Thousands of U.S. dollars <sup>1</sup>	
	2014	2013	2012	2011	2010	2009	2008	2007	2006	2005	2014	
<b>For the Period:</b>												
Net sales	¥ 104,920	¥ 93,708	¥ 89,241	¥ 99,701	¥ 61,730	¥ 53,108	¥ 91,618	¥ 86,161	¥ 68,885	¥ 60,321	\$ 1,019,440	
Precision processing systems	99,291	89,248	85,672	95,405	58,198						964,740	
Industrial grinding products	1,952	1,692	1,676	1,804	1,462						18,966	
Precision processing parts	3,677	2,767	1,893	2,492	2,069						35,727	
Operating income	17,353	11,602	10,662	15,915	4,668	76	19,334	19,524	13,949	9,869	168,609	
Income before income taxes and minority interests	17,306	10,826	11,103	16,569	4,046	770	18,452	17,716	13,385	9,081	168,151	
Net income	12,088	7,473	7,195	10,945	2,470	251	11,112	10,936	8,230	5,301	117,457	
Capital expenditures	13,378	5,758	8,448	7,311	11,626	13,497	10,038	6,554	3,288	11,815	129,984	
Depreciation and amortization	5,995	5,939	5,944	6,067	5,364	4,657	3,652	2,964	2,762	2,439	58,249	
Research and development expenses	11,457	10,266	9,331	9,771	7,767	8,532	8,332	6,415	6,353	6,256	111,319	
<b>At Year-End:</b>												
Total assets	¥ 170,161	¥ 155,667	¥ 135,790	¥ 139,240	¥ 124,313	¥ 123,925	¥ 118,603	¥ 113,791	¥ 99,319	¥ 84,839	\$ 1,653,335	
Interest-bearing debt	9,723	10,600	720	788	3,000	27,723	783	1,128	3,291	12,044	94,471	
Total net assets	123,456	110,556	102,537	97,633	88,092	86,329	89,665	81,824	70,277	55,727	1,199,539	
Number of shares issued and outstanding	34,004,418	34,004,418	34,004,418	34,004,418	34,004,418	34,004,418	33,995,418	33,982,518	33,562,718	32,180,240		
Share price (Yen)	6,420	5,320	4,575	5,680	5,750	2,435	4,290	7,200	7,740	4,600		
Number of shareholders	8,906	11,665	13,393	12,843	14,456	13,661	13,480	13,293	12,828	15,636		
Number of employees	3,073	2,909	2,745	2,565	2,465	2,438	2,260	2,012	1,721	1,678		
<b>Per Share of Common Stock (Yen and U.S. Dollars):</b>												
Basic net income	¥ 357.55	¥ 221.75	¥ 213.56	¥ 325.59	¥ 73.51	¥ 7.41	¥ 327.07	¥ 322.32	¥ 252.82	¥ 162.57	\$ 3.47	
Cash dividends	90.00	56.00	48.00	65.00	20.00	20.00	79.00	75.00	50.00	40.00	0.87	
Shareholders' equity	3,579.80	3,222	3,004	2,869	2,600	2,553	2,621	2,393	2,092	1,730	34.78	
<b>Ratios:</b>												
Gross profit margin (%)	51.6	47.7	46.6	47.1	46.5	47.2	51.1	51.1	52.5	50.7		
Operating income margin	16.5	12.4	11.9	16.0	7.6	0.1	21.1	22.7	20.2	16.4		
Income before income taxes and minority interests margin	16.5	11.6	12.4	16.6	6.6	1.5	20.1	20.6	19.4	15.0		
Net income margin	11.5	8.0	8.1	11.0	4.0	0.5	12.1	12.7	11.9	8.8		
Return on assets (ROA) <sup>2</sup>	10.7	8.0	7.8	12.1	3.8	0.2	16.9	18.5	15.2	12.0		
Return on equity (ROE) <sup>3</sup>	10.5	7.1	7.3	11.9	2.9	0.3	13.1	14.4	13.1	9.9		
Price-earning ratio	18.0	24.0	21.4	17.4	78.2	328.6	13.1	22.3	30.6	28.3		
Equity ratio	71.4	69.8	74.5	69.4	70.3	69.2	75.0	71.5	70.8	65.7		
Interest coverage ratio <sup>4</sup>	328.7	239.5	397.8	517.4	13.7	4.2	805.1	436.5	479.0	252.8		

Notes: (1) U.S. dollar amounts have been translated from Japanese yen, solely for the convenience of readers, at the rate of ¥102.92=US\$1, the approximate exchange rate prevailing on the Tokyo Exchange Market on March 31, 2014.

(2) ROA = (Operating income + Interest and dividend income) ÷ Average total assets × 100

(3) ROE = Net income ÷ Average shareholders' equity × 100

(4) Interest coverage ratio = (Operating income + Interest and dividend income) ÷ Interest expense

## Overview

DISCO's activities are targeted mainly toward the semiconductor and electronic component industries. In fiscal 2013 (the year ended March 31, 2014), manufacturers in these industries invested aggressively in plant and facilities in response to expanding demand for smartphones, tablets and other mobile devices, and an upsurge of investment relating to the development of advanced technology.

For DISCO, this situation was an opportunity to increase sales of high-added-value precision processing equipment, such as laser saws and precision grinders, which are used to achieve the increasingly high levels of miniaturization and functionality required for semiconductors and electronic components used in mobile devices. We set new records for both sales and

shipments of consumables, including precision processing blades and wheels, demand for which expanded in step with our customers' high facility operating rates.

These trends were reflected in year-on-year growth in both revenues and income, and net sales reached their highest level in the history of DISCO.

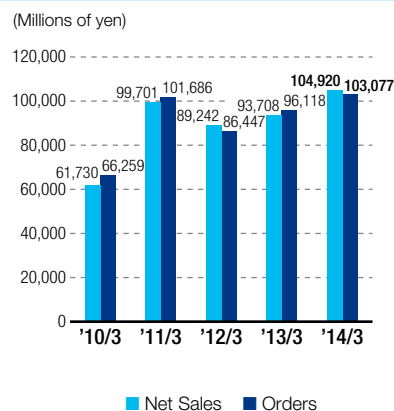
## Orders Received and Net Sales

We receive numerous urgent inquiries about products used in semiconductor manufacturing final assembly processes, which are the main focus of DISCO's business activities. As a result, trends in orders and sales tend to move basically in parallel. An analysis of sales and orders over the past three years shows that there is a cycle of strong and weak phases over the course

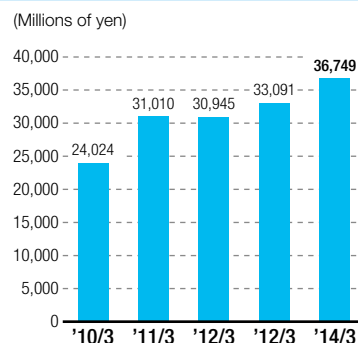
of each year. Our customers tend to concentrate their investment in plant and facilities in the first half of the year in preparation for the year-end selling season. This is followed by an adjustment phase during the third quarter, and a conspicuous recovery trend in the fourth quarter.

In fiscal 2013, demand for semiconductors and electronic components for mobile devices remained firm, while demand during the downward phase in the third quarter was underpinned by shipments of high-added-value products. As a result, the upward and downward phases of the cycle were smaller than in a normal year, and orders increased by 7.2% year on year to ¥103,077 million. Net sales were up 12.0% year on year at ¥104,920 million, exceeding ¥100,000 million for the first time.

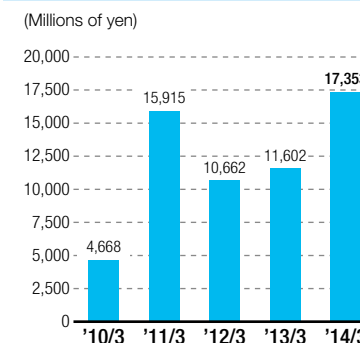
### Net Sales Orders



### SG&A Expenses



### Operating Income



## The Impact of the Exchange Rate

Movements in the yen-dollar exchange rate affect both net sales and income. Every one-yen change in the exchange rate causes our net sales and income to rise or fall by almost ¥400 million. Transactions in yen make up around 60% of our net sales, with the remaining 40% denominated in U.S. dollars. Our costs are mostly denominated in yen, since many of our manufacturing facilities and suppliers are located in Japan.

### Yen-U.S. Dollar Exchange Rate

FY09	FY10	FY11	FY12	FY13	FY14 (estimated)
¥92.7	¥86.0	¥79.1	¥82.1	¥99.7	¥100.0

After remaining strong for two or three years, the yen shifted to an accelerating downward trend in December 2012, and the effective U.S. dollar exchange rate for fiscal 2013 was ¥99.7.

## Costs and Profits

The cost of sales rose in step with net sales and was 3.7% higher year on year at ¥50,818 million. The gross profit ratio rose by 3.9% percentage points to 51.6%. Reasons for this increase included an improvement in the product mix due to strong shipments of high-added-value systems and precision blades and wheels, which are supplied as consumables, as well as exchange rate trends.

Selling, general and administrative expenses increased by 11.1% year on year to ¥36,749 million. This increase resulted from

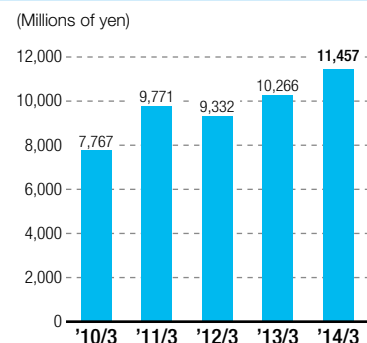
higher labor costs and a rise in variable costs in step with the growth of net sales, as well as an increase in R&D expenditure.

Our R&D activities center on the development of advanced technology in the areas of Kiru (cutting), Kezuru (grinding) and Migaku (polishing), including laser applications and through-silicon-via (TSV) technology. R&D expenditure increased by 11.6% year on year to ¥11,457 million. The ratio of R&D expenditure to net sales was 0.1 percentage points lower at 10.9%.

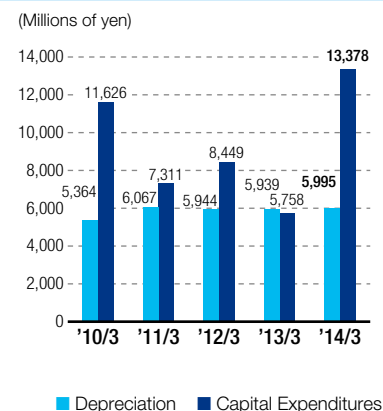
These factors were reflected in our income results. Operating income was 49.6% higher year on year at ¥17,353 million, while the operating income margin increased by 4.1 percentage points to 16.5%.

Capital investment in fiscal 2013 was 2.3-times higher than the previous year's total at ¥13,378 million. Major items included

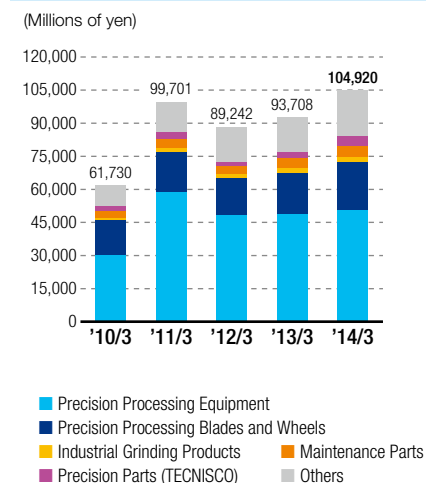
## R&D Expenses



## Depreciation Capital Expenditures



## Sales Breakdown by Product



the construction of a new building at the Kuwabata Plant, rationalization investment and the purchase of R&D equipment. At ¥5,995 million, depreciation was similar to the previous year's level.

## Segment Information

### Precision Processing Systems

Products manufactured by DISCO in this segment include precision processing equipment and precision blades and wheels. These products are supplied mainly to manufacturers of semiconductors, electronic parts and other items in Japan and overseas.

In the area of precision cutting equipment, sales of laser saws increased by approximately 5% year on year in the year ended March 2014, in part because of growth in the range of applications. However, slower sales of blade dicers, which are used

mainly for package processing, resulted in a 5% year-on-year decline in total dicer sales. Market expansion, combined with the increasing sophistication of mobile devices, was reflected in strong sales of precision grinding and polishing equipment, and sales of equipment for use in the production of electronic components were 2.5-times higher year on year. Sales of precision blades and wheels remained buoyant throughout fiscal 2013 and increased by 18% year on year. This resulted both from the depreciation of yen, and also strong demand for blades and wheels for use in the mass-production of ICs and electronic components.

Segment net sales reached ¥99,291 million, a year-on-year increase of 11.3%, while segment income was 32.9% higher at ¥21,180 million.

### Industrial Grinding Products

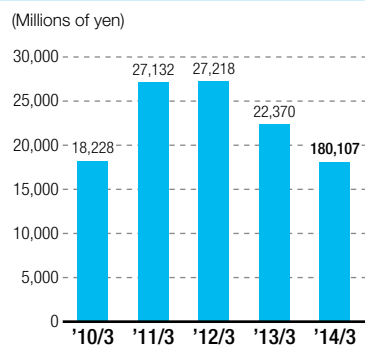
In this segment, DISCO manufactures and sells general-purpose grinding wheels used by manufacturers of motor vehicles, electronic components and other products, and industrial diamond tools for use in civil engineering, construction and manufacturing.

In fiscal 2013, segment net sales increased by 15.4% over the previous year's total to ¥1,952 million. Segment income was 94.6% higher at ¥415 million.

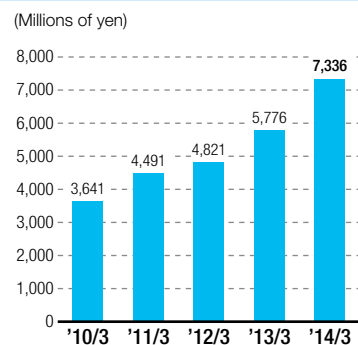
### Precision Processing Parts

DISCO manufactures and sells precision processing parts made from metals, glass, silicon and other materials for use in electronic, optical and medical products. In fiscal 2013, sales were

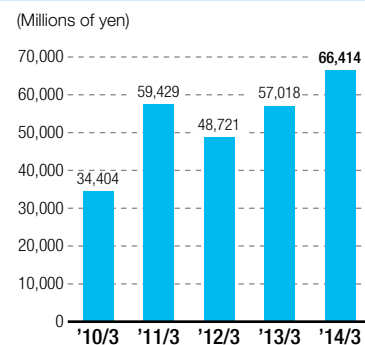
## Japan



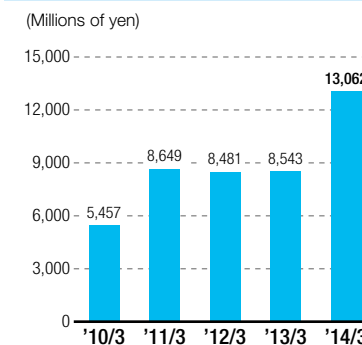
## North America



## Asia



## Europe





substantially higher year on year because of a strong trend in the area of smartphone cover glass processing, expanding demand in the Chinese market for heat sink products used in optical communications equipment, and strong sales of glass products for use in video equipment.

Segment net sales in the year ended March 2014 increased by 32.9% year on year to ¥3,677 million, and segment income reached ¥335 million, compared with a loss of ¥205 million in the previous fiscal year.

## Geographical Segment Information

In fiscal 2013, shipments to Asian markets remained consistently high. However, the Japan region's contribution to net sales shrank by 6.6 percentage points to 17.3% following a sharp

decline in the Japanese semiconductor market. In Europe, sales of high-added-value products remained strong, and net sales set a new record of ¥13,000 million in fiscal 2013.

Asia is a key center for semiconductor mass production, and in fiscal 2013 the region's contribution to net sales increased by 2.5 percentage points to 63.3%. An analysis of sales within Asia shows that Taiwan is the biggest market, followed by China and South Korea, and that sales to China have risen dramatically over the past 2–3 years.

A breakdown of overseas sales figures for fiscal 2013 reveals that sales in Asia increased by 16.5% to ¥66,414 million, and sales in the Americas by 27.0% to ¥7,336 million, while sales in Europe were 52.9% higher at ¥13,062 million. Although the level of sales in the United States and Europe is low compared with

Asia, we still regard these regions as important markets because of the large number of advanced R&D facilities in the fields of semiconductors and electronic components.

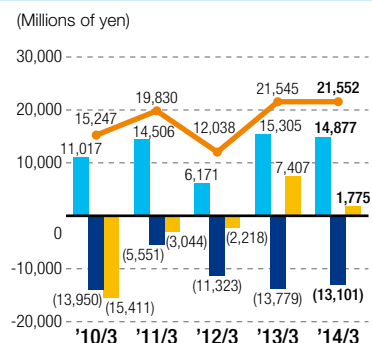
In the year ended March 2014, the contribution of overseas sales to consolidated net sales increased by 6.6 percentage points year on year to 82.7%.

\* Net sales have been divided into countries and regions according to the locations of customers.

## Other Income and Expenses

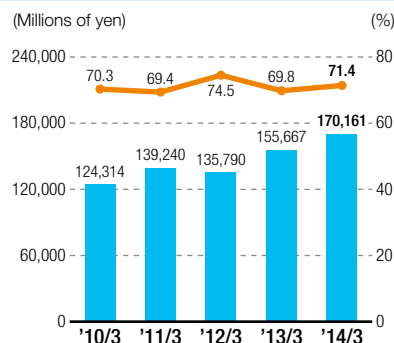
There were increases in a number of other income items, including subsidies relating to the Kuwabata Plant and the Kure Plant, and royalties. However, gains on sales of investment securities were lower, with the result that total other income was

## Cash Flows, and Cash and Cash Equivalents



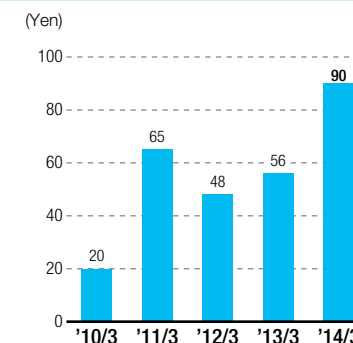
■ Cash Flows from Operating Activities  
 ■ Cash Flows from Investing Activities  
 ■ Cash Flows from Financing Activities  
 ● Cash and Cash Equivalents

## Total Assets and Equity Ratio



■ Total Assets ● Equity Ratio

## Cash Dividends



¥36 million below the previous year's level at ¥819 million.

Despite a marginal increase in exchange losses, total other expenses were reduced by ¥765 million to ¥866 million. This was because the results were no longer affected by fixed asset impairment losses relating to the old building at the Kuwabata Plant, which were incurred in previous year due to the construction of a new building.

## Income before Income Tax and Net Income

Income before income taxes and minority interests increased by 59.9% over the previous year's level to ¥17,306 million. Income taxes were 53.7% higher at ¥5,159 million, but the effective tax rate after the application of tax effect accounting was reduced to 29.8%. This was mainly because of an increase in tax reductions due to aggressive R&D activities.

Minority interests amounted to ¥57 million. This relates to a minority interest in TECNISCO, LTD., a consolidated subsidiary.

On this basis, net income increased by 61.8% year on year to a new record of ¥12,088 million. The ratio of net income to net sales was 3.5 percentage points higher at 11.5%, and net income per share amounted to ¥357.55, compared with ¥221.75 in the previous year. ROE rose by 3.4 percentage points to 10.5%.

## Cash Flows

### *Cash Flows from Operating Activities*

Despite higher inflows resulting from an increase in net income before income taxes and minority interests and the reduction of inventories, net cash provided by operating activities was 2.8% lower year on year at ¥14,877 million due to an increase in trade accounts receivable, corporation tax payments and other items.

### *Cash Flows from Investing Activities*

Net cash used for investing activities amounted to ¥13,101 million, a year-on-year reduction of 4.9%. Factors contributing to this figure include expenditure on the acquisition of tangible fixed assets, notably a new building at the Kuwabata Plant.

### *Cash Flows from Financing Activities*

Net cash used for financing activities amounted to ¥2,198 million, compared with a net inflow of ¥7,407 million in the previous year. This result was mainly attributable to the expenditure on the payment of dividends.

### *Cash and Cash Equivalents*

Cash and cash equivalents as of March 31, 2014 amounted to ¥21,552 million, an increase of ¥7 million from the position as of March 31, 2013. Free cash flows, which are the sum of net cash resulting from operating activities and net cash resulting from investing activities, increased by ¥1,775 million.

## Financial Position

### *Assets*

Total assets increased by ¥14,494 million from the position at the end of the previous fiscal year to ¥170,161 million as of March 31, 2013. Inventories were reduced, and the increase in total assets was mainly attributable to higher trade accounts receivable and an increase in tangible fixed assets due to the construction of a new building at the Kuwabata Plant.

### *Liabilities*

Liabilities totaled ¥46,704 million as of March 31, 2014, an increase of ¥1,593 million from the position at the end of the

previous fiscal year. Reasons for the higher figure included increases in accrued income tax payable and the reserve for bonus payments. Changes in current and fixed liabilities resulted mainly from the transfer of CBs to debt repayable within one year.

### *Net Assets*

Net assets increased by ¥12,900 million from the position at end of the previous fiscal year to ¥123,456 million as of March 31, 2014. As a result, the shareholders' equity ratio rose by 1.6 percentage points year on year to 71.4%.

## Business Risks and Other Risk Factors

Described below are some of the risk factors that could affect the DISCO Group, including its business activities and financial situation, or influence decisions by investors.

### *(1) Fluctuations in the Semiconductor Market*

The DISCO Group manufactures and sells products to manufacturers of semiconductors and electronic components throughout the world and is therefore affected by trends in the capital investment and production activities of its customers. The semiconductor market in particular is subject to changes in the supply-demand balance, and the business performance of semiconductor manufacturers is affected by the pattern known as the silicon cycle. The performance of the DISCO Group may be adversely affected if customers freeze capital investment, reduce production or take other actions during the downward phase of this cycle or when other unforeseen market fluctuations occur.

## *(2) Emergence of New Technologies*

The DISCO Group concentrates primarily on the manufacture and sale of semiconductor cutting and grinding equipment and precision tooling such as precision diamond blades and grinding wheels for use in silicon wafer processing. If a processing technology emerges to challenge precision diamond tooling in the future, the DISCO Group's business performance may be adversely affected. The DISCO Group also develops and sells laser saws, which can be used on materials that are difficult to cut with precision diamond tooling.

## *(3) Disasters*

The corporate headquarters and R&D center of the DISCO Group are located in Ota Ward, Tokyo, and its production facilities in Hiroshima and Nagano Prefectures. We are continually enhancing our business continuity management (BCM) systems, but corporate systems and production operations could be affected by a major disaster, outbreak of a new strain of influenza or other contingencies.

## *(4) Exchange Rate Fluctuations*

The DISCO Group manufactures products in Japan and exports them to manufacturers of semiconductor and electronic parts in various parts of the world. Transactions are normally denominated in yen, but transactions in some regions and with some customers need to be settled in U.S. dollars or other foreign currencies. This means that the business performance of the DISCO Group could be affected by exchange rate fluctuations.

## *(5) Environmental Regulations*

The DISCO Group has formulated "DISCO Environmental Vision 2020" and "Biodiversity Action Guidelines" covering various environmental issues, to reduce the burden on the environment. In this vision, we commit to a "25% reduction in DISCO's CO<sub>2</sub> emissions for business activities by FY2020 compared to FY2010 levels". In FY2012, we achieved 0.7% reduction compared to FY2010 levels.

However, the DISCO Group could be affected by

additional legal and/or social responsibilities with respect to environmental issues, regardless of negligence. In such a situation, additional expense could be incurred or our social credibility could be eroded.

## *(6) Other Risks*

In addition to the risk factors listed above, the business performance of the DISCO Group could also be adversely affected by global and local economic conditions, natural disasters, war or terrorism, trends in financial and capital markets, laws and government regulations, product defects, issues relating to suppliers and problems with intellectual property rights.

### **Disclaimer regarding forward-looking statements**

Any plans, predictions, strategies and beliefs in this annual report, other than those of historical fact, are forward-looking statements about the future performance of DISCO Corporation based upon management's assumptions and beliefs in light of information currently available. Actual results may differ substantially from those anticipated in these statements. Potential uncertainties include, but are not limited to, the cyclical nature of the semiconductor market; the increasingly horizontal international division of labor in the semiconductor manufacturing process; the concentration of the Company's business among certain customers; the emergence of new technologies; the Company's product development capabilities; the Company's ability to acquire and cultivate key human resources; exchange rate fluctuations; and other factors.

# Consolidated Balance Sheets

DISCO Corporation Annual Report 2014

	Millions of yen		Thousands of U.S. dollars
	2014	2013	2014
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents	¥ 21,552	¥ 21,544	\$ 209,407
Notes and accounts receivable—trade:			
Trade	32,028	25,234	311,202
Unconsolidated subsidiaries and associated companies	361	39	3,514
Allowance for doubtful receivables	(189)	(48)	(1,845)
Inventories	26,740	28,475	259,815
Deferred tax assets	2,803	1,927	27,240
Prepaid expenses and other current assets	13,512	12,384	131,295
Total current assets	96,809	89,556	940,629
<b>PROPERTY, PLANT AND EQUIPMENT:</b>			
Land	13,088	13,021	127,173
Buildings and structures	44,651	45,222	433,846
Machinery and equipment	35,620	31,710	346,100
Tools, furniture and fixtures	5,244	5,069	50,956
Construction in progress	9,257	2,736	89,945
Total	107,862	97,758	1,048,022
Accumulated depreciation	(44,799)	(42,243)	(435,283)
Net property, plant and equipment	63,063	55,515	612,738
<b>INVESTMENTS AND OTHER ASSETS:</b>			
Investment securities	397	591	3,863
Investments in unconsolidated subsidiaries and associated companies	1,924	1,568	18,699
Leasehold land	215	215	2,089
Long-term deposits	5,200	5,200	50,524
Deferred tax assets	202	409	1,966
Bond issuance cost	3	8	33
Other	2,400	2,672	23,322
Allowance for doubtful receivables	(54)	(67)	(532)
Total investments and other assets	10,288	10,596	99,967
<b>TOTAL</b>	<b>¥ 170,161</b>	<b>¥ 155,667</b>	<b>\$ 1,653,335</b>

	Millions of yen		Thousands of U.S. dollars
	2014	2013	2014
<b>LIABILITIES AND NET ASSETS</b>			
<b>CURRENT LIABILITIES:</b>			
Notes and accounts payable—trade	¥ 12,031	¥ 12,691	\$ 116,905
Short-term bank loans	—	250	—
Current portion of long-term debt	9,949	676	96,671
Accrued expenses	4,644	3,286	45,125
Accrued income taxes	3,052	2,125	29,656
Other current liabilities	5,557	4,869	54,001
Total current liabilities	35,235	23,897	342,359
<b>LONG-TERM LIABILITIES:</b>			
Long-term debt	8,858	18,759	86,075
Accrued retirement benefits	—	1,800	—
Net defined benefit liability	1,970	—	19,143
Other long-term liabilities	639	655	6,217
Total long-term liabilities	11,469	21,214	111,437
<b>CONTINGENT LIABILITIES</b>			
<b>NET ASSETS:</b>			
<b>SHAREHOLDERS' EQUITY:</b>			
Common stock, authorized 72,000,000 shares; number of shares issued, 34,004,418 shares in 2014 and 34,004,418 shares in 2013.	14,517	14,517	141,055
Additional paid-in capital	16,190	15,654	157,307
Retained earnings	89,203	79,343	866,730
Treasury stock—at cost, 87,493 shares in 2014 and 297,543 shares in 2013.	(235)	(798)	(2,290)
Total shareholders' equity	119,675	108,716	1,162,803
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME</b>			
Other securities valuation difference	17	12	174
Translation adjustments	1,864	(128)	18,112
Remeasurements of defined benefit plans	(142)	—	(1,380)
Total accumulated other comprehensive income	1,740	(116)	16,907
<b>SHARE SUBSCRIPTION RIGHTS</b>	1,219	1,223	11,845
<b>MINORITY INTERESTS</b>	821	731	7,983
Total net assets	123,456	110,556	1,199,539
<b>TOTAL</b>	<b>¥ 170,161</b>	<b>¥ 155,667</b>	<b>\$ 1,653,335</b>

# Consolidated Statements of Income

DISCO Corporation Annual Report 2014

	Millions of yen		Thousands of U.S. dollars
	2014	2013	2014
<b>NET SALES</b>	<b>¥ 104,920</b>	¥ 93,708	<b>\$ 1,019,440</b>
<b>COST OF SALES</b>	<b>50,818</b>	49,015	<b>493,765</b>
Gross profit	<b>54,102</b>	44,693	<b>525,675</b>
<b>SELLING, GENERAL AND ADMINISTRATIVE EXPENSES</b>	<b>36,749</b>	33,091	<b>357,065</b>
Operating income	<b>17,353</b>	11,602	<b>168,609</b>
<b>OTHER INCOME (EXPENSES):</b>			
Interest and dividend income	<b>76</b>	49	<b>745</b>
Interest expense	<b>(53)</b>	(49)	<b>(515)</b>
Foreign exchange gain (loss)	<b>(550)</b>	(547)	<b>(5,348)</b>
Equity in earnings gain of associated companies	<b>61</b>	216	<b>600</b>
Royalty income	<b>100</b>	—	<b>971</b>
Subsidy income	<b>353</b>	170	<b>3,439</b>
Loss on sale or disposal of property, plant and equipment	<b>(70)</b>	(131)	<b>(683)</b>
Devaluation loss on investment securities	<b>(38)</b>	(50)	<b>(369)</b>
Impairment loss on property, plant and equipment	<b>—</b>	(599)	<b>—</b>
Special retirement expenses	<b>(36)</b>	(40)	<b>(356)</b>
Provision of reserve for demolition cost	<b>—</b>	(98)	<b>—</b>
Gain on sale on investment securities	<b>0</b>	146	<b>2</b>
Gain on reversal of subscription rights to shares	<b>3</b>	12	<b>30</b>
Other, net	<b>105</b>	145	<b>1,024</b>
	<b>(47)</b>	(776)	<b>(457)</b>
<b>INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS</b>	<b>17,306</b>	10,826	<b>168,151</b>
<b>INCOME TAXES</b>			
Income taxes—Current	<b>5,852</b>	3,892	<b>56,864</b>
Income taxes—Deferred	<b>(692)</b>	(534)	<b>(6,732)</b>
	<b>5,159</b>	3,358	<b>50,131</b>
<b>INCOME BEFORE MINORITY INTERESTS</b>	<b>12,146</b>	7,468	<b>118,019</b>
<b>MINORITY INTERESTS IN INCOME (LOSS)</b>	<b>57</b>	(5)	<b>561</b>
<b>NET INCOME</b>	<b>¥ 12,088</b>	¥ 7,473	<b>\$ 117,457</b>

	Yen		U.S. dollars
	2014	2013	2014
<b>AMOUNT PER SHARE OF COMMON STOCK:</b>			
Net income			
Basic	<b>¥ 357.55</b>	¥ 221.75	<b>\$ 3.47</b>
Diluted	<b>340.22</b>	210.85	<b>3.31</b>
Cash dividends applicable to the year	<b>90.00</b>	56.00	<b>0.87</b>

# Consolidated Statements of Changes in Net Assets

DISCO Corporation Annual Report 2014

Millions of yen											
Number of shares of common stock	Shareholders' equity				Accumulated other comprehensive income			Share subscription rights	Minority interests	Total net assets	
	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Other securities valuation difference	Translation adjustments	Remeasurements of defined benefit plans				
<b>BALANCE at MARCH 31, 2012</b>	34,004,418	¥ 14,517	¥ 15,652	¥ 73,859	¥ (823)	¥ 6	¥ (1,980)	¥ —	¥ 981	¥ 325	¥ 102,537
Increase due to issuance of common stock											—
Cash dividend paid				(1,988)							(1,988)
Net income				7,473							7,473
Purchases of treasury stock					(1)						(1)
Disposal of treasury stock			2		26						28
Other											—
Net increase (decrease) during the year						6	1,851	—	243	407	2,507
<b>BALANCE at MARCH 31, 2013</b>	34,004,418	¥ 14,517	¥ 15,654	¥ 79,343	¥ (798)	¥ 12	¥ (128)	¥ —	¥ 1,223	¥ 731	¥ 110,556
Increase due to issuance of common stock											—
Cash dividend paid				(2,228)							(2,228)
Net income				12,088							12,088
Purchases of treasury stock					(2)						(2)
Disposal of treasury stock			535		565						1,101
Other											—
Net increase (decrease) during the year						5	1,993	(142)	(4)	89	1,941
<b>BALANCE at MARCH 31, 2014</b>	<b>34,004,418</b>	<b>¥ 14,517</b>	<b>¥ 16,190</b>	<b>¥ 89,203</b>	<b>¥ (235)</b>	<b>¥ 17</b>	<b>¥ 1,864</b>	<b>¥ (142)</b>	<b>¥ 1,219</b>	<b>¥ 821</b>	<b>¥ 123,456</b>

Thousands of U.S. dollars											
Number of shares of common stock	Shareholders' equity				Accumulated other comprehensive income			Share subscription rights	Minority interests	Total net assets	
	Common stock	Additional paid-in capital	Retained earnings	Treasury stock	Other securities valuation difference	Translation adjustments	Remeasurements of defined benefit plans				
<b>BALANCE at MARCH 31, 2013</b>	34,004,418	\$ 141,055	\$ 152,102	\$ 770,926	\$ (7,762)	\$ 123	\$ (1,253)	\$ —	\$ 11,891	\$ 7,111	\$ 1,074,196
Increase due to issuance of common stock											—
Cash dividend paid				(21,653)							(21,653)
Net income				117,457							117,457
Purchases of treasury stock					(22)						(22)
Disposal of treasury stock			5,205		5,494						10,699
Other											—
Net increase (decrease) during the year						50	19,365	(1,380)	(46)	871	18,861
<b>BALANCE at MARCH 31, 2014</b>	<b>34,004,418</b>	<b>\$ 141,055</b>	<b>\$ 157,307</b>	<b>\$ 866,730</b>	<b>\$ (2,290)</b>	<b>\$ 174</b>	<b>\$ 18,112</b>	<b>\$ (1,380)</b>	<b>\$ 11,845</b>	<b>\$ 7,983</b>	<b>\$ 1,199,539</b>

# Consolidated Statements of Cash Flows

DISCO Corporation Annual Report 2014

	Millions of yen		Thousands of U.S. dollars
	2014	2013	2014
<b>OPERATING ACTIVITIES:</b>			
Net income	¥ 12,088	¥ 7,473	\$ 117,457
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	5,995	5,939	58,251
Loss on sale or disposal of property, plant and equipment	70	131	683
Devaluation loss (gain) on investment securities	38	50	369
Impairment of fixed assets	—	599	—
Equity in earnings (losses) of associated companies	(61)	(216)	(600)
Decrease (Increase) in notes and accounts receivable—trade	(5,917)	3,155	(57,492)
Decrease (Increase) in inventories	2,034	(2,811)	19,770
Increase (Decrease) in notes and accounts payable—trade	(737)	1,856	(7,163)
Increase (Decrease) in accrued income taxes	318	1,121	3,097
Increase (Decrease) in accrued bonus	986	86	9,589
Increase (Decrease) in allowance for doubtful receivables	113	(123)	1,103
Increase (Decrease) in allowance for warranty cost	135	12	1,316
Increase (Decrease) in accrued retirement benefits	(1,800)	240	(17,489)
Increase (Decrease) in net defined benefit liability	1,970	—	19,143
Increase (Decrease) in accounts payable-non trade	755	(1,394)	7,345
Other, net	(1,114)	(813)	(10,829)
Net cash provided by operating activities	14,877	15,305	144,552
<b>INVESTING ACTIVITIES:</b>			
Purchases of property, plant and equipment	(12,725)	(5,433)	(123,641)
Proceeds from sales of property, plant and equipment	23	44	231
Net decrease (increase) in short-term loans receivable	(699)	(1)	(6,797)
Payments of long-term loans receivable	(1)	(858)	(5)
Payments into time deposits	(10,023)	(10,000)	(97,392)
Proceeds from withdrawal of time deposits	10,165	3,000	98,772
Purchase of investment securities	—	(446)	—
Proceeds from sales of investment securities	200	197	1,946
Purchase of intangible assets	(96)	(252)	(941)
Other	54	(31)	527
Net cash used in investing activities	¥ (13,101)	¥ (13,779)	\$ (127,300)

	Millions of yen		Thousands of U.S. dollars
	2014	2013	2014
<b>FINANCING ACTIVITIES:</b>			
Short-term bank loans, net	¥ (250)	¥ 67	\$ (2,429)
Proceeds from long-term debt	44	10,080	436
Repayment of long-term debt	(676)	(1,183)	(6,573)
Cash dividends paid	(2,231)	(1,987)	(21,682)
Proceeds from stock issuance to minority shareholders	—	409	—
Proceeds from sales of treasury stock	922	24	8,959
Other	(7)	(3)	(74)
Net cash used in financing activities	(2,198)	7,407	(21,364)
<b>EFFECT OF EXCHANGE RATE CHANGE ON CASH AND CASH EQUIVALENTS</b>	430	574	4,183
<b>NET CHANGE IN CASH AND CASH EQUIVALENTS</b>	7	9,507	71
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR</b>	21,544	12,038	209,335
<b>CASH AND CASH EQUIVALENTS, END OF YEAR</b>	¥ 21,552	¥ 21,544	\$ 209,407