Management's Discussion and Analysis

Sales and Income

Business Environment

In the fiscal year ended March 31, 2003, the global economy showed signs of recovery at one point, but was derailed again as accounting scandals at major U.S. firms, the downturn in stock markets worldwide, and the build up to the war in Iraq spun the economies of the United States and Europe sharply into decline. Conversely, in Asia, China's economy continued to expand strongly, and the economies of South Korea and Taiwan also showed mild upturns. Meanwhile, conditions in Japan's economy took another turn for the worse under pressure from the unrelenting cooling off of private-sector capital investment and personal consumption.

In the electronics market, there was a recovery in demand for some digital consumer products, such as DVD players and digital cameras, but the mobile phone, PC, and communications devices markets remained at low ebb. Against this backdrop in semiconductor-related markets, postponements or cutbacks in capital investment started to increase from last summer, resulting in a persistently difficult business environment. Moreover, the trend toward consolidation among semiconductor manufacturers has accelerated.

Sales

Amid this severe business climate, consolidated net sales for the fiscal year ended March 31, 2003 increased 10.2 percent from the prior fiscal year to ¥460.6 billion. Sales of the Company's core Semiconductor Production Equipment (SPE) division grew 12.0 percent, to ¥364.7 billion, supported by favorable growth in sales of FPD manufacturing equipment amid the slump in the semiconductor industry. The sales growth of the Computer Network and Electronic Components divisions also contributed to overall sales expansion.

Geographically, domestic sales rose 2.1 percent to ¥190.5 billion and overseas sales expanded 16.8 percent to ¥270.1 billion. As a result, the contribution of overseas sales to net sales increased to 58.6 percent from 55.4 percent in the previous fiscal year.

Consolidated orders received for the fiscal year under review totaled ¥458.5 billion, jumping 55.3 percent from the previous fiscal year. The order backlogs at the fiscal year-end edged down 1.3 percent to ¥150.7 billion.

Performance by Division

•Semiconductor Production Equipment

Semiconductor manufacturers increased their desire for capital investment at the beginning of 2002 because the view

	Millions of yen (percentage of net sales)						Thousands of U.S. dollars
	2003		2002		2001		**2003**
Net sales	**¥460,580**	**(100.0)**	¥417,825	(100.0)	¥723,880	(100.0)	**$3,831,782**
Cost of sales	**326,540**	**(70.9)**	302,270	(72.3)	458,902	(63.4)	**2,716,637**
Gross profit	**134,040**	**(29.1)**	115,555	(27.7)	264,978	(36.6)	**1,115,145**
SG&A expenses	**132,921**	**(28.9)**	133,865	(32.0)	143,892	(19.9)	**1,105,837**
Operating income (loss)	**1,119**	**(0.2)**	(18,310)	–	121,086	(16.7)	**9,308**
Other income (expenses)	**(24,129)**	**–**	(4,609)	–	(21,954)	–	**(200,743)**
Income (loss) before income taxes	**(23,010)**	**–**	(22,919)	–	99,132	(13.7)	**(191,435)**
Provision for income taxes	**18,532**	**(4.0)**	(2,990)	–	37,099	(5.1)	**154,180**
Minority interest	**12**	**(0.0)**	8	(0.0)	21	(0.0)	**100**
Net income (loss)	**(41,554)**	**–**	(19,938)	–	¥ 62,012	(8.6)	**(345,715)**

that inventories were low for some products was spreading throughout the industry. However, semiconductor demand did not continue to rise, resulting in excessive inventories building up for many products, sidetracking a genuine recovery in the industry. During the second half, these conditions produced a mixed response among semiconductor manufacturers, with some companies postponing capital investments while others continued to invest.

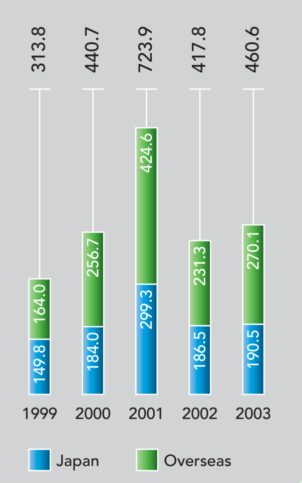
Consolidated orders of the SPE division for the fiscal year ended March 31, 2003, amounted to ¥363.4 billion, recovering 75.4 percent from the previous fiscal year's performance, which was posted amid the worst conditions ever recorded in the semiconductor industry. Consolidated sales climbed 12.0 percent to ¥364.7 billion. Contribution to consolidated sales also rose slightly, increasing to 79.2 percent from 78.0 percent.

Sales of flat panel display (FPD) production equipment, which are also included in this division, expanded significantly compared to last fiscal year. The supply and demand gap for FPDs contracted during the fiscal year thanks to the progressive replacement of CRT monitors in PCs with LCD monitors and the growth of the new LCD television set market. Encouraged by these trends, FPD manufacturers in South Korea and in Taiwan increased their capital investments.

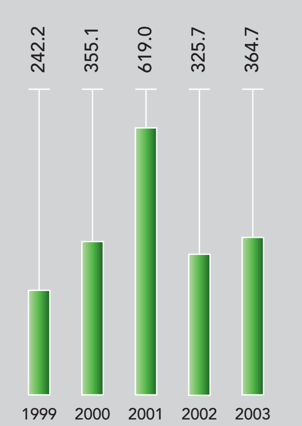
Performance by geographical region was mixed. Sales in Korea, where capital investment in semiconductor memory and FPD increased, rose 147.0 percent, to ¥57.3 billion. Sales in the People's Republic of China, where full-fledged capital investment in semiconductor manufacture has gotten under way, surged 168.4 percent, to ¥20.1 billion. Sales in Taiwan also rose, mainly due to increased purchases of FPD production equipment. On the other hand, sales in the U.S. market fell 21.6 percent, to ¥74.3 billion under the impact of a reduction in capital investments, particularly for logic devices, by major customers.

Sales also varied considerably by product during the fiscal year. Sales of thermal processing and thin-film formation systems increased thanks to the contributions of such new products as TELFORMULA™ and Trias™SPA. In addition, the division's market share of oxidation etch systems and wafer probers expanded as did sales. Sales of coaters/developers, however, declined slightly because of the restraint in capital investment in lithography equipment. In terms of wafer size, capital investment in 300mm wafer manufacturing lines continued to rise among semiconductor manufacturers in the United States and Korea as well as by the foundry manufacturers in Taiwan. In total, the sales portion of 300mm equipment is approaching 50 percent of our SPE sales. Nevertheless, 200mm-manufacturing lines remain the most appropriate for many ICs used in the small-lot-wide-variety production of digital consumer products. Consequently, the division expects that demand for 200mm wafer manufacturing equipment will continue to underpin the market for the time being.

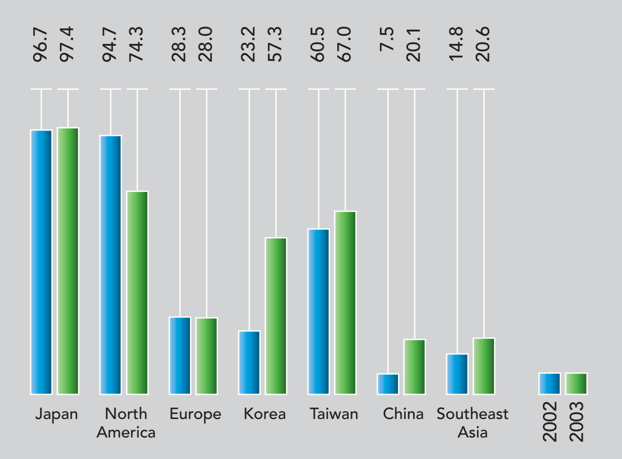
Domestic and Overseas Sales
(¥ Billions)



SPE division's Sales
(¥ Billions)



SPE division's Sales by Geographic Region
(¥ Billions)



Sales by third-party products imported into Japan are included in Japan Sales

•Computer Network

Amid continued severe economic conditions in Japan, net sales of the Computer Network (CN) division edged forward 0.9 percent, to ¥17.2 billion. The division's business is principally based on providing customers with Internet and storage area network (SAN) solutions.

One of the products contributing most to sales during the fiscal year was NetScreen Technologies' Firewall/VPN. A core product of the division, F5 Networks' Internet traffic management system also posted favorable sales growth and gained considerable attention in the market for its high network-availability and stability. SAN-related products also performed well, with original equipment manufacturing (OEM) sales of Brocade Communications Systems' Fibre Channel Fabric Switches climbing 1.3 times year on year. Establishing a base for future growth, TimesTen Performance Software's in-memory database products began to be utilized as infrastructure for soft switches in the voice over IP (VoIP) field during the fiscal year.

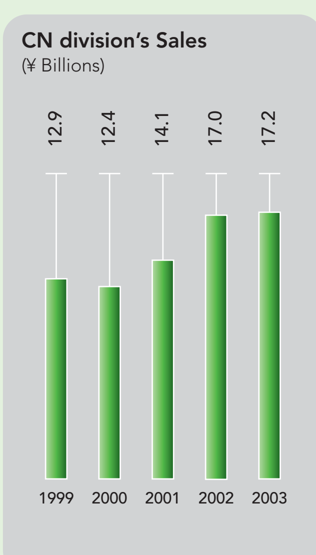
Among new developments, we established Procket Networks Japan, Inc., a joint venture that will act as a base for entry into the Japanese market by Procket Networks, Inc., a Silicon Valley based communications device venture. The Japanese joint venture, formed in collaboration with NTTCP Communications, Inc., and Net One Systems Co., Ltd., is marketing Procket Networks' advanced packet communications technology products, such as its representative ultra-high-end routers.

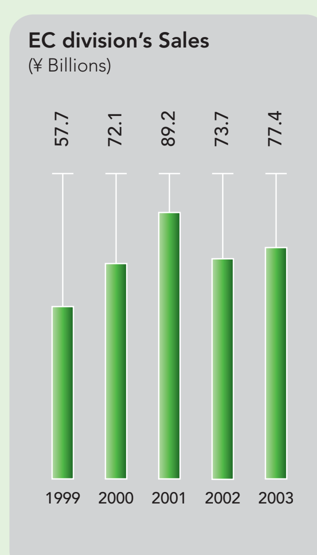
With our own proprietary Ruff Systems, we concentrated especially on development during the fiscal year to strengthen functions in line with such trends as the progressive shift to broadband and the digitization of television broadcasting. Utilizing our accumulated technologies in networks and SAN, we plan to offer Ruff Systems network as video solutions that encompass the entire process from content management to distribution.

•Electronic Components

Net sales for the Electronic Components (EC) division rose 5.1 percent to ¥77.4 billion. Sales growth was supported by strong efforts to sell high-value-added semiconductor devices to cope with the difficult conditions caused by the less-than-full recovery in the semiconductor market. The division's product lineup includes semiconductor devices, board computer products, software, and other electronic components.

Semiconductor products accounted for 88 percent of divisional net sales. Major contributors to sales growth included Xilinx's programmable logic devices (PLDs), for which applications are expanding in the consumer electronics market; Pixel





Works' custom ICs, which boast the number one share of the market for image enhancement ICs for liquid crystal display (LCD) projectors; and Linear Technology's analog ICs for power sources, which enjoyed robust demand for use in mobile devices. Because they require technical support, these high-value-added products provide a particular strong boost to sales.

Sales of motherboards, VME boards, and other boards struggled during the fiscal year, resulting in an overall slight decline in the category. On the other hand, sales of software edged forward thanks to expanded sales of operating system software for embedded system devices. Sales of general electronic components also advanced slightly due to increased sales of panel programmable controllers and power switches for consumer electronics devices.

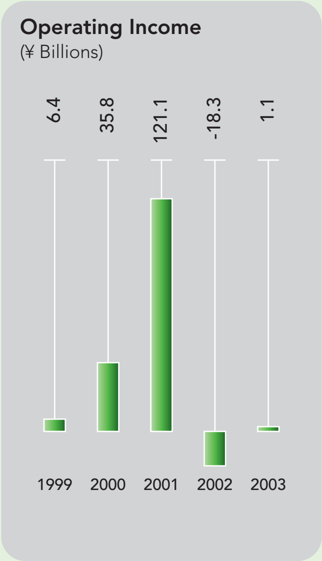
Utilizing the abundant experience of its design & development centers, the division offers a design service for semi-custom ICs such as PLD and ASIC on a contract basis as well as developing its own products. In May 2002, the division established a dedicated sales force for its design services, and successfully increased the volume of orders. In proprietary product development, the division created a variety of large-scale integrated circuits (LSIs) that achieve synergies with distributing products handled by the division. Examples included peripheral LSIs for Xilinx's PLDs and a multi input-output controller for LCD projectors under an alliance with Pixel Works.

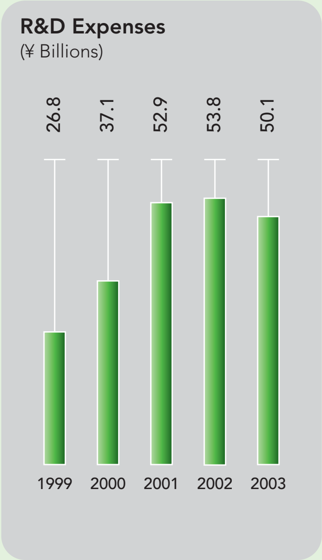
In the future, the division will aggressively market high-value-added products that require technical support. At the same time, it will improve and expand its lineup of products for digital consumers. Furthermore, the division will work to establish a strong foundation as a "technology trading company" by selling high-value-added products that require technical support, utilizing the technical capabilities of its design development centers to design and develop semi-custom ICs, and strengthening development of original products.

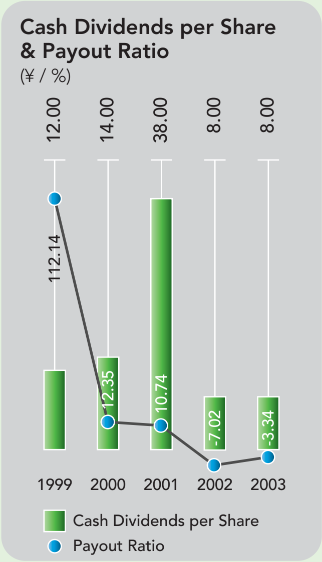
On March 7, 2003, Tokyo Electron Device Ltd., a subsidiary operating the Electronic Components Division, went public, listing its shares on the Second Section of the Tokyo Stock Exchange.

Cost of Sales, SG&A Expenses and Operating Income

Although cost of sales increased 8.0 percent to ¥326.5 billion, cost of sales as a percentage of net sales declined to 70.9 percent from 72.3 percent for the prior fiscal year. Although downward pressure on prices by customers negatively affected profitability, the decrease in cost of sales as a percentage of net sales can be primarily attributed to reductions in the production fixed cost and the increase in plant utilization rates due to sales growth. Consequently, gross profit amounted to ¥134.0 billion, up 16.0 percent and gross margin rose 1.4 points to 29.1 percent.







Selling, general and administrative expenses decreased 0.7 percent to ¥132.9 billion. Based on efforts to be selective and focused in R&D projects that the Company undertakes, R&D expenses, which are included in SG&A expenses, decreased 6.9 percent to ¥50.1 billion year on year. R&D expenses were allocated principally to the development of 90 nanometer-and-smaller design rule process technology and equipment as well as new technology.

As a result of the increase in gross profit and the decline in SG&A expenses, operating income improved ¥19.4 billion from the ¥18.3 billion loss in the prior fiscal year, to ¥1.1 billion.

Other Income (Expenses) and Net Income

Net other expenses expanded by ¥19.5 billion to ¥24.1 billion. The increase can be mainly attributed to an extraordinary loss of ¥20.6 billion related to restructuring expenses. Major expenses included ¥10.0 billion in devaluation of inventories that will be disposed and ¥7.8 billion for an expenses reserve related to the planned reduction of employees in the fiscal year ending March 2004. Income before income taxes declined ¥100 million from the prior fiscal year to a loss of ¥23.0 billion.

Based on a decision on the potential recovery of deferred tax assets, a reversal from the deferred tax assets account resulted in provision income taxes of ¥18.5 billion in the fiscal year under review. Consolidated net loss, therefore, expanded ¥21.6 billion, to ¥41.6 billion. Consequently, net loss per share fell from ¥113.85 to ¥238.57. Cash dividends were ¥8.00 per share, the same as in the prior fiscal year.

Impact of Fluctuation in Foreign Currency Exchange Rates on Performance

Changes in exchange rates have no material effect on Tokyo Electron's results because exports from Japan are generally denominated in yen. While some settlements are denominated in U.S. dollars, exchange risk is hedged by concluding forward exchange contracts individually at the time orders are received. Also, the contribution of foreign currency-denominated transactions involving foreign-made merchandise imported to Japan is comparatively low and did not have a material effect in the year ended March 31, 2003.

Financial Position and Cash Flows

Financial Position

Current assets at March 31, 2003 expanded 0.9 percent year on year to ¥356.4 billion. Among the main factors in this increase were a ¥14.2 billion rise in trade notes and accounts receivable along with greater sales and a ¥4.6 billion increase in cash and cash equivalents. Inventory, however, declined ¥15.5 billion by devaluation and so forth. Excluding accounts receivable—others, trade notes and accounts receivable turnover based at the end of fiscal year improved to 135 days, compared with 138 days for the prior fiscal year, and inventory turnover improved to 89 days, compared with 111 days in the previous fiscal year.

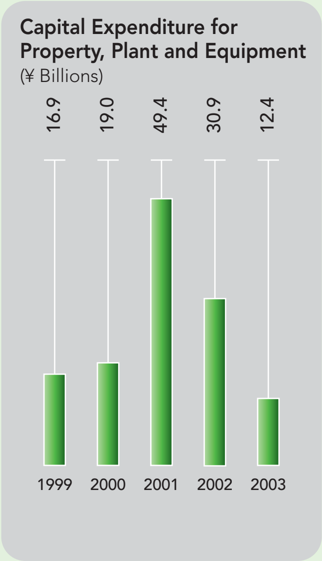
Property, plant and equipment declined 11.1 percent to ¥119.6 billion year on year. The primary factors contributing to the decline were the sale of land and buildings by Tokyo

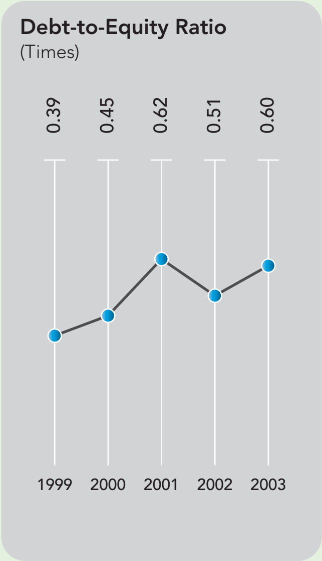
Electron Oregon, LLC and an evaluation loss on buildings owned by Tokyo Electron Texas, LLC. During the fiscal year, Tokyo Electron invested ¥12.4 billion in property, plant and equipment, consisting primarily of the purchase of equipment for evaluation and IT-related purchases.

Investments and other assets dropped 29.2 percent to ¥48.9 billion. The main factors in the decrease in investments and other assets were the ¥13.2 billion fall in deferred tax assets compared with the previous fiscal year and a ¥2.3 billion decrease in investments in securities due to mark-to-market adjustments. Total assets declined 5.7 percent to ¥524.9 billion, primarily because of the drop in fixed assets.

Current liabilities expanded 46.8 percent to ¥160.7 billion. There were two major factors behind this increase. There was an increase in trade notes and accounts payable due to greater procurement necessary for the higher production levels. Also, a ¥5.2 billion decline in short-term borrowings was offset by a ¥25.0 billion increase in commercial paper. In addition, the outstanding balance of ¥15.5 billion for the September 2003 scheduled redemption of the 2nd convertible bond was transferred from long-term to current liabilities. Furthermore, a ¥8.6 billion reserve was set up in preparation for a series of business restructuring measures.

	Millions of yen (percentage of total assets)				Thousands of U.S. dollars
	2003		2002		**2003**
Total assets	**¥524,901**	**(100.0)**	¥556,915	(100.0)	**$4,366,899**
Cash and cash equivalents	**52,982**	**(10.1)**	48,409	(8.7)	**440,784**
Trade notes and accounts receivable	**182,218**	**(34.7)**	167,982	(30.2)	**1,515,953**
Inventories	**111,810**	**(21.3)**	127,352	(22.9)	**930,201**
Investments and other assets	**48,851**	**(9.3)**	68,981	(12.4)	**406,419**
Property, plant and equipment	**119,611**	**(22.8)**	134,511	(24.2)	**995,101**
Total liabilities	**268,402**	**(51.1)**	249,278	(44.8)	**2,232,958**
Short-term borrowings	**8,729**	**(1.7)**	13,924	(2.5)	**72,623**
Trade notes and accounts payable	**48,279**	**(9.2)**	41,053	(7.4)	**401,656**
Accrued income taxes	**3,645**	**(0.7)**	1,663	(0.3)	**30,325**
Long-term debt, less current portion	**70,230**	**(13.4)**	105,452	(18.9)	**584,271**
Shareholders' equity	**252,904**	**(48.2)**	¥307,579	(55.2)	**2,104,029**





Working capital contracted to ¥195.7 billion from ¥243.9 billion in the previous fiscal year, and the current ratio declined to 2.2 to 1 from 3.2 to 1 a year earlier.

Because of the transfer of the current portion of convertible and straight bonds to current liabilities, Tokyo Electron's long-term debt declined 23.0 percent year on year to ¥107.7 billion.

The balance of equity-linked bonds outstanding at March 31, 2003 was ¥25.5 billion.

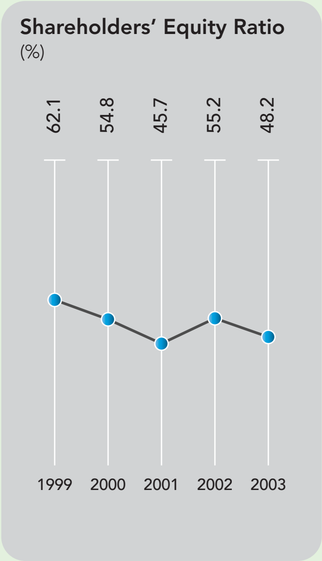
Shareholders' equity decreased 17.8 percent to ¥252.9 billion, due to the contraction in retained earnings and the increase of treasury stock. As a percentage of total assets, shareholders' equity declined to 48.2 percent from 55.2 percent a year earlier. Return on average total shareholders' equity was minus 14.8 percent.

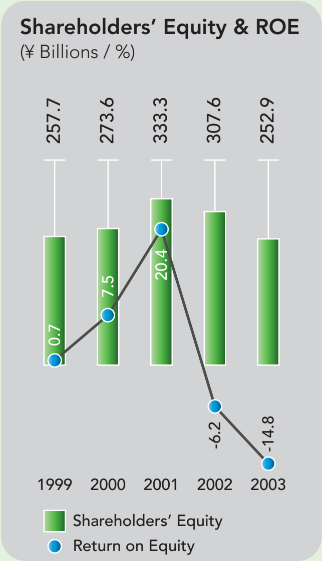
Cash Flows

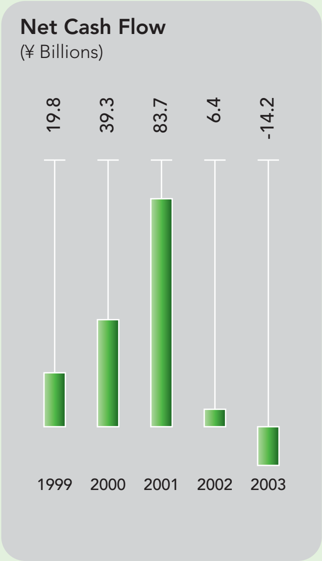
Net cash provided by operating activities amounted to ¥21.4 billion, decreasing from ¥77.6 billion a year earlier. Net cash flow, defined as the sum of net income and depreciation and amortization, dropped from ¥6.4 billion to minus ¥14.2 billion. Growth in accounts receivables due to increased sales contributed to the decline in net cash flow provided by operating activities.

Net cash used in investing activities was ¥7.3 billion, down from ¥35.8 billion in the prior fiscal year. Investment in property, plant and equipment totaling ¥7.0 billion mainly comprised the purchase of equipment for R&D.

Net cash used in financing activities amounted to ¥9.9 billion compared with ¥57.2 billion a year earlier. Tokyo Electron had significant outlays during the fiscal year related to the redemption of the 6th unsecured bond issue, the repayment of short-term borrowings, the acquisition of treasury stock, and the payment of dividends. These outlays were offset, however, by proceeds from the issue of commercial paper and from the initial public offering of Tokyo Electron Device. Cash and cash equivalents at the end of the year totaled ¥53.0 billion, up ¥4.6 billion from ¥48.4 billion at the end of the prior fiscal year.







Net Cash Flow =
Net income + Depreciation and Amortization