

Annual Report
2004

Envisioning the Next Fifty Years



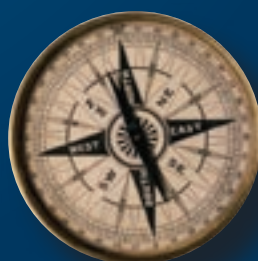
A Half Century of Excellence

Building upon our strength in test and measurement technology
to advance our inherent value to industry and society

Since its establishment in 1954, Advantest has been a pioneer in the measurement technology industry, bringing to market automated test equipment and measuring instruments that have enabled the research, development and production of electronic devices, and hence the computers and telecommunications equipment that now power the digital universe. As one of the recognized leaders in the testing and measuring technology industry, with a greater than 60% share of the global memory test system market, Advantest has won the confidence of customers worldwide.

In 2004, Advantest celebrates its 50th anniversary, and rededicates its commitment to creating new businesses and strengthening its management base in order to ensure its continuous outreach and growth.

Our corporate mission to “support advanced technology at the cutting edge” has never been stronger, as we endeavor to increase our enterprise value by creating stable, long-term relationships with our customers and stakeholders.



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FINANCIAL HIGHLIGHTS

Years ended March 31

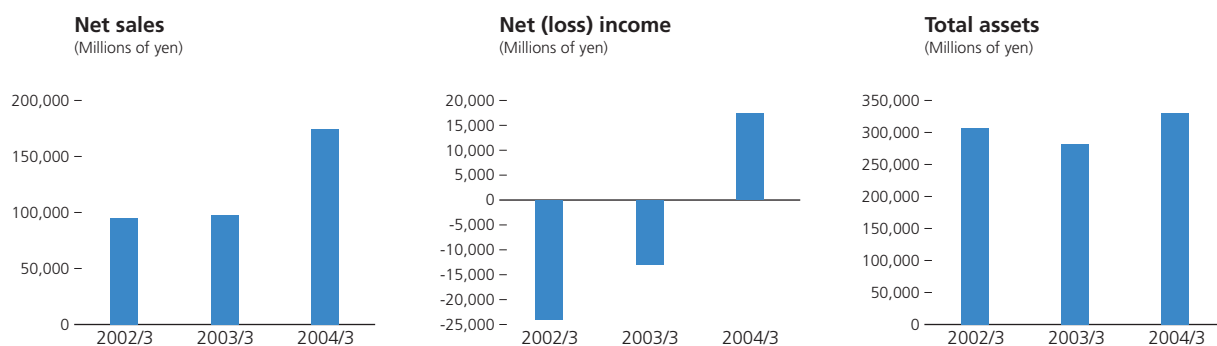
Advantest Corporation and Consolidated Subsidiaries	2002	2003	2004	2004
	Yen (Millions)			U.S. Dollars (Thousands)
Net Sales:	¥ 95,244	¥ 97,740	¥ 174,218	\$1,648,387
Automated test equipment	74,206	84,910	160,855	1,521,951
Measuring instruments	21,038	12,830	13,363	126,436
Net (loss) income	(23,906)	(12,994)	17,329	163,961
Per Share:				
Net (loss) income (Yen and U.S. Dollars)	¥(240.38)	¥(131.99)	¥176.37	\$1.67
Cash dividends (Yen and U.S. Dollars)	40.00	30.00	40.00	0.38

As of March 31:

Total assets	¥307,562	¥281,224	¥330,808	\$3,129,984
Total stockholders' equity	240,716	210,663	221,768	2,098,287

Note 1: The above selected financial data were prepared under U.S. GAAP.

Note 2: In this annual report, amounts reported in Japanese yen have been translated into U.S. dollars for the convenience of readers. The rate used for this translation was \$1.00=¥105.69, the approximate exchange rate in Japan on March 31, 2004.



Cautionary Statements with Respect to Forward-Looking Statements

This annual report contains "forward-looking statements" that are based on Advantest's current expectations, estimates, and projections. These forward-looking statements are subject to known and unknown risks, uncertainties, and other factors that may cause Advantest's actual results, levels of activities, performance, or achievements to be materially different from those expressed or implied by such forward-looking statements. These factors include: (i) changes in demand for the products and services produced and offered by Advantest's customers, including semiconductors, communications services, and electronic goods; (ii) circumstances relating to Advantest's investment in technology, including its ability to timely develop products that meet the changing needs of semiconductor manufacturers and communications network equipment and components makers and service providers as well as risks associated with Advantest's investment in OPENSTAR®, an industrywide open architecture for SoC testing; (iii) significant changes in the competitive environment in the major markets where Advantest purchases materials, components, and supplies for the production of its principal products or where its products are produced, distributed, or sold; and (iv) changes in economic conditions, currency exchange rates, or political stability in the major markets where Advantest procures materials, components, and supplies for the production of its principal products or where its products are produced, distributed, or sold. A discussion of these and other factors which may affect Advantest's actual results, levels of activity, performance, or achievements is contained in the "Operating and Financial Review and Prospects," "Key Information – Risk Factors," and "Information on the Company" sections and elsewhere in Advantest's annual report on Form 20-F, which is on file with the United States Securities and Exchange Commission.

Leading the industry in a solutions based approach to test and measurement



Worldwide sales of semiconductors surged 18% in 2003

Semiconductor demand, which turned sluggish following a peak in 2000, has recently shown clear signs of recovery. In 2003, worldwide semiconductor sales were approximately \$166.4 billion, up approximately 18% from the previous year, according to World Semiconductor Trade Statistics Inc. By region, the U.S. semiconductor market grew 3%. In Japan, however, semiconductor sales increased 28% from the previous year. This growth was due to strong sales of digital consumer products, which spurred capital investments by domestic semiconductor manufacturers.

Advantest returns to profitability with record gains

In sharp contrast to the net loss posted in the previous fiscal year, in fiscal 2003,

Hiroshi Oura
Chairman of the Board and CEO (seated)

Toshio Maruyama
President and COO

Advantest returned to profitability. With strong business and new product introductions well received, Advantest was positioned among the world's leading semiconductor test equipment providers in fiscal 2003, according to industry estimates.

Orders received surged 105.9% year-on-year to ¥208.9 billion (US\$1,977 million) on a consolidated basis. Net sales increased 78.2% to ¥174.2 billion (US\$1,648 million). Income before taxes amounted to ¥28.8 billion, and net income reached ¥17.3 billion (US\$ 164 million).

In fiscal 2003, we implemented various initiatives to restore profitability. First, we ensured a timely release of our new products to boost sales and focused our efforts on winning new orders and increasing sales. Second, by merging and restructuring our manufacturing subsidiaries, we shortened our production schedule to realize greater efficiencies. Third, by working together to reduce fixed costs, Advantest and its consolidated subsidiaries were able to achieve a rapid recovery in earnings.

With this growth taking concrete form, fiscal 2003 proved to be extremely significant. And, with such positive results from our efforts, we now find ourselves faced with the challenge of sustaining and improving upon these processes.



T2000, utilizing the OPENSTAR® standard

Launch of T2000 accelerates adoption of open architecture environment

Our Open Architecture Initiative (OAI) evolved in response to our customers' need for more cost efficient and flexible test alternatives. With product life cycles shrinking as newer and more complex SoC (System-on-a-Chip) devices were brought to market, the testing industry required a new business model. Advantest's efforts to create an open test environment with the modular flexibility required for adapting to these changing needs have now been realized. In October 2003, we launched the T2000, the industry's first SoC test system to be based upon the industry's open architecture standard, OPENSTAR®.

In contrast to existing test system offerings, we believe these new products based on the OPENSTAR® standard are superior in terms of scalability and flexibility, and are far more economical in their approach to accommodating current and future needs. Our customers are recognizing this, and accordingly, orders received have been favorable.

The next step is to construct an "Open Architecture World" with the involvement of third party vendors. The adoption of an open architecture test platform, though beneficial for the customer, can impact the manner in which test equipment manufacturers differentiate their products. However, with cutting-edge technologies and a solutions-based approach that relies on turnkey product offerings and includes world-class support, we believe that Advantest will continue to have a differentiated business model.

Integrating our operations in automated test equipment and measuring instruments

In the area of our measuring instruments business, despite our vast resources, superior engineering, and the constituent technologies that represent Advantest's core competence, we face the reality that profits are not generated. Our performance in this segment remained weak due to the protracted sluggishness of Japan's telecommunications market in fiscal 2003.

To combat this trend, by means of a thorough restructuring process, as of April 1, 2004, we integrated the automated test equipment business with the measuring instruments business. In order to fully utilize our strength in measuring instruments, which is the root of our business success, we have reclassified our business segment to better reflect Advantest's current lines of business and strategic focus.

As part of these administrative reforms, Advantest entered into an agreement with Metric Test, under which Metric Test became a distributor of Advantest's measuring instruments in the U.S. This arrangement allows Advantest America Measuring Solutions, Inc. (AAM), which previously handled sales and maintenance services in the American market, to concentrate on marketing activities that are related to more advanced technologies, and on innovating cutting-edge communications technology.

Strengthening corporate governance through large-scale structural reforms

In June 2003, we undertook extensive management reforms centered on the implementation of an executive officer system and the restructuring of our board of directors.

The Committee on Corporate Social Responsibility (CSR) was established in July 2003 to monitor and supervise Advantest's corporate activities, and to ensure that it takes social responsibilities into account. In January 2004, the CSR Committee organized a subcommittee on corporate governance, in addition to the five existing subcommittees. In this way, we are implementing measures to enhance the efficiency of management, increase the reliability of our financial reports, and strengthen our adherence to laws and regulations.

Meeting the targets under the "Initiative 21" business plan in fiscal 2004

In Japan, sales of digital consumer products remain strong. And, with the widespread adoption of third-generation mobile telephones, demand for semiconductors is expected to remain firm. In particular, SoC devices are predicted to see a large surge in demand.

In addition, Japanese semiconductor manufacturers have commenced full-scale production of 300mm wafers. Coupled with the switch to next-generation memory devices, large increases in capital investment by Japanese semiconductor manufacturers are expected.

Fiscal 2004 marks the final year of a company-wide campaign entitled "Initiative 21," the goal of which has been to bolster Advantest's competitiveness in the current climate of mega-competition. We are making solid progress towards achieving our numerical targets, and we hope to close fiscal 2004 with an even stronger performance.

Marking our 50th anniversary as a trendsetter for the industry

The year 2004 is a major milestone in the history of Advantest, as it marks our 50th anniversary. The occasion will be commemorated throughout the year, with Advantest's Exhibition 2004 at the Tokyo International Forum in June kicking off the event calendar. This private exhibition was host to over 4000 guests from around the globe, and offered a comprehensive look at Advantest's products and history and communicated Advantest's vision for the next 50 years.

Since our founding, we believe we have become the industry's leading manufacturer of memory testers, commanding greater than a 60% worldwide market share. And, in the field of SoC testers, we are enthusiastically promoting an open architecture initiative that has the potential for radically altering the way and manner in which these complex devices are tested. This is a dynamic time for Advantest, as we undertake new business endeavors in keeping with our mission to always support leading edge technology, and contribute to the advancement of the industry as a whole.

We would like to express our warm appreciation for the continued support of our stakeholders.



Hiroshi Oura
Chairman of the Board and CEO

Toshio Maruyama
President and COO

Board of Directors and Corporate Auditors



Standing from left: Takashi Tokuno Hiroji Agata Kiyoshi Miyasaka Junji Nishiura Hitoshi Owada

Seated from left: Takashi Takaya Noboru Yamaguchi Shimpei Takeshita Hiroshi Oura Toshio Maruyama Kuniaki Suzuki Tadahiko Hirano

Board of Directors

Hiroshi Oura
Chairman of the Board and CEO

Toshio Maruyama
Representative Board Director

Junji Nishiura
Director

Hitoshi Owada
Director

Shimpei Takeshita
Vice Chairman of the Board

Kiyoshi Miyasaka
Director

Hiroji Agata
Director

Takashi Tokuno
Director

Corporate Auditors

Noboru Yamaguchi
Standing Corporate Auditor

Tadahiko Hirano
Standing Corporate Auditor

Takashi Takaya
Corporate Auditor

Kuniaki Suzuki
Corporate Auditor

Executive Officers

Toshio Maruyama
President and COO

Managing Executive Officers

Executive Officers

Senior Executive Officers

Kiyoshi Miyasaka
Corporate Planning and Strategy

Junji Nishiura
Technology and Production

Hiroji Agata
Sales and Marketing

Hitoshi Owada
Corporate Affairs

Takashi Tokuno
Product Development
Senior Vice President, ATE Business Group

Kenichi Mitsuoka
Senior Vice President, FA Business Group

Norihito Kotani
Senior Vice President, Application Specific
Business Group

Yuri Morita
Senior Vice President, Corporate Affairs
Group

Jiro Katoh
Senior Vice President, Technology
Development Group

Takao Tadokoro
Senior Vice President, Sales and
Marketing Group

Hiroyasu Sawai
Vice President, SE, ATE Business Group

Hiroshi Tsukahara
Senior Vice President, DI Business Group

Masao Shimizu
Vice President, SoC Tester Products, ATE
Business Group

Masao Araki
Director and President of Advantest
(Suzhou) Co., Ltd. and Advantest
Shanghai Ltd.

Yoshiaki Furuse
Vice President, Sales and Marketing
Group

Yuichi Kurita
Vice President, Finance, Corporate Affairs
Group

Yoshiro Yagi
Vice President, ATE, Sales and Marketing
Group

Hideaki Imada
Vice President, OAI, Sales and Marketing
Group

Shinichiro Umeda
Vice President, Software, ATE Business
Group

Creating an Open Architecture Environment

— An open architecture test platform lowers the cost of testing, benefiting both semiconductor manufacturers and test system developers —

- **Endorsing the goals of the Semiconductor Test Consortium (STC)**
- **Introduced industry's first OPENSTAR® compliant test system**



A Charter Member of the STC, promoting the OPENSTAR® standard

In March 2003, responding to the need for test systems targeted at increasingly complex SoC (System-on-a-Chip) devices, Advantest, along with Intel, Motorola and over 30 companies worldwide that represent the semiconductor, equipment, and instrumentation sectors, established the Semiconductor Test Consortium, Inc. (STC), an organization dedicated to the advancement of an open test platform for SoCs and other complex logic devices. One year has passed since its inception, and the Consortium has gained considerable momentum in the industry.

The STC is advocating the widespread adoption of its open architecture environment, which it sees as key to cost reductions for device manufacturers. This Open Semiconductor Test Architecture (OPENSTAR®) standard enables chipmakers to implement flexible automated test equipment (ATE) solutions to meet their divergent test needs in a cost-effective manner, by providing unique multi-vendor interoperability at both the hardware and software levels.

Since the introduction of the concept of "Open Architecture," the STC has won support from some major semiconductor manufacturers worldwide. As of June



2004, membership has totaled 37, including 26 companies and 11 institutions. STC continues to promote the benefits and efficiencies of its open architecture standard, and to seek new members worldwide.

Advantest recently debuted the T2000, a new open architecture test system that conforms to the standards set by the STC. Advantest encourages third party vendors of modules and test equipment to unite in the goal of providing cost efficient test offerings to the semiconductor industry.

T2000, the industry's first test system to be certified as compliant with the STC open architecture standard

The T2000 debuted in October 2003. It is the first test system to be developed based upon the open architecture OPENSTAR® platform. Not only do we expect it to contribute to the Advantest's performance in terms of profitability, Advantest has also derived recognition for leading the industry into a new era of cost effective testing and flexible performance. In this sense, this is a very significant product for Advantest.

The open architecture platform was designed to address the increasing number of devices in development, and their corresponding use in products with shorter life cycles. These shorter life cycles are driving

the cost of testing significantly higher. Until this time, for each new introduction of device or application, a new tester was needed. Through its modular design, the T2000 helps to minimize the costs associated with testing.

Hastening the industry-wide adoption of an open architecture platform, and targeting a larger share of the SoC test market

The T2000 has attracted much interest since its market launch, and sales have been strong. The initial success of the T2000 is helping to generate great interest in the open architecture initiative, and a number of third party vendors are expressing interest in developing modules compatible with the platform. With each new vendor participant, the world of OPENSTAR® expands, increasing the prospect for further reductions in test costs and raising the efficiency of the software and related options.

Through efforts such as this, we expect to substantially increase Advantest's share of the global SoC tester market from its current level of about 10%.



The Solutions Business

— The “GETsolution” service promise delivers global support networking —

- **A comprehensive solution, from semiconductor design to product shipment**
- **Guaranteed fast delivery of parts and products responds to customers’ time-to-market imperative**



Leading edge technology and a corresponding global support system

Advantest is known not only for its products, but also for its solutions approach to business and world-class customer support capabilities. Advantest has introduced the Globally Enabled Total Solution, or “GETsolution,” a comprehensive service that offers customers with a solutions approach to problems that arise during the semiconductor production process, from chip design through product delivery.

The Testing Set Solution

The Testing Set Solution is a quick response system that helps our customers resolve the initial problems often encountered with new devices, allowing them to move rapidly from the measurement stage to the production stage of development. Such functions as system inspections, engineering, program design and interface checks are addressed here, as is the debugging process.

Test Technology Service Solution

Test Technology Service Solution helps in creating test programs or test boards, making the design stage of the device less labor intensive. In the creation of test boards, it provides total support, for everything from

parts collection to the development of a system design that fully maximizes the system's features.

ACS develops new maintenance services

Advantest Customer Support Corp. (ACS) is responsible for providing maintenance and support services for the hardware and software operations of Advantest and its consolidated subsidiaries.

ACS takes the innovative approach of combining hardware and software services, and will ultimately train systems engineers world wide to respond in this way to customer needs. The new service will begin in fiscal 2004.

Delivering maintenance parts anywhere in the world within 48 hours

Global leadership in an industry as dynamic as semiconductor testing, requires service that is responsive and immediate. Using the Internet and a network of call centers, we are able to troubleshoot problems as they arise, and through special contract, we are guaranteed that delivery of parts will reach our customers swiftly, often within 24 hours.



Flash BIST tester T5724 allows simultaneous testing of a vast number of devices



Entering the automotive device testing market with the new T7721 mixed signal test system

Research and Development

— Our competitive advantage is our cutting edge technology —

- Continuing to aggressively invest in critical R&D
- Fostering an environment for new technologies and designs



R&D expenses remain at a high level

In order to support leading technology, Advantest continues to develop products with measurement capabilities that can be utilized in such fields as electronics, communications, and semiconductor manufacturing. Advantest's research and development focuses on the development of new products and the refinement of existing products. Automated test equipment, in particular, is highly specialized and sold in relatively low volumes, and therefore requires a large and ongoing investment in development by Advantest to maintain competitiveness. Advantest also conducts research of basic technologies.

Advantest's expenditures for research and development were approximately ¥26.6 billion in fiscal 2001, ¥23.6 billion in fiscal 2002 and ¥21.6 billion (US\$205 million) in fiscal 2003. Advantest employs over 1,000 engineers and other personnel in its research and development division.



Some of Advantest's current research and development activities

Basic Technology

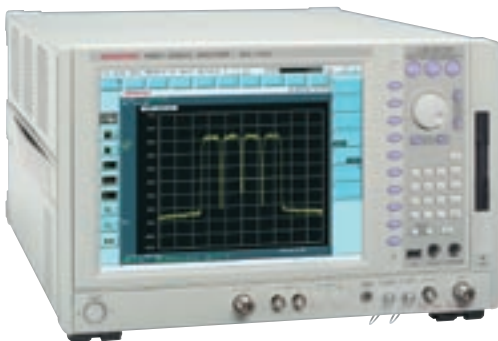
- Development of devices for the measurement of millimeter waves, that consist of electromagnetic radiation with extremely high frequencies that are used in broadband communications and radars.
- Development of testing and measuring technologies and components for photonic networks, which are networks that transmit communication signals entirely through optical signals.
- Development of constituent technologies, including high speed, energy-saving micro switches and high speed samplers used in semiconductor test systems and millimeter wave measuring instruments.
- Development of methods to detect timing jitters in high bit-rate signals.

Automated Test Equipment

- Development of automated test equipment that has improved front-end DRAM testing functionality and requires less floor space.
- Development of automated test equipment that has the capacity to simultaneously test multiple complex SoC semiconductors with large pin counts and requires less floor space.

Measuring Instruments

- Development of measuring instruments for devices that operate at extremely high frequencies and for networks that carry extremely high density transmissions.
- Continued development of component module-based measuring instruments. Modularization is a process through which functions of Advantest's measuring instrument product lines are installed into modules, thereby allowing for multi-functional instruments.



R3671 signal analyzer designed to test high-performance amplifiers for base stations



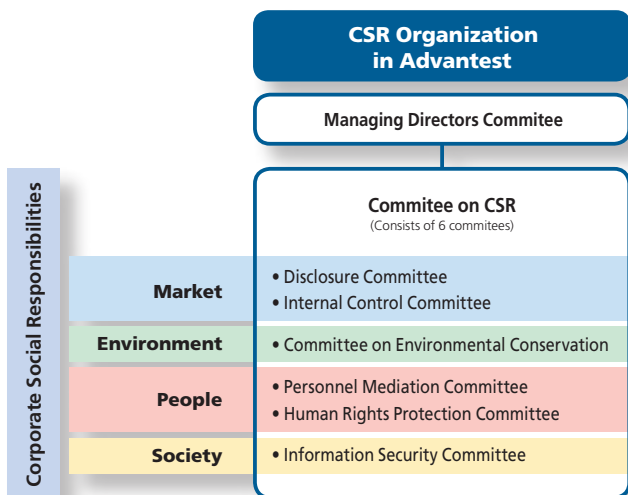
Q7761 optical network analyzer for testing optical fibers and components

CORPORATE SOCIAL RESPONSIBILITY (CSR) ACTIVITIES

Toward the realization of a sustainable society

The management of Advantest has publicly stated its belief that one of the most important social duties of a business enterprise is to work to simultaneously lower the environmental burden of its corporate activities while raising its overall value proposition. By so doing, companies are able to benefit themselves, their customers, and the environment. Based on this stance, in July 2003 we established the Committee on Corporate Social Responsibility (CSR), with the aim of raising the level of Advantest's contribution to the creation of a sustainable society.

The principles of corporate social responsibility require companies to address issues broadly relating to four areas — the market, the environment, the company's staff and the society at large. Until this time, Advantest had assigned independent committees to these tasks, but under the reorganized system, these dedicated committees now serve as subcommittees under the umbrella of the Committee on CSR. This committee serves as the guiding body over these activities, offering supervisory and evaluative direction. Additionally, we have set up a new subcommittee to take charge of corporate governance.



Principles of Advantest's environmental preservation activities

Aim to be No.1	We aim to take the lead over our competitors in the development and marketing of high-quality, ecologically friendly products that meet the three basic requirements of energy conservation, recyclability, and absence of toxic substances.
Raise competitiveness and customer satisfaction	By incorporating eco-friendly technologies into product development, we aim to provide our customers with solutions for realizing energy conservation and reducing test costs. In this way, we will improve our market competitiveness while raising customer satisfaction levels.
Environmental consciousness	Through the establishment of an effective system for assessing the environmental impact of products, we can eliminate losses resulting from incorrect parts procurement or faulty design, thus ensuring that our business operations meet all the essential requirements of low cost, high quality, environmental soundness, and safety.

Advantest's response to EU directives on waste disposal

One of our management priorities for some time to come will be responding to the directives of the European Union that came into effect in February 2003 — the WEEE (Waste from Electrical and Electronic Equipment) and RoHS (Restriction of Hazardous Substances in Electrical and Electronic Equipment) directives. The former prohibits the sale within the EU from July 2006 of any electrical component or electronic equipment containing lead, mercury, cadmium, and other toxic substances. In order to bring to market environmentally friendly, or "green", products, we are earnestly tackling the various issues relating to environmental preservation from the perspectives of simpler design, reduced number of components, and enhanced recyclability.

Lead-free products: green design and manufacturing

Currently, eutectic solder, a tin-lead solder that melts at a conveniently low temperature, is widely used to connect electronic components within semiconductor testers and other testing and measuring equipment. When the RoHS directive comes into force, however, the use of this solder will be prohibited because of its lead content. Certain lead-free solders have already been commercialized, but because of their high fusion temperature

(melting point), it will be necessary to modify some components of semiconductor devices to increase their heat resistance. Advantest will exert its full effort towards overcoming the related technical problems, and will begin production of lead-free products by the end of 2005.

Green Procurement — Protecting and respecting our natural resources

Our goal is to manufacture products that routinely conform to “green” requirements, and we are taking steps to reduce the environmental burden of the entire production process — including operations by companies from whom we procure materials and components, and at affiliates or outsourced service providers responsible for assembly or processing work. By March 2004, following guidelines voluntarily laid down by Advantest, we succeeded in reducing the content of harmful substances as specified in the RoHS directive for approximately 35,000 different items used in our manufacturing process (parts and materials). We are continuing to search out new alternative materials, and will enforce a blanket prohibition from January 2005 on the procurement of all items not conforming to the RoHS directive.

Harmonizing our operations with the natural environment

To play a role, however small, in reviving and preserving the once renowned pastoral beauty of the Kanto Plain, we have established a biotope at our Gunma R&D Center. (A biotope is an area uniform in environmental conditions that serves as a habitat for animals and plants, and stimulates their growth and preservation.) We are working to turn this area — which features wetland plants, shrubbery and trees to provide a home for a variety of birds, insects, and fish — into a nature preserve where people can coexist with the natural world and learn the importance of protecting the environment.



In one corner of the tract of land that houses the Advantest Laboratories in the Aoba district of Sendai, a major city in northern Japan, there is a stand of Japanese redwood pine trees over 100 years old. To protect this precious resource, which serves as a home to local pheasants, we employ tree surgeons to provide proper forest management.

Contribution to local communities and society as a whole

To fulfill our responsibilities as a corporate citizen, we actively support the local communities around our plants and offices, and the broader society in which we live and work. Our worldwide staff are encouraged to work in cooperation with local groups and to partake in events that meet the needs of the communities in which they operate. We vigorously encourage staff to participate in volunteer community services.

Advantest is a contributor to such charitable organizations as the Red Feather Community Chest, and to UNESCO. In addition, we provide financial support for the DIIN Project, an industry group which aims to develop an ultrafast manufacturing process for semiconductors. The project is funded by experts from private industry, government, and academia.

The measures and results of our environmental activities are publicized inside and outside Advantest, and this encourages the proliferation of further work. Advantest disseminates information about its environmental initiatives through the Environmental Report on its website, as well as in a wide range of other publications and media.

For further details regarding Advantest’s environmental activities and social contribution initiatives, access our website at <http://www.advantest.co.jp/about/en-index.shtml>

Directors

The board of directors has the ultimate responsibility for the administration of the affairs of Advantest. Advantest's articles of incorporation limit the number of directors to 10. Directors are elected at a general meeting of stockholders, and the standard term of office of directors is two years. Directors may serve any number of consecutive terms. The board of directors elects one or more representative directors from among its members, each of whom has the authority individually to represent Advantest. From among its members, the board of directors may elect the chairman and the vice chairman. None of the directors of Advantest has a service contract with Advantest that provides for benefits upon termination of service.

Corporate Auditors

Advantest's articles of incorporation provide for no more than four corporate auditors and Advantest currently has two standing corporate auditors and two outside corporate auditors. Corporate auditors are elected at the general meeting of stockholders and the standard term of office of corporate auditors is four years. The two outside corporate auditors are those who have not been a director or employee of Advantest or any of its subsidiaries during the five-year period immediately prior to his or her election as a corporate auditor, as required under the Commercial Code of Japan and the Law concerning Exceptional Measures to the Commercial Code with respect to Auditing, etc. of Joint Stock Corporations, or the Special Exception Law (hereinafter, the same). Subsequent to the ordinary general meeting of stockholders to be held in June 2006, at least half of the corporate auditors will be required to be persons who have not been a director, executive officer, manager, or employee of Advantest or any of its subsidiaries at any time prior to such corporate auditor's election. Corporate auditors may not at the same time be directors, executive officers, managers, or employees of Advantest or any of its subsidiaries. Advantest increased the number of required outside corporate auditors from one to two at the general meeting of stockholders held in June 2003 in order to strengthen the

auditing function of the board of corporate auditors. Corporate auditors are under a statutory duty to oversee the administration of Advantest's affairs by its directors, to examine its financial statements and business reports to be submitted annually by its board of directors to the general meetings of the stockholders and to report their opinions thereon. They are also required to attend the meetings of the board of directors and to express their opinions, but are not entitled to vote.

Corporate auditors constitute the board of corporate auditors. The board of corporate auditors has a statutory duty to prepare and submit an audit report to the directors each year. A corporate auditor may note his or her opinion in the audit report if his or her opinion is different from the opinion expressed in the audit report. The board of corporate auditors is empowered to establish audit principles, the method of examination by corporate auditors of Advantest's affairs and financial position and other matters concerning the performance of the corporate auditors' duties.

Advantest does not have a remuneration committee.

Significant Differences in Corporate Governance Practices between Advantest and U.S. Companies Listed on the New York Stock Exchange

Pursuant to home country practices exemptions granted by the New York Stock Exchange, or the NYSE, Advantest is permitted to follow certain corporate governance practices complying with Japanese laws, regulations and stock exchange rules in lieu of NYSE's listing standards. In November 2003, the United States Securities and Exchange Commission, or the SEC, approved changes to the NYSE's listing standards related to corporate governance practices of listed companies. Advantest is exempted from the approved changes, except for requirements that (a) Advantest's audit committee satisfy the requirements of Rule 10A-3 under the U.S. Securities Exchange Act of 1934 as amended, or the Exchange Act, (b) Advantest must disclose significant differences in the corporate governance practices followed by Advantest as compared to those followed by domestic companies

under the NYSE listing standards and (c) Advantest's CEO must notify the NYSE of material non-compliance with (a) and (b). Advantest's corporate governance practices and those followed by domestic companies under the NYSE listing standards, or NYSE Corporate Governance have the following significant differences:

1. Directors

Advantest currently does not have any independent director on its board of directors. Unlike NYSE Corporate Governance, the Commercial Code of Japan and related legislation (including the Special Exception Law), or the Code (hereinafter, the same), do not require Japanese companies with boards of corporate auditors such as Advantest to have any independent directors on its board of directors. While NYSE Corporate Governance requires that the non-management directors of each listed company meet at regularly scheduled executive sessions without management, Advantest currently has no non-management director on its board of directors. Unlike NYSE Corporate Governance, the Code does not require, and accordingly Advantest does not have, an internal corporate organ or committee comprised of only independent directors.

2. Committees

Under the Code, Advantest has elected to structure its corporate governance system as a company with corporate auditors, which are under a statutory duty to monitor, review and report on the administration of the affairs of Advantest. Advantest, consistent with other Japanese companies with corporate auditors, but unlike NYSE Corporate Governance, does not have specified committees, including those that are responsible for director nomination, corporate governance and executive compensation.

Pursuant to the Code, Advantest's board of directors nominates and submits a proposal for appointment of directors for stockholder approval. The stockholders vote on such nomination at Advantest's general meeting of stockholders. The Code requires that the respective total amount of remuneration to be paid to all directors and all corporate auditors must be determined by a

resolution of the general meeting of stockholders, unless their remuneration is provided for in the Articles of Incorporation. The distribution of remuneration among directors is broadly delegated to Advantest's board of directors and the distribution of remuneration among corporate auditors is determined by consultation among Advantest's corporate auditors.

3. Audit Committee

Advantest plans to avail itself of paragraph (c)(3) of Rule 10A-3 of the Exchange Act, which provides a general exemption from the audit committee requirements to a foreign private issuer with a board of corporate auditors, subject to certain requirements which continue to be applicable under Rule 10A-3. Consistent with the requirements of the Code, Advantest elects its corporate auditors through a resolution adopted at a general meeting of stockholders. Advantest currently has four (4) corporate auditors, which exceeds the minimum number of corporate auditors required pursuant to the Code.

Unlike NYSE Corporate Governance, the Code, among others, does not require corporate auditors to establish an expertise in accounting nor are they required to present other special knowledge and experience. Under the Code, the board of corporate auditors may determine the auditing policies, method of investigating the conditions of the business and the assets of Advantest, and may resolve other matters concerning the execution of the corporate auditor's duties, prepare auditors' reports and give consent to proposals of the nomination of corporate auditors and accounting auditors.

Advantest currently has two (2) corporate auditors who satisfy the requirements of "independent" under the Code. Unlike NYSE Corporate Governance, under the Code, at least one of the corporate auditors of Advantest must be "independent", which is such person who was not a director, executive officer, manager, or employee of Advantest or any of its subsidiaries during the five-year period prior to such corporate auditor's election. Subsequent to the ordinary general meeting of stockholders to be held in June 2006, at least half of the corporate auditors will be

required to be persons who have not been a director, executive officer, manager, or employee of Advantest or any of its subsidiaries at any time prior to such corporate auditor's election. Corporate auditors may not at the same time be directors, executive officers, managers, or employees of Advantest or any of its subsidiaries.

4. Corporate Governance Guidelines

Unlike NYSE Corporate Governance, Advantest is not required to adopt or disclose corporate governance guidelines under Japanese laws and regulations, including the Code and the Securities and Exchange Law of Japan or stock exchange rules. However, Advantest is required to disclose policies and the present status of its corporate governance in its annual securities report and certain other disclosure documents in accordance with the regulations under the Securities and Exchange Law of Japan and regulations thereunder, and stock exchange rules in respect of timely disclosure.

5. Code of Business Conduct and Ethics

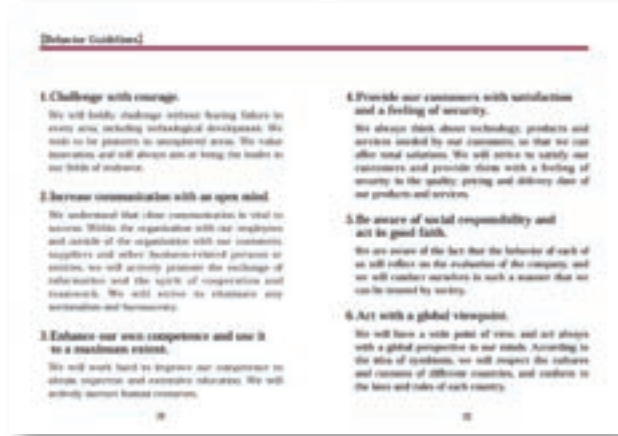
Unlike NYSE Corporate Governance, under Japanese law (including the Code and the Securities and Exchange Law of Japan), and stock exchange rules, Advantest is not required to adopt a code of business conduct and ethics for directors, officers and employees. Accordingly, Advantest is not required to adopt and disclose a code of business conduct and ethics for these individuals. However, Advantest has established a code of ethics consistent with Section 406 of the Sarbanes-Oxley Act.

6. Stockholder Approval of Equity Compensation Plans

Unlike NYSE Corporate Governance, in which material revisions to equity-compensation plans of the listed companies are subject to stockholder approval, pursuant to the Code, if Advantest desires to adopt an equity-compensation plan under which stock acquisition rights are granted on favorable terms to the recipient under the plan (except where such rights are granted to all of its

stockholders on a pro-rata basis at the same time), then Advantest must obtain stockholder approval by a "special resolution" of a general meeting of stockholders, where the quorum is one-third of the total number of voting rights and the approval of at least two-thirds of the voting rights represented at the meeting is required.

ADVANTEST BEHAVIOR NORMS (Code of Conduct)



Financial Section

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Cautionary Statements with Respect to Management's Discussion and Analysis of Financial Condition and Results of Operations

Please note that this Management's Discussion and Analysis of Financial Condition and Results of Operations is derived from and is qualified in its entirety by the more detailed information appearing in Items 5.A, 5.B, and 11 of the Company's annual report on Form 20-F, as filed with the U.S. Securities and Exchange Commission on June 29, 2004.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Overview

In fiscal 2003, Advantest's business segments are the automated test equipment business and measuring instruments business. Automated test equipment is used during the semiconductor production process to confirm that a semiconductor functions properly. Automated test equipment manufactured by Advantest consists of semiconductor test systems, test handlers, device interfaces and software. Advantest classifies its semiconductor test systems as equipment for either memory or non-memory semiconductors. Automated test equipment is Advantest's most significant business segment, accounting for 92.3% of net sales in fiscal 2003.

Measuring instruments are used primarily by manufacturers and network service providers to design, manufacture, check and adjust communications equipment and networks and other electronic devices and equipment. Advantest's measuring instruments primarily serve the wireless and fiber optic communications industries and the electronics industry.

Automated Test Equipment

The market for automated test equipment is highly cyclical and competitive. Demand for automated test equipment can vary significantly from year to year. Demand for automated test equipment depends, to a large extent, on:

- the level of demand and market prices for semiconductors worldwide and the resulting capital expenditure decisions of semiconductor manufacturers;
- advancements in semiconductor technology; and
- changes in semiconductor manufacturing processes.

During fiscal 2003, conditions affecting Advantest's automated test equipment business have been generally favorable due to an increase in capital expenditures in the semiconductor manufacturing industry, as stimulated by the substantial sales of digital consumer products including digital cameras and DVD recorders, decreased volatility of DRAM prices, and improved demand for personal computers.

In the automated test equipment business, flash memory testers in the memory tester market increased sales both domestically and overseas. In addition, DRAM testers experienced increased sales, particularly with respect to new models such as the T5593 high-speed memory tester for next generation double data rate, or DDR, memory and general purpose high-speed memory testers, which generated a high level of purchase inquiries both in Japan and overseas.

In the SoC and application specific semiconductor testers market, testers for SoC used in mobile phones and digital computer devices and testers for LCD driver integrated circuits maintained sales at high levels from the previous fiscal year, particularly in Japan and Taiwan. In addition, Advantest introduced new products aimed at the CCD and in-car device market.

As a result of the above, net sales of the automated test equipment business in fiscal 2003 increased by 89.4% to ¥160,855 million compared with fiscal 2002. This follows a 14.4% increase in fiscal 2002 compared to fiscal 2001. Advantest experienced an increase in net sales in the second half of fiscal 2003 of 86.2% compared to the first half of fiscal 2003. Overseas sales as a percentage of total sales in the automated test equipment business were 70.2% in fiscal 2003, as compared to 65.4% in the

previous fiscal year. Advantest believes that, despite the beginning of a recovery in the semiconductor market, there exists significant cyclicality and a continued lack of visibility regarding semiconductor demand.

While Advantest's net sales and financial conditions and results of operations in fiscal 2003 were affected by price pressure, results of operations showed significant increase over fiscal 2002. Net sales in the memory semiconductor test systems increased by 117.4% as compared to fiscal 2002, and net sales in the non-memory semiconductor test systems increased by 56.1% as compared to fiscal 2002. Advantest's best selling non-memory semiconductor test systems in fiscal 2003 were the T6300 series, which tests LCD driver integrated circuits used in LCD displays, and the T6500 series, Advantest's lower cost SoC semiconductor test system in its product line-up. Demand for these semiconductor test systems was driven by expanded production during 2002 and 2003 of digital consumer electronics that incorporate semiconductors, including wireless handsets, DVD recorders and digital cameras. These semiconductors typically are mass-produced and carry per unit market prices that are lower than high-end SoC semiconductors and high-bandwidth DRAM and SRAM products. Therefore, Advantest's customers that produce these semiconductors required less expensive semiconductor test systems in order to reduce their overall manufacturing costs.

Advantest believes that demand for its newer models was driven by customers' increased levels of capital expenditures towards the improvement of their production capacities, such as through investments relating to 300 millimeter wafers and to the next generation of memory devices. In most cases, the sales price of a semiconductor test system product line gradually decreases over its commercial life.

Advantest believes that price pressure with respect to automated test equipment tends to be strongest during periods when demand, in terms of volume, for semiconductors is increasing, but there exists pressure on the market price for semiconductors. Advantest faced significant price pressure in almost all of its product lines during fiscal 2001 and 2002. Advantest believes that, in fiscal 2003, there continued to exist significant price pressure. While the semiconductor industry experienced a recovery, increased competition in the market for digital consumer products and personal computers drove down prices of these goods, subsequently creating significant price pressure on its product lines. Advantest believes that despite this significant price pressure, Advantest was able to increase its competitiveness by bringing to market new models.

Measuring Instruments

Advantest net sales from measuring instruments increased in fiscal 2003 by 4.2% compared to fiscal 2002 following a 39.0% decrease in fiscal 2002 compared to fiscal 2001.

Demand for Advantest's measuring instruments is closely tied to growth rates in the wireless and fiber optic communications industries. In fiscal 2003, major contributing factors to the overall investment levels in communications infrastructure were:

- the recovery of the global economy,
- the slow pace of implementation of third-generation wireless communications networks in the U.S., Europe and Asia, and
- the completion of the build-out of third-generation wireless communications networks in Japan.

In 2003, Advantest believes that investment in third-generation wireless networks in Europe increased as compared to 2002. Advantest believes that in Japan, investment in third-generation wireless networks peaked in 2003. Advantest also believes that investment in wireless communications networks increased in Asia (excluding Japan) in 2003, primarily due to the commencement of services using third-generation wireless networks in Korea and increased investments in the mobile communications industry in the rest of Asia, particularly the People's Republic of China.

As a result of the above, net sales in the measuring instruments business increased marginally in fiscal 2003 by 4.2% as compared with the previous fiscal year. Overseas sales as a percentage of total sales in the measuring instruments business were 25.2% in fiscal 2003, as compared to 25.8% in fiscal 2002.

Advantest also sells general measuring instruments, demand for which is affected by the impact on electronics manufacturers of global consumer spending levels and economic growth. Demand for general measuring instruments in fiscal 2003 was positively affected by the increase in capital expenditures by Japanese electronics manufacturers and by the recovery of the market particularly in the second half of fiscal 2003. Beginning in April 2003, Advantest offers its customers general measuring instruments through a distribution agreement with its former subsidiary.

Advantest also sold products manufactured by Rohde & Schwarz GmbH & Co., KG in Japan. These products are predominantly used in designing and manufacturing high frequency devices and audio/video electronics. Sales of Rohde & Schwarz products constituted 22.6% of net sales of Advantest's measuring instruments business in fiscal 2002 and 19.0% in fiscal 2003. Advantest purchases products from Rohde & Schwarz at wholesale prices, and records the total sales price as net sales from the sale of measuring instruments as Advantest assumes the risks of ownership upon the purchase of products from Rohde & Schwarz. Sales of Rohde & Schwarz products fell by 10.7% in fiscal 2003 compared to fiscal 2002. As of April 2004, Advantest and Rohde & Schwarz GmbH & Co. KG of Germany terminated the distribution agreement under which Advantest was the exclusive distributor in Japan of signal generators, signal analyzers, spectrum analyzers, network analyzers and power meters manufactured by Rohde & Schwarz. An affiliate of Rohde & Schwarz will continue to sell Advantest's measuring instruments in Europe.

Since July 2002, Advantest's wholly-owned subsidiary, Advantest America Measuring Solutions, Inc. has been the sole distributor of measuring instruments in North America. In April 2004, Advantest commenced an arrangement with MetricTest, a company with a large sales and distribution network, under which MetricTest became a distributor of Advantest's measuring instruments in the U.S. Advantest's sales of measuring instruments in North America increased by approximately 1.2% in fiscal 2003 compared to fiscal 2002 and decreased by approximately 74.4% in fiscal 2002 compared to fiscal 2001. Advantest is focused on increasing its market share in the U.S.

Advantest continued to face a significant amount of price pressure on its measuring instrument products in fiscal 2003 primarily due to the slow recovery in demand in its customers' industries and excess inventory on the part of its competitors.

Research and Development

Research and development expenses represent a significant portion of Advantest's annual operating expenses. Advantest's research and development expenses were ¥26,674 million in fiscal 2001, ¥23,615 million in fiscal 2002, and ¥21,637 million in fiscal 2003, which resulted in research and development expenses as a percentage of net sales of 28.0% in fiscal 2001, 24.1% in fiscal 2002 and 12.4% in fiscal 2003. Advantest expects to continue to make substantial investments in research and development, with approximately ¥25.0 billion currently budgeted for research and development in fiscal 2004. The amount of Advantest's research and development budget for fiscal 2004 is subject to change based on its results of operations during fiscal 2004 and changes in its expectations for future periods.

Personnel

As of March 31, 2004, Advantest had a total of 3,544 full-time employees, an increase of 25 persons, or 0.7%, over March 31, 2003. During fiscal year 2002, there was a reduction in the number of Advantest employees by approximately 700 through a voluntary early retirement program offered to employees in Japan and lay-offs of employees in foreign locations and the sale of all of its shares of a subsidiary in Japan pursuant to a management buyout.

Advantest plans to continue its periodic recruitment of new graduates as part of its mid- to long-term growth strategy. Advantest expects that a majority of these new hires will join the research and development division or the customer support/service division to support the growth of Advantest's businesses. The remainder of these new hires is expected to join Advantest's sales or administrative divisions. The addition of these new hires may increase Advantest's future selling, general and administrative expenses and its research and development expenses.

Currency Fluctuations

Advantest is affected to some extent by fluctuations in foreign currency exchange rates. Advantest is principally exposed to fluctuations in the value of the Japanese yen against the U.S. dollar and, to a much lesser extent, other currencies of countries where Advantest does business. Advantest's consolidated financial statements, which are presented in Japanese yen, are affected by foreign currency exchange fluctuations through both translation risk and transaction risk.

Translation risk is the risk that Advantest's consolidated financial statements for a particular period or for a particular date will be affected by changes in the prevailing exchange rates of the currencies in which subsidiaries of Advantest prepare their financial statements against the Japanese yen. Even though the fluctuations of currencies against the Japanese yen can be substantial and, therefore, significantly impact comparisons with prior periods and among various geographic markets, the translation effect is a reporting consideration and does not reflect Advantest's underlying results of operations. Advantest does not hedge against translation risk.

Transaction risk is the risk that the currency structure of Advantest's costs and liabilities will deviate from the currency structure of sales proceeds and assets. Advantest produces substantially all of its products, including all semiconductor test systems, in Japan. A small portion of the components and parts used in Advantest's semiconductor test systems is purchased in currencies other than the yen, predominantly the U.S. dollar.

Advantest enters into foreign exchange forward contracts to address a portion of its transaction risk. This has reduced, but not eliminated, the effects of foreign currency exchange rate fluctuations against the Japanese yen, which in some years can be significant.

Generally, a weakening of the Japanese yen against other currencies, particularly the U.S. dollar, has a positive effect on Advantest's operating income and net income. A strengthening of the Japanese yen against other currencies, particularly the U.S. dollar, has the opposite effect. The Japanese yen generally strengthened against the U.S. dollar throughout fiscal 2003 and fiscal 2002, when compared to fiscal 2001.

Advantest's business is subject to risks associated with doing business internationally, and its business could be impacted by certain governmental, economic, fiscal, monetary or political policies or factors, including trade protection measures and import or export licensing requirements, that may materially affect, directly or indirectly, Advantest's operations or its future results.

U.S. GAAP Selected Consolidated Financial Data

The following selected financial data have been derived from Advantest's audited consolidated financial statements. These consolidated financial statements were prepared under accounting principles generally accepted in the United States, or U.S. GAAP. Advantest's U.S. GAAP audited consolidated financial statements for fiscal 2002 and fiscal 2003 were included in its Japanese Securities Reports filed with the Director of the Kanto Local Finance Bureau.

	Year ended March 31,					
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
	(in millions, except per share and share data)				(thousands, except per share and share data)	
Consolidated Statement of Income Data:						
Automated Test Equipment:						
Net sales	¥135,728	¥241,499	¥74,206	¥84,910	¥160,855	\$1,521,951
Operating income (loss)	40,723	86,413	(20,104)	465	48,562	459,476
Measuring Instruments:						
Net sales	22,850	35,013	21,038	12,830	13,363	126,436
Operating income (loss)	(68)	6,672	(7,826)	(7,939)	(9,053)	(85,656)
Total Company:						
Net sales	158,578	276,512	95,244	97,740	174,218	1,648,387
Operating income (loss)	34,802	84,905	(37,105)	(16,743)	30,960	292,932
Income (loss) before income taxes.....	33,494	86,333	(38,480)	(18,688)	28,878	273,233
Net income (loss).....	20,905	53,121	(23,906)	(12,994)	17,329	163,961
Net income (loss) per share:						
Basic	210.63	534.44	(240.38)	(131.99)	176.37	1.67
Diluted	209.99	533.24	(240.38)	(131.99)	176.02	1.67
Basic weighted average shares						
outstanding	99,249,719	99,394,909	99,453,203	98,445,111	98,250,830	98,250,830
Diluted weighted average shares						
outstanding	99,553,269	99,618,561	99,453,203	98,445,111	98,446,136	98,446,136
As of March 31,						
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
	(in millions)			(in thousands)		
Consolidated Balance Sheet Data:						
Total assets:						
Automated test equipment.....	¥163,215	¥230,389	¥146,790	¥138,114	¥200,833	\$1,900,208
Measuring instruments	21,730	34,528	20,000	18,332	10,838	102,545
Corporate.....	135,947	142,514	140,772	124,778	119,137	1,127,231
Total	320,892	407,431	307,562	281,224	330,808	3,129,984
Current installments of long-term debt	10,000	4,343	43	2,243	4,543	42,984
Long-term debt, less current installments	26,822	26,911	26,868	24,626	20,083	190,018
Stockholders' equity	214,594	267,929	240,716	210,663	221,768	2,098,287
Year ended March 31,						
	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
	(in millions, except percentages)				(in thousands)	
Other Data:						
Capital expenditures.....	¥6,649	¥12,280	¥13,254	¥7,564	¥5,621	\$53,184
Research and development expenses	23,481	28,541	26,674	23,615	21,637	204,721
Cash flows provided by operating activities	21,707	29,597	9,009	4,967	28,215	266,960
Cash flows used in investing activities.....	(9,080)	(16,130)	(18,573)	(8,419)	(5,070)	(47,970)
Cash flows used in financing activities	(1,775)	(10,266)	(9,463)	(14,488)	(6,376)	(60,327)
Operating margin ⁽¹⁾	21.95%	30.71%	(38.96)%	(17.13)%	(17.77)%	
Net income margin ⁽²⁾	13.18%	19.21%	(25.10)%	(13.29)%	(9.95)%	

- (1) Operating income as a percentage of net sales.
- (2) Net income as a percentage of net sales.

Dividends

Advantest normally pays cash dividends twice per year. Advantest's board of directors recommends dividends to be paid following the end of each fiscal year. This recommended dividend must then be approved by shareholders at the ordinary general meeting of shareholders usually held in June of each year. Immediately following approval of the dividend at the shareholders' meeting, Advantest pays the dividend to holders of record as of the preceding March 31. In addition to these year-end dividends, Advantest may pay interim dividends in the form of cash distributions from its retained earnings to its shareholders of record as of September 30 in each year by resolution of its board of directors and without shareholder approval. Advantest normally pays interim dividends in December.

The following table sets forth the dividends paid by Advantest for each of the periods shown. The periods shown are the six months ended on that date. The U.S. dollar equivalents for the dividends shown are based on the exchange rate in Japan on each record date shown.

<u>Six months ended/Record date</u>	<u>Dividend per Share</u>	
	<u>Yen</u>	<u>Dollars</u>
September 30, 1999	¥17	\$0.16
March 31, 2000	20	0.19
September 30, 2000	25	0.23
March 31, 2001	25	0.20
September 30, 2001	25	0.21
March 31, 2002	15	0.11
September 30, 2002	20	0.16
March 31, 2003	10	0.08
September 30, 2003	15	0.13
March 31, 2004	25	0.24

The payment and the amount of any future dividends are subject to the level of Advantest's future earnings, its financial condition and other factors, including statutory restrictions on the payment of dividends.

**ADVANTEST CORPORATION
AND SUBSIDIARIES**

Consolidated Balance Sheets

March 31, 2003 and 2004

Assets	Yen (Millions)		U.S. Dollars (Thousands)
	2003	2004	2004
Current assets:			
Cash and cash equivalents	¥ 87,338	101,146	\$ 957,006
Trade accounts receivable, less allowance for doubtful accounts of ¥1,240 million in 2003 and ¥2,464 million (\$23,313 thousand) in 2004	42,921	76,133	720,343
Inventories	34,995	49,423	467,622
Deferred tax assets	13,875	24,223	229,189
Other current assets	2,886	4,837	45,766
Total current assets	182,015	255,762	2,419,926
Investment securities	6,928	7,952	75,239
Property, plant and equipment, net	55,431	50,516	477,964
Deferred tax assets	27,827	9,599	90,822
Intangible assets, at cost, less accumulated amortization	5,291	3,756	35,538
Other assets	3,732	3,223	30,495
Total assets	¥ 281,224	330,808	\$ 3,129,984

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION
AND SUBSIDIARIES**

Consolidated Balance Sheets

March 31, 2003 and 2004

Liabilities and Stockholders' Equity	Yen (Millions)		U.S. Dollars (Thousands)
	2003	2004	2004
Current liabilities:			
Current installments of long-term debt	¥ 2,243	4,543	\$ 42,984
Trade accounts payable	10,787	38,214	361,567
Income taxes payable	1,949	3,845	36,380
Accrued expenses	6,443	8,939	84,578
Accrued warranty expenses	2,396	3,121	29,530
Deferred revenue	1,361	4,543	42,984
Other current liabilities	3,219	3,406	32,226
Total current liabilities	28,398	66,611	630,249
Long-term debt, excluding current installments	24,626	20,083	190,018
Accrued pension and severance cost	14,219	18,348	173,602
Other liabilities	3,006	3,411	32,274
Total liabilities	70,249	108,453	1,026,143
Minority interests	312	587	5,554
Stockholders' equity:			
Common stock,			
Authorized 220,000,000 shares; issued 99,783,385 shares in 2003 and 2004; outstanding 98,246,359 shares in 2003 and 98,275,640 shares in 2004	32,363	32,363	306,207
Capital surplus	32,973	32,973	311,978
Retained earnings	162,547	177,404	1,678,531
Accumulated other comprehensive income (loss)	(4,055)	(8,061)	(76,270)
Treasury stock, 1,537,026 shares in 2003 and 1,507,745 shares in 2004, at cost	(13,165)	(12,911)	(122,159)
Total stockholders' equity	210,663	221,768	2,098,287
Total liabilities and stockholders' equity	¥ 281,224	330,808	\$ 3,129,984

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION
AND SUBSIDIARIES**

Consolidated Statements of Income

Years ended March 31, 2002, 2003 and 2004

	Yen (Millions)			U.S. Dollars (Thousands)
	2002	2003	2004	2004
Net sales	¥ 95,244	97,740	174,218	\$ 1,648,387
Cost of sales	76,713	56,551	85,513	809,093
Gross profit	18,531	41,189	88,705	839,294
Research and development expenses	26,674	23,615	21,637	204,721
Selling, general and administrative expenses	28,962	34,317	36,108	341,641
Operating income (loss)	(37,105)	(16,743)	30,960	292,932
Other income (expense):				
Interest and dividends income	720	407	339	3,207
Interest expense	(533)	(490)	(469)	(4,438)
Minority interests	(83)	(107)	(214)	(2,025)
Equity in losses of affiliates	(794)	(109)	(117)	(1,107)
Other	(685)	(1,646)	(1,621)	(15,336)
	(1,375)	(1,945)	(2,082)	(19,699)
Income (loss) before income taxes	(38,480)	(18,688)	28,878	273,233
Income taxes	(14,574)	(5,694)	11,549	109,272
Net income (loss)	¥ (23,906)	(12,994)	17,329	\$ 163,961
	2002	2003	2004	2004
Net income (loss) per share:				
Basic	¥ (240.38)	(131.99)	176.37	\$ 1.67
Diluted	(240.38)	(131.99)	176.02	1.67

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION
AND SUBSIDIARIES**

Consolidated Statements of Stockholders' Equity

Years ended March 31, 2002, 2003 and 2004

	Yen (Millions)			U.S. Dollars (Thousands)
	2002	2003	2004	2004
Common stock:				
Balance at beginning of year	¥ 32,207	32,363	32,363	\$ 306,207
Warrants exercised	156	—	—	—
Balance at end of year	<u>32,363</u>	<u>32,363</u>	<u>32,363</u>	<u>306,207</u>
Capital surplus:				
Balance at beginning of year	32,802	32,973	32,973	311,978
Warrants exercised	171	—	—	—
Balance at end of year	<u>32,973</u>	<u>32,973</u>	<u>32,973</u>	<u>311,978</u>
Retained earnings:				
Balance at beginning of year	207,876	178,998	162,547	1,537,959
Net income (loss)	(23,906)	(12,994)	17,329	163,961
Cash dividends	(4,972)	(3,457)	(2,456)	(23,238)
Loss on disposal of treasury stock	—	—	(16)	(151)
Balance at end of year	<u>178,998</u>	<u>162,547</u>	<u>177,404</u>	<u>1,678,531</u>
Accumulated other comprehensive income (loss):				
Balance at beginning of year	(2,534)	(1,184)	(4,055)	(38,367)
Other comprehensive income (loss), net of tax	1,350	(2,871)	(4,006)	(37,903)
Balance at end of year	<u>(1,184)</u>	<u>(4,055)</u>	<u>(8,061)</u>	<u>(76,270)</u>
Treasury stock:				
Balance at beginning of year	(2,422)	(2,434)	(13,165)	(124,561)
Treasury stock purchased	(43)	(10,731)	(32)	(303)
Exercise of stock options	—	—	180	1,703
Decrease in treasury stock upon share exchange	—	—	105	993
Treasury stock sold	31	—	1	9
Balance at end of year	<u>(2,434)</u>	<u>(13,165)</u>	<u>(12,911)</u>	<u>(122,159)</u>
Total stockholders' equity	¥ <u>240,716</u>	<u>210,663</u>	<u>221,768</u>	\$ <u>2,098,287</u>
Disclosure of comprehensive income (loss):				
Net income (loss)	¥ (23,906)	(12,994)	17,329	\$ 163,961
Other comprehensive income (loss), net of tax	1,350	(2,871)	(4,006)	(37,903)
Total comprehensive income (loss)	¥ <u>(22,556)</u>	<u>(15,865)</u>	<u>13,323</u>	\$ <u>126,058</u>

See accompanying notes to consolidated financial statements.

**ADVANTEST CORPORATION
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Consolidated Statements of Cash Flows

Years ended March 31, 2002, 2003 and 2004

	Yen (Millions)			U.S. Dollars (Thousands)
	2002	2003	2004	2004
Cash flows from operating activities:				
Net income (loss)	¥ (23,906)	(12,994)	17,329	\$ 163,961
Adjustments to reconcile net income (loss) to net cash provided by operating activities:				
Depreciation and amortization	11,289	10,942	9,328	88,258
Deferred income taxes	(15,808)	(8,012)	6,703	63,421
Impairment loss on long-lived assets	-	-	3,030	28,669
Changes in assets and liabilities:				
Trade accounts receivable	72,427	(10,927)	(35,285)	(333,854)
Inventories	29,594	17,415	(14,570)	(137,856)
Trade accounts payable	(34,314)	6,963	29,190	276,185
Income taxes payable	(26,289)	1,878	1,997	18,895
Accrued expenses	(3,485)	(2,198)	2,518	23,824
Accrued warranty expenses	(3,127)	(440)	709	6,708
Deferred revenue	(1,374)	489	3,441	32,557
Accrued pension and severance cost	233	1,022	2,639	24,969
Other	3,769	829	1,186	11,222
Net cash provided by operating activities	9,009	4,967	28,215	266,959
Cash flows from investing activities:				
Proceeds from sale of available-for-sale marketable securities	-	-	323	3,056
Proceeds from sale of available-for-sale non-marketable securities	38	7	387	3,662
Purchases of investments in affiliates	(1,425)	-	-	-
Purchases of non-marketable securities	(2,228)	(1,000)	(1,288)	(12,187)
Proceeds from sale of property, plant and equipment	644	583	435	4,116
Purchases of intangible assets	(2,374)	(947)	(358)	(3,387)
Purchases of property, plant and equipment	(13,184)	(6,827)	(5,068)	(47,952)
Other	(44)	(235)	499	4,722
Net cash used in investing activities	(18,573)	(8,419)	(5,070)	(47,970)
Cash flows from financing activities:				
Principal payments on long-term debt	(4,342)	(42)	(3,811)	(36,058)
Payments to acquire treasury stock	(43)	(10,733)	(31)	(293)
Proceeds from issuance of shares	308	-	-	-
Dividends paid	(4,968)	(3,453)	(2,462)	(23,295)
Other	(418)	(260)	(72)	(681)
Net cash used in financing activities	(9,463)	(14,488)	(6,376)	(60,327)
Net effect of exchange rate changes on cash and cash equivalents	1,417	(654)	(2,961)	(28,016)
Net change in cash and cash equivalents	(17,610)	(18,594)	13,808	130,646
Cash and cash equivalents at beginning of year	123,542	105,932	87,338	826,360
Cash and cash equivalents at end of year	¥ 105,932	87,338	101,146	\$ 957,006
Supplemental data:				
Cash paid during the year for:				
Income taxes	¥ 27,731	507	1,936	\$ 18,318
Interest	529	490	473	4,475

See accompanying notes to consolidated financial statements.

ADVANTEST CORPORATION AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(1) Description of Business and Summary of Significant Accounting Policies and Practices

(a) Description of Business

Advantest Corporation (the “Company”) and its subsidiaries (hereafter collectively referred to as “Advantest”) are engaged in the design, manufacture, and sale of automated test equipment for semiconductors. Advantest has a diverse product line that meets the needs of semiconductor manufacturers, as well as assembly and testhouses worldwide, for sophisticated systems that test the operation and performance of different types of semiconductors. Advantest equips its automated test equipment with sophisticated, yet easy-to-use, operating systems and testing software. Advantest supports its products and customers through a worldwide customer service network staffed by trained technical and maintenance personnel.

Advantest also designs, manufactures, and sells standard and customized measuring instruments that are used by the communications, electric equipment and systems industries. These instruments are used by Advantest’s customers to improve time-to-market, lower costs of manufacturing and improve the quality of their products.

Advantest’s net sales in the years ended March 31, 2002, 2003 and 2004 were distributed as follows; Automated test equipment 77.9%, 86.9% and 92.3%, and Measuring instruments 22.1%, 13.1% and 7.7%, respectively.

The Company was incorporated on December 2, 1954 under the name of Takeda Riken Industry Co., Ltd. as a limited liability, joint-stock company in Japan under the Commercial Code of Japan. Takeda Riken Industry Co., Ltd. changed its legal name to Advantest Corporation in 1985.

Effective April 1, 2004, Advantest reclassified and regrouped its two reportable segments of “automated test equipment” and “measuring instruments” into the following three new segments; “semiconductor and component test system”, “mechatronics system” and “services, support and others”.

(b) Principles of Consolidation

The Company and its domestic subsidiaries maintain their records and prepare their financial statements in accordance with accounting principles generally accepted in Japan, and its foreign subsidiaries in conformity with the standards of the country of their domicile. Certain adjustments and reclassifications have been incorporated in the accompanying consolidated financial statements to present them in conformity with accounting principles generally accepted in the United States of America. These adjustments are not recorded in the statutory books of account.

The consolidated financial statements include the financial statements of the Company and its majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

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In December 2003, the Financial Accounting Standards Board (the “FASB”) issued FASB Interpretation No. 46 (revised December 2003) (“FIN 46R”), “Consolidation of Variable Interest Entities”, which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity.

FIN 46R replaces FASB Interpretation No. 46, “Consolidation of Variable Interest Entities”, which was issued in January 2003. For variable interest entities (“VIEs”) that must be consolidated under FIN 46R that were created before April 1, 2003, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interests of the VIE. Advantest was required to apply FIN 46R to the VIEs in consolidated financial statements as of March 31, 2004. The adoption of FIN 46R did not have a material effect on Advantest’s consolidated financial position and results of operations.

(c) *Cash Equivalents*

Cash equivalents consist of deposits and certificates of deposit with an initial maturity of three months or less from the date of purchase. For purposes of the consolidated statements of cash flows, Advantest considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

(d) *Allowance for Doubtful Accounts*

Advantest recognizes allowance for doubtful accounts to ensure that trade accounts receivable are not overstated due to uncollectability, which represents Advantest’s best estimate of the amount of probable credit losses in Advantest’s existing trade accounts receivable. Advantest periodically reviews its estimated allowances for doubtful accounts taking into account the customer’s payment history, assessing the customer’s current financial position and considering other information that is publicly available and the customer’s credit worthiness. Additional reviews are undertaken upon reports of significant changes in the financial condition of Advantest’s significant customers and the semiconductor industry.

(e) *Inventories*

Inventories are stated at the lower of cost or market. Cost is determined using the average cost method.

(f) *Investments in Affiliated Companies*

Investments in affiliated companies owned 20% to 50%, where Advantest exercises significant influence over their operating and financial policies, are accounted for on the equity method. All significant intercompany profits from affiliates have been eliminated.

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(g) *Investment Securities*

Investment securities at March 31, 2003 and 2004 consist of equity securities. Advantest classifies its equity securities in one of two categories: trading or available-for-sale. Trading securities are bought and held principally for the purpose of selling them in the near term. All equity securities not included in trading are classified as available-for-sale.

Trading and available-for-sale securities are recorded at fair value. Unrealized gains and losses on trading securities are included in earnings. Unrealized gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of accumulated other comprehensive income (loss) until realized.

A decline in the fair value of any available-for-sale security below cost that is deemed to be other than temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. Dividend income is recognized when earned.

On a continuous basis, but no less frequently than at the end of every half year, Advantest evaluates the cost basis of an available-for-sale security for possible impairment. Factors considered in assessing whether an indication of other than temporary impairment exists include: the degree of change in ratio of market prices per share to book value per share at date of evaluation compared to that of at date of acquisition, the financial condition and prospects of each investee company, industry conditions in which the investee company operates, the period of time the fair value of an available-for-sale security has been below the cost basis of the investment and other relevant factors.

Impairment to be recognized is measured based on the amount by which the carrying amount of the investment exceeds the fair value of the investment. Fair value is determined based on quoted market prices, projected discounted cash flow or other valuation techniques as appropriate.

The cost of a security sold or the amount reclassified out of accumulated other comprehensive income (loss) into earnings is determined by the specific identification method.

As of March 31, 2003 and 2004, all equity securities held by Advantest are classified as available-for-sale.

(h) *Derivative Financial Instruments*

Derivative financial instruments are accounted for under Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities", and SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities, an amendment of FASB Statement No. 133". SFAS No. 133, as amended, standardizes the accounting for derivative

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instruments, including certain derivative instruments embedded in other contracts. Under SFAS No. 133, as amended, entities are required to carry all derivative instruments in the consolidated balance sheets at fair value. The accounting for changes in the fair value (that is, gains or losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, on the reason for holding the instrument. If certain conditions are met, entities may elect to designate a derivative instrument as a hedge of exposures to changes in fair values, cash flows, or foreign currencies. If the hedged exposure is a fair value exposure, the gain or loss on the derivative instrument is recognized in earnings in the period of change together with the offsetting loss or gain on the hedged item attributable to the risk being hedged. If the hedged exposure is a cash flow exposure, the effective portion of the gain or loss on the derivative instrument is reported initially as a component of other comprehensive income (loss) and subsequently reclassified into earnings when the forecasted transaction affects earnings. Any amounts excluded from the assessment of hedge effectiveness as well as the ineffective portion of the gain or loss are reported in earnings immediately. If the derivative instrument is not designated as a hedge, the gain or loss is recognized in earnings in the period of change.

Advantest uses foreign exchange forward contracts to manage currency exposure, resulting from changes in foreign currency exchange rates, on trade accounts receivable. However, these contracts do not qualify for hedge accounting since they do not meet the hedging criteria specified by SFAS No. 133.

Foreign exchange forward contracts generally have maturities of several months. These contracts are used to reduce Advantest's risk associated with exchange rate movements, as gains and losses on these contracts are intended to offset exchange losses and gains on underlying exposures. Changes in fair value of foreign exchange forward contracts are recognized in earnings under the caption of other income (expense).

Advantest does not, as a matter of policy, enter into derivative transactions for the purpose of speculation.

(i) *Property, Plant and Equipment*

Property, plant and equipment is stated at cost. Equipment under capital leases is stated at the present value of minimum lease payments.

Depreciation is computed principally using the declining-balance method except for buildings and machinery and equipment under capital leases for the Company and its domestic subsidiaries and the straight-line method over estimated useful lives of the assets for foreign subsidiaries. Buildings are principally depreciated using the straight-line method over their estimated useful lives. Depreciation for machinery and equipment under capital leases is computed using the straight-line method over the lease term. The depreciation period for significant assets ranges from 15 years to 50 years for buildings, 4 years to 10 years for machinery and equipment, and 2 years to 5 years for furniture and fixtures.

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Depreciation expense was ¥8,938 million, ¥8,670 million and ¥7,563 million (\$71,558 thousand) in the years ended March 31, 2002, 2003 and 2004, respectively.

(j) *Intangible Assets and Other Assets*

Intangible assets principally consist of licenses, goodwill and computer software for internal-use, including computer software under capital leases. Other assets consist of investments, security deposits and prepaid expenses, of which no one individual item was material to the consolidated financial statements of Advantest.

Advantest capitalizes certain costs incurred to purchase or develop software for internal-use. Costs incurred to develop software for internal-use are expensed as incurred during the preliminary project stage, which includes costs for making strategic decisions about the project, determining performance and system requirements and vendor demonstration cost. Costs incurred subsequent to the preliminary project stage through implementation are capitalized. Advantest also expenses costs incurred for internal-use software projects in the post implementation stage such as costs for training and maintenance.

Costs incurred to develop software to be included with and sold as part of the Company's automated test equipment are capitalized subsequent to the attainment of technological feasibility in accordance with the provisions of SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed". To date, costs incurred subsequent to the attainment of technological feasibility have been insignificant and, therefore, have been charged directly to expense. Costs incurred prior to reaching technological feasibility are expensed as incurred.

The cost of software is amortized straight-line over the estimated useful life, which is generally five years. The cost of computer software under capital leases is amortized straight-line over the lease term. The remaining weighted average life of software at March 31, 2004 is 1.7 years.

Business combinations are accounted for using the purchase method in accordance with SFAS No. 141, "Business Combinations". SFAS No. 141 establishes certain criteria for the recognition of intangible assets separately from goodwill. Under SFAS No. 142, "Goodwill and Other Intangible Assets", goodwill is no longer amortized, but instead is tested for impairment at least annually. Intangible assets with definite useful lives are amortized over their respective estimated useful lives and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Any recognized intangible assets determined to have an indefinite useful life are not amortized, but instead are tested for impairment until its life is determined to be no longer indefinite.

Advantest performs its annual impairment test at the end of each year. Advantest completed its annual impairment test at the end of the years ended March 31, 2003 and 2004, with no indication of impairment identified.

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(k) *Impairment of Long-Lived Assets*

Advantest accounts for long-lived assets in accordance with the provisions of SFAS No. 144. SFAS No. 144 requires that long-lived assets and certain identifiable intangibles with definite useful lives be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

As one of the independent cash flow-generating units, measuring instruments' assets group reported operating losses for two consecutive years, and future operating results of the assets group is not expected to be profitable, due to the customers' continuously inactive industries such as wireless communications. Therefore, Advantest concluded that the carrying amount of the assets group was higher than the undiscounted net cash flows expected to result from the use and eventual disposition of the assets group. Accordingly, Advantest adjusted its carrying amount to the recoverable amount. The recoverable amount was based on the observable market price and Advantest's cash flow analysis. Total recognized impairment loss is ¥3,030 million (\$28,669 thousand) and is included in selling, general and administrative expenses for the year ended March 31, 2004. The impairment loss consists of ¥1,226 million (\$11,600 thousand) from buildings, ¥175 million (\$1,656 thousand) from machinery and equipment, ¥683 million (\$6,462 thousand) from furniture and fixtures, ¥681 million (\$6,443 thousand) from software, and ¥265 million (\$2,508 thousand) from other assets.

(l) *Accrued Warranty Expenses*

Advantest's products are generally subject to warranty, and Advantest provides an allowance for such estimated costs when product revenue is recognized. To provide for future repairs during warranty periods, estimated repair expenses over the warranty period are accrued based on the historical ratio of actual repair expenses to corresponding sales.

(m) *Accrued Pension and Severance Cost*

The Company and certain of its domestic subsidiaries have retirement and severance defined benefit plans covering substantially all of their employees. The benefits are based on years of service and the employee's compensation and vest after one year of service. Prior service cost that results from amendments to the plan is amortized over the average remaining service period of the employees expected to receive benefits. Unrecognized net gain and loss is also amortized over the average remaining service period of the employees expected to receive benefits. See note (16) to the consolidated financial statements for further discussion.

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(n) Revenue Recognition

Automated test equipment

Revenue from sales of automated test equipment which require installation work is recognized when the related installation work is completed and the equipment is accepted by the customer. Revenue from sales of parts for automated test equipment such as backup boards, which do not require installation work by Advantest, is recognized upon shipment if the terms of the sale are free on board (“FOB”) shipping point or upon delivery if the terms are FOB destination which coincide with the passage of title and risk of loss.

Measuring instruments

Revenue from sales of measuring instruments which do not require installation work by Advantest is recognized upon shipment if the terms of the sale are FOB shipping point and upon delivery if the terms are FOB destination. Revenue from sales of measuring instruments which require installation work is recognized when the related installation work is completed and the instrument is accepted by the customer. Advantest utilizes distributors to market certain of its measuring instruments which do not require installation work. Advantest recognizes revenues from sales of measuring instruments to distributors upon shipment or delivery of instruments to the distributors which coincide with the passage of title and risk of loss.

Service fee

Revenue from fixed-price, long-term service contracts is recognized on the straight-line basis over the contract term.

Operating lease

Revenue from operating leases is recognized on the straight-line basis over the lease term.

Multiple deliverables

Multiple Deliverables are accounted for under the Emerging Issues Task Force Issue No. 00-21 (“EITF 00-21”), “Revenue Arrangements with Multiple Deliverables”. EITF 00-21 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting. In applying EITF 00-21, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary. EITF 00-21 also addresses how consideration should be measured and allocated to the separate units of accounting in the arrangement.

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Advantest enters into certain revenue arrangements with multiple deliverables, which include combination of automated test equipment, installation and warranty services. As those installation or warranty services are not interchangeable to be provided by Advantest or other parties and as fair values of those services are not determinable, these elements are not considered to qualify for separate accounting under EITF 00-21 and accordingly Advantest treats them as a single unit of accounting.

Advantest adopted the provisions of EITF 00-21 for the transactions entered into on and after July 1, 2003. The effect on Advantest's consolidated financial statements was insignificant.

(o) *Selling, General and Administrative Expenses*

Shipping and handling costs totaled ¥927 million, ¥774 million and ¥1,011 million (\$9,566 thousand) for the years ended March 31, 2002, 2003 and 2004, respectively, and are included in selling, general and administrative expenses in the consolidated statements of income.

(p) *Research and Development*

Research and development costs are expensed as incurred.

(q) *Stock-Based Compensation*

Advantest applies the intrinsic value-based method of accounting prescribed by APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations including FASB Interpretation No. 44, "Accounting for Certain Transactions Involving Stock Compensation, an Interpretation of APB Opinion No. 25", in accounting for its stock-based compensation plans. As such, stock-based compensation cost would be recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation", as amended by SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of FASB Statement No. 123", establishes accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, Advantest has elected to continue to apply the intrinsic value-based method of accounting described above, and has adopted the disclosure requirements of SFAS No. 123, as amended.

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Had Advantest determined stock-based compensation cost using the fair value-based method at the grant date for its stock options and warrants under SFAS No. 123, Advantest's net income (loss) and net income (loss) per share would have been reduced to the pro forma amounts indicated below:

	Yen			U.S. Dollars
	(Millions) except for per share data			(Thousands) except for per share data
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
Net income (loss):				
As reported	¥ (23,906)	(12,994)	17,329	\$ 163,961
Deduct: stock-based employee compensation cost	—	<u>(2,592)</u>	<u>(1,963)</u>	<u>(18,574)</u>
Pro forma	¥ <u>(23,906)</u>	<u>(15,586)</u>	<u>15,366</u>	\$ <u>145,387</u>
Basic net income (loss) per share:				
As reported	¥ (240.38)	(131.99)	176.37	\$ 1.67
Pro forma	(240.38)	(158.32)	156.39	1.48
Diluted net income (loss) per share:				
As reported	¥ (240.38)	(131.99)	176.02	\$ 1.67
Pro forma	(240.38)	(158.32)	156.08	1.48

No compensation expense was reflected in net income for the years ended March 31, 2002, 2003 and 2004.

The per share weighted average fair value of stock options and warrants granted during the years ended March 31, 2003 and 2004 was ¥3,526 and ¥2,570 (\$24) on the date of grant using the Black Scholes option-pricing model with the following weighted-average assumptions: the year ended March 31, 2003 - expected dividend yield of 0.5%, risk-free interest rate of 0.6%, volatility of 67.8%, and an expected life of 4 years; the year ended March 31, 2004 - expected dividend yield of 0.8%, risk-free interest rate of 0.6%, volatility of 69.5%, and an expected life of 4 years.

(r) Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

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(s) *Net Income (Loss) per Share*

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of shares outstanding during the year. Diluted net income per share is calculated by dividing net income by the sum of the weighted average number of shares plus additional shares that would have been outstanding if potential dilutive shares had been issued for granted stock options and warrants.

At March, 31, 2002, 2003 and 2004, the Company had outstanding stock options and warrants exercisable into 739,200, 1,113,800 and 329,500 shares of common stock, respectively, which could potentially dilute net income per share in future periods.

(t) *Translation of Foreign Financial Statements*

Foreign currency financial statements have been translated in accordance with SFAS No. 52, "Foreign Currency Translation". Under SFAS No. 52, the balance sheet accounts of non-Japanese subsidiaries, which are denominated in currencies other than the Japanese yen, are translated at rates of exchange prevailing at end of year. Revenue and expense accounts are translated at average rates of exchange in effect during the year. Resulting translation adjustments are included as a separate component of other comprehensive income (loss).

(u) *Foreign Currency Transactions*

Assets and liabilities denominated in foreign currencies are translated at the applicable current rates on the balance sheet date. All revenue and expenses associated with foreign currencies are converted at the rates of exchange prevailing when such transactions occur. The resulting exchange gains or losses are reflected in other income (expense) in the accompanying consolidated statements of income.

(v) *Use of Estimates*

Management of Advantest has made a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statement and the reported amounts of revenues and expenses during the period to prepare these consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. Significant items subject to such estimates and assumptions include valuation allowances for trade accounts receivables, inventories and deferred tax assets, and assets and obligations related to employees retirement and severance plans. Actual results could differ from those estimates.

(w) *Reclassifications*

Certain reclassifications have been made to the prior years' consolidated financial statements to conform presentation used for the year ended March 31, 2004.

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(2) U.S. Dollar Amounts

U.S. dollar amounts presented in the consolidated financial statements and related notes are included solely for the convenience of the reader. These translations should not be construed as representations as to what the yen amounts actually represent, or have been or could be converted into, U.S. dollars. For this purpose, the rate of ¥105.69 per U.S.\$1, the approximate current exchange rate at March 31, 2004, was used for the translation of the accompanying financial results of Advantest as of and for the year ended March 31, 2004.

(3) Allowance for Doubtful Accounts

Changes in the allowance for doubtful accounts are as follows:

		Yen (Millions)			U.S. Dollars (Thousands)	
		<u>2002</u>	<u>2003</u>	<u>2004</u>		<u>2004</u>
Balance at beginning of year	¥	261	533	1,240	\$	11,732
Amount utilized		(9)	(103)	(17)		(161)
Reversal of doubtful accounts		—	—	(212)		(2,006)
Provision for doubtful accounts		<u>281</u>	<u>810</u>	<u>1,453</u>		<u>13,748</u>
Balance at end of year	¥	<u>533</u>	<u>1,240</u>	<u>2,464</u>	\$	<u>23,313</u>

(4) Inventories

Inventories are composed of the following:

		Yen (Millions)		U.S. Dollars (Thousands)	
		<u>2003</u>	<u>2004</u>		<u>2004</u>
Finished goods	¥	8,863	14,819	\$	140,212
Work in process		16,595	25,433		240,637
Raw materials		<u>9,537</u>	<u>9,171</u>		<u>86,773</u>
	¥	<u>34,995</u>	<u>49,423</u>	\$	<u>467,622</u>

Advantest recognized inventory write-downs in cost of sales of ¥2,553 million and ¥2,126 million (\$20,115 thousand) for the years ended March 31, 2003 and 2004, respectively. The write-downs of ¥2,126 million (\$20,115 thousand) for the year ended March 31, 2004 mainly consist of ¥1,593 million (\$15,072 thousand) derived from discontinuation of products lines, including those lines that are being replaced by new product lines.

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(5) Property, Plant and Equipment

Property, plant and equipment is composed of the following:

		Yen (Millions)			U.S. Dollars (Thousands)
		<u>2003</u>	<u>2004</u>		<u>2004</u>
Land	¥	18,666	19,174	\$	181,417
Buildings		50,780	49,368		467,101
Machinery and equipment		25,446	24,660		233,324
Furniture and fixtures		26,638	21,200		200,587
Construction in progress		<u>929</u>	<u>647</u>		<u>6,122</u>
		122,459	115,049		1,088,551
Less accumulated depreciation		<u>67,028</u>	<u>64,533</u>		<u>610,587</u>
	¥	<u>55,431</u>	<u>50,516</u>	\$	<u>477,964</u>

(6) Goodwill and Other Intangible Assets

The components of acquired intangible assets excluding goodwill at March 31, 2003 and 2004 were as follows:

		Yen (Millions)			
		<u>2003</u>		<u>2004</u>	
		Gross carrying amount	Accumulated amortization	Gross carrying amount	Accumulated amortization
Intangible assets subject to amortization:					
Software	¥	9,271	5,446	¥	5,852
Other		<u>1,277</u>	<u>681</u>		<u>1,464</u>
Total	¥	<u>10,548</u>	<u>6,127</u>	¥	<u>7,316</u>

		U.S. dollars (Thousands)	
		<u>2004</u>	
		Gross carrying amount	Accumulated amortization
Intangible assets subject to amortization:			
Software	\$	55,369	37,184
Other		<u>13,852</u>	<u>12,130</u>
Total	\$	<u>69,221</u>	<u>49,314</u>

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Intangible assets not subject to amortization at March 31, 2003 and 2004 were insignificant.

Aggregate amortization expense for the years ended March 31, 2002, 2003 and 2004 was ¥2,177 million, ¥2,292 million and ¥1,765 million (\$16,700 thousand), respectively. Estimated amortization expense for the next five years ending March 31 is: ¥1,152 million (\$10,900 thousand) in 2005, ¥556 million (\$5,261 thousand) in 2006, ¥244 million (\$2,309 thousand) in 2007, ¥96 million (\$908 thousand) in 2008, and ¥42 million (\$397 thousand) in 2009, respectively.

Changes in the carrying amount of goodwill for the year ended March 31, 2003 and 2004 were as follows:

	Yen (Millions) <u>2003</u>	Yen (Millions) <u>2004</u>	U.S. dollars (Thousands) <u>2004</u>
Balance at beginning of year	¥ 645	¥ 645	\$ 6,103
Acquisition during the year	<u>—</u>	<u>781</u>	<u>7,389</u>
Balance at end of year	¥ <u>645</u>	¥ <u>1,426</u>	\$ <u>13,492</u>

All amount of this goodwill is allocated to Automated test equipment segment.

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Advantest adopted the provision of SFAS No. 142, "Goodwill and Other Intangible Assets", as of April 1, 2002. Reconciliation of "net income (loss)" and "net income (loss) per share" to the amounts adjusted for the exclusion of goodwill amortization for the years ended March 31, 2002, 2003 and 2004 are as follows:

	Yen (Millions) except for per share data			U.S. dollars (Thousands) except for per share data
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
Net income (loss):				
Reported net income (loss)	¥ (23,906)	(12,994)	17,329	\$ 163,961
Add back: goodwill amortization (net of tax)	<u>122</u>	<u>—</u>	<u>—</u>	<u>—</u>
Adjusted net income (loss)	¥ <u>(23,784)</u>	<u>(12,994)</u>	<u>17,329</u>	\$ <u>163,961</u>
Basic net income (loss) per share:				
Reported basic net income (loss) per share	¥ (240.38)	(131.99)	176.37	\$ 1.67
Add back: goodwill amortization (net of tax)	<u>1.24</u>	<u>—</u>	<u>—</u>	<u>—</u>
Adjusted net income (loss) per share	¥ <u>(239.14)</u>	<u>(131.99)</u>	<u>176.37</u>	\$ <u>1.67</u>
Diluted net income (loss) per share:				
Reported diluted net income (loss) per share:	¥ (240.38)	(131.99)	176.02	\$ 1.67
Add back: goodwill amortization (net of tax)	<u>1.24</u>	<u>—</u>	<u>—</u>	<u>—</u>
Adjusted diluted net income (loss) per share:	¥ <u>(239.14)</u>	<u>(131.99)</u>	<u>176.02</u>	\$ <u>1.67</u>

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(7) Investment Securities

Marketable securities consist of equity securities. The acquisition cost, gross unrealized gains, gross unrealized losses and fair value at March 31, 2003 and 2004 were as follows:

		<u>Yen (Millions)</u>			
		<u>2003</u>			
		<u>Acquisition</u>	Gross	Gross	
		<u>cost</u>	<u>unrealized</u>	<u>unrealized</u>	<u>Fair value</u>
			<u>gains</u>	<u>losses</u>	
Noncurrent:					
Available-for-sale:					
Equity securities	¥	1,173	182	28	1,327

		<u>Yen (Millions)</u>			
		<u>2004</u>			
		<u>Acquisition</u>	Gross	Gross	
		<u>cost</u>	<u>unrealized</u>	<u>unrealized</u>	<u>Fair value</u>
			<u>gains</u>	<u>losses</u>	
Noncurrent:					
Available-for-sale:					
Equity securities	¥	2,238	2,093	1	4,311

		<u>U.S. dollars (Thousands)</u>			
		<u>2004</u>			
		<u>Acquisition</u>	Gross	Gross	
		<u>cost</u>	<u>unrealized</u>	<u>unrealized</u>	<u>Fair value</u>
			<u>gains</u>	<u>losses</u>	
Noncurrent:					
Available-for-sale:					
Equity securities	\$	21,175	19,803	9	40,789

Gross realized gains and losses for the years ended March 31, 2002, 2003 and 2004 were as follows:

		<u>Yen (Millions)</u>		<u>Yen (Millions)</u>	
		<u>2002</u>		<u>2003</u>	
		Gross	Gross	Gross	Gross
		<u>realized</u>	<u>realized</u>	<u>realized</u>	<u>realized</u>
		<u>gains</u>	<u>losses</u>	<u>gains</u>	<u>losses</u>
Noncurrent:					
Available-for-sale:					
Equity securities	¥	71	1,265	¥	—
					1,876

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	<u>Yen (Millions)</u>		<u>U.S. dollars (Thousands)</u>	
	<u>2004</u>		<u>2004</u>	
	Gross realized <u>gains</u>	Gross realized <u>losses</u>	Gross realized <u>gains</u>	Gross realized <u>losses</u>
Noncurrent:				
Available-for-sale:				
Equity securities	¥	224	1,455	\$ 2,119 13,767

Gross realized gains and losses are included in “other income (expense)” in the consolidated statements of income, and “other” in net cash provided by operating activities in the consolidated statements of cash flows.

Gross unrealized losses on available-for-sale equity securities and the fair value of the related securities, aggregated by length of time that individual securities have been in a continuous unrealized loss position, at March 31, 2004, were as follows:

	<u>Yen (Millions)</u>			
	<u>2004</u>			
	<u>Less than 12 months</u>		<u>12 months or longer</u>	
	<u>Fair value</u>	Gross unrealized <u>losses</u>	<u>Fair value</u>	Gross unrealized <u>losses</u>
Noncurrent:				
Available-for-sale:				
Equity securities	¥	—	—	16 1

	<u>U.S. dollars (Thousands)</u>			
	<u>2004</u>			
	<u>Less than 12 months</u>		<u>12 months or longer</u>	
	<u>Fair value</u>	Gross unrealized <u>losses</u>	<u>Fair value</u>	Gross unrealized <u>losses</u>
Noncurrent:				
Available-for-sale:				
Equity securities	\$	—	—	151 9

Advantest maintains long-term investment securities, issued by nonpublic companies, which are recorded at cost. In addition, the fair values of such securities were not readily determinable, the carrying amount of which is ¥5,010 million and ¥3,641 million (\$34,450 thousand) at March 31, 2003 and 2004, respectively.

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(8) Derivative Financial Instruments

Derivative financial instruments are utilized by Advantest primarily to reduce foreign currency exchange risk. Advantest does not hold or issue financial instruments for trading purposes. Advantest generally does not require or place collateral for these financial instruments.

Derivative financial instruments contain an element of risk in the event the counterparties are unable to meet the terms of the agreements. However, Advantest minimizes risk exposure by limiting the counterparties to major international banks and financial institutions meeting established credit guidelines. Management of Advantest does not expect any counterparty to default on its obligations and, therefore, does not expect to incur any losses due to counterparty default on its obligations.

Advantest had no outstanding foreign exchange forward contracts at March 31, 2003. At March 31, 2004, Advantest had foreign exchange forward contracts to exchange currencies among Japanese yen, U.S. dollars and Euro. The notional amounts of these contracts were ¥8,736 million (\$82,657 thousand) at March 31, 2004. The fair values of these contracts at March 31, 2004 are shown in note (9) to the consolidated financial statements. These contracts do not qualify for hedge accounting since they do not meet the hedging criteria specified by SFAS No. 133. Changes in the fair values are recognized in earnings under the caption of other income (expense).

(9) Fair Value of Financial Instruments

The following table presents the carrying amounts and estimated fair values of Advantest's financial instruments at March 31, 2003 and 2004. Fair value estimates are made at a specific point in time based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

	<u>Yen (Millions)</u>			
	<u>2003</u>		<u>2004</u>	
	<u>Carrying amount</u>	<u>Fair value</u>	<u>Carrying amount</u>	<u>Fair value</u>
Financial assets:				
Investment securities for which it is:				
Practicable to estimate fair value	¥ 1,327	1,327	4,311	4,311
Not practicable to estimate fair value	5,010	—	3,641	—
Foreign exchange forward contracts	—	—	91	91
Financial liabilities:				
Foreign exchange forward contracts	—	—	105	105
Long-term debt including current installments	26,869	27,415	24,626	25,223

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	<u>U.S. Dollars (Thousands)</u>	
	<u>2004</u>	
	<u>Carrying amount</u>	<u>Fair value</u>
Financial assets:		
Investment securities for which it is:		
Practicable to estimate fair value	\$ 40,789	40,789
Not practicable to estimate fair value	34,450	—
Foreign exchange forward contracts	861	861
Financial liabilities:		
Foreign exchange forward contracts	993	993
Long-term debt including current installments	233,002	238,651

The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions. And the carrying amounts of foreign exchange forward contracts are included in other current assets and other current liabilities.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

Cash and cash equivalents, trade accounts receivable, other current assets, trade accounts payable, and accrued expenses (nonderivatives): The carrying amounts approximate fair value because of the short maturity of these instruments.

Investment securities: The fair values of equity investments are based on quoted market prices at the reporting date for those investments. It was not practicable to estimate the fair value of nonpublic companies; those investments are carried at cost.

Long-term debt: The fair value of Advantest's long-term debt is estimated by discounting the future cash flows of each instrument at rates currently offered to Advantest for similar debt instruments of comparable maturities by financial institutions.

Foreign exchange forward contracts: The fair value of foreign exchange forward contracts are estimated by obtaining quotes from financial institution.

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(10) Leases - Lessor

Advantest provides leases that enable its customers to acquire automated test equipment. All leases are classified as operating leases. Lease terms range from 1 year to 5 years, and certain of the lease agreements are cancelable. The gross amount of machinery and equipment and the related accumulated depreciation on operating leases as of March 31, 2003 and 2004 were as follows:

		Yen (Millions)			U.S. Dollars (Thousands)	
		<u>2003</u>	<u>2004</u>		<u>2004</u>	
Machinery and equipment	¥	8,174	5,450	\$	51,566	
Less accumulated depreciation		<u>3,101</u>	<u>2,398</u>		<u>22,689</u>	
	¥	<u>5,073</u>	<u>3,052</u>	\$	<u>28,877</u>	

Depreciation of machinery and equipment held under operating leases are included with depreciation expense. These assets are included in property, plant and equipment.

Future minimum lease income from equipment on noncancelable operating leases as of March 31, 2004 is as follows:

<u>Year ending March 31</u>		Yen (Millions)			U.S. Dollars (Thousands)	
2005	¥	967		\$	9,149	
2006		346			3,274	
2007		186			1,760	
2008		88			833	
2009		<u>18</u>			<u>170</u>	
Total minimum lease income	¥	<u>1,605</u>		\$	<u>15,186</u>	

(11) Leases - Lessee

Advantest is obligated under various capital leases for certain machinery and equipment and software that expire at various dates during the next three years. At March 31, 2003 and 2004, the gross amount of machinery and equipment and software, and the related accumulated depreciation and amortization recorded under capital leases were as follows:

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		Yen (Millions)			U.S. Dollars (Thousands)
		<u>2003</u>	<u>2004</u>		<u>2004</u>
Machinery and equipment	¥	559	142	\$	1,344
Software		<u>245</u>	<u>22</u>		<u>208</u>
		804	164		1,552
Less accumulated depreciation and amortization		<u>678</u>	<u>138</u>		<u>1,306</u>
	¥	<u>126</u>	<u>26</u>	\$	<u>246</u>

Depreciation and amortization of assets held under capital leases are included with depreciation and amortization expense. Machinery and equipment is included in property, plant and equipment and software is included in intangible assets.

Future minimum capital lease payments as of March 31, 2004 are as follows:

<u>Year ending March 31</u>		Yen (Millions)		U.S. Dollars (Thousands)
2005	¥	24	\$	228
2006		5		47
2007		<u>1</u>		<u>9</u>
Total minimum lease payments		30		284
Less amount representing interest (at rates ranging from 2.19% to 2.91%)		<u>2</u>		<u>19</u>
Present value of net minimum capital lease payments		28		265
Less current installments		<u>23</u>		<u>218</u>
Obligations under capital leases, excluding current installments	¥	<u>5</u>	\$	<u>47</u>

Obligations under capital leases is included in “other current liabilities” and “other liabilities” in the consolidated balance sheets.

Advantest also has several noncancelable operating leases, primarily for office space and office equipment that expire over the next five years. Rent expense, including rental payments for cancelable leases, for the years ended March 31, 2002, 2003 and 2004 was ¥2,301 million, ¥1,638 million and ¥1,352 million (\$12,792 thousand), respectively.

Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of March 31, 2004 are as follows:

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<u>Year ending March 31</u>	<u>Yen (Millions)</u>	<u>U.S. Dollars (Thousands)</u>
2005	¥ 320	\$ 3,027
2006	279	2,640
2007	216	2,044
2008	62	587
2009	<u>7</u>	<u>66</u>
Total minimum lease payments	¥ <u>884</u>	\$ <u>8,364</u>

Short-Term and Long-Term Debt

Long-term debt at March 31, 2003 and 2004 consists of the following:

	<u>Yen (Millions)</u>		<u>U.S. Dollars (Thousands)</u>
	<u>2003</u>	<u>2004</u>	<u>2004</u>
Partially secured borrowings by mortgage of property, plant and equipment, due 2003 to 2008 with annual interest rates ranging from 1.05% to 4.125% in 2003 and 2004	¥ 169	126	\$ 1,192
Unsecured 1.05% bonds, due January 27, 2004	2,200	—	—
Unsecured 0.88% bonds, due February 5, 2005	4,500	4,500	42,577
Unsecured 1.88% bonds, due December 14, 2005	<u>20,000</u>	<u>20,000</u>	<u>189,233</u>
Total long-term debt	26,869	24,626	233,002
Less current installments	<u>2,243</u>	<u>4,543</u>	<u>42,984</u>
Long-term debt, excluding current installments	¥ <u>24,626</u>	<u>20,083</u>	\$ <u>190,018</u>

Unsecured 1.05% bonds and 0.88% bonds were issued with detachable warrants in connection with one of Advantest's stock-based compensation plans. As described in note (15) to the consolidated financial statements, upon issuance of each bond, the Company purchased all detachable warrants from the underwriter and distributed such warrants to the directors and selected employees of the Company and its subsidiaries. No gain or loss was recognized on the sale and purchase of the warrants. For financial reporting purposes, these transactions were accounted for as the issuance of debt to third parties and separately as the issuance of warrants to directors and employees.

At March 31, 2004, property, plant and equipment with a carrying amount of ¥403 million (\$3,813 thousand) was pledged as collateral for certain debt obligations in the amount of ¥38 million (\$360 thousand).

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The aggregate maturities of long-term debt for each of the five years subsequent to March 31, 2004 are as follows:

<u>Year ending March 31</u>	<u>Yen (Millions)</u>	<u>U.S. Dollars (Thousands)</u>
2005	¥ 4,543	\$ 42,984
2006	20,043	189,639
2007	30	284
2008	<u>10</u>	<u>95</u>
Total long-term debt	¥ <u>24,626</u>	\$ <u>233,002</u>

Advantest had ¥6,679 million (\$63,194 thousand) in lines of credit available for immediate borrowing and the interest rates were prime rate plus 0.50% - 0.75 % as of March 31, 2004. None of them were utilized as of March 31, 2004.

(13) Income Taxes

The components of income (loss) before income taxes and provision for income taxes as shown in the consolidated statements of income are as follows:

	<u>2002</u>	<u>Yen (Millions) 2003</u>	<u>2004</u>	<u>U.S. Dollars (Thousands) 2004</u>
Income (loss) before income taxes:				
The Company and domestic subsidiaries	¥ (41,956)	(18,581)	20,096	\$ 190,141
Foreign subsidiaries	<u>3,476</u>	<u>(107)</u>	<u>8,782</u>	<u>83,092</u>
	¥ <u>(38,480)</u>	<u>(18,688)</u>	<u>28,878</u>	\$ <u>273,233</u>
Provision for income taxes:				
Current:				
The Company and domestic subsidiaries	¥ 97	624	1,356	\$ 12,830
Foreign subsidiaries	1,137	1,694	3,490	33,021
Deferred:				
The Company and domestic subsidiaries	(15,905)	(6,939)	6,749	63,856
Foreign subsidiaries	<u>97</u>	<u>(1,073)</u>	<u>(46)</u>	<u>(435)</u>
	¥ <u>(14,574)</u>	<u>(5,694)</u>	<u>11,549</u>	\$ <u>109,272</u>

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The Company and its domestic subsidiaries are subject to a corporate tax of 30%, an inhabitant tax of between 18.1% and 20.7% and a deductible business tax of between 9.6% and 10.1%, which in the aggregate resulted in a statutory income tax rate of approximately 42%. Amendments to the Japanese tax regulations were enacted on March 24, 2003. As a result of these amendments, the statutory income tax rate was reduced from approximately 42% to 40% effective from the year beginning April 1, 2004. Consequently, the statutory tax rate is to be lowered to approximately 40% applicable for deferred tax assets and liabilities expected to be settled or realized subsequent to April 1, 2004. The adjustments of deferred tax assets and liabilities for this change in the tax rate are ¥143 million (\$1,353 thousand) and reflected in the consolidated statements of income for the year ended March 31, 2004.

A reconciliation of the Japanese statutory income tax rate and the effective income tax rate as a percentage of income before income taxes is as follows:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Statutory tax rate	(42.0)%	(42.0)%	42.0%
Increase (reduction) in income taxes resulting from:			
Earnings of foreign subsidiaries taxed at different rate from the statutory rate in Japan	(1.1)	(0.6)	(2.7)
Tax credits utilized	(0.1)	(0.4)	(0.5)
Expenses not deductible for tax purposes	0.2	0.3	1.2
Change in valuation allowance	3.1	7.3	(0.3)
Tax rate change	—	6.0	(0.5)
Other, net	<u>2.0</u>	<u>(1.1)</u>	<u>0.8</u>
	<u>(37.9)%</u>	<u>(30.5)%</u>	<u>40.0%</u>

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at March 31, 2003 and 2004 are presented below.

	Yen		U.S.
	(Millions)		Dollars
	<u>2003</u>	<u>2004</u>	<u>(Thousands)</u>
			<u>2004</u>
Deferred tax assets:			
Inventories	¥ 8,521	7,698	\$ 72,836
Investments in affiliates	292	—	—
Accrued warranty expenses	594	566	5,355
Accrued pension and severance cost	5,558	6,500	61,501
Minimum pension liability adjustments	—	943	8,922
Accrued expenses	1,657	2,460	23,276
Research and development expenses capitalized for tax purposes	3,253	1,688	15,971
Operating loss carryforward	20,905	13,079	123,749
Property, plant and equipment and Intangible assets	—	1,097	10,379
Other	<u>2,507</u>	<u>2,177</u>	<u>20,598</u>
Total gross deferred tax assets	43,287	36,208	342,587
Less valuation allowance	<u>1,640</u>	<u>2,149</u>	<u>20,333</u>
Net deferred tax assets	<u>41,647</u>	<u>34,059</u>	<u>322,254</u>
Deferred tax liabilities:			
Net unrealized gains on marketable securities	62	669	6,330
Property, plant and equipment and Intangible assets	235	—	—
Other	<u>110</u>	<u>67</u>	<u>634</u>
Total gross deferred tax liabilities	<u>407</u>	<u>736</u>	<u>6,964</u>
Net deferred tax assets	¥ <u>41,240</u>	<u>33,323</u>	\$ <u>315,290</u>

The net changes in the total valuation allowance for the years ended March 31, 2003 and 2004 were an increase of ¥1,371 million and ¥509 million (\$4,816 thousand), respectively.

At March 31, 2004, Advantest had net operating losses carried forward for income tax purposes of approximately ¥32,455 million (\$307,077 thousand) which are available to reduce future income taxes, if any. These operating losses will expire starting from the year ending March 31, 2005 through the year ending March 31, 2011.

Management of Advantest intends to reinvest certain undistributed earnings of the Company's foreign subsidiaries for an indefinite period of time. As a result, no provision

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for income taxes has been made on undistributed earnings of these subsidiaries not expected to be remitted in the foreseeable future, aggregating ¥5,604 million (\$53,023 thousand) as of March 31, 2004.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized.

The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. At March 31, 2004, Advantest has recorded on its consolidated balance sheet, net deferred tax assets of ¥33,323 million (\$315,290 thousand) of which ¥13,079 million (\$123,749 thousand) represents net operating losses (“NOLs”) carried forward available to offset future taxable income. In order to fully realize these NOLs, the Company will need to generate taxable income in excess of approximately ¥32,455 million (\$307,077 thousand) during the period the NOLs expire. Based upon projections for future taxable income over the periods in which the deferred tax assets are deductible including management’s expectations of future semiconductor and automated test equipment market prospects, the results of cutting fixed costs continually and other factors, management believes it is more likely than not that Advantest will realize the benefits of these deductible differences including NOLs, net of the existing valuation allowance, at March 31, 2004. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced and the effect on Advantest’s consolidated financial position and results of operations could be significant.

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(14) Other Comprehensive Income (Loss)

The accumulated balances for each classification of other comprehensive income (loss) are as follows:

		<u>Yen (Millions)</u>			
		Foreign currency translation adjustments	Net unrealized gains on securities	Minimum pension liability adjustments	Accumulated other comprehensive income (loss)
Balance at April 1, 2001	¥	(2,636)	102	—	(2,534)
Change during the year		1,440	(453)	—	987
Reclassification adjustments for realized portion		<u>—</u>	<u>363</u>	<u>—</u>	<u>363</u>
		<u>1,440</u>	<u>(90)</u>	<u>—</u>	<u>1,350</u>
Balance at March 31, 2002		(1,196)	12	—	(1,184)
Change during the year		(2,915)	(159)	—	(3,074)
Reclassification adjustments for realized portion		<u>—</u>	<u>203</u>	<u>—</u>	<u>203</u>
		<u>(2,915)</u>	<u>44</u>	<u>—</u>	<u>(2,871)</u>
Balance at March 31, 2003		(4,111)	56	—	(4,055)
Change during the year		(3,976)	1,330	(1,396)	(4,042)
Reclassification adjustments for realized portion		<u>—</u>	<u>36</u>	<u>—</u>	<u>36</u>
		<u>(3,976)</u>	<u>1,366</u>	<u>(1,396)</u>	<u>(4,006)</u>
Balance at March 31, 2004	¥	<u>(8,087)</u>	<u>1,422</u>	<u>(1,396)</u>	<u>(8,061)</u>

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		<u>U.S. Dollars (Thousands)</u>			
		<u>Foreign currency translation adjustments</u>	<u>Net unrealized gains on securities</u>	<u>Minimum pension liability adjustments</u>	<u>Accumulated other comprehensive income (loss)</u>
Balance at March 31, 2003	\$	(38,897)	530	—	(38,367)
Change during the year		(37,619)	12,583	(13,208)	(38,244)
Reclassification adjustments for realized portion		<u>—</u>	<u>341</u>	<u>—</u>	<u>341</u>
		<u>(37,619)</u>	<u>12,924</u>	<u>(13,208)</u>	<u>(37,903)</u>
Balance at March 31, 2004	\$	<u>(76,516)</u>	<u>13,454</u>	<u>(13,208)</u>	<u>(76,270)</u>

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The related tax effects allocated to each component of other comprehensive income (loss) are as follows:

		<u>Yen (Millions)</u>		
		Before-tax	Tax	Net-of-tax
		<u>amount</u>	(expense) or benefit	<u>amount</u>
Year ended March 31, 2002:				
Foreign currency translation adjustments	¥	1,440	—	1,440
Net unrealized gains on securities:				
Net unrealized gains arising during the year		(753)	300	(453)
Less reclassification adjustments for net gains realized in earnings		<u>622</u>	<u>(259)</u>	<u>363</u>
Net unrealized gains		<u>(131)</u>	<u>41</u>	<u>(90)</u>
Other comprehensive income (loss)	¥	<u>1,309</u>	<u>41</u>	<u>1,350</u>
Year ended March 31, 2003:				
Foreign currency translation adjustments	¥	(2,915)	—	(2,915)
Net unrealized gains on securities:				
Net unrealized gains arising during the year		(266)	107	(159)
Less reclassification adjustments for net gains realized in earnings		<u>340</u>	<u>(137)</u>	<u>203</u>
Net unrealized gains		<u>74</u>	<u>(30)</u>	<u>44</u>
Other comprehensive income (loss)	¥	<u>(2,841)</u>	<u>(30)</u>	<u>(2,871)</u>
Year ended March 31, 2004:				
Foreign currency translation adjustments	¥	(3,976)	—	(3,976)
Net unrealized gains on securities:				
Net unrealized gains arising during the year		1,938	(608)	1,330
Less reclassification adjustments for net gains realized in earnings		<u>36</u>	<u>—</u>	<u>36</u>
Net unrealized gains		1,974	(608)	1,366
Minimum pension liability adjustments		<u>(2,339)</u>	<u>943</u>	<u>(1,396)</u>
Other comprehensive income (loss)	¥	<u>(4,341)</u>	<u>335</u>	<u>(4,006)</u>

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<u>U.S. Dollars (Thousands)</u>			
	<u>Before-tax</u>	<u>Tax</u>	<u>Net-of-tax</u>
	<u>amount</u>	<u>(expense)</u>	<u>amount</u>
		<u>or benefit</u>	
Year ended March 31, 2004:			
Foreign currency translation adjustments	\$ (37,619)	—	(37,619)
Net unrealized gains on securities:			
Net unrealized gains arising during the year	18,336	(5,753)	12,583
Less reclassification adjustments for net gains realized in earnings	<u>341</u>	<u>—</u>	<u>341</u>
Net unrealized gains	18,677	(5,753)	12,924
Minimum pension liability adjustments	<u>(22,131)</u>	<u>8,923</u>	<u>(13,208)</u>
Other comprehensive income (loss)	\$ <u>(41,073)</u>	<u>3,170</u>	<u>(37,903)</u>

(15) Stock-Based Compensation

Advantest has two types of stock-based compensation plans as incentive plans for directors and selected employees. One plan uses stock options and the other plan uses bonds with detachable warrants.

In January 2000 and February 2001, the Company issued unsecured bonds with detachable warrants. Simultaneously with the issuance of the unsecured bonds, the Company purchased all of the detachable warrants from the underwriter and distributed such warrants to the directors and selected employees of the Company and its subsidiaries. By exercising a warrant, directors and selected employees can purchase the shares of the Company, the number of which is 99,000 shares and 319,500 shares at the exercise price of ¥21,840 and ¥14,018 for warrants issued in January 2000 and February 2001, respectively. Warrants were granted with an exercise price equal to 1.05 times the closing price of the Company's shares traded on the Tokyo Stock Exchange on the date of each grant. Under each plan, 990 warrants and 3,195 warrants in January 2000 and February 2001, respectively, were issued. The warrants vested fully immediately, and were exercisable up to 4 years from the date of grant. For financial reporting purposes, these transactions were accounted for as the issuance of debt to third parties and separately as the issuance of warrants to directors and employees. The issuance of the warrants to directors and employees was accounted for under APB Opinion No. 25. All unexercised warrants issued during the year ended March 31, 2000 expired in accordance with their original terms during the year ended March 31, 2004.

In July 2002, stock options were issued to directors, corporate auditors and certain employees under a stock option plan approved by the Board of Directors. The number of granted shares totaled 735,000. Options were granted with an exercise price of ¥8,148 per share that is equal to the higher of (1) 1.05 times the average price of the Company's common shares of the preceding month on the date of grant and (2) the closing price of the

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Company's common shares traded on the Tokyo Stock Exchange on the date of grant. The options have an exercise period of 4 years and vested fully on April 1, 2003.

In April 2003, stock options were issued to a director and certain employees of foreign subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 14,000. Options were granted with an exercise price of ¥8,148 per share that is equal to the higher of (1) 1.05 times the average price of the Company's common shares of the preceding month on the date of grant, (2) the closing price of the Company's common shares traded on the Tokyo Stock Exchange on the date of grant, and (3) the exercise price at which the July 2002 options were granted. The options have an exercise period of no later than March 31, 2007 and vested fully on May 1, 2003.

In June 2003, stock options were issued to directors, executive officers, corporate auditors and certain employees under a stock option plan approved by the Board of Directors. The number of granted shares totaled 734,000. Options were granted with an exercise price of ¥5,160 per share that is equal to the higher of (1) 1.05 times the average price of the Company's common shares of the preceding month on the date of grant and (2) the closing price of the Company's common shares traded on the Tokyo Stock Exchange on the date of grant. The options have an exercise period of 4 years and vested fully on April 1, 2004.

In August 2003, January 2004 and March 2004, stock options were issued to a director and certain employees of foreign subsidiaries under a stock option plan approved by the Board of Directors. The number of granted shares totaled 6,000, 7,000 and 3,000, respectively. Options were granted with exercise prices of ¥8,090, ¥9,220 and ¥8,550 per share, respectively, that are equal to the higher of (1) 1.05 times the average price of the Company's common shares of the preceding month on the date of grant, (2) the closing price of the Company's common shares traded on the Tokyo Stock Exchange on the date of grant, and (3) the exercise price at which the June 2003 options were granted. All of the options have an exercise period of 4 years and vested fully on April 1, 2004.

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Stock option and warrant activity during the years ended March 31, 2002, 2003 and 2004 is as follows:

	<u>Number of shares</u>	<u>Yen</u> Weighted average <u>exercise price</u>	<u>U.S. Dollars</u> Weighted average <u>exercise price</u>
Balance at April 1, 2001	787,037	¥ 11,883	
Exercised	(44,537)	(6,533)	
Expired	<u>(3,300)</u>	(15,914)	
Balance at March 31, 2002	739,200	12,187	
Granted	735,000	8,148	
Expired	<u>(360,400)</u>	(7,799)	
Balance at March 31, 2003	1,113,800	10,942	\$ 104
Exercisable at March 31, 2003	403,800	15,854	150
Granted	764,000	5,288	50
Exercised	(21,000)	(8,148)	(77)
Expired	<u>(84,300)</u>	(21,060)	(199)
Balance at March 31, 2004	<u>1,772,500</u>	7,973	75
Exercisable at March 31, 2004	1,022,500	9,982	94

At March 31, 2004, all of the outstanding stock options and warrants were as follows:

<u>Yen</u>	<u>Exercise price</u>	<u>Number outstanding</u>	<u>Weighted average remaining contractual life</u>
¥	5,160	734,000	4.0 years
	8,090 - 9,220	719,000	3.0 years
	14,018	<u>319,500</u>	0.9 years
		<u>1,772,500</u>	

(16) Accrued Pension and Severance Cost

The Company and certain of its subsidiaries have unfunded retirement and severance plans. On terminating employment, substantially all employees of the Company and the subsidiaries are entitled to lump-sum payments based on the employees' compensation and years of service.

The Company and its domestic subsidiaries also have contributory defined benefit retirement and severance plan covering substantially all employees. Benefits payable under the plan is based on employee earnings and years of service. The contributory plan

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mainly represents the Employees' Pension Fund ("EPF") plan, composed of the substitutional portions based on the pay-related part of the old age pension benefits prescribed by the Welfare Pension Insurance Law in Japan and the corporate portions based on contributory defined benefit pension arrangements established at the discretion of the Company and its subsidiaries. Management considers that substitutional portions of the EPF, which are administered by a board of trustees composed of management and labor representatives, represent welfare pension plan carried on behalf of the Japanese government. This contributory plan is funded in conformity with the funding requirements of applicable Japanese governmental regulations.

In January 2003, the EITF reached a final consensus on EITF 03-2, "Accounting for the Transfer to the Japanese Government of the Substitutional Portion of Employee Pension Fund Liabilities". EITF 03-2 addresses accounting for a transfer to the Japanese government of the substitutional portion of an EPF plan. EITF 03-2 requires employers to account for the entire separation process of the substitutional portion from the EPF upon completion of the transfer to the government of the substitutional portion of the benefit obligation and related plan assets as the culmination of a series of steps in a single settlement transaction. Under this approach, the difference between the fair value of the obligation and the assets required to be transferred to the government should be accounted for and separately disclosed as a subsidy. On August 1, 2003, Advantest and certain of its consolidated domestic subsidiaries received approval from the Minister of Health, Labor and Welfare to be exempted from obligation for benefits related to future employee service under the substitutional portion of its EPF plans as part of the transfer of its EPF plans to the Japanese government pursuant to the Defined Benefit Corporate Pension Law. Accordingly, there has been no effect on Advantest's consolidated financial statements for the year ended March 31, 2004. The aggregate effect of this separation will be determined based on the Company's total pension benefits obligation as of the date the transfer is completed and the amount of plan assets required to be transferred. This separation could have a significant effect on Advantest's financial condition or results of operations.

In December 2003, the FASB issued SFAS No. 132 (revised 2003) ("SFAS No. 132R"), "Employers' Disclosures about Pensions and Other Postretirement Benefits". SFAS No. 132R revises and prescribes employers' disclosures about pension plans and other postretirement benefit plans; it does not change the measurement or recognition of those plans. SFAS No. 132R retains the disclosure requirements contained in the original SFAS No. 132. It also requires additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. SFAS No. 132R is generally effective for fiscal years ending after December 15, 2003. Advantest's disclosures below incorporate the requirements of SFAS No. 132R.

Information about the retirement and severance plans of Advantest are as follows:

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	<u>2002</u>	<u>Yen (Millions) 2003</u>	<u>2004</u>	<u>U.S. Dollars (Thousands) 2004</u>
Components of net periodic benefit cost:				
Service cost	¥ 2,364	2,529	1,691	\$ 16,000
Interest cost	1,003	960	860	8,137
Expected return on plan assets	(619)	(622)	(495)	(4,684)
Amortization of unrecognized:				
Net transition obligation	214	214	214	2,025
Net actuarial gain or loss	(52)	318	317	3,000
Prior service cost	<u>(27)</u>	<u>(117)</u>	<u>(116)</u>	<u>(1,098)</u>
Net periodic benefit cost	¥ <u>2,883</u>	<u>3,282</u>	<u>2,471</u>	\$ <u>23,380</u>

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The following table sets forth the plan's benefit obligation, fair value of plan assets, funded status at March 31, 2003 and 2004.

	<u>Yen (Millions)</u>		<u>U.S. Dollars</u> <u>(Thousands)</u>
	<u>2003</u>	<u>2004</u>	<u>2004</u>
Change in benefit obligation:			
Balance at beginning of year	¥ 38,463	34,507	\$ 326,493
Service cost	2,529	1,691	16,000
Interest cost	960	860	8,137
Employee contributions	302	85	804
Actuarial gain or loss	(3,768)	6,644	62,863
Benefits paid	(2,931)	(904)	(8,554)
Acquisition	—	93	880
Divestiture	<u>(1,048)</u>	<u>—</u>	<u>—</u>
Balance at end of year	34,507	42,976	406,623
Change in plan assets:			
Balance at beginning of year	20,727	16,492	156,041
Employer contributions	927	631	5,970
Employee contributions	302	85	804
Actual return on plan assets	(3,377)	2,994	28,329
Benefits paid	(1,599)	(761)	(7,200)
Divestiture	<u>(488)</u>	<u>—</u>	<u>—</u>
Balance at end of year	<u>16,492</u>	<u>19,441</u>	<u>183,944</u>
Funded status	18,015	23,535	222,679
Unrecognized prior service cost	1,830	1,714	16,217
Unrecognized net transition obligation	(214)	—	—
Unrecognized net actuarial gain or loss	<u>(5,412)</u>	<u>(9,240)</u>	<u>(87,425)</u>
Net amount recognized	¥ <u>14,219</u>	<u>16,009</u>	\$ <u>151,471</u>
Amounts recognized in the balance sheet:			
Accrued pension and severance cost	¥ 14,219	18,348	\$ 173,602
Accumulated other comprehensive income (loss), gross of tax	<u>—</u>	<u>(2,339)</u>	<u>(22,131)</u>
Net amount recognized	¥ <u>14,219</u>	<u>16,009</u>	\$ <u>151,471</u>

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	<u>Yen (Millions)</u>		<u>U.S. Dollars</u>
	<u>2003</u>	<u>2004</u>	<u>(Thousands)</u>
			<u>2004</u>
Pension plans with accumulated benefit obligations in excess of plan assets:			
Projected benefit obligation	¥ 34,507	42,976	\$ 406,623
Accumulated benefit obligation	29,411	37,789	357,546
Fair value of plan assets	16,492	19,441	183,944

During the year ended March 31, 2003, Advantest reduced its number of employees by approximately 700 through a voluntary early retirement program offered to employees in Japan and lay-offs of employees in foreign locations and a sale of all shares of a subsidiary in Japan pursuant to a management buyout. Advantest recorded additional severance costs of ¥3,595 million related to severance packages of the employees that accepted early retirement and lay-offs and classified such charge in selling, general and administrative expenses. At March 31, 2003, Advantest had paid approximately ¥3,250 million of the liability. Substantially all of the remaining liability was paid in April 2003.

Information about the retirement and severance plans of Advantest is as follows:

Measurement date:

The measurement date for the pension plans is March 31.

Assumptions:

Weighted-average assumptions used to determine benefit obligations as of March 31:

	<u>2003</u>	<u>2004</u>
Discount rate	2.5%	2.0%
Rate of compensation increase	3.3%	3.3%

Weighted-average assumptions used to determine net periodic benefit cost for the years ended March 31:

	<u>2002</u>	<u>2003</u>	<u>2004</u>
Discount rate	3.0%	2.5%	2.5%
Expected return on plan assets	3.0%	3.0%	3.0%
Rate of compensation increase	3.3%	3.3%	3.3%

Advantest determines the expected return based on asset portfolio, historical returns and estimated future returns.

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Plan assets:

Advantest's domestic benefit plans' weighted-average assets allocations at March 31, 2003 and 2004 by asset category are as follows:

	<u>2003</u>	<u>2004</u>
Equity securities	59.3%	42.7%
Debt securities	34.6%	18.3%
Cash	5.5%	32.2%
Life insurance company general accounts	<u>0.6%</u>	<u>6.8%</u>
	<u>100.0%</u>	<u>100.0%</u>

Advantest converted certain of its securities into cash in acknowledgement of the pending separation of the remaining substitutional portion (that is, the benefit obligation related to past services) by the year ended March 31, 2004.

Advantest's investment policies are designed to ensure adequate plan assets are available to provide future payments of pension benefits to eligible participants by attaining necessary long-term total returns on plan assets. Taking into consideration the expected returns, associated risks and correlations of returns between asset categories in plan assets, Advantest determines optimal combination of equity and debt securities as Policy Asset Allocation ("PAA"). Plan assets are invested in individual equity and debt securities according to PAA with mid-term to long-term viewpoint, which is revised periodically to the extent considered necessary to achieve the expected long-term rate of return on plan assets.

Cash flows:

Advantest expects to contribute ¥575 million (\$5,440 thousand) to its domestic defined benefit plans in the year ending March 31, 2005.

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(17) Stockholders' Equity

Changes in the number of shares issued and treasury stock during the years ended March 31, 2002, 2003 and 2004 are as follows:

	<u>Total shares of common stock</u>	<u>Shares of treasury stock</u>
Number of shares as of April 1, 2001	99,735,569	324,095
Purchase of shares	—	3,859
Exercise of warrants	47,816	—
Sale of shares	<u>—</u>	<u>(2,300)</u>
Number of shares as of March 31, 2002	99,783,385	325,654
Purchase of shares	<u>—</u>	<u>1,211,372</u>
Number of shares as of March 31, 2003	99,783,385	1,537,026
Purchase of shares	—	4,141
Exercise of stock options	—	(21,000)
Decrease upon share exchange	—	(12,283)
Sale of shares	<u>—</u>	<u>(139)</u>
Number of shares as of March 31, 2004	<u>99,783,385</u>	<u>1,507,745</u>

The Commercial Code of Japan, amended effective on October 1, 2001, provides that an amount equal to at least 10% of appropriations paid in cash be appropriated as a legal reserve until an aggregated amount of additional paid-in capital and the legal reserve equals 25% of common stock. Certain foreign subsidiaries are also required to appropriate their earnings to legal reserves under the laws of the respective countries.

Cash dividends for the years ended March 31, 2002, 2003 and 2004 represent dividends paid out during those years. The accompanying consolidated financial statements do not include any provision for the dividend for the second half-year of ¥25 (\$0.24) per share, aggregating ¥2,457 million (\$23,247 thousand), subsequently proposed by the Board of Directors in respect of the year ended March 31, 2004.

The amount available for dividends under the Commercial Code of Japan is based on the amount recorded in the Company's books of account and amounted to ¥119,679 million (\$1,132,359 thousand) at March 31, 2004.

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(18) Noncash Financing and Investing Activities

Obligations under capital leases of ¥11 million, nil and ¥4 million (\$38 thousand) were incurred in the years ended March 31, 2002, 2003 and 2004, respectively, when Advantest entered into leases for new machinery and equipment and software.

(19) Accrued Warranty Expenses

Advantest issues contractual product warranties under which it generally guarantees the performance of products delivered and services rendered for a certain period or term. Changes in accrued warranty expenses for the years ended March 31, 2003 and 2004 were summarized as follows:

		Yen		U.S. Dollars
		(Millions)		(Thousands)
		<u>2003</u>	<u>2004</u>	<u>2004</u>
Balance at beginning of year	¥	2,836	2,396	\$ 22,670
Addition		2,822	4,571	43,250
Acquisition		—	16	151
Utilization		(3,199)	(3,695)	(34,961)
Translation adjustments		<u>(63)</u>	<u>(167)</u>	<u>(1,580)</u>
Balance at end of year	¥	<u>2,396</u>	<u>3,121</u>	\$ <u>29,530</u>

(20) Operating Segment and Geographic Information

In accordance with SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information", Advantest has two operating and reportable segments, which are the design, manufacturing, and sale of automated test equipment and measuring instruments. These operating segments are determined based on the nature of the products and the markets. Automated test equipment is used to confirm that a semiconductor functions properly during the semiconductor manufacturing process at sites of manufactures of semiconductor or test houses. Automated test equipment consists of semiconductor test systems, test handlers or probers, semiconductor device interfaces and software. Test handlers or probers, semiconductor device interfaces and software are always with or incorporated in automated test equipment. Measuring instruments are used primarily by manufacturers of equipment and components and service providers of the fiber optic communications industry, the wireless communications industry and the electronics industry. Fundamental research and development activities and headquarters functions are represented by Corporate.

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Operating segment information during the years ended March 31, 2002, 2003 and 2004 are as follows:

	<u>Yen (Millions)</u>			
	<u>Automated test equipment</u>	<u>Measuring instruments</u>	<u>Corporate</u>	<u>Total</u>
As of and for the year ended				
March 31, 2002:				
Net sales to unaffiliated customers	74,206	21,038	—	95,244
Depreciation and amortization	7,562	1,105	2,622	11,289
Operating income (loss)	(20,104)	(7,826)	(9,175)	(37,105)
Expenditures for additions to long-lived assets	7,718	1,936	4,804	14,458
Equity in losses of affiliates	(794)	—	—	(794)
Total assets	146,790	20,000	140,772	307,562
Equity investments	598	—	—	598
As of and for the year ended				
March 31, 2003:				
Net sales to unaffiliated customers	84,910	12,830	—	97,740
Depreciation and amortization	7,269	1,236	2,437	10,942
Operating income (loss)	465	(7,939)	(9,269)	(16,743)
Expenditures for additions to long-lived assets	5,844	648	1,072	7,564
Equity in losses of affiliates	(109)	—	—	(109)
Total assets	138,114	18,332	124,778	281,224
Equity investments	591	—	—	591
As of and for the year ended				
March 31, 2004:				
Net sales to unaffiliated customers	160,855	13,363	—	174,218
Depreciation and amortization	6,439	777	2,112	9,328
Operating income (loss)	48,562	(9,053)	(8,549)	30,960
Expenditures for additions to long-lived assets	5,166	254	201	5,621
Equity in losses of affiliates	(117)	—	—	(117)
Total assets	200,833	10,838	119,137	330,808

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	<u>U.S. Dollars (Thousands)</u>			
	<u>Automated test equipment</u>	<u>Measuring instruments</u>	<u>Corporate</u>	<u>Total</u>
As of and for the year ended				
March 31, 2004:				
Net sales to unaffiliated customers	\$ 1,521,951	126,436	—	1,648,387
Depreciation and amortization	60,923	7,352	19,983	88,258
Operating income (loss)	459,476	(85,656)	(80,888)	292,932
Expenditures for additions to long-lived assets	48,879	2,403	1,902	53,184
Equity in losses of affiliates	(1,107)	—	—	(1,107)
Total assets	1,900,208	102,545	1,127,231	3,129,984

Adjustments to operating income (loss) in Corporate principally represent corporate general and administrative expenses and research and development expenses related to fundamental research activities that are not allocated to operating segments.

As discussed in note (1) (k) to the consolidated financial statements, an impairment charge of ¥3,030 million (\$28,669 thousand) for long-lived assets was included in the operating income (loss) of Measuring instruments for the year ended March 31, 2004.

Additions to long-lived assets included in Corporate consist of purchases of software and fixed assets for general corporate use.

Total assets included in Corporate consist of cash and cash equivalents, assets for general corporate use and assets used for fundamental research activities, which are not allocated to reportable segments. Total assets in Corporate included cash and cash equivalents of ¥83,052 million, ¥59,672 million and of ¥65,687 million (\$621,506 thousand) as of March 31, 2002, 2003 and 2004, respectively. Assets for general corporate use were ¥19,008 million, ¥18,083 million and ¥16,825 million (\$159,192 thousand) as of March 31, 2002, 2003 and 2004, respectively.

One customer and its related entities in the automated test equipment segment accounted for approximately 16%, 12% and 12% of total consolidated net sales for the years ended March 31, 2002, 2003 and 2004.

Effective April 1, 2004, Advantest reclassified and regrouped its two reportable segments of “automated test equipment” and “measuring instruments” into the following three new segments; “semiconductor and component test system”, “mechatronics system” and “services, support and others”.

Information as to Advantest’s net sales and long-lived assets in various geographical areas is as follows:

Net sales to unaffiliated customers for the years ended March 31, 2002, 2003 and 2004 are as follows:

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		<u>Yen</u> <u>(Millions)</u>		<u>U.S. Dollars</u> <u>(Thousands)</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
Japan	¥ 37,748	38,873	57,990	\$ 548,680
North America	19,143	8,666	16,264	153,884
Europe	8,284	8,940	10,401	98,410
Asia	<u>30,069</u>	<u>41,261</u>	<u>89,563</u>	<u>847,413</u>
Total	¥ <u>95,244</u>	<u>97,740</u>	<u>174,218</u>	\$ <u>1,648,387</u>

Net sales to unaffiliated customers are based on the customer's location. Net sales indicated as Asia are generated in Korea, Taiwan, Singapore and others in the amount of ¥9,734 million, ¥5,315 million and ¥15,020 million, and ¥13,321 million, ¥13,605 million and ¥14,335 million, and ¥28,613 million (\$270,726 thousand), ¥31,819 million (\$301,060 thousand) and ¥29,131 million (\$275,627 thousand) for the years ended March 31, 2002, 2003 and 2004, respectively. Substantially all net sales indicated as North America are generated in the United States of America.

Long-lived assets as of March 31, 2002, 2003 and 2004 are as follows:

		<u>Yen</u> <u>(Millions)</u>		<u>U.S. Dollars</u> <u>(Thousands)</u>
	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2004</u>
Japan	¥ 56,191	52,961	48,226	\$ 456,297
North America	2,440	2,019	1,552	14,684
Europe	1,124	1,137	707	6,689
Asia	<u>5,630</u>	<u>4,605</u>	<u>3,787</u>	<u>35,832</u>
Total	¥ <u>65,385</u>	<u>60,722</u>	<u>54,272</u>	\$ <u>513,502</u>

Long-lived assets are those assets located in each geographic area.

There is no individually material country with respect to long-lived assets outside Japan. Substantially all long-lived assets indicated as North America are located in the United States of America.

(21) Related Party Transactions

Advantest sells products and purchases raw materials from its 20.5% owner and its group companies. The terms of sales are the same as those with third parties. Advantest purchases raw materials after receiving competitive bids from several suppliers. Advantest also purchases various pieces of software, information system related services, research and development materials and services from related parties. Advantest had the following transactions with these related parties as of and for the years ended March 31:

**ADVANTEST CORPORATION
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Notes to Consolidated Financial Statements

		<u>2002</u>	<u>Yen (Millions) 2003</u>	<u>2004</u>	<u>U.S. Dollars (Thousands) 2004</u>
Sales of products	¥	1,296	2,327	2,766	\$ 26,171
Purchases of raw materials		3,570	2,893	10,028	94,881
Receivables		467	1,381	1,882	17,807
Payables		1,392	2,198	6,746	63,828
Purchases of software, hardware and other		1,547	417	262	2,479
Research and development expenses, computer rentals, maintenance and other expenses		1,788	1,779	2,048	19,377

Advantest also has various capital lease contracts with a related company. Obligations under capital leases with this related company as of March 31, 2004 were ¥5 million (\$47 thousand).

(22) Per Share Data

The following table sets forth the computation of basic and diluted net income (loss) per share and cash dividends per share as of March 31:

		<u>2002</u>	<u>Yen (Millions) except for per share data 2003</u>	<u>2004</u>	<u>U.S. Dollars (Thousands) except for per share data 2004</u>
Numerator:					
Net income (loss)	¥	(23,906)	(12,994)	17,329	\$ 163,961
Denominator:					
Basic weighted average shares		99,453,203	98,445,111	98,250,830	
Dilutive effect of exercise of stock options and warrants		—	—	195,306	
Diluted weighted average shares		<u>99,453,203</u>	<u>98,445,111</u>	<u>98,446,136</u>	
Basic net income (loss) per share	¥	(240.38)	(131.99)	176.37	\$ 1.67
Diluted net income (loss) per share		(240.38)	(131.99)	176.02	1.67
Cash dividends per share	¥	40.00	30.00	40.00	\$ 0.38

Cash dividends per share are computed based on dividends declared with respect to earnings for the periods.

**ADVANTEST CORPORATION
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Notes to Consolidated Financial Statements

(23) Concentration

As of and for the years ended March 31, 2002, 2003 and 2004, five customers accounted for approximately 20%, 35% and 38%, respectively, of accounts receivable and approximately 37%, 38% and 37%, respectively, of net sales.

(24) Commitments

In November 2002, the FASB issued FIN 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34". FIN 45 requires that a liability be recorded in the guarantor's balance sheet upon issuance of a guarantee. The initial recognition and measurement provisions of FIN 45 were applicable to guarantees issued or modified after December 31, 2002.

Advantest provides guarantees to third parties mainly for customers lease obligations. At March 31, 2004, these guarantees amounted to ¥569 million (\$5,384 thousand). Advantest would be required to satisfy customers lease obligations in the event of default. The guarantees are collateralized by the leased equipment. At March 31, 2004, Advantest has not accrued any obligation with respect to such guarantees as it estimates the fair value of its obligations to be insignificant.



KPMG AZSA & Co.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Advantest Corporation:

We have audited the accompanying consolidated balance sheets of Advantest Corporation and subsidiaries as of March 31, 2004 and 2003, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended March 31, 2004. 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 standards of the Public Company Accounting Oversight Board (United States). 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 Advantest Corporation and subsidiaries as of March 31, 2004 and 2003, and the results of their operations and their cash flows for each of the years in the three-year period ended March 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements as of and for the year ended March 31, 2004 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 2 of the notes to the consolidated financial statements.

KPMG AZSA & Co.

Tokyo, Japan
April 26, 2004



KPMG AZSA & Co., an audit corporation incorporated under the Japanese Certified Public Accountants Law, is the Japan member firm of KPMG International, a Swiss cooperative.

CORPORATE INFORMATION

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Advantest Group

Significant Overseas Subsidiaries

Advantest America Corporation (Holding Company)
Advantest America, Inc.
Advantest America R&D Center, Inc.
Advantest America Measuring Solutions, Inc.
Advantest (Europe) GmbH
Advantest Europe R&D S.A.R.L.
Advantest (Singapore) Pte. Ltd.
Advantest (Malaysia) Sdn. Bhd.
Advantest Engineering (M) Sdn. Bhd.
Advantest Philippines, Inc.
Advantest Korea Co., Ltd.
Advantest Taiwan Inc.
Advantest Taiwan Engineering Inc.
Advantest (Suzhou) Co., Ltd.
Advantest Shanghai Co., Ltd.

As of July 1, 2004

STOCKHOLDERS' DATA

Capital:	¥32,363 million
Common Stock:	Authorized: 220,000,000 shares Issued: 99,783,385 shares
Number of Stockholders:	33,112
Stock Exchange Listings:	Tokyo (Code: 6857) New York (Ticker Symbol: ATE)
Transfer Agent:	Tokyo Securities Transfer Agent Co., Ltd. Shin-Marui Building, 1-5-1, Marunouchi, Chiyoda-ku, Tokyo 100-0005, Japan
Depository Bank for ADRs:	JPMorgan Chase Bank 270 Park Avenue New York, NY 10017-2070, U.S.A.

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As of March 31, 2004



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