FINANCIAL REVIEW

Financial results in this section refer to the Company's performance for fiscal 2007, the year ended March 31, 2007. Percentage comparisons refer to year-on-year changes from fiscal 2006.

The Company adopted the following revised accounting standards and business segment.

- Effective from fiscal 2005, the policy for revenue recognition of semiconductor and FPD production equipment was changed from the time of shipment of products to, in principle, the time of confirmation of set-up and testing of products. The effect of this change decreased net sales, operating income and income before income taxes by ¥80,956 million, ¥20,541 million and ¥20,563 million, respectively, for fiscal 2005, compared with the corresponding amounts which would have been recorded if the previous method had been applied.
- Effective from fiscal 2005, the accounting treatment of after-sale repair expenses incurred during the warranty period for semiconductor and FPD production equipment was changed. In the past, the Company charged such expenses to income as incurred. Effective from the fiscal year ended March 31, 2005, the Company provides accrued warranty expenses for estimated expenses, calculated on the basis of after-sale repair expenses incurred in the past. The effect of this change decreased operating income and income before income taxes by ¥635 million and ¥13,106 million, respectively, for the year ended March 31, 2005, compared with the corresponding amounts which would have been recorded if the previous method had been applied.
- On October 1, 2006, Tokyo Electron's computer networks division was transferred to Tokyo Electron Device Limited. Accordingly, sales from computer networks, which formerly had been included in the industrial electronic equipment segment, are now included as part of the electronic components and computer networks segment (formerly the electronic components segment), effective from fiscal 2007.

Sales and Income

Operating Environment

During the fiscal year ended March 31, 2007, the US economy was affected by a housing slump during the latter half of the year, but consumer spending and capital investment remained firm. In Asia, strong exports and brisk capital investment supported high economic growth in China, while both South Korea and Taiwan also registered favorable results. In Japan, meanwhile, the economy continued to recover on the back of aggressive capital investment and increased exports, mainly driven by good performing companies.

In the electronics industry, in which the Company participates, rising demand for digital consumer electronics, such as large flat-panel TVs, as well as rising market penetration for mobile phones and PCs in emerging economies, created a healthy business environment. These trends prompted manufacturers of semiconductors and flat-panel displays to invest aggressively in new plant and equipment.

(Millions of Yen)

	2003	2004	2005	2006	**2007**
Net sales	¥460,580	¥529,654	¥635,710	¥673,686	**¥851,975**
Gross profit	134,040	140,155	175,913	189,732	**272,649**
Gross profit margin	29.1%	26.5%	27.7%	28.2%	**¥32.0%**
Selling, general and administrative expenses	132,921	117,875	111,930	114,029	**128,670**
Operating income	1,119	22,280	63,983	75,703	**143,979**
Operating margin	0.2%	4.2%	10.1%	11.2%	**16.9%**
Income (loss) before income taxes	(23,010)	14,936	55,775	75,328	**144,414**
Net income (loss)	(41,554)	8,297	61,601	48,006	**91,263**

Effective from fiscal 2005, the Company made certain changes in accounting policies as discussed in this financial review.

Sales

Consolidated net sales grew 26.5% year on year, to a new record high of ¥852.0 billion, supported by rapid growth in sales of semiconductor and FPD production equipment. By region, sales of semiconductor production equipment grew sharply in Japan, South Korea and Taiwan, while sales in other regions were steady. Sales of FPD production equipment were driven primarily by demand from Japan and Taiwan. As a result, net sales in Japan rose 19.5% year on year, to ¥313.8 billion, while overseas net sales increased by 30.9%, to ¥538.2 billion. Overseas net sales increased as a share of consolidated net sales, to 63.2% compared with 61.0% in fiscal 2006.

Meanwhile, consolidated orders received increased by 35.4% year on year, to ¥977.2 billion, and the consolidated order backlog at the end of fiscal 2007 rose 34.7%, to ¥486.3 billion. Both figures were historical records.

Gross Profit, SG&A Expenses and Operating Income

The cost of sales increased by 19.7% year on year, to ¥579.3 billion, and gross profit jumped 43.7%, to ¥272.6 billion. The gross profit margin improved by 3.8 percentage points, to 32.0%, the result mainly of the launch of new products, which pushed up average unit prices, a decline in warranty expenses and after-warranty expenses, and improvements to production efficiency which lowered the cost of sales.

Selling, general and administrative (SG&A) expenses increased by 12.8% year on year, to ¥128.7 billion, but the ratio of SG&A expenses to net sales improved to 15.1%, compared with 17.0% in fiscal 2006. R&D expenses, which are included in general and administrative expenses, rose by ¥7.8 billion, to ¥57.0 billion and were the major reason for the increase in SG&A expenses.

As a result, operating income grew 90.2% year on year, to ¥144.0 billion. The operating margin improved by 5.7 percentage points, to 16.9%. Both of these figures were new record highs for the Company.

Research and Development

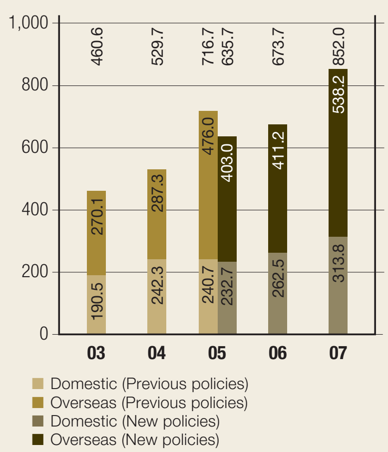
R&D expenses, as noted earlier, rose 15.8% year on year, to ¥57.0 billion.

In semiconductor production equipment, R&D efforts focused on the development of new technologies and products that respond to rising market demands, not only for equipment that responds to finer designs rules of semiconductor devices, but also for responses to new materials for realizing higher speeds and lower power consumption. As a result of ongoing R&D efforts, the Company launched new semiconductor production equipment in all six product categories. In FPD production equipment, the focus remained on the development of equipment designed for large glass substrates.

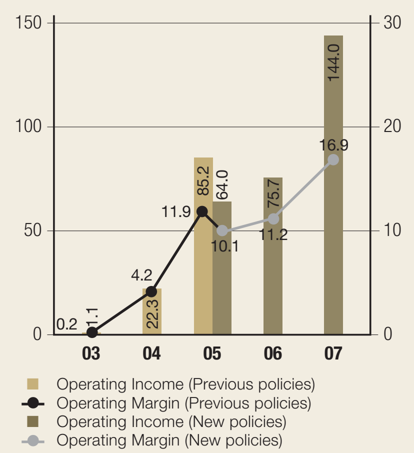
Another important R&D theme was lowering the environmental load of production equipment based on their individual characteristics. A certain portion of the R&D budget is allocated for this purpose.

In addition to R&D spending to develop new technologies and products in existing areas of operation, the Company also invested in creating new businesses derived from its core technologies such as applying RLSA plasma source, which has superior features, to equipment, and MEMS-related equipment.

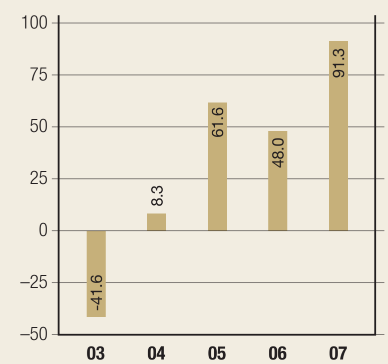
Domestic and Overseas Sales
(Billions of Yen)



Operating Income and Operating Margin
(Billions of Yen) (%)



Net Income (Loss)
(Billions of Yen)



Other Income (Expenses) and Net Income

As was the case in the previous fiscal year, there were no major extraordinary gains or losses. In fiscal 2007, net non-operating income was ¥0.4 billion, compared with net non-operating expenses of ¥0.4 billion in fiscal 2006. As a result, income before income taxes rose 91.7% year on year, to ¥144.4 billion.

Net income grew 90.1% year on year, to ¥91.3 billion, a record for the Company. Net income per share increased from ¥267.61 in the previous fiscal year, to ¥511.27 in fiscal 2007.

Dividend Policy and Dividend

The fundamental policy regarding return of profit to shareholders is to pay dividends linked to business performance and backed by earnings. Since fiscal 2006, the Company has applied a new dividend policy that aims at a payout ratio of 20% of consolidated net income. On this basis, the Company increased the cash dividend per share by ¥48, to ¥103 per share. On a consolidated basis, this represented a dividend payout ratio of 20.1%.

Performance by Segment

Industrial Electronic Equipment Segment

Segment sales (including intersegment sales) rose 30.7% year on year in fiscal 2007, to ¥746.9 billion. Segment operating income grew 96.2%, to ¥140.4 billion, and the operating margin improved by 6.3 percentage points, to 18.8%.

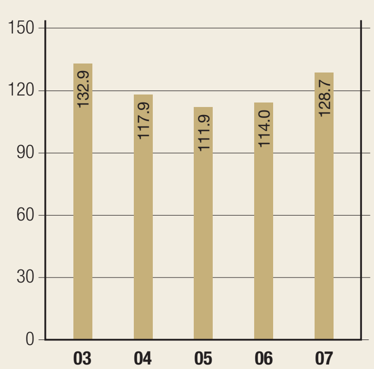
Semiconductor Production Equipment

Sales to external customers in fiscal 2007 increased 32.0% year on year, to ¥642.6 billion.

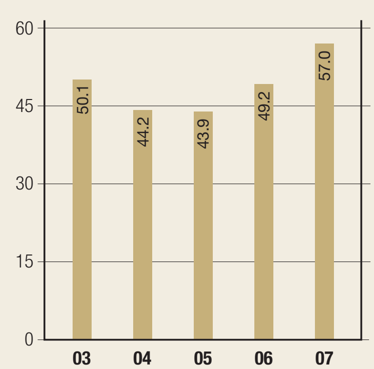
Increased market penetration for digital consumer electronics and increasing global demand for mobile phones and PCs boasted demand for DRAM, flash memory and other semiconductor memory used in these devices. The launch of Microsoft's new PC operating system, *Windows Vista*™, and expectations for growing demand for semiconductors due to the increasing functionality of digital consumer electronics and mobile equipment led semiconductor memory manufacturers to step up investment in production equipment. This favorable business environment stimulated inquiries for production equipment.

By equipment type, backed by strong capital investment by semiconductor memory manufacturers, particularly in Asia, sales of coater/developers, etch systems, thermal processing systems, CVD systems and cleaning systems recorded large increases in sales. By model, Tokyo Electron saw sales growth of *CLEAN TRACK*™ *LITHIUS*™, a coater/developer compatible with next-generation design rule technologies, new *TELINDY*™ thermal processing systems, *EXPEDIUS*™ automated wet stations, and *Telius*™, a plasma etch system equipped with an SCCM™-JI etch chamber.

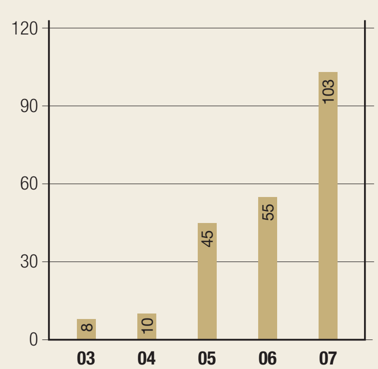
Selling, General and Administrative Expenses
(Billions of Yen)



R&D Expenses
(Billions of Yen)



Cash Dividend per Share
(Yen)



In terms of wafer diameter, 89% of sales were for 300mm wafer plants and 11% of sales were for 200mm wafer plants.

Division orders rose 60.1% year on year, to ¥800.4 billion, and the order backlog at the end of fiscal 2007 grew 63.3% compared with the end of the previous fiscal year, to ¥407.0 billion.

FPD Production Equipment

Sales to external customers rose 24.1% year on year, to ¥100.8 billion. LCD TVs and other flat-panel TVs are seeing rapidly increasing demand stimulated by the shift to digital broadcasting technology and high-definition (HDTV) broadcasts, as well as falling unit prices. In response, LCD panel manufacturers in Japan and other parts of Asia made investments to develop high-performance, large-screen display panels and to increase production capacity. In light of these circumstances, the Company worked to develop and market products that address market trends and needs. In fiscal 2007, the Company introduced *Exceliner*™ FPD coater/developers designed to process eighth-generation large glass substrates, following in the footsteps of *Impressio*™ FPD etch/ash system.

Although sales were brisk, the supply-demand balance for LCD panels began to weaken in the latter half of fiscal 2007, causing orders to drop off. Division orders received declined by 41.0% year on year, to ¥66.9 billion, and the order backlog fell 34.2%, to ¥65.2 billion at the end of fiscal 2007.

Others

Other sales consist primarily of in-house services, such as insurance and travel services. Sales in this segment declined by 10.3% year on year, to ¥1.1 billion.

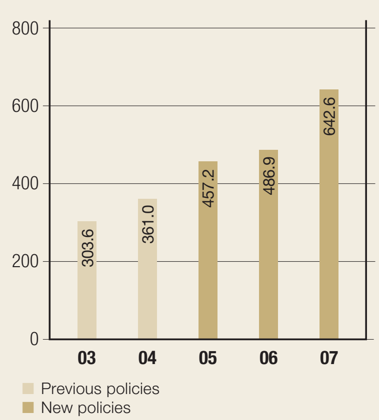
Electronic Components and Computer Networks (Tokyo Electron Device Limited)

Net sales in this segment, including intersegment sales, amounted to ¥108.7 billion. Operating income declined by 5.1%, to ¥4.0 billion, and the operating margin declined 0.3 percentage points, to 3.7%.

On October 1, 2006, Tokyo Electron's computer networks division was transferred to Tokyo Electron Device Limited. Accordingly, sales from computer networks, which formerly had been included in the industrial electronic equipment segment, are now included as part of the electronic components and computer networks segment (formerly the electronic components segment), effective from fiscal 2007.

Semiconductor Production Equipment Sales

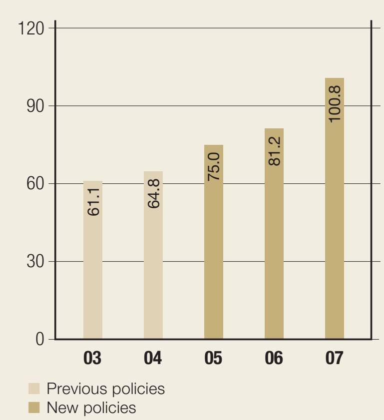
(Billions of Yen)



Notes: 1. Since fiscal 2005, sales of FPD production equipment have been shown separately from SPE Division sales, in which they were previously included. In the left graph, SPE sales for fiscal 2004 and prior years exclude FPD production equipment sales on a non-consolidated basis for the convenience of readers. (These figures are unaudited.)
2. Effective from fiscal 2005, the Company made certain changes in accounting polices as discussed in this financial review.

FPD Production Equipment Sales

(Billions of Yen)



Notes: 1. Since fiscal 2005, sales of FPD production equipment have been shown separately from SPE Division sales, in which they were previously included. In the left graph, FPD production equipment sales for fiscal 2004 and prior years are on a non-consolidated basis, while those from fiscal 2005 are on a consolidated basis.
2. Effective from fiscal 2005, the Company made certain changes in accounting polices as discussed in this financial review.

Electronic Components

Sales to external customers rose 1.6% year on year in fiscal 2007, to ¥88.3 billion. The main strategic market for domestic operations is the industrial equipment industry, and sales focus on custom ICs, general-purpose (analog) ICs and other high value-added products that require advanced technical support. Meanwhile, the Company concentrated on increasing orders for contract design services and developing products for industrial equipment to increase sales of Tokyo Electron Device's *inrevium* brand products. Overseas, consolidated subsidiary Tokyo Electron Device Hong Kong Limited opened a new base in Singapore in order to provide better support to Japanese customers who have production facilities abroad.

Computer Networks

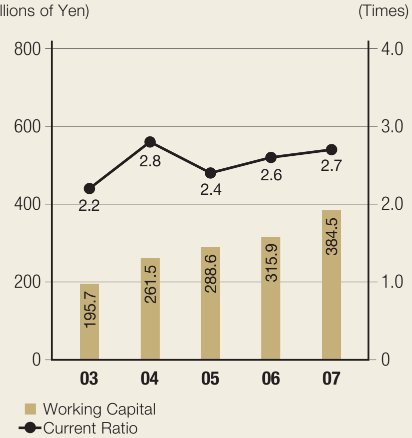
Sales to external customers rose 9.6% year on year in fiscal 2007, to ¥19.2 billion. Demand from corporations for products that can enhance security and internal control have led to a surge in capital investment, which elevated sales of network and storage equipment.

The computer networks business and electronic components business have common customers. Also, both businesses are engaged in distribution businesses that handle state-of-the-art products mainly of overseas suppliers. Therefore, Tokyo Electron transferred the computer networks operation to Tokyo Electron Device, in order to capture greater synergies, expand the scale of the distribution business and raise earnings.

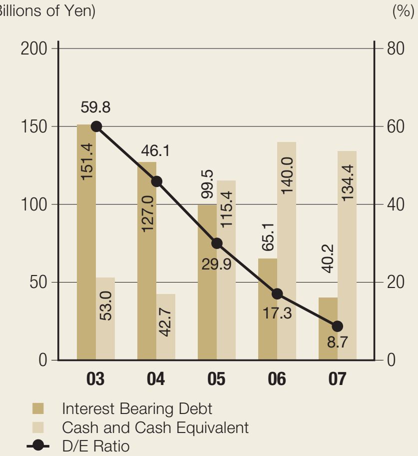
Business Segment Information

	Millions of yen				
2007:	Industrial electronic equipment	Electronic components and computer networks	Total	Eliminations and corporate	Consolidated
1. Net sales and operating income					
Net sales					
(1) Sales to external customers	¥744,512	¥107,463	¥851,975	¥ –	¥851,975
(2) Intersegment sales or transfers	2,382	1,247	3,629	(3,629)	–
Total	746,894	108,710	855,604	(3,629)	851,975
Operating expenses	606,540	104,740	711,280	(3,283)	707,996
Operating income	140,354	3,970	144,324	(346)	143,979
2. Assets, depreciation and amortization expenses and capital expenditure					
Assets	¥728,236	¥ 46,730	¥774,966	¥(4,452)	¥770,514
Depreciation and amortization expenses	20,061	360	20,421	–	20,421
Capital expenditure, including intangible and other assets	34,795	274	35,069	–	35,069

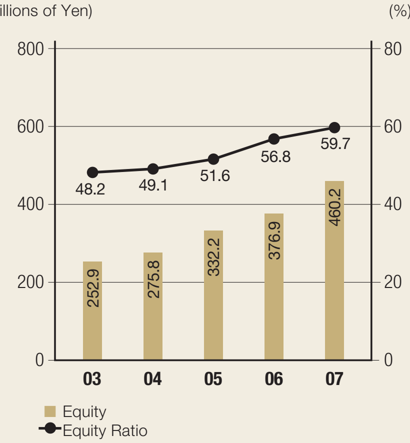
Working Capital and Current Ratio



Interest-Bearing Debt, Cash and Cash Equivalents, D/E Ratio



Equity and Equity Ratio



Financial Position and Cash Flows

Assets, Liabilities and Net Assets

At March 31, 2007, total assets stood at ¥770.5 billion, an increase of ¥107.3 billion from the end of March 2006. Current assets increased by ¥92.9 billion, to ¥610.4 billion. This partly reflected an increase in trade notes and accounts receivable of ¥59.7 billion due to higher sales. In addition, the surge in orders during the second half caused inventories to increase by ¥31.1 billion.

Net property, plant and equipment rose ¥10.2 billion year on year, to ¥104.9 billion, mainly reflecting the purchase of buildings and land.

Investments and other assets rose ¥4.2 billion, to ¥55.2 billion. A major factor was the acquisition of U.S.-based Epion Corporation (at a cost of ¥4.5 billion), which increased intangible assets.

Total liabilities increased by ¥20.1 billion, to ¥300.7 billion. Rising orders, and the associated increase in procurement, caused trade notes and accounts payable to increase by ¥21.0 billion, to ¥96.8 billion. In addition, the increase in taxable income produced a ¥22.8 billion year-on-year rise in income taxes payable, to ¥45.7 billion. Total interest-bearing debt, which includes short term borrowings, the current portion of corporate bonds, long-term debt and corporate bonds, was ¥40.2 billion. This reflected the redemption of ¥20.0 billion in unsecured straight bonds, as well as ¥4.5 billion in unsecured bonds with warrants. The debt-to-equity ratio (interest-bearing debt / equity) consequently improved to 8.7%, compared with 17.3% at the end of fiscal 2006.

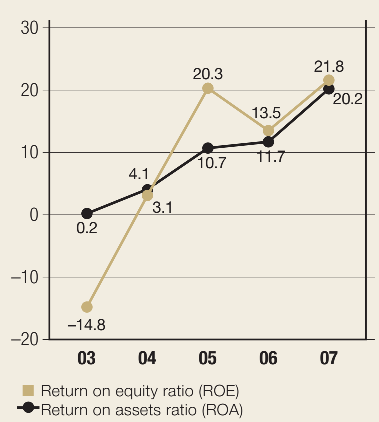
Total net assets was bolstered by the strong earnings posted in fiscal 2007, with retained earnings rising by ¥78.1 billion year on year. Net assets thus increased by ¥87.2 billion, to ¥469.8 billion at the fiscal year-end. As a result, the equity ratio rose 2.9 percentage points, to 59.7%, and return on equity (ROE) improved by 8.3 percentage points year on year, to 21.8%.

Capital Expenditures*1 and Depreciation and Amortization*2

Capital expenditures increased by 103.4% to ¥27.1 billion. Major capital expenditure items included the purchase of land and buildings for a new research and development center in Sendai, Miyagi Prefecture; expansion work on the Company's production facility in Matsushima, Miyagi Prefecture; and the construction of a new office building at the Company's South Korean subsidiary. In addition, the Company acquired new capital equipment to help enhance research and development. Depreciation and amortization expenses declined 1.8% year on year, to ¥18.8 billion.

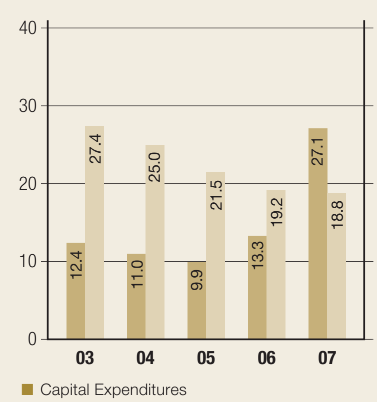
*1 Capital expenditures only represent the gross increase in property, plant and equipment.
*2 Depreciation and amortization does not include amortization of goodwill.

ROE and ROA
(%)

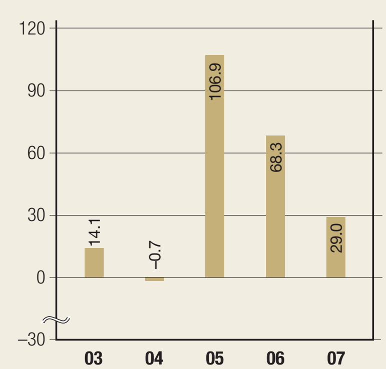


ROA=(Operating income+Interest and dividend income)/Average total assetsx100

Capital Expenditures and Depreciation and Amortization
(Billions of Yen)



Free Cash Flows
(Billions of Yen)



Free Cash Flows=Cash Flows From Operating Activities+Cash Flows From Investing Activities

Cash Flows

Cash flow from operating activities in fiscal 2007 was ¥54.3 billion, ¥24.6 billion less than in fiscal 2006. The main sources of cash were ¥144.4 billion from income before income taxes, depreciation and amortization of ¥18.8 billion and a ¥17.2 billion increase in trade notes and accounts payable. The main uses of cash, meanwhile, included a ¥58.4 billion increase in trade notes and accounts receivable, a ¥31.6 billion increase in inventories, a ¥12.5 billion decline in customer advances, and ¥37.8 billion for the payment of income taxes.

Investing activities used net cash of ¥25.3 billion, ¥14.8 billion more than in fiscal 2006. The main use of cash was ¥25.2 billion for the purchase of property, plant and equipment intended to promote the Company's future growth. The acquisition of U.S.-based Epion Corporation used a further ¥4.5 billion in cash. On the other hand, in order to improve the liquidity of Tokyo Electron Devices' shares, the Company generated ¥4.2 billion in cash by selling some shares in this subsidiary, which is listed on the Second Section of the Tokyo Stock Exchange.

Financing activities used net cash of ¥34.7 billion, ¥8.7 billion less than the outflow in fiscal 2006. The Company used ¥20.0 billion in cash to redeem its unsecured straight bond issue #10, and ¥4.5 billion to redeem its #4 issue of unsecured bonds with warrants. The Company also used ¥12.8 billion in cash to pay dividends.

As a result, the balance of cash and cash equivalents declined by ¥5.6 billion year on year, to ¥134.4 billion at the end of March 2007.

Business-related and Other Risks

The following are possible risks that may have an impact on Tokyo Electron's business performance, stock price, or financial position.

(1) Impact of Fluctuating Foreign Exchange Rates

Success in the development of overseas operations has increased the share of sales generated overseas. As a rule, Tokyo Electron conducts export transactions on a yen basis to avert exposure to foreign currency risks. However, some exports are denominated in foreign currencies. In these cases, Tokyo Electron hedges foreign currency risk by using a forward foreign exchange contract when an order is received or by other means. However, foreign exchange rate risks can arise from fluctuations in prices due to sudden foreign exchange movements, which could have an indirect adverse effect on Tokyo Electron's business performance.

(2) Impact From Research and Development

Through ongoing and proactive R&D investment and activities in cutting-edge technologies—miniaturization, vacuum, plasma, thermal-processing, coating/developing, cleaning, wafer-transfer and clean technologies—Tokyo Electron has created advanced technologies. At the same time, by quickly bringing to market new products incorporating these technologies, Tokyo Electron has successfully captured a high market share in each of the product fields it has entered and generated a high profit margin. However, delays in the launch of new products and other factors could adversely affect Tokyo Electron's business performance.

(3) Impact From Changes in the Semiconductor Market

Tokyo Electron has achieved a high profit margin by concentrating resources in high-tech fields, including semiconductor production equipment, where technological innovation is rapid but Tokyo Electron can effectively use its strengths. Although technological change is responsible for the semiconductor market's rapid growth, Tokyo Electron has actively undertaken structural reforms to be able to generate profits under any circumstances, such as when the market contracts temporarily due to imbalance of supply and demand. However, order cancellations, excess capacity and personnel and increased inventories resulting from an unexpectedly large market contraction could adversely affect Tokyo Electron's business performance.

(4) Impact From Concentration of Transactions on Particular Customers

Tokyo Electron has been successful at increasing transactions with the leading semiconductor manufacturers worldwide, including those in Japan, through the provision of products featuring outstanding, cutting-edge technology and of services offering a high level of customer satisfaction. However, Tokyo Electron's sales may from time to time be temporarily concentrated on particular customers due to the timing of large capital investments of major semiconductor manufacturers. The resulting escalation in sales competition could adversely affect Tokyo Electron's business performance.

(5) Safety-related Impacts

Tokyo Electron's basic philosophy is to always bear in mind safety and health in the execution of business activities, including development, manufacturing, sales, services and management. In accordance with this philosophy, Tokyo Electron works actively and continuously to improve the safety of its products and to eliminate any harmful impact on health. However, harm to customers, order cancellations or other circumstances resulting from safety problems or other problems related to Tokyo Electron's products could adversely affect Tokyo Electron's business performance.

(6) Impact From Quality Issues

Tokyo Electron actively develops outstanding, cutting-edge technologies for incorporation in new products that are brought quickly to market. At the same time, Tokyo Electron works to establish a quality assurance system, efforts that include obtaining ISO 9001 certification, as well as to establish a world-class service system. These actions have resulted in a large number of customers adopting Tokyo Electron's products. However, because Tokyo Electron's products are based on cutting-edge technologies, and due to other factors, many of the technologies developed are in unfamiliar fields. The occurrence of unforeseen defects or other issues could adversely affect Tokyo Electron's business performance.

(7) Impact of Intellectual Property Rights

In order to distinguish its products and make them more competitive, Tokyo Electron has promoted its R&D strategy for the early development of cutting-edge technologies together with its business and intellectual property strategies. This approach has enabled Tokyo Electron to obtain sole possession of many proprietary technologies that have been instrumental to Tokyo Electron's ability to capture a high market share and generate high profit margins in each of its product fields. However, Tokyo Electron's products incorporate and optimize many of these proprietary cutting-edge technologies. There may be cases, whereby avoiding the use of third-party technologies and intellectual property rights, Tokyo Electron's business performance could be adversely affected.

(8) Other Risks

Tokyo Electron is actively involved in reforming the corporate structure so that it can generate profits even when markets contract. These reforms have entailed creating new high-growth, high-return businesses and pursuing higher earnings from existing businesses. At the same time, Tokyo Electron has promoted activities to preserve the environment and worked to restructure its compliance and risk management systems. However, as long as it conducts business activities, as with peer companies or companies in different industries, Tokyo Electron is subject to the effect of many other factors. These include the world and regional economic environments, natural disasters, war, terrorism, unavoidable occurrences (such as infectious diseases), financial or stock markets, government or other regulations, supply systems of suppliers, market conditions for products and real estate, the ability to recruit personnel in Japan and overseas, competition over standardization, and loss of key personnel. Any of these factors could adversely affect Tokyo Electron's business performance.