CONSOLIDATED BALANCE SHEETS

Tokyo Electron Limited and Subsidiaries
March 31, 2006 and 2005

ASSETS	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current assets:			
Cash and cash equivalents	¥140,024	¥115,420	$1,191,998
Trade notes and accounts receivable	169,038	172,488	1,438,989
Allowance for doubtful accounts	(165)	(114)	(1,403)
Inventories	163,746	161,489	1,393,938
Deferred income taxes	21,356	18,173	181,802
Prepaid expenses and other current assets	23,489	27,730	199,953
Total current assets	517,488	495,186	4,405,277
Property, plant and equipment:			
Land	18,150	18,351	154,504
Buildings	112,225	111,119	955,351
Machinery and equipment	94,764	90,497	806,712
Construction in progress	2,216	1,786	18,863
Total property, plant and equipment	227,355	221,753	1,935,430
Less: Accumulated depreciation	132,617	123,337	1,128,941
Net property, plant and equipment	94,738	98,416	806,489
Investments and other assets:			
Investment securities	14,860	10,381	126,502
Deferred income taxes	13,175	15,313	112,153
Intangible assets	16,710	18,612	142,246
Other assets	6,272	6,412	53,396
Total investments and other assets	51,017	50,718	434,297
Total assets	¥663,243	¥644,320	$5,646,063

See accompanying Notes to Consolidated Financial Statements.

LIABILITIES AND SHAREHOLDERS' EQUITY	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Current liabilities:			
Short-term borrowings	¥ 2,100	¥ 976	$ 17,877
Current portion of long-term debt	24,500	35,476	208,564
Trade notes and accounts payable	75,842	70,472	645,627
Customer advances	33,811	42,970	287,824
Income taxes payable	22,895	13,357	194,902
Accrued employees' bonuses	10,231	8,645	87,093
Accrued warranty expenses	12,219	13,106	104,024
Accrued expenses and other current liabilities	20,029	21,609	170,504
Total current liabilities	201,627	206,611	1,716,415
Long-term debt, less current portion	38,500	63,000	327,743
Accrued pension and severance costs	38,751	36,382	329,880
Other liabilities	2,743	1,751	23,349
Total liabilities	281,621	307,744	2,397,387
Minority interests	4,722	4,411	40,196
Contingent liabilities			
Shareholders' equity:			
Common stock	54,961	54,961	467,874
Authorized: 300,000,000 shares			
Issued: 180,610,911 shares as of March 31, 2006 and 2005			
Capital surplus	78,079	78,023	664,670
Retained earnings	249,938	212,094	2,127,676
Unrealized gains on securities	5,118	2,133	43,565
Foreign currency translation adjustments	3,921	997	33,381
Treasury stock, at cost	(15,117)	(16,043)	(128,686)
2,336,475 and 2,529,672 shares as of March 31, 2006 and 2005, respectively			
Total shareholders' equity	376,900	332,165	3,208,480
Total liabilities and shareholders' equity	¥663,243	¥644,320	$5,646,063

CONSOLIDATED STATEMENTS OF INCOME

Tokyo Electron Limited and Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Net sales	¥673,686	¥635,710	$5,734,965
Cost of sales	483,954	459,797	4,119,814
Gross profit	189,732	175,913	1,615,151
Selling, general and administrative expenses	114,029	111,930	970,705
Operating income	75,703	63,983	644,446
Other income (expenses):			
Interest and dividend income	504	236	4,289
Interest expenses	(687)	(1,094)	(5,846)
Income from development grants	1,537	2,194	13,081
Foreign exchange losses	(1,676)	(723)	(14,266)
Gain on refund for foreign indirect taxes	855	–	7,282
Loss on impairment of fixed assets	(419)	–	(3,566)
Gain on return of substitutional portion of employees' pension fund	–	7,084	–
Provision for warranty expenses for prior years	–	(12,470)	–
Loss on business reorganization	–	(2,783)	–
Loss on impairment of investment securities	(94)	(573)	(804)
Loss on disposal of property, plant and equipment	(658)	(1,388)	(5,604)
Other, net	263	1,309	2,244
Income before income taxes	75,328	55,775	641,256
Income taxes:			
Current	29,189	15,540	248,490
Deferred	(2,352)	(21,970)	(20,025)
Minority interests	485	604	4,128
Net income	¥ 48,006	¥ 61,601	$ 408,663
Per share of common stock:	Yen		U.S. dollars
Net income — basic	¥ 267.61	¥ 343.63	$ 2.28
Net income — diluted	267.32	343.54	2.28
Cash dividends	55.00	45.00	0.47

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Tokyo Electron Limited and Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	2006
Common stock			
Balance at beginning of year	¥ 54,961	¥ 54,961	$ 467,874
Balance at end of year	54,961	54,961	467,874
Capital surplus			
Balance at beginning of year	78,023	78,023	664,196
Gain on sale of treasury stock	56	–	474
Balance at end of year	78,079	78,023	664,670
Retained earnings			
Balance at beginning of year	212,094	154,343	1,805,515
Net income	48,006	61,601	408,663
Cash dividends	(9,796)	(3,743)	(83,391)
Directors' bonuses	(350)	(107)	(2,973)
Effect of newly consolidated subsidiary	(16)	–	(138)
Balance at end of year	249,938	212,094	2,127,676
Unrealized gains on securities			
Balance at beginning of year	2,133	2,396	18,155
Net changes during the year	2,985	(263)	25,410
Balance at end of year	5,118	2,133	43,565
Foreign currency translation adjustments			
Balance at beginning of year	997	(720)	8,488
Net changes during the year	2,924	1,717	24,893
Balance at end of year	3,921	997	33,381
Treasury stock, at cost			
Balance at beginning of year	(16,043)	(13,203)	(136,568)
Purchase	(39)	(2,840)	(330)
Resale for stock option plan	965	–	8,212
Balance at end of year	(15,117)	(16,043)	(128,686)
Total shareholders' equity	¥376,900	¥332,165	$3,208,480

See accompanying Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Tokyo Electron Limited and Subsidiaries
Years ended March 31, 2006 and 2005

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Cash flows from operating activities:			
Income before income taxes	**¥ 75,328**	¥ 55,775	**$ 641,256**
Depreciation and amortization	**19,170**	21,463	**163,191**
Amortization of goodwill	**1,600**	1,600	**13,622**
Loss on impairment of fixed assets	**419**	–	**3,566**
Increase in accrued pension and severance costs	**2,340**	5,158	**19,919**
Increase in accrued employees' bonuses	**1,587**	2,258	**13,503**
Increase (decrease) in accrued warranty expenses	**(985)**	13,106	**(8,387)**
Interest expenses	**687**	1,094	**5,846**
Gain on refund for foreign indirect taxes	**(855)**	–	**(7,282)**
Loss on disposal of property, plant and equipment	**658**	1,388	**5,604**
Gain on return of substitutional portion of employees' pension fund	**–**	(7,084)	**–**
Loss on business reorganization	**–**	2,783	**–**
Decrease in trade notes and accounts receivable	**5,144**	59,115	**43,790**
Increase in inventories	**(5,467)**	(59,914)	**(46,542)**
Increase (decrease) in trade notes and accounts payable	**6,743**	(7,440)	**57,402**
Increase (decrease) in customer advances	**(9,505)**	30,816	**(80,911)**
Other, net	**1,751**	1,482	**14,910**
Subtotal	**98,615**	121,600	**839,487**
Receipts from interest and dividends	**503**	241	**4,281**
Interest paid	**(739)**	(1,159)	**(6,289)**
Payment for business reorganization	**–**	(1,558)	**–**
Income taxes paid	**(19,525)**	(4,774)	**(166,213)**
Net cash provided by operating activities	**78,854**	114,350	**671,266**
Cash flows from investing activities:			
Payment for purchase of property, plant and equipment	**(8,601)**	(8,680)	**(73,218)**
Proceeds from sale of property, plant and equipment	**1,280**	3,798	**10,893**
Payment for acquisition of intangible assets	**(2,611)**	(1,780)	**(22,224)**
Other, net	**(605)**	(788)	**(5,148)**
Net cash used in investing activities	**(10,537)**	(7,450)	**(89,697)**
Cash flows from financing activities:			
Increase (decrease) in short-term borrowings	**1,037**	(5,864)	**8,831**
Repayment of long-term debt	**(5,476)**	(1,754)	**(46,613)**
Redemption of unsecured bonds	**(30,000)**	(20,000)	**(255,384)**
(Increase) decrease in treasury stock	**982**	(2,840)	**8,356**
Dividends paid	**(9,796)**	(3,743)	**(83,391)**
Other	**(167)**	(143)	**(1,431)**
Net cash used in financing activities	**(43,420)**	(34,344)	**(369,632)**
Effect of exchange rate changes on cash and cash equivalents	**(341)**	214	**(2,899)**
Net increase in cash and cash equivalents	**24,556**	72,770	**209,038**
Cash and cash equivalents at beginning of year	**115,420**	42,650	**982,550**
Effect of newly consolidated subsidiary	**48**	–	**410**
Cash and cash equivalents at end of year	**¥140,024**	¥115,420	**$1,191,998**

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Tokyo Electron Limited and Subsidiaries

1. Basis of Presentation of Consolidated Financial Statements

The accompanying consolidated financial statements of Tokyo Electron Limited (hereinafter "the Company") and its subsidiaries (hereinafter collectively referred to as "Tokyo Electron") have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

The accounts of overseas subsidiaries are based on their accounting records maintained in conformity with generally accepted accounting principles prevailing in the respective countries of domicile.

The accompanying consolidated financial statements have been restructured and translated into English from the statutory Japanese language consolidated financial statements. Some supplementary information included in the statutory Japanese language consolidated financial statements, which is not required for fair presentation, is not presented in the accompanying consolidated financial statements.

U.S. dollar amounts included herein are solely for the convenience of readers and are presented at the rate of ¥117.47 to $1.00, the approximate rate as of March 31, 2006. The translation should not be construed as a representation that the Japanese yen amounts shown could be converted into U.S. dollars at that or any other rate.

2. Summary of Significant Accounting Policies

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its 24 subsidiaries.

The investments in affiliates in which the Company's ownership is 20% to 50% are accounted for by the equity method.

All significant inter-company accounts, transactions and unrealized profits or losses have been eliminated in consolidation.

The fiscal year of all entities is March 31, except for two foreign subsidiaries, which use a December 31 year-end, and no significant transactions were noted between the different fiscal year-ends.

(b) Foreign currency translation

All assets and liabilities denominated in foreign currencies are translated into Japanese yen at the year-end rates, except for those hedged by forward exchange contracts, which are translated at the contracted rates.

Revenue and expense items are translated at the rates that approximate those rates prevailing at the time of the transactions.

The balance sheet accounts of the foreign subsidiaries are translated into Japanese yen at the rates of exchange in effect at the balance sheet date, except for shareholders' equity accounts, which are translated at the historical rates. Revenue and expense accounts of the foreign subsidiaries are translated at average rates of exchange in effect during the year. Resulting translation adjustments are presented as a component of shareholders' equity and minority interests in the consolidated financial statements.

(c) Investment securities

Tokyo Electron is required to examine the intent of holding each security and classify those securities as trading securities, held-to-maturity debt securities or other securities. Tokyo Electron has no trading or held-to-maturity debt securities. Other securities with market prices are valued at fair market value prevailing at the balance sheet date. The differences between the book and market prices of other securities, net of applicable income taxes, are presented as a component of shareholders' equity. Other securities without market value are valued at cost using the weighted average method.

The cost of sold securities is calculated using the weighted average method.

(d) Inventories

Inventories other than raw materials are stated principally at cost, which is determined principally by the individual method. Raw materials are stated principally at cost, which is determined principally by the moving-average method.

(e) Property, plant and equipment

Property, plant and equipment are stated at cost. Depreciation of buildings, machinery and equipment of the Company and its domestic subsidiaries is computed under the declining balance method, except for buildings acquired subsequent to March 31, 1998 which were depreciated under the straight-line method based on the estimated useful lives of assets. The straight-line method is mainly applied for its foreign subsidiaries over the estimated useful lives of assets.

Estimated useful lives of property, plant and equipment are as follows:

Buildings	2 to 60 years
Machinery and equipment	2 to 17 years

(f) Intangible assets

Intangible assets, which primarily comprise of capitalized costs for computer software and goodwill, are amortized by the straight-line method over their estimated useful lives. Capitalized costs for computer software for internal use are amortized over a period of two to five years. Goodwill is evaluated on an individual basis and amortized over a period not exceeding 20 years.

(g) Impairment of fixed assets

Tokyo Electron evaluates the carrying value of fixed assets to be held for use in the business.

If the carrying value of a fixed asset is impaired, a loss is recognized based on the amount by which the carrying value exceeds its recoverable amount, higher of the net selling price or the value in use of the assets, which are determined using the fair value less disposal costs and the total amount of discounted cash flows generated from the continuing use of the individual assets or the asset group and the disposal of these assets, respectively.

The Company adopted "Accounting Standard for Impairment of Fixed Assets", issued by the Business Accounting Deliberation Council and the implementation guidance for the accounting standard for impairment of fixed assets (the Financial Accounting Standard Implementation Guidance No. 6 issued by the Accounting Standard Board of Japan), effective from the fiscal year beginning April 1, 2005.

As a result of this change, impairment losses on fixed assets amounting to ¥419 million ($3,566 thousand) were recognized for the year ended March 31, 2006, and therefore income before income taxes decreased by the same amount as compared with before the change.

(h) Allowance for doubtful accounts

The allowance for doubtful accounts is provided at an amount determined based on the historical experience of bad debts with respect to ordinary receivables, and an estimate of uncollectible amounts determined by reference to specific doubtful receivables from customers which are experiencing financial difficulties.

(i) Accrued pension and severance costs

The Company and its domestic subsidiaries provide an accrual for employees' pension and severance costs based on the projected benefit obligation and pension assets on the account settlement date. Prior service costs are charged to income on a straight-line basis, beginning from the fiscal year in which they are incurred, over a fixed number of years (four years) within the average remaining years of service of employees when the differences occur. Actuarial differences are charged to income on a straight-line basis, beginning from the fiscal year after they are recognized, over a fixed number of years (four years) within the average remaining years of service of employees when the differences occur.

The annual provision for accrued pension and severance costs for directors and statutory auditors of the Company and its domestic subsidiaries is calculated in accordance with internal regulations.

The Company and certain domestic subsidiaries decided to discontinue the severance pay for directors and statutory auditors after April 1, 2005, and at the shareholders' meetings on June 24, 2005 it was resolved that the severance pay for their directors and statutory auditors until March 31, 2005 would be paid at the termination of their service. As discussed in note 9, the accruals for the severance costs for directors and statutory auditors were included in accrued pension and severance costs in the consolidated balance sheets.

(j) Accrued warranty expenses

Tokyo Electron's products are generally subject to warranty, and Tokyo Electron accrues such estimated costs when product revenue is recognized. To prepare for future repairs during warranty periods, estimated after-sale repair expenses over the warranty period are accrued based on the historical ratio of actual repair expenses to corresponding sales.

(k) Leases

Noncancelable leases are primarily accounted for as operating leases (whether such leases are classified as operating or finance leases), except for leases that have transfer of ownership condition to the lessee at the end of the lease which are accounting for as finance leases.

(l) Derivatives and hedge accounting

The Company and a domestic subsidiary make use of derivatives in order to manage certain risks arising from adverse fluctuations in foreign currency exchange rates. The amount of derivatives is limited to the extent of foreign currency assets, liabilities and actual orders, and the Company does not trade in derivatives for speculative purposes.

Derivatives are carried at fair value with changes in unrealized gain or loss charged or credited to income, except for those which meet the criteria for deferred hedge accounting under which unrealized gain or loss is deferred as an asset or a liability. Receivables and payables hedged by qualified forward foreign exchange contracts are translated at the corresponding foreign exchange contract rates.

(m) Income taxes

Income taxes of the Company and its domestic subsidiaries consist of corporate income taxes, local inhabitants' taxes and enterprise tax. Tokyo Electron records deferred tax assets and liabilities, which are measured using the enacted tax rates and laws which will be in effect when the differences are expected to reverse, on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

(n) Revenue recognition

Revenue from Semiconductor and FPD (Flat Panel Display) production equipment is principally recognized at the time of the confirmation of set-up and testing of products. Revenue from such equipment not requiring substantial installation is recognized at the time of shipment. Revenue from other products, such as electronic components, is recognized at the time of shipment. Service revenue from maintenance is recognized ratably over the term of the maintenance contract.

(o) Per share information

Net income per share is computed based on the weighted average number of shares of common stock outstanding during each year.

The Company applies "Accounting Standards Regarding Net Income per Share (Business Accounting Standards No. 2)" and "Practical Guidelines for Applying Accounting Standards Regarding Net Income per Share (Practical Guidelines for Applying Accounting Standards No. 4)" released by the Accounting Standards Board of Japan.

Dividends per share have been presented on an accrual basis and include, in each fiscal year ended March 31, dividends approved or to be approved after March 31 but applicable to the year then ended.

(p) Research and development expenses

Research and development expenses are charged to income as incurred, and amounted to ¥49,182 million ($418,673 thousand) and ¥43,889 million for the years ended March 31, 2006 and 2005, respectively.

(q) Cash equivalents

For purposes of the consolidated statements of cash flows, Tokyo Electron considers all highly-liquid instruments purchased with original maturities of three months or less to be cash equivalents.

(r) Reclassifications

Certain reclassifications have been made to the prior year's consolidated financial statements to conform with the presentation used for the year ended March 31, 2006. These changes had no impact on previously reported results of operations or shareholders' equity.

3. Changes in Accounting Policies

(a) Revenue recognition

Until the year ended March 31, 2004, revenue from Semiconductor and FPD production equipment was recognized at the time of shipment. Effective from the year ended March 31, 2005, the Company changed its method of revenue recognition in which such equipment sales revenue is principally recognized at the time of the confirmation of set-up and testing of products. This change is intended to reflect the actual situation of revenue more appropriately, corresponding to the fact that the process from the shipment of products to the confirmation of set-up and testing of products has shown a marked tendency to become longer, and review of post-shipment business processes has made it possible to provide a complete set of data upon the confirmation of set-up and testing of products.

The effect of this change was to decrease net sales, operating income and income before income taxes by ¥80,956 million, ¥20,541 million and ¥20,563 million, respectively, for the year ended March 31, 2005 as compared with the corresponding amounts which would have been recorded if the previous method had been followed.

(b) Accrued warranty expenses

Until the year ended March 31, 2004, after-sale repair expenses incurred during the warranty period for Semiconductor and FPD production equipment were charged to income as incurred. Effective from the year ended March 31, 2005, the Company changed its method to account for after-sale repair expenses by implementing accrued warranty expenses for such equipment, calculated on the basis of after-sale repair expenses incurred in the past. This change is intended to make periodic income more appropriate by matching after-sale repair expenses with revenues when products are sold, with the increased importance on after-sale service. A complete set of historical data on actual after-sale repair expenses, as well as remaining warranty period compiled, has made possible the calculation of accrued warranty expenses.

The effect of this change was to decrease operating income and income before income taxes by ¥635 million and ¥13,106 million, respectively, for the year ended March 31, 2005 as compared with the corresponding amounts which would have been recorded if the previous method had been followed. The provision for accrued warranty expenses related to revenues recognized in prior years were recorded as other expense in the accompanying consolidated statement of income for the year ended March 31, 2005.

(c) Business segment

Tokyo Electron is involved in the manufacture and sale of industrial electronic products. In the past, Tokyo Electron's business was classified as a single segment based on its sales method.

Effective from the year ended March 31, 2005, the segment classification was changed and separated into two segments: "industrial electronic equipment" and "electronic components", which were determined based on the types of products and service, as well as sales methods. The new classification of the business segments reflects more appropriately the businesses of Tokyo Electron.

4. Investment Securities

Investment securities, which solely comprise of other securities, as of March 31, 2006 and 2005 are as follows:

	Millions of yen	
2006:	Cost	Carrying value
Securities with market prices		
Equity securities	**¥5,348**	**¥13,940**
Other	**114**	**119**
Securities without market value		
Unlisted stock	**1,708**	**778**
Other	**23**	**23**
Total	**¥7,193**	**¥14,860**

	Millions of yen	
2005:	Cost	Carrying value
Securities with market prices		
Equity securities	¥5,484	¥ 9,059
Other	114	115
Securities without market value		
Unlisted stock	1,712	1,184
Other	23	23
Total	¥7,333	¥10,381

	Thousands of U.S. dollars	
2006:	Cost	Carrying value
Securities with market prices		
Equity securities	**$45,528**	**$118,670**
Other	**968**	**1,015**
Securities without market value		
Unlisted stock	**14,545**	**6,623**
Other	**194**	**194**
Total	**$61,235**	**$126,502**

5. Inventories

Inventories as of March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Finished products	**¥ 95,564**	¥102,418	**$ 813,514**
Work in process, raw materials and supplies	**68,182**	59,071	**580,424**
Total	**¥163,746**	¥161,489	**$1,393,938**

6. Impairment of Fixed Assets

For the fixed asset impairment test, the Company generally groups fixed assets used for normal operations at a business unit level of which profits are reasonably controllable. Also, the Company assesses the recoverability of individual assets not used in normal operations or that are idle.

The Company recorded impairment losses for the lands used for employees' welfare of ¥419 million ($3,566 thousand) in 2006. These charges were recorded in other income (expenses) in the consolidated statement of income.

7. Pledged Assets

Tokyo Electron did not hold any assets pledged as collateral as of March 31, 2006 and 2005.

8. Short-term Borrowings and Long-term Debt

Short-term borrowings are represented by 365-day notes issued by Tokyo Electron to banks and bore interest at the average annual rate of 1.58% and 1.80% as of March 31, 2006 and 2005, respectively.

Long-term debt as of March 31, 2006 and 2005 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
1.30% unsecured bonds due 2005	**¥ –**	¥ 30,000	**$ –**
0.42% unsecured bonds due 2006	**20,000**	20,000	**170,256**
0.72% unsecured bonds due 2008	**30,000**	30,000	**255,384**
1.59% unsecured bonds with warrants due 2006	**4,500**	4,500	**38,308**
0.86% unsecured bonds with warrants due 2007	**5,500**	5,500	**46,821**
Other loans from banks	**3,000**	8,476	**25,538**
Current portion	**(24,500)**	(35,476)	**(208,564)**
Total	**¥ 38,500**	¥ 63,000	**$ 327,743**

As of March 31, 2006, Tokyo Electron has unused lines of credit amounting to ¥113,500 million ($966,204 thousand).

The maturities of long-term debt are summarized as follows:

	Millions of yen	Thousands of U.S. dollars
Year ending March 31	**2006**	**2006**
2007	**¥24,500**	**$208,564**
2008	**8,500**	**72,359**
2009	**30,000**	**255,384**
2010	**–**	**–**
2011 and thereafter	**–**	**–**
Total	**¥63,000**	**$536,307**

9. Accrued Pension and Severance Costs

Prior to January 2005, the Company and its domestic subsidiaries had noncontributory retirement and severance benefit plans that provided for pension or lump-sum payment benefits to employees who retired or terminated their employment for reasons other than dismissal for cause. In addition, the majority of the employees of the Company and its domestic subsidiaries were covered by a contributory pension plan, whose benefits were based on length of service and certain other factors. This pension plan included a substitutional portion representing the government social security welfare pension.

In January 2004, following the enactment of changes to the Japanese Welfare Pension Insurance Law, the Company and its domestic subsidiaries obtained an approval from the Japanese Ministry of Health, Labor and Welfare for exemption from the future benefit obligation with respect to the substitutional portion of the Welfare Pension Insurance Scheme. After obtaining the approval, in January 2005, these companies obtained another approval for separation of the remaining benefit obligation of the substitutional portion that was related to past employees services. The transfer to the government was completed on July 22, 2005.

The Company and its domestic subsidiaries accounted for the transitional provisions in accordance with paragraph 44-2 of the JICPA Accounting Committee Report No. 13, "Practical Guideline for Accounting of Retirement Benefits (Interim Report)," and recognized a gain of ¥7,084 million, upon the receipt of the second approval in January 2005, as "Gain on return on substitutional portion of employees' pension fund" in the consolidated statement of income for the year ended March 31, 2005.

In January 2005, following the approval for separation of the substitutional portion, the Company and its domestic subsidiaries amended the contributory pension plan to a cash balance pension plan. Additionally, the Company and its domestic subsidiaries amended the noncontributory retirement and severance benefit plans. The net effect of these plan amendments was to increase the benefit obligation by ¥3,799 million, and the resulting prior service cost was amortized over four years.

The additional gain derived from the difference in the fair value of plan assets between approval date and transfer completion date was recorded for the year ended March 31, 2006. The effect of the additional gain to the consolidated financial statements was not material.

Certain foreign subsidiaries have a noncontributory retirement and severance benefit plan that provided for pension or lump-sum payment benefits to employees who retire or terminate their employment for reasons other than dismissal for cause.

The funded status of the defined benefit plans, a substantial portion of which consists of domestic benefit plans, as of March 31, 2006 and 2005 is as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Benefit obligation	**¥(64,689)**	¥(59,984)	**$(550,690)**
Fair value of plan assets	**24,962**	18,388	**212,500**
Unrecognized benefit obligation	**(39,727)**	(41,596)	**(338,190)**
Unrecognized actuarial difference	**(1,496)**	1,249	**(12,731)**
Unrecognized prior service cost	**3,188**	4,714	**27,140**
Amount recognized in the consolidated balance sheets (Note)	**¥(38,035)**	¥(35,633)	**$(323,781)**

Note: The annual provision for accrued pension and severance costs for directors and statutory auditors (¥716 million ($6,095 thousand) in 2006 and ¥749 million in 2005) is not included in the above.

Net pension cost of the plans is as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Service cost	**¥4,757**	¥4,724	**$40,488**
Interest cost	**1,186**	1,397	**10,095**
Expected return on plan assets	**(276)**	(317)	**(2,348)**
Amortization of actuarial difference	**1,876**	4,677	**15,973**
Amortization of prior service cost	**1,526**	350	**12,993**
Net pension cost	**9,069**	10,831	**77,201**
Gain on return of substitutional portion of employees' pension fund	**–**	(7,084)	**–**
Other	**(24)**	–	**(199)**
Net	**¥9,045**	¥3,747	**$77,002**

Significant assumptions of domestic pension plans used to determine these amounts are as follows:

	2006	2005
Allocation method of benefit obligation	Straight-line method	
Discount rate	**2.00%**	2.00%
Expected rate of return on plan assets	**2.00%**	1.50%
Amortization period of prior service cost	**4 years**	4 years
Amortization period of actuarial difference	**4 years**	4 years

10. Income Taxes

Significant components of the deferred tax assets and liabilities of Tokyo Electron as of March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Deferred tax assets			
Accrued pension and severance costs	**¥ 15,134**	¥13,469	**$128,834**
Elimination of unrealized profit on inventories	**8,298**	6,293	**70,641**
Accrued warranty expenses	**4,737**	5,333	**40,326**
Accrued employees' bonuses	**4,140**	3,498	**35,240**
Depreciation and amortization	**3,653**	2,501	**31,095**
Devaluation of inventories	**1,954**	3,751	**16,634**
Accrued business taxes	**1,555**	1,030	**13,234**
Net operating loss carryforwards	**1,123**	2,082	**9,564**
Elimination of unrealized profit on fixed assets	**1,002**	1,104	**8,533**
Other	**4,955**	4,690	**42,176**
Total gross deferred tax assets	**46,551**	43,751	**396,277**
Less valuation allowance	**(2,848)**	(2,112)	**(24,239)**
Total deferred tax assets	**43,703**	41,639	**372,038**
Deferred tax liabilities			
Net unrealized gains on securities	**(3,480)**	(1,443)	**(29,623)**
Undistributed earnings of foreign subsidiaries	**(2,766)**	(2,444)	**(23,544)**
Reserves under Special Taxation Measures Law, etc.	**(2,547)**	(2,568)	**(21,685)**
Prepaid start-up expenses	**(1,856)**	(2,783)	**(15,804)**
Other	**(288)**	(254)	**(2,449)**
Total gross deferred tax liabilities	**(10,937)**	(9,492)	**(93,105)**
Net deferred tax assets	**¥ 32,766**	¥32,147	**$278,933**

Effective from the year ended March 31, 2006, the Company and its wholly-owned domestic subsidiaries adopted the tax consolidation for national corporate tax purposes.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which those temporary differences become deductible. For assessment of the realizability of deferred tax assets, management considers the scheduled reversal of deferred tax liabilities, future taxable income, tax planning strategies and level of net operating loss carryforwards, if any, in accordance with accounting principles generally accepted in Japan.

In 2005, the Company and its certain subsidiaries utilized a significant portion of net operating loss carryforwards as of March 31, 2004 with operating income earned under the favorable semiconductor industry and significant portion of valuation allowance of ¥31,431 million as of March 31, 2004 was reversed. Management believes Tokyo Electron will realize the benefits of deferred tax assets, net of remaining valuation allowance as of March 31, 2005.

In 2006, based on the level of historical taxable income and future taxable income over the periods which the deferred tax assets are deductible, management believes Tokyo Electron will realize the benefits of these deferred tax assets, net of valuation allowance as of March 31, 2006.

The Company is subject to a corporate tax, an inhabitant tax and a deductible business tax, which in the aggregate resulted in a statutory income tax rate of approximately 40.69% for the years ended March 31, 2006 and 2005. The aggregate statutory income tax rate was reduced from the year ended March 31, 2005 due to the revised local tax law. As of March 31, 2004, the Company and its domestic subsidiaries applied the reduced aggregate statutory income tax rate of 40.69% for calculating deferred tax assets and liabilities that are expected to be recovered or settled in the years commencing on April 1, 2004 or later. The effects of the reduction in the tax rate were not material to the consolidated financial statements.

Significant components of the difference between the statutory and effective tax rates for the years ended March 31, 2006 and 2005 are as follows:

	2006	2005
Statutory tax rate in Japan	40.69%	40.69%
Adjustments:		
Tax credits for research and development costs, etc.	(5.70)	(2.81)
Change in valuation allowance		
other than net operating loss carryforwards	0.95	(24.79)
Elimination of unrealized profit on inventories	(0.94)	(3.17)
Utilization of net operating loss carryforwards	–	(27.77)
Increase in deferred tax liabilities on undistributed		
earnings of foreign subsidiaries	0.43	4.38
Others, net	0.20	1.94
Effective tax rate	35.63%	(11.53)%

11. Shareholders' Equity

The Japanese Commercial Code provides that an amount equal to at least 10% of cash dividends and other cash appropriations shall be appropriated and set aside as a legal reserve until the total amount of legal reserve and additional paid-in capital, which is included in capital surplus in the accompanying consolidated balance sheets, equals 25% of common stock. The total amount of legal reserve and additional paid-in capital may be used to eliminate or reduce a deficit by a resolution of the shareholders' meeting or may be capitalized by a resolution of the board of directors. On condition that the total amount of legal reserve and additional paid-in capital remains being equal to or exceeding 25% of common stock, they are available for distribution by the resolution of the shareholders' meeting. Legal reserve as of March 31, 2006 amounted to ¥5,660 million ($48,183 thousand), and is included in retained earnings in the accompanying consolidated financial statements.

The maximum amount that the Company can distribute as dividends is calculated based on the non-consolidated financial statements of the Company in accordance with Japanese Commercial Code. Cash dividends charged to retained earnings for the years ended March 31, 2006 and 2005 represent dividends paid out during those years. The total amount of legal reserve and additional paid-in capital of the Company has reached to 25% of common stock, and therefore, the Company is not required to provide legal reserve any more. Appropriations are not accrued in the financial statements for the period to which they relate, but are recorded in the subsequent accounting period when the approval has been obtained. Retained earnings at March 31, 2006 include amounts representing the year-end cash dividends of ¥30 ($0.26) per share and bonuses to directors approved at the shareholders' meeting held on June 23, 2006.

Under the Japanese Commercial Code, the entire amount of the issue price of shares is required to be designated as common stock, although a company may, by a resolution of the board of directors, designate an amount not exceeding one-half of the issue price of the new shares as additional paid-in capital, which is included in capital surplus.

The Japanese Corporate Law enforced on May 1, 2006 provides that earnings in an amount equal to 10% of appropriations of retained earnings that are paid in cash shall be appropriated as a capital surplus or a legal reserve until the total amount of legal reserve and capital surplus equal 25% of common stock.

At the shareholders' meeting on June 23, 2006, in accordance with the Japanese Corporate Law, the Company altered the articles to allow for the distribution of earnings to shareholders on dates, other than the mid-term and year-end by a resolution of the board of directors.

12. Stock-based Compensation

Tokyo Electron has two types of stock-based compensation plans as incentive plans for directors and selected employees. The stock-based compensation plans include stock options ("Stock option plan") and bonds with detachable warrants ("Warrant plan").

Stock option plan

The Company's shareholders have approved annual stock option plans for directors and selected employees since the year ended March 31, 1999. In addition, a stock option plan for statutory auditors was additionally approved at the Company's shareholders' meeting in June 2005. The cumulative number of shares authorized up to the year ended March 31, 2004 totaled 2,131,900, with the weighted average exercise price of ¥7,909. Options to purchase 85,200 and 92,000 shares were authorized and granted at exercise prices of ¥1 ($0.01) and ¥6,468 ($55.06), respectively for the year ended March 31, 2006. Options to purchase 799,700 shares were authorized and granted at an exercise price of ¥5,884 for the year ended March 31, 2005. The options under the plans vest immediately with restriction on exercise up to two or three years after the date of grant, and have an exercise period of eight or twenty years from the date of grant.

Warrant plan

In June 2000 and June 2001, the Company issued unsecured bonds with detachable warrants. Upon issuance of the unsecured bonds with detachable warrants, the Company purchased all of the detachable warrants and distributed them to the directors and selected employees. By exercising the warrant, directors and selected employees can purchase the common stock of the Company, the numbers of which were 319,829 shares and 572,439 shares at the exercise price of ¥14,070 and ¥9,608 for warrants issued in June 2000 and June 2001, respectively. As noted above, the stock option plan granted stock options at exercise price of ¥1 and to be in accordance with the Warrant plan, the exercise prices of these warrants were adjusted to ¥14,064 ($120) and ¥9,604 ($82), respectively. The number of outstanding granted options increased by 283 shares as a result of this adjustment to the exercise price of the warrant.

The warrants vest immediately with restriction on exercise up to two years after the date of grant, and have exercise period of six years from the date of grant. For financial reporting purposes, these transactions were accounted for as an issuance of debt to third parties and separately as the issuance of warrants to directors and selected employees.

As of April 1, 2004, outstanding granted stock options, including the warrant plan, were 2,680,590 shares, with a weighted-average exercise price of ¥8,790. For the year ended March 31, 2005, 67,770 shares of the options were forfeited with no exercise. For the year ended March 31, 2006, 28,705 shares of the options were forfeited and 198,900 shares of the options were exercised. As of March 31, 2006, outstanding granted stock options, including the warrant plan, were 3,362,398 shares with a weighted-average exercise price of ¥8,014 ($68.22).

13. Leases

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligation under finance leases, and depreciation expense of finance leases that do not transfer ownership of leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2006 and 2005 are as follows:

Leased assets not recorded in the consolidated balance sheets:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Acquisition cost	**¥1,448**	¥1,216	**$12,325**
Accumulated depreciation	**797**	704	**6,782**
Net leased property	**¥ 651**	¥ 512	**$ 5,543**

Future minimum lease payments:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥247**	¥296	**$2,104**
Due over one year	**404**	216	**3,439**
Total	**¥651**	¥512	**$5,543**

Lease payments relating to finance leases accounted for as operating leases amounted to ¥318 million ($2,709 thousand) and ¥292 million, which approximated the corresponding depreciation on the respective leased property computed by the straight-line method over the lease terms for the years ended March 31, 2006 and 2005, respectively.

Future minimum lease payments on non-cancelable operating leases:

	Millions of yen		Thousands of U.S. dollars
	2006	2005	**2006**
Due within one year	**¥ 690**	¥ 514	**$ 5,875**
Due over one year	**696**	668	**5,927**
Total	**¥1,386**	¥1,182	**$11,802**

14. Contingent Liabilities

Tokyo Electron did not have any material contingent liabilities as of March 31, 2006.

15. Derivative Financial Instruments

The Company and a domestic subsidiary have entered into forward foreign exchange contracts in order to hedge risks of adverse fluctuations in foreign currency exchange rates associated with export-import transactions, but do not enter into such transactions for speculative purposes. The Company and the domestic subsidiary are exposed to credit risk in the event of nonperformance by the counterparties to the derivative transactions, but any such loss would not be material because the Company and the domestic subsidiary enter into those transactions only with financial institutions with high credit ratings. Execution and management of all derivative transactions are conducted pursuant to the internal management rule for derivatives by the finance division and the effectiveness of derivative transactions is reported on a semi-annual basis to the board of directors.

The estimated fair values of the derivative financial instruments as of March 31, 2006 and 2005 are as follows:

	Millions of yen		
2006:	Contract amount	Fair value	Unrealized gains (losses)
Sell U.S. dollars	**45,872**	**46,313**	**(441)**
Buy U.S. dollars	**1,909**	**1,922**	**13**

	Millions of yen		
2005:	Contract amount	Fair value	Unrealized gains (losses)
Sell U.S. dollars	–	–	–
Buy U.S. dollars	–	–	–

	Thousands of U.S. dollars		
2006:	Contract amount	Fair value	Unrealized gains (losses)
Sell U.S. dollars	**390,500**	**394,253**	**(3,753)**
Buy U.S. dollars	**16,251**	**16,364**	**113**

The contract amounts of the forward foreign exchange contracts presented above exclude those entered into to hedge receivables and payables denominated in foreign currencies which have been translated and are reflected at their corresponding contracted rates in the accompanying consolidated balance sheets. In addition, the disclosure of the fair value for derivatives, which are accounted for as hedges is omitted.

16. Segment Information

Business segment information as of and for the years ended March 31, 2006 and 2005 is as follows:

2006:	Industrial electronic equipment (Millions of yen)	Electronic components	Total	Eliminations and corporate	Consolidated
1. Net sales and operating income					
Net sales					
(1) Sales to external customers	**¥586,805**	**¥86,881**	**¥673,686**	**¥ –**	**¥673,686**
(2) Intersegment sales or transfers	**1,004**	**1,409**	**2,413**	**(2,413)**	**–**
Total	**587,809**	**88,290**	**676,099**	**(2,413)**	**673,686**
Operating expenses	**515,241**	**85,190**	**600,431**	**(2,448)**	**597,983**
Operating income	**72,568**	**3,100**	**75,668**	**35**	**75,703**
2. Assets, depreciation and amortization expenses and capital expenditure					
Assets	**¥626,838**	**¥37,089**	**¥663,927**	**¥ (684)**	**¥663,243**
Depreciation and amortization expenses	**20,512**	**258**	**20,770**	**–**	**20,770**
Loss on impairment of fixed assets	**419**	**–**	**419**	**–**	**419**
Capital expenditure, including intangible and other assets	**16,223**	**144**	**16,367**	**–**	**16,367**

2005:	Industrial electronic equipment (Millions of yen)	Electronic components	Total	Eliminations and corporate	Consolidated
1. Net sales and operating income					
Net sales					
(1) Sales to external customers	¥549,461	¥86,249	¥635,710	¥ –	¥635,710
(2) Intersegment sales or transfers	1,053	1,831	2,884	(2,884)	–
Total	550,514	88,080	638,594	(2,884)	635,710
Operating expenses	489,724	84,973	574,697	(2,970)	571,727
Operating income	60,790	3,107	63,897	86	63,983
2. Assets, depreciation and amortization expenses and capital expenditure					
Assets	¥609,296	¥35,988	¥645,284	¥ (964)	¥644,320
Depreciation and amortization expenses	22,773	290	23,063	–	23,063
Capital expenditure, including intangible and other assets	12,088	603	12,691	(348)	12,343

2006:	Industrial electronic equipment (Thousands of U.S. dollars)	Electronic components	Total	Eliminations and corporate	Consolidated
1. Net sales and operating income					
Net sales					
(1) Sales to external customers	**$4,995,366**	**$739,599**	**$5,734,965**	**$ –**	**$5,734,965**
(2) Intersegment sales or transfers	**8,542**	**11,997**	**20,539**	**(20,539)**	**–**
Total	**5,003,908**	**751,596**	**5,755,504**	**(20,539)**	**5,734,965**
Operating expenses	**4,386,149**	**725,206**	**5,111,355**	**(20,836)**	**5,090,519**
Operating income	**617,759**	**26,390**	**644,149**	**297**	**644,446**
2. Assets, depreciation and amortization expenses and capital expenditure					
Assets	**$5,336,159**	**$315,731**	**$5,651,890**	**$ (5,827)**	**$5,646,063**
Depreciation and amortization expenses	**174,617**	**2,196**	**176,813**	**–**	**176,813**
Loss on impairment of fixed assets	**3,566**	**–**	**3,566**	**–**	**3,566**
Capital expenditure, including intangible and other assets	**138,104**	**1,224**	**139,328**	**–**	**139,328**

Note: 1. Method of classifying business segments: Business segments are classified after considering similarities in types of products and service, as well as sales methods.

2. Major products in each business segment:

Business segment	*Major products*
Industrial electronic equipment	*Semiconductor production equipment, FPD production equipment, computer systems and networks and others*
Electronic components	*Semiconductor products, boards, software and other electronic components*

3. Change in accounting policies

(1) Effective from the year ended March 31, 2005, Tokyo Electron changed its method of revenue recognition to the confirmation of set-up and testing of products basis. The effect of this change was to decrease net sales and operating income for the industrial electronic equipment segment by ¥80,956 million and ¥20,541 million, respectively, for the year ended March 31, 2005, as compared with the corresponding amounts which would have been recorded if the previous method had been followed. The change did not affect the figures of the electronic components segment.

(2) Effective from the year ended March 31, 2005, Tokyo Electron changed its method to account for after-sale repair expenses by implementing accrued warranty expenses for Semiconductor and FPD production equipment. The effect of this change was to decrease operating income for the industrial electronic equipment segment by ¥635 million for the year ended March 31, 2005, as compared with the corresponding amounts which would have been recorded if the previous method had been followed. The change did not affect the figures of the electronic components segment.

Geographical segment information as of and for the year ended March 31, 2006 is as follows:

	Millions of yen				
2006:	Japan	Other regions	Total	Eliminations and corporate	Consolidated
1. Net sales and operating income					
Net sales					
(1) Sales to external customers	¥602,564	¥ 71,122	¥673,686	¥ –	¥673,686
(2) Intersegment sales or transfers	61,443	43,811	105,254	(105,254)	–
Total	664,007	114,933	778,940	(105,254)	673,686
Operating expenses	588,933	107,639	696,572	(98,589)	597,983
Operating income	75,074	7,294	82,368	(6,665)	75,703
2. Assets	¥636,559	¥ 85,730	¥722,289	¥ (59,046)	¥663,243

	Thousands of U.S. dollars				
2006:	Japan	Other regions	Total	Eliminations and corporate	Consolidated
1. Net sales and operating income					
Net sales					
(1) Sales to external customers	$5,129,517	$605,448	$5,734,965	$ –	$5,734,965
(2) Intersegment sales or transfers	523,050	372,955	896,005	(896,005)	–
Total	5,652,567	978,403	6,630,970	(896,005)	5,734,965
Operating expenses	5,013,476	916,312	5,929,788	(839,269)	5,090,519
Operating income	639,091	62,091	701,182	(56,736)	644,446
2. Assets	$5,418,909	$729,800	$6,148,709	$(502,646)	$5,646,063

Note: 1. For the reporting of geographical segment information, net sales and operating income are separated based on the location of the Company and its subsidiaries. Assets are separated by geographic location.
2. Others comprises primarily of the United States of America, Europe and Korea.

Total assets and sales outside Japan comprised less than 10% of the consolidated total assets and sales as of and for the year ended March 31, 2005. Accordingly, geographical segment information has not been disclosed.

Domestic and overseas sales for the years ended March 31, 2006 and 2005 are as follows:

	Millions of yen		Thousands of U.S. dollars
Net sales	2006	2005	2006
Japan	¥262,532	¥232,678	$2,234,883
Taiwan	150,322	141,493	1,279,664
United States of America	93,314	62,769	794,365
Korea	83,571	85,203	711,424
Others	83,947	113,567	714,629
Total	¥673,686	¥635,710	$5,734,965

Note: 1. For the reporting of domestic and overseas sales, overseas sales (other than Japan) include export sales of the Company and its domestic subsidiaries and sales of the foreign subsidiaries, except for export sales to Japan.
2. Others comprises primarily of Singapore, Ireland and China.

17. Subsequent Event

Grant of stock options under the stock option plans

On May 12, 2006, the Company's board of directors decided to submit a resolution to the shareholders' meeting for approval of the issuance of stock subscription rights to directors and selected employees of Tokyo Electron. This issuance of stock subscription rights is intended to enable the grant of stock options. Under this stock option plan, the options to purchase the shares of the Company at an exercise price of ¥1 ($0.01), up to 65,000 shares will be granted to directors and selected employees of the Company and its domestic subsidiaries and senior directors of foreign subsidiaries, and the options to purchase the shares of the Company at an exercise price of ¥1 ($0.01), up to 8,000 shares will be granted to directors and selected employees of foreign subsidiaries. This grant of stock options was approved at the annual general meeting of the shareholders of the Company on June 23, 2006.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Tokyo Electron Limited:

We have audited the accompanying consolidated balance sheets of Tokyo Electron Limited and subsidiaries as of March 31, 2006 and 2005, and the related consolidated statements of income, shareholders' equity and cash flows for the years then ended, expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Tokyo Electron Limited and subsidiaries as of March 31, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in note 2 (g) to the consolidated financial statements, the Company adopted "Accounting Standard for Impairment of Fixed Assets", issued by the Business Accounting Deliberation Council, for the year beginning April 1, 2005.

As discussed in note 3 to the consolidated financial statements, the Company changed its method of revenue recognition, accrued warranty expenses, and the classification of business segments in the year ended March 31, 2005.

The accompanying consolidated financial statements as of and for the year ended March 31, 2006 have been translated into United States dollars solely for the convenience of the reader. We have recomputed the translation and, in our opinion, the consolidated financial statements expressed in yen have been translated into United States dollars on the basis set forth in note 1 to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
June 23, 2006