Sales and Income

Operating Environment

The overall world economy in fiscal 2014 saw gradual recovery, as economic conditions in the United States picked up slightly and Europe showed signs of recovery, despite slowing growth in China and other emerging countries. The Japanese economy improved as well, supported by governmental economic stimulus measures and by the general upturn in the world economy.

In the electronics industry, in which Tokyo Electron operates, demand for TVs and PCs remained sluggish, but shipments of mobile devices were firm, driven primarily by growth in demand for smartphones and tablets in emerging countries. Demand for semiconductors also grew, reflecting the global spread of mobile devices and increasing demand for data center servers accompanying the growing use of cloud computing. As a result, capital investment by semiconductor manufacturers, customers of Tokyo Electron’s, also recovered.

Sales

Net sales in fiscal 2014 increased 23.1% year on year to ¥612.2 billion. This was due to substantial recovery in sales of mainstream semiconductor production equipment, reflecting the upturn in the business environment.

Domestic sales grew 36.4% year on year to ¥161.6 billion, while overseas sales grew 18.9% year on year to ¥450.5 billion. Overseas sales as a share of total consolidated sales came to 73.6%, down 2.6 percentage points from 76.2% in fiscal 2013.

Orders received during the fiscal year under review increased 54.5% compared to the previous year to ¥96.2 billion. The order backlog at the end of March 2014 was ¥265.1 billion, up 46.6% year on year.

Gross Profit, SG&A Expenses and Operating Income

Cost of sales for the period under review increased 21.2% year on year to ¥410.3 billion, while the cost of sales ratio dropped 1.1 percentage points to 67.0%.

As a result, gross profit was up 27.2% year on year to ¥201.9 billion, with the gross profit margin rising to 33.0% from 31.9% in fiscal 2013. SG&A expenses rose 16.1% year on year to ¥169.7 billion. This was due to increased R&D expenses in fields related to the four overseas subsidiaries acquired in fiscal 2013, the full inclusion of costs, including amortization of goodwill, related to those companies in the fiscal 2014 results; and an increase in the yen conversion of local currency expenses incurred by overseas subsidiaries due to the depreciation of the yen. Nevertheless, sales growth outpaced the increase in SG&A expenses. Accordingly, the ratio of SG&A expenses to consolidated net sales dropped from 29.4% in the previous fiscal year to 27.7%.

Consequently, operating income increased 156.6% year on year to ¥32.2 billion, and the operating margin rose from 2.5% to 5.3%.

Research and Development

R&D expenses were up 7.4% year on year to ¥78.7 billion. As Tokyo Electron views R&D as a source of growth, the Company invested not only in strengthening existing business areas, but also in new areas that are expected to support future growth. Due to the significant increase in net sales, R&D expenses as a percentage of net sales dropped from 14.7% to 12.9%.

R&D investment in semiconductor production equipment was focused on multiple patterning technology for further miniaturization and key technologies such as deposition, etch and cleaning technologies for new 3D structure devices and new materials. Other areas of R&D investment included the development of production equipment for STT-MRAM*, a promising candidate for the next-generation of memory device, and the development of advanced packaging technology. In PPD production equipment, R&D investment concentrated on developing inkjet printing systems for manufacturing OLED panels.

* STT-MRAM: Spin Transfer Torque Magnetoresistive Random Access Memory (an emerging memory promising for its low power consumption)

Other Income (Expenses) and Net Income (Loss)

During fiscal 2014, Tokyo Electron recognized interest and dividend income of ¥13.2 billion and revenue from grants of ¥1.2 billion but also recognized a ¥47.0 billion loss on impairment, comprised of a ¥32.8 billion loss attributable to the PV Production Equipment segment mainly on goodwill due to revaluations of future cash flow estimates, a ¥9.0 billion loss attributable mainly to goodwill of TEL NEXO, Inc. (acquired in May 2012) due to revaluations in its business plan, and an ¥6.3 billion loss on fixed assets accompanying Tokyo Electron’s decision to reorganize facilities. As a result, other income (expense) amounted to ¥44.0 billion of net expense, compared with ¥5.2 billion of net income in fiscal 2013. This contributed to the ¥11.8 billion net loss before taxes and minority interests, compared with ¥17.8 billion in net income before income taxes and minority interests in the previous year.

Net loss totaled ¥19.4 billion, compared with net income of ¥6.1 billion in fiscal 2013. Net loss per share was ¥108.31, compared with ¥33.91 in fiscal 2013.

Comprehensive Income (Loss)

In fiscal 2014, Tokyo Electron recognized comprehensive loss of ¥10.3 billion, compared with income of ¥15.8 billion in fiscal 2013. This was due mainly to the aforementioned net loss of ¥19.4 billion and loss before minority interests of ¥19.2 billion recognized in the fiscal year, despite foreign currency translation adjustments of ¥6.9 billion, which reflect the depreciation of the yen and the ¥1.4 billion gain on changes in fair value of investment securities.

Dividend Policy and Dividends

It is the policy of Tokyo Electron to pay dividends on the basis of business performance and earnings results. The dividend payout ratio has been set at approximately 35% of consolidated net income. While there has been no change to this policy, in light of the Group’s financial standing and global financial and economic trends, Tokyo Electron paid annual dividends of ¥55 per share, comprising a mid-term dividend of ¥25 per share and a year-end dividend of ¥30 per share, as a special measure to return profits to shareholders.

Performance by Segment

Semiconductor Production Equipment

Since the second half of 2013, capital investment related to DRAM and NAND flash memory for mobile applications has been brisk, reflecting strong demand for smartphones and other mobile devices and growing demand for data center servers. Capital investment by foundries in advanced technologies for logic chips has also remained strong.

Segment net sales to external customers increased 22.1% year on year to ¥478.8 billion. Segment net sales including intersegment sales or transfers were up 22.1% to ¥478.9 billion. Segment profit before taxes or minority interests, comparably, rose 52.8% compared with fiscal 2013 to ¥74.3 billion. This was due mainly to the aforementioned net loss of ¥19.4 billion and loss before minority interests of ¥19.2 billion recognized in the fiscal year, despite foreign currency translation adjustments of ¥6.9 billion, which reflect the depreciation of the yen and the ¥1.4 billion gain on changes in fair value of investment securities.

Domestic and Overseas Sales

Orders received in this segment increased 34.6% compared to the previous year to ¥171.7 billion. The order backlog at the end of March 2014 was ¥235.2 billion, up 36.6% year on year.
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>**FPD (Flat Panel Display) Production Equipment**

Capital investment in high-definition small- and medium-sized panels remained firm as strong demand persisted for smartphones and tablets. Investment for large-sized panels for TVs, which was sluggish in the previous fiscal year, began to show signs of recovery in the second half of 2013, primarily in China. Segment net sales to external customers increased 41.0% year on year to ¥28.3 billion. Segment net sales including intersegment sales or transfers also increased 41.0% to ¥28.3 billion. Segment loss came to ¥46.4 billion, compared with a loss of ¥1.8 billion in fiscal 2013.

Orders in this segment increased from ¥83 million in fiscal 2013 to ¥4.3 billion. The order backlog as of March 31, 2014 was up 19.1% to ¥100.7 billion. For a business overview of this segment, please see page 9.

>**PV (Photovoltaic Panel) Production Equipment**

In 2009, aiming to break into the thin-film silicon photovoltaic panel market, Tokyo Electron became the exclusive sales representative of Switzerland-based Oerlikon Solar and began sales of end-to-end production lines for photovoltaic panels. In 2012, the Company acquired Oerlikon Solar, seeking to merge its technologies with the production equipment technologies of the Group to generate growth in the PV business. However, due to changes in the market environment, panel production equipment has since been in oversupply. While Tokyo Electron boosted development efforts to increase conversion efficiency and took all available measures to reduce costs, the business environment has remained extremely harsh. Having determined that it could not expect a reasonable return on investment going forward, the Company announced its decision to withdraw from the research and development, manufacturing and sales of photovoltaic panel production equipment at the end March 2014, and retain only support operations for delivered units. As a result, Tokyo Electron recognized a loss on impairment mainly of goodwill and fixed assets totaling ¥32.8 billion in the period under review.

Segment net sales to external customers increased from ¥83 million in fiscal 2013 to ¥3.8 billion. Segment net sales including intersegment sales or transfers also increased from ¥83 million to ¥3.8 billion. Segment profit fell 43.7% year on year to ¥0.7 billion, and the segment profit margin fell from 1.5% in fiscal 2013 to 0.7%.

For a business overview of this segment, please see page 9.

>**Electronic Components and Computer Networks**

Demand for electronic components for industrial use recovered in fiscal 2013. Sales in the electronic components business, chiefly in general-purpose ICs, were firm, reflecting growing demand in automobile usage coupled with the expansion of commercial rights. In the computer networks business, sales of equipment for data centers were firm, supported by the spread of cloud computing. Segment net sales to external customers increased 19.0% year on year to ¥100.7 billion. Segment net sales including intersegment sales or transfers were up 19.1% to ¥101.8 billion. Segment profit fell 43.7% year on year to ¥0.7 billion, and the segment profit margin fell from 1.5% in fiscal 2013 to 0.7%.

For a business overview of this segment, please see page 9.

Financial Position and Cash Flows

Assets, Liabilities and Net Assets

**Assets**

Current assets increased by ¥100.0 billion from the end of the previous fiscal year to ¥261.5 billion, reflecting increases of ¥52.6 billion in inventories, ¥28.5 billion in trade notes and accounts receivable, and ¥28.0 billion in total liquidity on hand (cash, cash equivalents and short-term investments). The turnover period for trade notes and accounts receivable worsened slightly from 74 days in fiscal 2013 to 77 days, and the inventory turnover period remained unchanged year on year at 100 days.

Net property, plant and equipment increased from ¥621.5 billion, in fiscal 2013 to ¥775.5 billion, due in part to ¥12.8 billion in fixed asset acquisitions, ¥24.9 billion in depreciation and amortization, ¥30.0 billion in intangible and other assets.

**Liabilities and Net Assets**

Net sales

Sales to external customers

Intersegment sales or transfers

Total

Segment profit (loss)

Segment assets

Depreciation and amortization

Amortization of goodwill

Loss on impairment

Capital expenditures, including intangible and other assets

Cash Dividends per Share
Financial Review

and ¥18.3 billion in impairment of fixed assets due to plans for facility reorganization.

Investments and other assets decreased ¥23.6 billion year on year to ¥94.8 billion, mainly due to impairment accompanying revisions to business plans for the PV Production Equipment segment and TEL NEXX., Inc., which led to a ¥29.0 billion decrease in goodwill. As a result, total assets as of March 31, 2014 stood at ¥206.6 billion, up ¥53.1 billion year on year.

Liabilities and Net Assets

Current liabilities increased ¥93.8 billion from the end of fiscal 2013 to ¥170.5 billion. This reflected increases of ¥20.9 billion in customer advances, ¥17.4 billion in trade notes and accounts payable, and ¥11.7 billion in income taxes payable.

Non-current liabilities increased ¥37.7 billion year on year to ¥167.5 billion, due mainly to increases in deferred tax liabilities of ¥44.5 billion.

Beginning fiscal 2014, the Group’s retirement benefit obligations are presented as net liability for retirement benefits, which are calculated by deducting pension assets from retirement benefit obligations and include previously unrecognized actuarial differences. The difference is recognized as net asset for retirement benefits, under assets. Accordingly, at the end of the period under review, the Company recognized ¥54.0 billion in net liability for retirement benefits for noncontributory retirement and severance benefit plans (compared with ¥15.7 billion in accrued pension and severance costs in fiscal 2013) and ¥9.8 billion in net asset for retirement benefits for corporate pension plans (cash balance plan) (compared with ¥3.0 billion in prepaid pension and severance costs in fiscal 2013).

As of March 31, 2014, the balance of interest-bearing debt (long- and short-term debt) was ¥13.5 billion, up from ¥3.8 billion at the end of the previous fiscal year, due to an increase in the interest-bearing debt of Tokyo Electron Device. The debt/equity ratio rose to 2.3%, 1.7 percentage points higher than at the end of fiscal 2013. Total liabilities (current liabilities and non-current liabilities), stood at ¥323.0 billion, up ¥67.5 billion from the end of the previous fiscal year. Net assets came to ¥306.6 billion, down ¥14.5 billion from the end of fiscal 2013. This was mainly due to decreases resulting from the ¥19.4 billion net loss recognized for the period under review, ¥4.7 billion in year-end dividends paid for the previous fiscal year, the ¥19.1 billion increase in customer advances and a ¥15.6 billion increase in notes and accounts payable. Major negative factors included ¥11.8 billion in loss before income taxes and minority interests, ¥32.1 billion increase in inventories and a ¥25.4 billion increase in trade notes and accounts receivable.

Net cash used in investing activities was ¥19.6 billion, compared with ¥14.1 billion in the previous fiscal year. This included ¥9.5 billion used in the payment for purchase of property, plant and equipment and an ¥8.5 billion net increase in short-term investments.

Capital Expenditures* and Depreciation and Amortization**

Capital expenditures were ¥12.8 billion in fiscal 2014, a 4.1% year-on-year decrease. Primary factors included the acquisition of evaluation equipment for development, primarily for areas with high growth potential in the SPE and PPD production equipment businesses. Tokyo Electron also acquired equipment for use in R&D related to its R&D program at Tohoku University to develop STT-MRAM. Depreciation and amortization decreased 6.5% to ¥24.9 billion.

Operating Activities

Operating activities provided net cash of ¥44.4 billion, down ¥39.8 billion year on year to ¥268.1 billion at the end of March 2014. Total liquidity on hand, which consists of cash, cash equivalents and short-term investments, increased ¥28.0 billion year on year to ¥268.1 billion at the end of March 2014.

Financial Position

<table>
<thead>
<tr>
<th>Financial Position</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total current assets</td>
<td>¥552,939</td>
<td>¥644,231</td>
<td>¥607,051</td>
<td>¥521,501</td>
<td>¥621,492</td>
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<tr>
<td>Net property, plant, and equipment</td>
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<td>112,552</td>
<td>126,885</td>
<td>135,698</td>
<td>112,344</td>
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<td>Total investments and other assets</td>
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<td>52,422</td>
<td>49,875</td>
<td>118,309</td>
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<tr>
<td>Total assets</td>
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<td>809,205</td>
<td>783,611</td>
<td>775,528</td>
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<tr>
<td>Total current liabilities</td>
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<td>168,038</td>
<td>124,794</td>
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<td>170,510</td>
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<tr>
<td>Total liabilities</td>
<td>172,982</td>
<td>224,403</td>
<td>185,008</td>
<td>170,401</td>
<td>237,873</td>
</tr>
<tr>
<td>Total net assets (Total shareholders’ equity)</td>
<td>523,370</td>
<td>584,802</td>
<td>598,603</td>
<td>605,127</td>
<td>590,614</td>
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</table>

Interest-Bearing Debt, D/E Ratio

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<thead>
<tr>
<th>Interest-Bearing Debt</th>
<th>D/E Ratio</th>
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<tbody>
<tr>
<td>Millions of yen</td>
<td>(%)</td>
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<tr>
<td>2010</td>
<td>2011</td>
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Equity and Equity Ratio

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<tr>
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<tbody>
<tr>
<td>Millions of yen</td>
</tr>
<tr>
<td>2010</td>
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</tbody>
</table>

ROE

| ROE = (Net income / Average total equity) x 100 |
|------------------|---------|
| 2010             | 2011    |

Capital Expenditures and Depreciation and Amortization

<table>
<thead>
<tr>
<th>Capital Expenditures</th>
<th>Depreciation and Amortization</th>
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</thead>
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<tr>
<td>Millions of yen</td>
<td>(%)</td>
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<tr>
<td>2010</td>
<td>2011</td>
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Total Liquidity on Hand

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<tr>
<td>Millions of yen</td>
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<td>2010</td>
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Financial Section
Business-related and Other Risks

The following risks may have a material impact on Tokyo Electron’s business performance, stock price, or financial position.

(1) 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, including 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 unexpected large market contraction, losses from bad debts resulting from the worsening of a supplier’s financial position, and supply shortages resulting from the worsening of a supplier’s management situation, could adversely affect Tokyo Electron’s business performance considerably.

(2) 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.

(3) 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, water 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.

(4) Safety-related Impact
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 or other problems related to Tokyo Electron’s products could adversely affect Tokyo Electron’s business performance.

(5) 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.

(6) 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 the Company’s ability to capture a high market share and generate high profit margins in each of its product fields. Tokyo Electron’s products incorporate and optimize many of these proprietary cutting-edge technologies. There may be cases in which, by avoiding the use of third-party technologies and intellectual property rights, Tokyo Electron’s business performance could be adversely affected.

(7) 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.

(8) Influence of Corporate Acquisitions
On September 24, 2013, Tokyo Electron and Applied Materials, Inc. agreed to enter a merger of equals and concluded a business combination agreement. Both companies are currently preparing for the merger. However, failure to obtain approval or approval necessary for the merger from the relevant authorities, delays or other factors that could prevent the merger from proceeding as planned, changes to the content of the merger, or failure to realize the full synergistic effect expected after the merger is completed could adversely affect the new combined company’s business performance.

(9) Impact of Business Combination
Tokyo Electron is actively engaged in reforming its corporate structure so that it can generate profits even when markets contract. These reforms have entailed creating new high-growth and 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, risk management and information security 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, infectious diseases and other unavoidable occurrences, financial or stock markets, government or other regulations, supply chains, 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.